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I. INTRODUCTION

In February 2009, the Securities and Exchange Commission (the “SEC”), conducted an on-site examination of Respondent, ZPR INVESTMENT MANAGEMENT, INC. (“ZPR”), at its offices located in Orange City, Florida. The SEC’s examination staff made numerous requests for documents and information from ZPR before, during and after the onsite examination, which lasted from February 2, 2009 until February 13, 2009. The examination resulted in an investigation¹ being commenced in August 2010 against ZPR and Max E. Zavanelli (“Mr. Zavanelli”). Subsequently, on April 4, 2013, the SEC issued an Order Instituting Administrative and Cease and Desist Proceedings (“OIP”) against ZPR and Mr. Zavanelli, which alleged that ZPR advertised the performance results for its Small Cap Value (“SCV”) composite that omitted material information, which would have revealed that ZPR’s historical performance results were underperforming its benchmark index rather than outperforming it. The OIP further alleged that these advertisements as well as client newsletters that were distributed to existing and prospective clients by ZPR through Mr. Zavanelli falsely claimed that the firm’s performance results were in compliance with the Global Investment Performance Standards (“GIPS”). The OIP further alleged that ZPR made false statements through certain *Morningstar* reports regarding its GIPS verification firm, Ashland Partners & Company, LLP (“Ashland”) and the status of a pending SEC investigation. In all, the OIP identified five (5) advertisements ZPR ran in *Smart Money* magazine for October, November and December of 2008 and February and May of 2011; one advertisement ZPR ran in *Barron’s* magazine in March 2011; two (2) ZPR client newsletters for April and December 2009; and two (2) *Morningstar* reports dated September 30, 2010, and March 31, 2011, to be at issue.

¹ ZPR’s management and Mr. Zavanelli did not understand the nature or meaning of the SEC’s investigation until much later than the date it started.

While the *Smart Money* and *Barron's* magazine articles did not contain all of the information as set forth in the GIPS Advertising Guidelines, the performance results published in these advertisements for the various ZPR composites were accurate and not misleading. ZPR, through Mr. Zavanelli, made information available to existing and prospective clients on its website at www.zprim.com and through the direct distribution of other marketing materials, brochures and other written documents that contained information required by the GIPS Advertising Guidelines. The website link was also disclosed in the advertisements.

Further, a fully compliant presentation that satisfied the requirements of GIPS was provided by ZPR to each prospective client prior to the establishment of any investment advisory account. Thus, any GIPS compliance deficiencies relating to the *Smart Money* and *Barron's* advertisements at issue were cured through additional disclosures made by the Respondents to existing and prospective clients.

The availability of these disclosures and the efforts made by the Respondents to provide this information to existing and prospective clients also refutes any contention raised by the SEC that there was an attempt by the Respondents to intentionally or willfully conceal or withhold any material information regarding the firm's composite performance results.

During the relevant period, Mr. Zavanelli did not consider monthly client newsletters that were prepared and distributed by ZPR to be advertisements as contemplated by the GIPS standards. The monthly client newsletters were utilized primarily as a means to inform ZPR's existing clients, other colleagues and friends of Mr. Zavanelli about the firm's composite performance results for the previous month, economic and business events and Mr. Zavanelli's commentary regarding other topics. Since the Respondents did not utilize the client newsletters as a means to solicit prospective clients or retain existing clients, the provisions of GIPS should

not be applicable to these publications. An article by Mr. Zavanelli about the SEC's uptick rule and its effects on the firm's composite performance results that appeared in the April 2009 ZPR client newsletter was never intended to be a marketing piece that required ZPR to comply with the provisions of GIPS.

The GIPS Advertising Guidelines also do not apply to a publication or an advertisement where no claim of GIPS compliance is made and there is no specific claim of GIPS compliance made by ZPR in its December 2009 client newsletter. As a result, it had no duty to include performance results for its composites in this client newsletter. Nevertheless, these performance results together with a fully compliant GIPS presentation were made available by ZPR on its website and provided directly to anyone who was interested in becoming a client of ZPR. Therefore, any GIPS deficiencies contained within the ZPR client newsletters were cured and remedied by these other disclosures.

The inclusion of the term "audited" for GIPS compliance by ZPR in a *Morningstar* report dated September 20, 2010, is not a material deficiency under the GIPS standards especially since ZPR corrected this language in a subsequent *Morningstar* report dated March 31, 2011, by substituting the term "verified" for "audited".

Ashland had served as ZPR's GIPS verification firm from approximately January 2006 until July 2010. Ashland had previously instructed ZPR to use the term "verify" and not "audit" to describe the services relating to GIPS provided by Ashland. While steps had been taken by Ted Bauchle ("Mr. Bauchle"), a former ZPR employee who was the firm's main contact for Ashland, to remove the term audit from written disclosures distributed by ZPR, he neglected to timely correct this item in the September 30, 2010 *Morningstar* report. Mr. Bauchle, through inadvertence, also did not change language in this report that disclosed Ashland had verified

ZPR for GIPS compliance through the date of the *Morningstar* report, September 30, 2010. Ashland had, in fact, resigned as ZPR's GIPS verification firm in July 2010. This inaction to correct the *Morningstar* report by Mr. Bauchle was not done willfully or intentionally and simply represented an honest mistake that was later corrected by Mr. Bauchle in a *Morningstar* report dated March 31, 2011.

During the relevant period of time, ZPR's management did not believe there was a duty to disclose to *Morningstar* that the firm was under a pending SEC investigation. The *Morningstar* web screen where data changes could be entered by ZPR, required a specific date related to a "Pending SEC Investigation Charge" to be disclosed. Until the OIP was issued on April 4, 2013, no charges had been filed by the SEC and, therefore, it appeared to ZPR that disclosure of a pending SEC investigation was not required before the date of that event. Additionally, if the box was checked, a description of the charges was required to be added and no details of the charges were available for disclosure by ZPR until the OIP was issued.

The *Morningstar* reports are not available to the public and may only be accessed by institutional investors through subscription. As a result, the reports themselves are not advertisements.

An inadvertent departure from the GIPS guidelines pertaining to advertisements does not require the firm to cease its overall claim of GIPS compliance where corrective action is taken to address the deficiencies. Errors committed by firms in their attempt to be compliant are clearly contemplated by the GIPS standards and guidelines. Thus, while the *Smart Money* and *Barron's* magazine advertisements at issue did not include all of the required GIPS advertising disclosures, the Respondents did not act with scienter to willfully or intentionally place these advertisements to mislead or deceive any third party. In addition, the Respondents have taken corrective and

remedial action to address the GIPS compliance and other issues raised in the OIP concerning its advertising policies for magazine advertisements, client newsletters and *Morningstar* reports.

ZPR has retained National Compliance Service (“NCS”) as an outside consultant to review its policies and policies for advertising and other areas. Both NCS and ZPR’s current GIPS verification firm, Alpha Performance Verification Services (“Alpha”), review and provide guidance for advertisements placed by ZPR and other marketing materials, client newsletters and ZPR’s website to ensure compliance with the GIPS standards and other SEC requirements. Since October 2011, Mark Zavanelli has taken over the role of Chief Compliance Officer and President of ZPR and addressed a number of compliance issues relating to the firm’s advertising and marketing. Mark Zavanelli has also established an advertisement review policy to ensure that GIPS compliance and other issues raised through the OIP do not reoccur in the future.

Due to these efforts and the lack of any scienter by the Respondents to distribute the advertisements and other written publications at issue in this proceeding, a cease and desist order, fine and industry bar are not appropriate sanctions. In addition, Respondents’ oversight and neglect to follow applicable GIPS standards through certain advertisements and client newsletters do not give rise to a statutory violation of either the Investment Advisers Act of 1940, as amended (“IAA”) or the Investment Company Act of 1940, as amended (“ICA”), or warrant the imposition of any sanctions.

II. BACKGROUND FACTS REGARDING RESPONDENTS

Respondent, ZPR INVESTMENT MANAGEMENT, INC. (“ZPR”) is a Florida corporation that was organized on July 29, 1994. ZPR maintains its office in Orange City, Florida and since April 2006 has been registered with the SEC as an investment advisor. (OIP, pg 2, ¶B.1.)

Since its formation and until October, 2011, Respondent, Max E. Zavanelli (“Mr. Zavanelli”) has served as the President, Chief Operating Officer and sole shareholder of ZPR. (OIP pg. 2, ¶B.2.) Between May 2009 and October 2011, Mr. Zavanelli also served as the Chief Compliance Officer for ZPR². DX 79, ¶9. Trial Transcript (“TR”), pg 1298, lines 11-14.

ZPR currently has eight (8) employees and as of December 31, 2012, has discretionary authority over approximately 105 client accounts with assets under management valued at approximately 164 million. Respondents’ Exhibits (“RX”), pg 2-3, ¶C.1. More than half of the assets under ZPR’s management are institutional. ZPR allocates client assets in equities amongst several proprietary strategies that include its Fundamental Small Cap Value composite (“SCV”).

ZPR manages its composites using a theory of stock prices known as the Growth Rate Arbitrage Price Equilibrium System (“GRAPES”), which was proposed and researched in 1986. ZPR has a proprietary data base that was started in 1980 and expanded in 1994 to cover thousands of U.S. stocks and subsequently, expanded to cover thousands of international stocks. TR pg 1380, lines 3-13.

Mr. Zavanelli is 67 years old and has been a portfolio manager for over 30 years. After graduating from high school, Mr. Zavanelli worked as a computer operator with Continental Can in New York City. TR pg 1335, lines 9-12. In 1965, he enlisted in the Army and served for approximately three and half years. TR pg 1356, lines 2-6. In 1969, Mr. Zavanelli was honorably discharged with a rank of first lieutenant. *Id.* at lines 7-11. During his military service, Mr. Zavanelli received a top secret crypto security classification because of his position as a nuclear weapons officer. *Id.* at lines 12-15. After his military service ended, Mr. Zavanelli

² On October 1, 2011, Mr. Zavanelli resigned as the President and Chief Compliance Officer for ZPR and his son, Mark D. Zavanelli took over those positions. TR pg 1298, lines 11-14. When Mark D. Zavanelli joined ZPR, he received a 25% ownership of ZPR. Subsequently, on or about October 2013, Mark D. Zavanelli received 100% of the ownership for ZPR. TR pg. 761, lines 8-21.

returned to Continental Can as a chief computer scheduler. *Id.* at 20-25. He also attended college at this time at Bernard Baruch College and received a degree in business administration. TR pg 1357, lines 1-12. Mr. Zavanelli continued his education at Columbia University and spent four (4) years there in a Ph.D. program where he studied finance and economics but for financial reasons, he did not earn a doctorate degree from that institution. TR pg 1357, lines 17-25; TR pg 1358, lines 1-2.

Mr. Zavanelli then worked at Mellon Bank as a senior financial analyst and in 1977, joined American National Bank as a stock market theoretician. Soon after joining American National Bank, he became one of two investment strategists for the bank. TR pg 1358, lines 18-22; TR pg 1359, lines 3-12. While employed with American National Bank, Mr. Zavanelli had the opportunity to work with Rex Sinquefield, the chief investment officer for American National Bank, who also formed the first S&P 500 index fund and other well-known financial consultants. TR pg 1359, lines 13-25; TR 1360, lines 1-16.

In 1982, Mr. Zavanelli registered Zavanelli Portfolio Research as an investment advisor with the SEC to manage money for institutional clients. TR pg 1361, lines 12-22. Prior to this time, this company also sold research to institutional clients and money managers and was formed after Mr. Zavanelli left American National Bank. TR pg 1361, lines 6-8.

In 1991, Mr. Zavanelli relocated his investment advisory and research business to Orange City, Florida, in order to accept a teaching position at Stetson University as the first Roland George Professor and Chair of Applied Investments and Research. TR pg 1369, lines 6-24.

Subsequently, in 1994, Mr. Zavanelli stopped teaching in order to devote his full time to his businesses. *Id.* lines 11-24. At this time, Zavanelli Portfolio Research was divided into three (3) separate corporate divisions and operated as ZPR Investment Management, Inc., ZPR

Investment Research, Inc. and ZPR International, Inc. TR pg 741, line 25 through TR pg 742, lines 1-4.

III. ZPR RETAINS ASHLAND PARTNERS & COMPANY, LLC AS ITS GIPS VERIFIER

On January 30, 2006, ZPR retained Ashland Partners & Company, LLP (“Ashland”) to verify that ZPR’s composite construction satisfied the requirements of GIPS on a firm wide basis and to verify that ZPR had policies and procedures in place that were designed to calculate performance results in accordance with the GIPS standards. SEC’s Exhibit (“DX”) 37, pgs 1-2.

ZPR also retained Ashland to conduct performance examinations for its SCV composite and its Equity International Global (“International”) composite to ensure that the performance of the portfolios within each composite and the performance of the composites themselves were calculated in accordance with the GIPS standards. DX 37, pg 3-4 and TR pg 913, lines 23-25 through TR 914, lines 1-8. Ashland verified ZPR’s claim of GIPS compliance from December 31, 2000 through December 31, 2009 and conducted performance examinations of its SCV and International composites for the same time period. RX 14, Bate Stamp “ZPR Ashland Opinions 00001-00007.

A. Background and Overview of GIPS

Historically, the measurement of performance, reporting of performance results and other investment management practices varied significantly on a global scale. These differences limited the comparability of performance results between investment firms from different countries and also presented marketing challenges for investment firms on a global basis. RX 3, pg 1. The CFA Institute recognized the need for a global set of performance presentation standards and in 1995 sponsored the GIPS Committee to develop a uniform standard for presenting investment performance results that would allow firms to compete through an

uniform set of standards. *Id.* The Committee adopted the initial GIPS standards in February 1999 which were later amended and became effective on January 1, 2006 (“2005 GIPS Standards”). RX 3, pg 3, ¶13. One of the objectives of GIPS is to:

Insure accurate and consistent investment performance data for reporting, record keeping, marketing and presentations. *Id.* at pg 1, ¶C.7.

In addition, investment firms must apply the GIPS standards:

[W]ith the goal of full disclosure and fair representation of investment performance. *Id.* at pg 2, ¶D.10.g.

It is important to note that GIPS standards are voluntary in nature and investment firms are not required to follow them. TR pg 904, lines 9-11.

The 2005 GIPS standards address a number of categories that include composite construction, calculation, methodology, compliance and also include guidelines regarding a firm’s election to advertise. RX 3, “Table of Contents”. The 2005 GIPS Advertising Guidelines provided a checklist of requirements that firms who advertised their performance results were to follow. RX 3 pg 34. Section B.5. of these requirements identified the types of performance returns to be included in advertisements:

- a. 1-, 3-, and 5-year cumulative annualized COMPOSITE returns with the end-of-period date clearly identified (or annualized period since COMPOSITE inception if inception is greater than 1 and less than 5 years). Periods of less than 1 year are not permitted to be annualized. The annualized returns MUST be calculated through the same period of time as presented in the corresponding compliant presentation; or
- b. 5 years of annual COMPOSITE returns with the end-of-period date clearly identified (or since COMPOSITE inception if inception is less than 5 years). The annual returns MUST be calculated through the same period of time as presented in the corresponding compliant presentation.

The GIPS standards were later amended in 2010 and became effective on January 1, 2011. RX 4 pg 3. Section B.5. of the 2005 GIPS Advertising Guidelines was also amended to eliminate the requirement by firms to include period to date performance results in advertising.

Id. at pg. 30. This section now states the following:

- a. One-, three-, and five-year annualized COMPOSITE returns through the most recent period with the period-end date clearly identified. If the COMPOSITE has been in existence for less than five years, FIRMS MUST also present the annualized returns since the COMPOSITE INCEPTION DATE. (For example, if a COMPOSITE has been in existence for four years, FIRST MUST present one-, three-, and four-year annualized returns through the most recent period.) Returns for period of less than one year MUST NOT be annualized.
- b. Period-to-date COMPOSITE returns in addition to one-, three-, and five-year annualized COMPOSITE returns through the same period of time as presented in the corresponding COMPLIANT PRESENTATION with the period end date clearly identified. If the COMPOSITE has been in existence for less than five years, FIRMS MUST also present the annualized returns since the COMPOSITE INCEPTION DATE. (For example, if a COMPOSITE has been in existence for four years, FIRST MUST present one-, three-, and four-year annualized returns in addition to the period-to date COMPOSITE return.) Returns for period of less than one year MUST NOT be annualized.
- c. Period-to-date COMPOSITE returns in addition to five years of annual COMPOSITE returns (or for each annual period since the COMPOSITE INCEPTION DATE if the COMPOSITE has been in existence for less than five years) with the period end date clearly identified. The annual returns MUST be calculated through the same period of time as presented in the corresponding COMPLIANT PRESENTATION.

B. Ashland GIPS Verification Process

After Ashland was retained in January 2006 to perform GIPS verification services, ZPR provided information relating to its performance results as part of Ashland's initial verification process. DX 40. The initial verification was completed by Ashland in March 2006 and covered the period from January 1, 2001 through December 31, 2005. TR pg 918, lines 16-20.

After this date, ZPR continued to provide Ashland with information that was required to verify its claim of GIPS compliance on a firm wide basis and examine the performance of ZPR's SCV and International composites for each quarterly period. TR pg 919, lines 6-19. Ted Bauchle served as the Operations Manager for ZPR in 2006 and was subsequently appointed to serve as its Vice President. TR pg 145, lines 3-7. At the time Ashland was retained by ZPR, Mr. Bauchle was listed by Ashland as the main contact for the firm for GIPS matters. DX 40. In addition, Mr. Bauchle had primary responsibility for GIPS compliance issues. TR pg 186, lines 11-16.

Information for each verification period was requested from ZPR by Ashland and included marketing materials which Mr. Bauchle provided. TR pg 1019, lines 9-15. After completion of the initial GIPS verification in March 2006, Ashland assisted ZPR in creating a template that could be used to place magazine advertisements. TR 187, lines 17-22. This advertisement template listed performance returns on a year by year basis and also included the period to date return information required by the 2005 GIPS Advertising Guidelines. TR 187, lines 23-25 through TR 188, lines 1-14. *See also* RX 3, pg 34, ¶B.5. According to Mr. Bauchle's testimony, advertisements utilizing the template Ashland helped to create were placed by ZPR starting in late 2006. TR 187, lines 17-25 through TR 188, lines 1-3. The ad format that Ashland helped ZPR to create included a footnote that contained certain disclosures. Based upon

Mr. Zavanelli's testimony, this footnote was originally prepared by Ashland and included in the ads ZPR placed. TR pg 1397, lines 13-21.

As part of its verification for first quarter 2008, Mr. Bauchle, on January 11, 2008, provided Ashland with a copy of a magazine advertisement that ZPR placed in January 2008. After submitting this ad, Mr. Bauchle testified that no one from Ashland contacted him to discuss any deficiencies with it. TR pg 290, lines 22-25 through pg 291, lines 1-9. The format utilized by ZPR to place this January 2008 advertisement was the same as those that ZPR had previously placed in 2007. TR pg 1397, lines 22-25 through pg 1395, lines 1-6. ZPR continued to use this format for other advertisements it ran in February, March and April of 2008. TR pg 290, lines 2-5. *See also* DX 21, Bate Stamp "ZPR Advertise" Nos. 00001 through 00004.

At some point after these advertisements had been placed, Ashland informed ZPR to remove the word "audit" from the footnote that appeared in these four (4) ads and the firm complied with that request in subsequent advertisements that were placed. TR pg 293, lines 21-25 through pg 294, lines 1-3. Nikola Feliz, a senior manager with Ashland testified that the use of word "audit" by ZPR in these advertisements was not material and did not affect its firm wide claim of GIPS compliance. TR pg 1067, lines 20-25 through pg 1069, lines 1-4. Ms. Feliz also testified that firms do make mistakes and errors occur, which GIPS recognizes through an error correction policy. TR pg 1029, lines 12-16. She also stated that if errors are promptly corrected, those deficiencies do not jeopardize a firm's claim of GIPS compliance. *Id.* at lines 16-18. Therefore, the use of the word "audit" in certain advertisements did not adversely affect Ashland's ability to issue GIPS verification reports for ZPR. *See* RX 14, Ashland Independent Verifier's Report dated May 21, 2009, covering the period from December 31, 2000 through December 31, 2008. Ashland's instruction that ZPR remove the word "audit" from the footnote

is perplexing for two reasons. First, Mr. Zavanelli testified that Ashland had originally provided all of the language contained in this footnote. TR 1397, lines 13-21. In addition, GIPS standards recognize that a performance examination of a composite is also considered to be a performance audit of that composite. RX 3, pg 25, ¶C “Detailed Examinations of Investment Performance Presentations.” Therefore, ZPR’s prior claim that its performance had been “audited and verified” by Ashland was technically correct since Ashland had “audited” the performance of ZPR’s SCV and International composites and “verified” ZPR’s claim of GIPS compliance on a firm wide basis. Nevertheless, ZPR followed Ashland’s instruction and deleted the word “audited” from its magazine advertisements after April 2008. *See* DX 21.

C. ZPR Did Not Withhold Advertisements From Ashland

During the final hearing, Ms. Feliz testified that after Mr. Bauchle sent the January 2008 ad (DX 21, Bates Stamp “ZPR Advertise”, No. 00002), she and Carrie Hoxmeier, an Ashland verifier, called him to provide feedback on certain GIPS compliance issues. TR pg 927, lines 9-23. According to Ms. Feliz, she and Ms. Hoxmeier told Mr. Bauchle that the January 2008 ad did not disclose the currency used for the returns and did not disclose how a prospective client could receive a GIPS compliant presentation and a list of composites for the firm. TR pg 928, lines 6-21. In addition, Ms. Feliz claimed to have told Mr. Bauchle that the word “audit” should not be used in the ad. *Id.* She testified that the conversation with Mr. Bauchle occurred mid-year 2008 even though Mr. Bauchle had sent the January 2008 ad to Ashland on January 11, 2008, months before this alleged conversation took place. Compare TR pg 933, lines 23-25 through pg 934, lines 1-7 with DX 55 “January 2008 e-mail from ZPR to Carrie Hoxmeier” (TE 43) (ZPR Ashland TB Outbox 00001-00008).

Ms. Feliz also provided testimony that Mr. Bauchle listened to these suggestions and either during the same call or in another call Ms. Feliz had with him later that month, he indicated that ZPR had no intention of placing any future magazine ads. TR pg 934, lines 8-25. ZPR did place ads in financial magazines after mid-year 2008 and through Ms. Feliz, the SEC suggested that future ZPR ads were withheld from Ashland after Mr. Bauchle had told Ashland that ZPR was not going to run any more magazine ads after mid-year 2008. TR pg 935, lines 24-25 through pg 936, lines 1-11.

Ms. Feliz' testimony is highly suspect and inaccurate for a number of reasons. First, it is inconsistent with Mr. Bauchle's testimony that no one from Ashland ever contacted him to discuss the advertisement he sent to Ashland on January 11, 2008. TR pg 290, lines 22-25 through pg 291, lines 1-9. There is also no written evidence that was introduced in this proceeding to support Ms. Feliz's testimony about these conversations with Mr. Bauchle. She testified that she did not follow up this conversation with any e-mail or other correspondence to Mr. Bauchle. TR pg 1020, lines 9-23. Ms. Feliz was also unaware if Ms. Hoxmeier had followed up with Mr. Bauchle in writing on the GIPS compliance items or if she instructed Ms. Hoxmeier to do so. *Id.* In addition, Ms. Feliz testified that the working papers maintained by Ashland that she had reviewed in preparation for her testimony did not contain any reference or entry concerning any conversations Ms. Feliz had with Mr. Bauchle about the ad (January 2008). TR pg 1020, lines 24-25 through pg 1021, lines 1-18. Evidence was also presented during the final hearing that Ms. Hoxmeier had previously provided guidance through an e-mail to Mr. Bauchle concerning a marketing material ZPR sent to Ashland for the 2007 fourth quarter verification period. This correspondence was dated April 3, 2008, and addressed, among other

issues, the use of the word “audited”³ by ZPR in a Flash Report for its SCV and International composites. *See* DX 64. There are no e-mails, however, from Ms. Hoxmeier or anyone else from Ashland that provide guidance on any GIPS compliant issues concerning the January 2008 ad that Mr. Bauchle sent. To cast further doubt on the existence of the call with Mr. Bauchle in mid-year 2008, Ms. Feliz testified that it was the practice of Ms. Hoxmeier to send e-mails and give written instructions on GIPS compliance issues to Ashland clients. TR pg 1023, lines 22-25 through pg 1024, lines 1-2.

The testimony that Ms. Feliz gave during the final hearing about the mid-year 2008 call with Mr. Bauchle was also inconsistent with investigative testimony she had previously provided to the SEC on February 22, 2011. At that time, Mr. Feliz stated that prior to her first conversation with Max Zavanelli in early 2010 concerning the ZPR December 2009 client newsletter, no Ashland verifier had expressed any concerns about Max [Zavanelli], Ruth [Ann Fay] or Ted’s [Bauchle] noncompliance with GIPS in marketing materials, presentation materials, advertisements or newsletters. DX 89, “Testimony of Nikola Feliz”, pg 36, line 1 through pg 37, lines 1-18. During her testimony at the final hearing, Ms. Feliz admitted that the testimony she had previously given during the investigation was truthful and that prior to 2010, there were no GIPS compliance issues for ZPR. TR pg 1028, lines 2-25 through pg 1029, lines 1-7. Despite this testimony, Ms. Feliz affirmed her statement about the conversation she had with Mr. Bauchle in 2008. *Id.*, lines 8-12.

During her investigative testimony before the SEC, Ms. Feliz also reviewed the same January 2008 ad Mr. Bauchle had sent to Ashland and claimed she did not recall ever having reviewed it. DX 89 “Testimony of Nikola Feliz”, pg 146, lines 14-25 through pg 147, lines 1-5.

³ After the date of this correspondence from Ms. Hoxmeier, ZPR removed the word “audit” from all future magazine advertisements it placed. *See* DX 21.

Ms. Feliz went on to state that this ad did not inform someone how to get a full GIPS disclosure presentation from the firm and did not identify the currency used for performance. *Id.* at pg 147, lines 7-25 through pg 148, lines 1-19. Ms. Feliz also pointed out that the ad used the word “audit.” *Id.* at pg 148, lines 21-25 through pg 149, lines 1-3. These were the same identical issues Ms. Feliz claims she spoke to Mr. Bauchle about in mid-year 2008, but during her investigative testimony, she never mentioned the conversation and could not recall if she had ever reviewed the January 2008 ad that Mr. Bauchle sent.

Shortly after the SEC’s on-site examination of ZPR in February 2009, Ms. Fay, on February 17, 2009, sent an e-mail to Geoff Hecht, a manager with Ashland, to explain that the SEC had raised issues about certain ads ZPR had placed and that until the ads were GIPS compliant, ZPR could not advertise or make presentations. *See* RX 13. Ms. Fay also asked Mr. Hecht in this e-mail if ZPR should be sending its ads to Ashland for review as the SEC had suggested. *Id.* Mr. Hecht responded to Ms. Fay and stated the following:

“Thank you for your e-mail. Currently, Nikola Feliz (Senior Manager on your engagement) and I are reviewing your e-mail and working on some comments.” *Id.*

When asked about this e-mail, Ms. Feliz testified that she had no recollection about any conversation that she had with Mr. Hecht about it. TR pg 1035, lines 8-17. Ms. Feliz also testified that she didn’t know if Mr. Hecht responded to Ms. Fay’s request about sending future ads to Ashland for review. *Id.* at lines 18-22.

By contrast, Ms. Fay testified that no one from Ashland ever responded to her e-mail. TR pg 1274, lines 16-20. She also testified that she did not follow up with Ashland to ask if ZPR should be sending ads to Ashland but expected Mr. Bauchle to since he was the primary contact for Ashland. *Id.* at lines 21-25 through pg 1275, lines 1-4.

Prior to sending the February 17, 2009, e-mail (RX 12), Ms. Fay had also called Ashland to discuss the ZPR ads that the SEC raised concerns about during the on-site examination. TR pg 1276, lines 22-25 through pg 1277, lines 1-6. Ms. Fay testified that after this call, ZPR stopped running ads entirely until November 2009. *Id.* at pg 1277, lines 7-13. Ms. Fay also testified that neither she, Mr. Zavanelli nor anyone else at ZPR ever told Mr. Bauchle that ZPR was not going to run any more magazine ads in 2008. TR pg 1275, lines 15-19. Therefore, while ZPR informed Ashland that it was not going to place magazine ads, this decision was conveyed in February 2009 and not, as Ms. Feliz testified, in mid-year 2008. In addition, Ms. Fay's testimony and her February 17, 2009 e-mail to Ashland demonstrates that ZPR was not withholding any ads or other information from Ashland following the alleged mid-year 2008 conversation Ms. Feliz claimed to have had with Mr. Bauchle.

The Respondents may not have been aware that they were to send ads to Ashland, but there is no evidence that Ashland ever instructed them to do so. Both engagement letters between ZPR and Ashland fail to mention advertisements or any obligation on the part of ZPR to submit that information. *See* DX 38 and 40. In addition, the "Representation Letter" that Ms. Feliz testified was required to be signed before Ashland could verify a firm's claim of GIPS compliance (TR pg 919, lines 1-2 through pg 920, lines 1-6) does not contain any representation that ZPR had provided advertisements to Ashland and, in fact, does not even mention the word advertisement. *See* DX 39 "ZPR letter to Ashland dated 4/28/09" (TE 27).

In addition, Ms. Feliz testified that she did not believe she ever had a conversation with Mr. Bauchle to explain that presentation materials also included ads or marketing materials. TR pg 1040, lines 24-25 through pg 1041, lines 1-3. She further testified that to her knowledge, no one at Ashland ever instructed Mr. Bauchle to provide copies of ZPR ads. *Id.* at lines 10-17.

After Mr. Bauchle provided a copy of the January 2008 ad to Ashland on January 11, 2008 (DX 55), Ms. Feliz testified that she did not contact him to determine if ZPR had placed additional ads and, if so, to provide copies for Ashland's review. *Id.* at lines 18-25.

During the period from December 31, 2000 through December 31, 2009, when Ashland verified ZPR's claim of GIPS compliance, all information that Ashland requested from ZPR was provided by Mr. Bauchle. TR pg 1042, line 1 through pg 1043, lines 1-5. The evidence and testimony presented during the final hearing further demonstrates that ZPR would also have provided copies of magazine ads it placed if Mr. Bauchle or other members of ZPR's management had been instructed by Ashland to submit such information. Clearly, however, they were not.

IV. ZPR MAGAZINE ADVERTISEMENT IDENTIFIED IN THE OIP

The OIP has alleged ZPR placed three (3) advertisements in *Smart Money* between October and December 2008 that did not comply with the GIPS Advertising Guidelines relating to ZPR's performance results. The Respondents have admitted that, standing alone, these advertisements did not satisfy certain requirements of GIPS but assert that no information was concealed from these advertisements to make them materially false and misleading. RX 2, pg 3 and pg 4, ¶5. Respondents further contend that all ZPR performance results that were required by GIPS including period to date performance results were disclosed and available to prospective clients of the firm between October and December 2008 when these advertisements in *Smart Money* were published. *Id.* Therefore, the non-compliant GIPS deficiencies that appeared in these advertisements were corrected by ZPR through other disclosures being made at the same time on ZPR's public website to prospective clients which complied with GIPS standards and revealed that ZPR's SCV composite was under performing its benchmark during 2008. RX 8.

In addition, the disclosure of GIPS compliant performance results to prospective investors during the same periods that the *Smart Money* advertisements were published negates any allegation that those advertisements intentionally or willfully omitted ZPR's performance results. The performance results contained in these ads were accurate and there was nothing false or misleading about the ads themselves.

The OIP also alleges that ZPR falsely claimed that advertisements placed in the February and May 2011 issues of *Smart Money* magazine and in the March 2011 issue of *Barron's* magazine were GIPS compliant when they were not. The OIP contends that certain GIPS required performance returns were not included in those ads. OIP pg 5, ¶9. Respondents have also admitted that these advertisements standing alone did not comply with all of the GIPS Advertising Guidelines but contend that accurate and complete performance results as required by GIPS were provided to prospective clients. RX 2, pg 6, ¶9. Respondents further deny that these advertisements were false or misleading since the performance results contained within such advertisements represented previously published information by the *Pensions and Investments* magazine. See e.g. RX 21.

A. The October, November and December *Smart Money* Advertisement

In the summer of 2008, Mr. Zavanelli testified that ZPR decided to place additional advertisements for its SCV composite. TR pg 1408, lines 18-22. Mr. Zavanelli gave Ted Bauchle the format for these new ads, which was going to be the same as those that ZPR placed between January and April of that same year but with revised 2008 year to date performance results. *Id.* at lines 3-8. DX 21 Bate Stamp "ZPR Advertise" Nos. 00001 - 00004. Mr. Zavanelli was very clear in his instructions to Mr. Bauchle that the ZPR upcoming 2008 fall ads

had to be placed using the same format that had been used for the previous April 2008 *Smart Money* advertisement. TR pg 1413, lines 25 through pg 1414, lines 1-4.

After the decision was made to run more advertisements in the fall of 2008, David Sappir (“Sappir”), who was engaged by ZPR as a solicitor (DX 59), prepared a series of proposed advertisements and sent copies to Amy Bauchle⁴ at ZPR for review. RX 46. The first and second proposed advertisements that Sappir provided followed the format that ZPR had used to place previous ads while the third and fourth proposed advertisements he sent reflected a new and different format. Compare RX 46 with DX 21, “ZPR Advertise” Bates Stamp Nos. 00001-00004. The third and fourth proposed advertisements did not include performance results for 1, 3, and 5 years of annualized returns or five years of annual returns for the SCV composite as required by the 2005 GIPS Advertising Guidelines. See RX 46. Instead, these proposed advertisements simply included performance results representing a compounded 10 year return for the SCV composite. On July 16, 2008, the same day he sent these proposed ads to Amy Bauchle, Sappir sent one of the non-compliant GIPS potential ads to Ted Bauchle through an e-mail stating, “This is my favorite. What do you think?” Mr. Bauchle’s reply was as follows:

“Easy to read. . . . Footnote needs some updating. When you guys decide on a final ad, make sure Amy gets a doc version to update the footnote.” P.S. “Ruth Ann will want you to ad “Inc.” to the end of our company name.” RX 46.

Mr. Bauchle was primarily concerned about the language in the footnote to this ad because he had previously been advised by Ashland in April 2008 to update the footnote that ZPR was utilizing in its marketing materials for the SCV and International composites. See RX 47. The version of the new and corrected footnote suggested by Ashland added certain

⁴ During the relevant periods set forth in the OIP, Amy Bauchle was employed by ZPR as an administrative assistant and married to Ted Bauchle, ZPR’s Operations Manager. TR pg 141, lines 14-21; TR pg 148, lines 4-9..

information and deleted the word “audit” from the footnote that ZPR had used in previous ads it placed between January and April 2008. Compare footnotes contained in DX 21 Bates Stamp “ZPR Advertise 00001-00004” with RX 47 “Fundamental Small Cap Value Composite Footnote.” Other than the footnote language in the proposed ad Sappir sent to him on July 16, 2008, Mr. Bauchle did not raise any issues or objections regarding the 10 year compounded performance results that were set forth in Sappir’s potential ad. RX 46.

Mr. Zavanelli was not copied on any of the transmittals that Sappir sent to either Amy or Ted Bauchle regarding the 4 potential ads contained in RX 46. He also testified that he had no input in preparing the third or fourth potential advertisements and was not shown these potential ads by anyone. TR pg 1414, lines 5-24. Before the new ads were placed during the fall of 2008, Mr. Zavanelli received a telephone call from someone that told him the ad format was too big and certain information needed to be removed. TR pg 1418, lines 12-24. Mr. Zavanelli was out of the country when he received this call but was told it was the last day to submit the ad to *Smart Money* and that if ZPR did not place the ad, it would forfeit the money it had paid. *Id.* It was suggested to Mr. Zavanelli that the footnote language in the ad be deleted or reduced to which he strongly objected because “Ashland had approved the footnote”. TR pg 1419, lines 1-7. Due to the collapse that was taking place in the financial markets and his focus on those issues, Mr. Zavanelli provided instructions to “do what you can” with regard to the ad. *Id.* at lines 1-10. When he returned to ZPR’s office in October 2008, Mr. Zavanelli also testified that there were no conversations with Mr. Bauchle about these ads. TR pg 1420, lines 20-22.

Mr. Zavanelli also testified that the first time he actually saw the ads that ran in October, November and December of 2008 was on February 2, 2009 during the SEC’s on-site examination of ZPR. TR pg 1415, lines 21-25 through pg 1417, lines 1-17. When he was shown

the ads by Jean Cabot, who at the time was an examiner with the SEC, Mr. Zavanelli became extremely upset and stated “these are not my ads.” TR pg 1417, lines 12-13.

Based upon this testimony and the evidence presented during the final hearing, Mr. Zavanelli was not aware of the contents of these ads and did not approve them prior to publication. He was also unaware that these ads did not comply with the GIPS Advertising Guidelines until after the ads were run. Mr. Bauchle testified that he had a conversation with Mr. Zavanelli and Ruth Ann Fay (“Ms. Fay”), the firm’s Chief Compliance Officer (“CCO”), at that time, regarding an ad that was going to run in September 2008. TR pg 192, lines 1-7. Mr. Bauchle stated that he was concerned about ZPR’s use of annualized returns in advertisements because Mr. Zavanelli did not believe it was important to show the 1, 3 and 5-year annualized periods required by GIPS as long as a prospective client received a GIPS compliant presentation from ZPR⁵. *Id.* at lines 8-18.

The credibility of Mr. Bauchle’s testimony, however, is questionable for a number of reasons. First, ZPR never ran an ad in September 2008. DX 21. Also, when Mr. Bauchle provided testimony during the SEC’s investigation of ZPR in 2010, he testified that he did not believe the January 2008 *Smart Money* ad was GIPS compliant because it did not set forth the 1, 3 and 5-years of annualized performance returns. DX 155, pg 103, lines 12-25. During his investigative testimony, Mr. Bauchle also stated that he told Mr. Zavanelli the January 2008 *Smart Money* ad was not GIPS compliant. DX 155, pg 104, lines 4-6. According to Mr. Bauchle, Mr. Zavanelli stated that the annualized 1, 3 and 5-years of performance returns were not necessary for the ad because but the individual years were being presented [5 years of annual

⁵ Under GIPS, firms are required to provide a compliant presentation to all prospective clients provided that if a prospective client has received a compliant presentation within the previous 12 months, the firm has satisfied this requirement. RX 3, pg 8, ¶O.A.11. Examples of ZPR’s GIPS compliant presentations for its SCV and International composites are attached to Ashland’s Independent Verifier’s Report dated May 21, 2009. See RX 14.

returns as permitted by section 5.B.b., 2005 GIPS Advertising Guidelines (RX 3, pg 34)]. *Id.* lines 7-15. Mr. Bauchle also stated that he did not suggest this ad be reviewed by Ashland for GIPS compliance. *Id.* pg 105, lines 13-18.

These statements, however, contradict testimony Mr. Bauchle provided during the final hearing when he agreed that the year by year performance results contained in prior ads placed by ZPR, which included the same January 2008 ad, were GIPS compliant. TR pg 402, lines 9-24. In addition, Mr. Bauchle actually provided Ashland with a copy of the January 2008 *Smart Money* ad (or another January 2008 ad that was identical) as part of Ashland's 2007 third quarter verification (DX 55) even though his testimony indicated that he did not suggest to Mr. Zavanelli that the January 2008 ad be sent to Ashland. DX 155, pg 105, lines 10-18.

In view of this conflicting testimony and the non GIPS compliant potential ad that Mr. Bauchle received from Sappir and did not object to, it is clear that his recollection of relevant dates, events and conversations regarding the October, November and December 2008 ads was flawed and, therefore, not reliable. In addition, Ms. Fay testified that prior to the SEC's examination in February 2009, she had never discussed any GIPS compliant issues with Mr. Bauchle regarding the October, November or December 2008 *Smart Money* ads. TR pg 1265, lines 1-25 through pg 1267, lines 1-11. She also testified that she learned from Ms. Cabot for the first time in February 2009 that these ads were not GIPS compliant. *Id.* at lines 18-22.

In addition and at the same time the October, November and December 2008 ads were placed, the ZPR website contained performance results for the firm's SCV composite that showed it was under performing its benchmark, the Russell 2000 index. RX 8, Bate Stamp "ZPR Website Pages Old" pages 00058 – 00059. Mr. Bauchle testified that it was his responsibility to update ZPR's performance numbers, which would then be posted to the firm's

website. TR pg 366. Lines 3-8. He also testified that ZPR's GIPS annual disclosure presentation was available on the website to prospective clients. TR pg 367, lines 20-25 through pg 368, lines 1-4. In addition, ZPR routinely provided prospective clients with a copy of the firm's most recent annual GIPS compliant presentation, which contained 1, 3 and 5 years of annualized performance results. TR 1065, lines 11-25. Ms. Feliz also testified that as a GIPS expert, the performance results disclosed by ZPR on its website complied with the GIPS requirements. TR pg 1056, lines 18-25 through pg 1057, lines 1-4. She also testified that she believed that the ZPR website was itself an advertisement. TR pg 1080, lines 5-23. Consequently, ZPR was placing advertisements through both *Smart Money* magazine and its website at the same time between October and December 2008. Although the *Smart Money* ads did not contain the performance results required by the 2005 GIPS Advertising Guidelines, they did provide the ZPR website address which included GIPS compliant performance returns and showed the SCV composite to be under performing its benchmark. Thus, the availability of this information on the website to any prospective client dispels any contention that the Respondents were trying to use the *Smart Money* ads in a false or misleading way.

Further and in the event someone responded to the October, November or December 2008 ads, ZPR would have sent that person a package of information, which described the firm, the composites being advertised and their performance results. RX 11 sets forth an example of the type of information ZPR was sending to prospective clients or interested parties in 2008. The information contained in RX 11 included a performance chart and bar graph that showed ZPR's SCV composite was under performing both the Russell 2000 and S&P 500 indexes for the prior one year period and for the first quarter period ending March 31, 2008.

Prospective clients who received a copy of the ZPR client newsletter during the fourth quarter of 2008 would have also read Mr. Zavanelli's commentary about the poor performance of the ZPR composites. For example, the November 2008 issue of the client newsletter that was also available on the ZPR website at that time⁶ indicated that:

“We were off 21.988% for October [2008] for Small Cap value with the Russell 2000 down 20.90%. The S&P 500 was down 16.85%” DX 71, pg 2.

If the Respondents were truly attempting to conceal the performance of the SCV composite relative to its benchmark, the Russell 2000, through the *Smart Money* ads at issue, this type of information would not have been published and made available through the client newsletter.

This information as well as the performance results that ZPR disclosed on its website and the testimony given during the final hearing clearly indicate that the Respondents were not attempting to willfully or intentionally conceal its 2008 performance results from any existing or prospective clients. Ms. Cabot, Ms. Feliz and Mr. Bauchle were called as witnesses by the SEC and all testified that the ZPR performance results were accurate. TR pg 681, lines 7-15 (Cabot); TR pg 1041, lines 13-24 (Feliz); and TR pg 363, lines 8-24 (Bauchle). Thus, the performance results contained in the October, November and December 2008 *Smart Money* ads were accurate and, therefore, the ads themselves were not false or misleading. Mr. Bauchle also testified he believed prospective clients always were provided with a good presentation of ZPR's performance. TR pg 407, lines 14-25 through pg 408, lines 1-4. He further stated that during his 18 years as an employee of ZPR, he had never seen Mr. Zavanelli do anything that was

⁶ ZPR posted monthly client newsletters on its website. TR pg 1277, lines 15-16.

dishonest. Finally, ZPR did not obtain any clients from the *Smart Money* ads placed between October and December, 2008. TR pg 1427, lines 12-20.

B. Advertisements Placed by ZPR in 2011

Commencing in approximately 1991, ZPR had provided data on the performance results of its composites to Pensions & Investments, who collected information and compared the investment results achieved by institutional money managers. TR pg 1463, lines 15-25. Pensions and Investments also published a magazine for institutions and ZPR was consistently being ranked as one of the top 10 investment managers. TR pg 1460, lines 8-14. As a result, Mr. Zavanelli wanted to reprint information from certain issues of the Pension and Investments magazine and advertise ZPR's successful performance against other managers. Id. In November 2010, ZPR paid Pensions and Investments a fee to reprint certain charts showing the top performing managers that Pensions and Investments had ranked. RX 21. As a condition of this arrangement, ZPR agreed not to alter or revise the charts it was being allowed to reprint. Id.

After obtaining permission from Pensions and Investments to use its information, ZPR placed two advertisements that ran in the February and May 2011 issues of *Smart Money* magazine and one ad that ran in a March 2011 issue of *Barron's*. See RX 15, 17 and 19. These advertisements contained a claim of GIPS compliance by ZPR but did not include 1, 3 and 5 years of annualized composite returns with the period end date clearly identified⁷ or other alternative performance return periods as provided by Section B.5. of the 2010 GIPS Advertising Guidelines. RX , pg 30, ¶B.5.a.-c.

Notwithstanding the technical deficiencies contained in these ads, Mr. Zavanelli testified that ZPR was not attempting to mislead anyone by reprinting an ad that was previously published

⁷ The 2010 GIPS Advertising Guidelines permitted but no longer required firms to include a period to date composite return in advertisements that present performance. See RX 4, pg 30, ¶B.5a-c.

and stated that anyone responding to these advertisements could review performance results of the International and All Asian composites, net of fees⁸ on ZPR's website which was identified in each ad. TR pg 1463, lines 3-14.

RX 16, 18 and 20, respectively, represent information that ZPR sent to any one that responded to the February and May 2011 *Smart Money* advertisements and the March 2011 *Barron's* advertisement that are the subject of the OIP. See copies of advertisements contained in RX 15, 17 and 19. The information provided to interested parties included GIPS compliant performance results for the ZPR International and All Asian composites being advertised. The disclosure of GIPS compliant performance results by ZPR to individuals who responded to the 2011 *Smart Money* and *Barron's* advertisements like Dan Cash (RX 16); David Pressman (RX 18) and Hayden Gaunt (RX 20) clearly refute any contention alleged by the SEC that the advertisements themselves were misleading. From December 31, 2000 through May 2011 when these advertisements were being placed, ZPR had been verified as having complied with GIPS on a firm wide basis. See RX 14 and RX 22. Therefore, ZPR's claim of GIPS compliance as contained in the 2011 *Smart Money* and *Barron's* ads was not false as the SEC has alleged.

Ms. Feliz, in her testimony, also indicated that sending GIPS compliant performance results to prospective clients responding to an advertisement would serve to correct GIPS non-compliant deficiencies that appeared in the ad. TR pg 1079, lines 9-25. Ms. Feliz also testified that the GIPS Advertising Guidelines do not apply unless a firm includes a claim of GIPS compliance in the ad itself. TR pg 82, lines 1-5. Therefore, if ZPR had simply removed the GIPS claim of compliance from the 2011 *Smart Money* and *Barron's* advertisements, the SEC

⁸ Gross returns were originally published by *Pensions & Investments* and since ZPR could not change this information, it included a footnote in each ad that disclosed performance results net of fees for its advertised composites could be viewed on its website to comply with SEC disclosure requirements

would not have asserted any claims against the Respondents regarding these ads since there was nothing false or misleading about them. Mr. Zavanelli testified that he included a claim of GIPS compliance in these ads because ZPR was GIPS compliant, and the firms numbers were GIPS compliant, TR pg 1505, lines 9-16, and these were accurate statements. During his investigative testimony before the SEC in June 2011, it was also apparent that Mr. Zavanelli did not understand that including a claim of GIPS compliance within an advertisement triggered application of the GIPS Advertising Guidelines. DX 89, pg 70, lines 8-18.

The evidence presented during the final hearing demonstrated that while there may have been technical errors by including a claim of GIPS compliance in the 2011 *Smart Money* and *Barron's* ads, Respondents did not intentionally or willfully violate the GIPS standards. TR pg 1729, lines 7-11.

V. CLIENT NEWSLETTERS

For approximately 20 years, ZPR prepared and distributed a monthly newsletter to the firm's clients as well as business associates, family members and friends of Mr. Zavanelli. TR pg 1437, lines 15-25. The newsletter is prepared by several ZPR employees but Mr. Zavanelli writes most of the articles and narrative. TR pg 1437, lines 25 through pg 1438, lines 1-8. Mr. Zavanelli did not consider the newsletter to be an advertisement since he didn't feel it was being used by ZPR for marketing purposes. Mr. Zavanelli testified that the newsletter was used to provide information about the markets, discuss investments and predict the economy and for those reasons he did not feel it was a marketing piece. TR pg 1430, lines 4-15.

Through the OIP, it is alleged that ZPR made reference to its compliance with GIPS in the April and December 2009 issues of the client newsletter but failed to include performance results that complied with GIPS. OIP pg 5, paragraph 10. Since those newsletters were not

intended to solicit prospective clients, however, the GIPS Advertising Guidelines should not be applicable. Further, the narrative references to GIPS and the context of the relevant articles within these two client newsletters, do not create an obligation for ZPR to disclose performance results as required by the GIPS Advertising Guidelines. Compare RX 3 pg 34, paragraph B with RX 23 “Good News” article, pgs 3-4 and Rx 24 “GIPS Compliance” article, pg 4.

A. April 2009 Client Newsletter

The April 2009 ZPR client newsletter contained an article Mr. Zavanelli had written about the SEC uptick rule⁹ and how the elimination of the rule adversely affected the performance of ZPR’s SCV composite. RX 23 “Good News” pgs 3-4. Mr. Zavanelli testified that when a company would report bad news or missed a forecast, pre-market trading could cause significant drops in stock prices at the market’s opening, and cause panic for smaller investors. TR pg 1440, lines 16-25 through pg 1441, lines 1-9.

This activity, according to Mr. Zavanelli, was having a negative impact on ZPR’s portfolio. *Id.* In his article, Mr. Zavanelli was comparing the impact that the uptick rule had on ZPR’s performance prior to its elimination and afterwards, and was letting clients know why ZPR was incurring huge losses. *Id.* at lines 20-25 through pg 1442, lines 1-9. The performance numbers for the SCV composite contained in the article were utilized merely to illustrate this point, not to promote the SCV composite itself to new clients. If ZPR was truly attempting to mislead and publish false statements through its April 2009 client newsletter as alleged, it is doubtful that performance results for the SCV composite would have been included for 2008 by ZPR which disclosed that it had underperformed both the Russell 2000 and the S&P 500 indices. *See* Rx 23, pg 3. While ZPR technically should not have made any reference to a claim of GIPS

⁹ The uptick rule, which was eliminated in May 2007, prevented short selling of equity securities unless the stock price would move up. TR pg 1440, lines 8-18

compliance in this client newsletter, the evidence clearly demonstrates that the Respondents did not intentionally or willfully violate any provisions of GIPS. In addition, Ashland reviewed this newsletter as part of its verification process and did not have any concerns about it. TR pg 990, lines 1-13; pg 991, lines 13-18.

B. December 2009 Client Newsletter

The December 2009 issue of the ZPR client newsletter under the heading “Top Performance” contained tables that listed performance results for ZPR’s SCV and International composites and other investment managers. See RX 24, pg. 3. These tables had been reprinted from magazine issues that Pensions and Investments had previously published. TR pg 1443, lines 9-12. In describing the rankings amongst these investment managers, Mr. Zavanelli included the statement “all numbers are GIPS compliant” because he was of the belief that the results of these investment managers had been verified. *Id.* at lines 8-15.

Notwithstanding this statement is directed to performance results of all investment managers listed in the tables, ZPR did not make a claim of GIPS compliance within the newsletter. Instead, Respondents specifically denied that the client newsletter was GIPS compliant. See RX 24 “GIPS Compliance”, pg 4. Mr. Zavanelli wrote the “GIPS Compliance” article to inform clients that in an attempt to distribute the newsletter as fast as possible, equal weighted calculations to determine performance results were used by ZPR as opposed to asset weighted calculations that were required by GIPS. TR pg 1444, lines 2-18. Mr. Zavanelli also testified that if ZPR had used an asset weighted calculation for performance results, distribution of the client newsletter would have been significantly delayed. *Id.* at lines 19-25 and pg 1445, lines 1-19. The use of equal weighted calculations in the client newsletter was disclosed at the bottom of the first page of each issue (*see e.g.* RX 24 disclosures at the bottom of page 1) and

Mr. Zavanelli testified that the use of equal weighted performance results was not intended to mislead anyone. TR pg 1445, lines 20-24. He also testified that ZPR's performance results for purposes of GIPS compliance were always calculated on an asset weighted basis as required. *Id.* at lines 5-7.

Ms. Feliz also testified that making references to GIPS from an editorial standpoint or to express an opinion about GIPS as Mr. Zavanelli was doing, did not violate the GIPS Advertising Guidelines. TR pg 1084, lines 9-14.

Since this client newsletter was used simply to inform existing clients and others who Zavanelli knew, about news and events that affected ZPR, the GIPS Advertising Guidelines should not apply especially since ZPR affirmatively disclosed that the newsletter was not GIPS compliant.

C. Ashland's Review of ZPR Client Newsletter

During the SEC's investigation, Ms. Feliz testified that there were no GIPS compliant issues with respect to ZPR prior to 2010. TR pg 1028, lines 2-25 through pg 1029, lines 1-7. An area of concern with Ashland, however, came up after the December 2009 client newsletter was distributed. Mr. Zavanelli testified that Ashland had contacted Mr. Bauchle in September or October 2009 and suggested he attach ZPR's GIPS annual disclosure presentation to the client newsletter. TR pg 1448, lines 23-25 through pg 1449, lines 1-8.

According to Ms. Feliz, Ashland felt that because the client newsletter showed performance results and included a claim of GIPS compliance, ZPR was required to follow the GIPS Advertising Guidelines or include a GIPS full disclosure presentation. TR pg 956, lines 21-25 through pg 957, lines 1-5. In response to this position, Mr. Zavanelli did not believe these corrective actions were necessary. He did not consider the client newsletter to be a marketing

piece that fell into the definition of an advertisement. TR pg 361, lines 10-16. In addition, he was of the belief that if a prospective client received a GIPS annual disclosure presentation from ZPR within the previous 12 months, the GIPS disclosure requirements were satisfied as provided by section O.A. 11 of the 2005 GIPS standards. TR pg 1453, lines 20-25 through pg 1454, line 1. He further testified that ZPR provided a GIPS disclosure presentation on its website and gave this information to all prospective clients who had an interest in opening an account with ZPR and, therefore, did not see the point of attaching the GIPS disclosure presentation to the client newsletter. *Id.* at lines 2-12 and lines 20-25; TR pg 1455, lines 1-25 through pg 1456, lines 1-6. As a result of this position, Mr. Zavanelli told Mr. Bauchle not to attach the GIPS disclosure presentation to any other client newsletters. TR pg 207, lines 21-25 through pg 208, lines 1-4. Since these disclosures were not included and based upon the article Mr. Zavanelli had written in the December 2009 client newsletter (RX 24, pg 4), Ms. Feliz, according to her testimony, called Mr. Zavanelli twice in 2010 to discuss this issue. TR pg 990, lines 14-25, pg 991, lines 1-25 and pg 972, lines 3-19. Mr. Zavanelli testified that he disagreed with her suggestion to attach the GIPS annual disclosure presentation to the client newsletter in part because the performance numbers in the annual disclosure presentation are not updated and he did not believe he was using the client newsletter for marketing purposes. TR pg 1450, lines 10-25 through pg 1451, lines 1-7. This conversation prompted a second call between Ashland and Mr. Zavanelli in March, 2010. *Id.* at lines 15-21. During this conversation, Ms. Feliz and one of Ashland's partners discussed the client newsletter issue with Mr. Zavanelli also, once again, emphasized the point that ZPR was providing the GIPS annual disclosure presentation to prospective clients as required by section O.A. 11 of the GIPS standards. TR pg 1456, lines 7-13. After the second call with Ashland, Mr. Zavanelli testified that he believed he had been successful in conveying

his position that the GIPS annual disclosure presentation did not need to be attached to the client newsletter and that the disagreement with Ashland had been resolved in his favor. *Id.* at lines 14-17.

After this call, Ashland prepared an undated letter to Ted Bauchle which outlined two options for ZPR to follow regarding the client newsletter and the GIPS standards. DX 52. These options generally suggested that ZPR could either (i) treat the client newsletter as a mass mailing, refrain from any references to GIPS and provide other disclosures concerning the availability of a GIPS full disclosure presentation and asset weighted performance results or (ii) comply with the GIPS Advertising Guidelines. *Id.*

Ms. Feliz testified that on April 22, 2010, she had a telephone conversation with Mr. Bauchle about this letter who indicated that Mr. Zavanelli had not made a decision but agreed to follow one of the two options presented. During the next verification period, Ms. Feliz testified that Ashland reviewed the June 2010 issue of the ZPR client newsletter and determined that neither option suggested by Ashland had been followed. *Id.* pg 1004, lines 4-10. As a result of this inaction by ZPR, Ashland resigned as its GIPS verification firm in July 2010. *Id.* at lines 13-16, *see also* DX 36 “Resignation Letter of Ashland.”

When the letter providing the options for the client newsletter was sent by Ashland to Mr. Bauchle, Mr. Zavanelli was not copied. DX 52. In addition, Ms. Feliz did not call Mr. Zavanelli to acknowledge his receipt of this letter. TR pg 1087, lines 14-18. In fact, Mr. Zavanelli did not see a copy of DX 52 until almost two years later when his testimony was taken during the SEC investigation on June 13, 2011. TR pg 1457, lines 2-16. He also testified that he did not have any conversations with Mr. Bauchle regarding the options Ashland had presented regarding the client newsletter. *Id.* at lines 17-21. Had Mr. Zavanelli received a copy of DX 52 prior to

Ashland's resignation, he testified that ZPR would have followed the first option presented and not mention GIPS in the client newsletter. TR pg 1458, lines 10-19.

Based upon the evidence presented, however, Mr. Zavanelli was never given this opportunity nor was he contacted by Ms. Feliz or anyone else at Ashland directly after DX 52 was sent, to discuss the client newsletter options. He was not attempting to ignore Ashland's suggestions about the client newsletters and was clearly unaware of the directives in DX 52 until after Ashland resigned. Had Mr. Bauchle or Ashland itself communicated with Mr. Zavanelli more effectively, the steps to address client newsletter issues would have been made and the decision by Ashland to resign would have been avoided.

VI. MORNINGSTAR REPORTS

As previously discussed, ZPR had provided information concerning its performance results to a database maintained by *Pensions and Investments* since approximately 1991. TR pg 1463, lines 15-25. According to Mr. Zavanelli and at some point, *Morningstar* acquired that feature from *Pensions and Investments* and ZPR then started to provide information to *Morningstar*. On May 1, 2011, ZPR entered into an agreement with *Morningstar* to license and use certain data that included the *Morningstar* rating service. RX 35. Prior to this time, ZPR had received and was using *Morningstar* ratings in magazine advertisements it placed. See e.g. RX 5, "October issue of *Smart Money*". ZPR, however, was not paying *Morningstar* for the use of this information until *Morningstar* made it aware that ZPR could not use the data unless it was paid for. TR pg 1464, lines 5-25.

Mr. Bauchle testified that he was responsible for providing data to *Morningstar* and that all of ZPR performance numbers he submitted were accurate. TR pg 271, lines 2-14. Mr. Bauchle also testified that Mr. Zavanelli did not have a password to access the information ZPR

submitted to *Morningstar* and that Mr. Zavanelli never reviewed *Morningstar* to look at this information. TR page 270, lines 1-9.

The information that ZPR provided to *Morningstar* was uploaded through its Data Manager Website. TR pg 1800, lines 22-25 through pg 1801, lines 1-8. In addition to performance numbers, *Morningstar* also required other information about ZPR to be submitted, which was consolidated into a report ZPR had access to before it entered into an agreement with *Morningstar*. RX 25; TR pg 1803, lines 19-25 through pg 1804, lines 1-6.

A. September 30, 2010, Morningstar Report

The information contained in the *Morningstar* report included a category labeled “Performance Disclosure”. RX 25, pg 7. Mr. Bauchle testified that there were two parts to the *Morningstar* database where he uploaded data. TR page 272, lines 6-15. One part was updated every quarter with new performance numbers and a second part was completed when ZPR first started supplying data that would be updated by him annually. *Id.* Under the “Performance Disclosure” category of the *Morningstar* Report, Mr. Bauchle testified that he provided information which listed Ashland as ZPR’s verifier for GIPS compliance for the period December 31, 2000 to the present. TR pg 277, lines 1-13. Mr. Bauchle also testified that the information relating to Ashland kept repeating itself in future *Morningstar* reports. *Id.* at lines 14-16. Through an e-mail he sent to Mr. Zavanelli on April 5, 2013, Mr. Bauchle stated that he used this language on *Morningstar* to describe Ashland so that he would not have to update the verification periods with specific dates each quarter. Since he was afraid he would forget to do that. *See* RX 27; OIP pg 6, ¶11.

Through oversight and inadvertence, Mr. Bauchle’s fear became reality and he forgot to modify the September 30, 2010, *Morningstar* report for the dates that Ashland served as ZPR’s

verifier. Ashland had previously resigned in July 2010 and the last GIPS verification report it issued for ZPR was dated for the period ending December 31, 2009. DX 36.

Mr. Bauchle later corrected this mistake, which is reflected on the *Morningstar* report for ZPR dated March 31, 2011, which contains accurate information for the period that Ashland served as ZPR's verifier for GIPS compliance. See RX 26, pg 2 of 13. This report also properly identified Alpha as ZPR's new GIPS verifier commencing in 2010.

Although the information provided in the September 30, 2010, regarding the date that Ashland served as ZPR's GIPS verification firm was not accurate, the evidence presented during the final hearing clearly established that the Respondents did not intentionally or willfully provide this information to *Morningstar* to mislead anyone. Mr. Bauchle simply forgot to change and update language on the *Morningstar* database after Ashland had resigned in July 2010. He also testified that Mr. Zavanelli did not have any involvement in uploading data to *Morningstar*. TR pg 277, lines 1-19.

B. Pending SEC Investigation

The *Morningstar* reports also contained a category labeled Firm Legal and Compliance Summary. See e.g. RX 26, pg 2 of 7. In this section of the report, firms were requested to state whether or not they were involved in any pending litigation or the subject of any SEC pending investigation. *Id.* When uploading data for purposes of disclosing this specific information, the *Morningstar* database screen requested an effective date that related to a "Litigation Charge" or a "Pending SEC Investigation Charge." See RX 38, pgs 2 and 3. Mr. Bauchle who was responsible for uploading data to *Morningstar*, testified that ZPR did not believe the SEC investigation was formal until the OIP was filed on April 4, 2013. TR pg 256, lines 11-18. Mr. Bauchle also testified that he was aware of the section on the *Morningstar* database that

requested the firm to state whether it was under investigation. TR pg 285, lines 13-16. He further testified that during the time the SEC investigation was ongoing, the SEC pending investigation box was checked “no” because ZPR “didn’t feel it was a real investigation until this April 4th” referring to the date the OIP was issued. *Id.* at lines 6-12.

Prior to this time and after ZPR received a Wells notice from the SEC, Mark Zavanelli testified that he spoke with the firm’s consultant, National Consulting Services (“NCS”) about the *Morningstar* disciplinary section. TR pg 1815, lines 9-25 through pg 1816, lines 1-6. NCS replied to him that the *Morningstar* section was unclear. *Id.* at lines 9-22. However, NCS did advise Mark Zavanelli that disclosure of the SEC’s Wells notice by ZPR on its Form ADV¹⁰ did not trigger any other disclosure requirements by the firm. *Id.* at lines 9-15.

The evidence and testimony presented during the final hearing establishes that prior to April 4, 2013, there was no charge asserted by the SEC against ZPR to require disclosure of the pending investigation on the *Morningstar* report. When ZPR received the SEC’s Wells notice, its management took reasonable steps to discuss the disclosure of this event with NCS, its outside consultant. When ZPR chose to disclose the Wells notice on its ADV, they also received guidance from NCS that no further disclosures were required which included the disciplinary section on *Morningstar*. TR pg 1815, lines 9-22. Therefore, ZPR did not intentionally or willfully misrepresent the SEC’s pending investigation on its *Morningstar* report. In addition, Max Zavanelli testified that he was not aware of the “SEC pending investigation” disclosure item in the *Morningstar* reports until May of 2012 when ZPR received the SEC’s Wells notice. TR pg 1467, lines 1-9. He also stated that Mr. Bauchle was never instructed not to disclose the SEC pending investigation on *Morningstar*. *Id.* at lines 22-25. Towards the conclusion of his

¹⁰ ZPR disclosed the SEC’s Wells notice through an amendment to its Form ADV dated June 7, 2012. See RX 28, pgs 21 and 27.

testimony during the final hearing, Judge Elliot asked Max Zavanelli a question about the pending SEC investigation disclosure item on the *Morningstar* report, and he answered as follows:

Judge Elliot: What would your answer have been without asking your lawyers or asking National Compliance Service?

The Witness: I would also say no because it said there is no – what I know now
[Max Zavanelli] is that if you actually say yes to this, up pops – I never accessed the system at all myself, but I was told and shown that, when you say yes, up pops the screen that asks what are the charges, what’s the date.

And we had no charges and no date. And I also know that my son asked the Morningstar analysts in 2013, after we saw the charges that – you know, how would we respond to this. Well, if you don’t have charges, you say no.

TR pg 1714, lines 11-25 through pg 1715, line 1.

The information ZPR provided to *Morningstar* that is reflected by the September 30, 2010 (RX 25) and March 31, 2011 (RX 26) reports are only available to institutional investors through subscription to *Morningstar* and, therefore, are not publicly available as alleged in the OIP. OIP pg 6, ¶11. According to *Morningstar* itself, these reports are not available to retail investors. See RX 37. Mark Zavanelli also testified that he had attempted to obtain the ZPR *Morningstar* reports through the *Morningstar* public website (www.morningstar.com) and through another premium subscription he personally has with *Morningstar*, and could not find any information regarding ZPR. TR pg 1798, lines 5-25. Therefore, the *Morningstar* reports themselves are not advertisements.

In addition, before ZPR entered into an agreement with the license data *Morningstar* in May 2011, ZPR did not distribute copies of the *Morningstar* reports to any prospective clients nor did it authorize any other party to provide this information on its behalf. TR pg 1633, lines

3-11 and pg 1687, lines 12-21. The *Morningstar* reports were never considered nor utilized by ZPR as advertisements. Further, Mr. Zavanelli testified that ZPR did not receive any institutional clients through *Morningstar*. TR pg 1587, lines 3-10.

VII. STEPS TAKEN BY RESPONDENTS TO ADDRESS ISSUES RAISED BY THE OIP

The Respondents have acknowledged that certain mistakes and errors were previously made regarding ZPR's efforts to comply with GIPS, but have taken corrective steps to address and remedy those issues. For example, in April 2008, when Ashland advised ZPR to remove the word "audit" from its marketing materials, no magazine advertisements placed after this date contained that word. *See* DX 21, Bates Stamp "ZPR Advertise" pages 00005-00021.

In February 2009 during the SEC examination, Ms. Cabot told Ms. Fay and Mr. Bauchle that the ads placed from October to December 2008 were not GIPS compliant. TR pg 1267, lines 18-22. In response to this information, ZPR did not place any magazine ads until November 2009 and contacted Ashland for guidance on these matters. Compare DX 21, Bates Stamp "ZPR Advertise 00007 with 00008. *See also* RX 13 and TR pg 1270, lines 22-25 through pg 1271, lines 1-4.

To address GIPS advertisement issues and other compliance matters that had previously arisen, Mr. Zavanelli hired his son, Mark Zavanelli, in the fall of 2011, to be the Chief Compliance Officer (CCO) and President of ZPR. TR pg 1479, lines 23-25. In addition, NCS was retained at this time to review ads and other areas of compliance for the firm. *Id.* at lines 13-17. ZPR also provided copies of advertisements to Alpha, its GIPS verifier, for review. *Id.* at lines 22-23.

When Mark Zavanelli became the CCO, he was aware that the SEC was looking into certain compliance issues relating to ZPR and he immediately started to familiarize himself with

those issues. TR pg 1750, lines 4-20. After reviewing the investigative testimony given by Max Zavanelli, Mr. Bauchle and possibly Ruth Ann Fay, Mark Zavanelli determined that the firm's GIPS compliance and its advertising policies were key issues and in his words "it was time to get that right ASAP." *Id.* at lines 12-21.

To address these areas, Mark Zavanelli requested NCS in late 2011 to review the ZPR website, the client newsletter and current brochures and ads being used. TR pg 1753, lines 6-25. At this time he also spoke with Mike Hultzapple of Alpha to discuss applicable GIPS guidelines and advertising issues that pertained to the firm. TR pg 1754, lines 1-12. Based upon the input and recommendations that he received from NCS and Alpha, Mark Zavanelli felt that certain changes regarding GIPS compliance needed to be made. *Id.* at lines 19-24.

Mark Zavanelli first addressed the ZPR website. He testified that the performance results that now appear on the firm's website have been limited to only cover periods that had been verified. TR pg 1758, lines 19-25 through pg 1759, lines 1-18. He also testified that a number of additional changes were made to the website in early to mid-2012. TR pg 1764, lines 5-13. He further stated that any significant change to the ZPR website must also be reviewed by Alpha for GIPS compliance and NCS for SEC compliance issues. *Id.* at lines 17-23. *See also* RX 29 "Select Pages From Current ZPR Website."

Mark Zavanelli has also made changes to the client newsletter and steps have been taken to comply with the GIPS Advertising Guidelines. He concluded that the ZPR client newsletter should be considered as an advertisement based upon conversations he had with Alpha and claims of GIPS compliance that were being made in the client newsletter itself.¹¹ TR pg 1767, lines 1-16. Copies of the ZPR composite returns that meet the GIPS Advertising Guidelines are

¹¹ If no claim of GIPS compliance is made in an issue of the client newsletter, then the GIPS Advertising Guidelines do not apply. TR pg 1769, lines 19-25 through pg 1770, line 11.

now included with each issue of the client newsletter. TR pg 1770, lines 2-17. *See also* RX 30 “ZPR Investment Report – December 2012.” Mark Zavanelli testified that any changes made to the ZPR composite returns other than updated numbers themselves, require review and approval from NCS and Alpha. TR pg 1772, lines 10-21. He also stated that changes he had made to the newsletter were discussed with Alpha to assure that GIPS requirements were met. TR pg 1771, line 25 through pg 1772, line 1.

After joining ZPR as the CCO and its President, Mark Zavanelli, with the assistance of NCS and Alpha also created a new ad format for ZPR to follow. TR pg 1776, lines 2-19. This new ad format addresses each item that is required by the GIPS Advertising Guidelines and was reviewed by both NCS and Alpha. TR pg 1778, lines 1-5. RX 31 “ZPR Fortune Magazine Advertisement” represents an example of the new ZPR ad format that was created by Mark Zavanelli and continues to be followed by ZPR. TR pg 1776, lines 20-25.

Mark Zavanelli also established an advertisement review policy for ZPR that requires all magazine ads to be reviewed by the CCO and by both NCS and Alpha. TR 1788, lines 2-20. Mark Zavanelli also maintains an ad-review file to document work involved in creating the ads. *Id.* at lines 21-93. In addition to magazine ads, the ZPR website, the client newsletter and information provided to prospective clients are all subject to this ad review policy. TR pg 1789, lines 3-19 and pg 1790, lines 2-22.

Also, since Mr. Bauchle is no longer employed by ZPR, Mark Zavanelli is supervising other ZPR employees who upload data onto the *Morningstar* website. TR pg 1800, lines 23-25 through pg 1801, lines 1-8. Mark Zavanelli also has direct access to the *Morningstar* website where data is uploaded in order to review uploaded information provided by ZPR. *Id.*

The evidence and testimony presented during the final hearing was unrebutted and established that since Mark Zavanelli joined ZPR in October 2011, he has addressed each issue raised in the OIP and taken steps to correct the deficiencies and mistakes that previously appeared in certain magazine ads placed by ZPR, its client newsletter and the *Morningstar* reports. Mark Zavanelli is a former mutual fund manager for OppenheimerFunds. and holds a degree in economics from the Wharton School of Business. TR pg 1738, line 25 through pg 1740, lines 1-14. He is also a member of the CFA Institute and is a Chartered Financial Analyst. TR pg 1741, lines 16-20.

With the involvement of NCS and Alpha, the implementation of ZPR's ad review policy and other significant changes made to the firm's marketing and advertising materials, Mark Zavanelli is both qualified and capable of continuing to serve as President and CCO for the firm. He has ultimate control and final decision making over compliance issues for ZPR (TR pg 1786, lines 7-16) and is the sole shareholder of ZPR. TR pg 1615, line 21-23. For these reasons, the likelihood of ZPR failing to comply with GIPS standards or its reporting requirements to *Morningstar* in the future is extremely remote and no harm to the public due to ZPR's future advertising efforts will result.

VIII. CONCLUSIONS OF LAW

In connection with the remaining portion of the Respondent's brief, heavy reliance has been placed upon the recent administrative decision of In The Matter of Michael R. Pelosi, Release No. 448 (2012), for legal authority and reasoning including reference to various citations used in that opinion.

The SEC contends that Max Zavanelli and ZPR violated Sections 206(1) and (2) of the Investment Advisers Act of 1940 ("IAA") in connection with the various advertisements. The

SEC is required to prove that Max Zavanelli and ZPR engaged in fraudulent activities and they negligently breached their fiduciary duties by making false and misleading statements or omissions of material fact. *See SEC v. Merrill Scott & Assc., Ltd*, 505 F. Supp. 2d 1193 (D. Utah 2007); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-192 (1963). Additionally, a violation of Section 206(1) requires the SEC to prove the Respondents acted with scienter. *SEC v. Steadman*, 967 F.2d 636,641 & n.3 (D.C. Cir. 1992). The SEC also contends that ZPR and Max Zavanelli violated Rule 206(4)-1(a)(5) of the IAA, which prohibits fraudulent or deceptive advertisements that contain untrue statements of material facts.

A. Misrepresentation

The evidence is clear that the advertisements did not misrepresent the actual performance by the various composites or the performance of Mr. Zavanelli. Ms. Cabot, the SEC examiner, testified that she checked those performance numbers in the advertisements and could find no errors. TR pg 681, lines 7-15. Ms. Feliz, the Ashland representative, also stated that during the examination period and the verification periods from 2000 to 2009 there were no misrepresentations in any of the performance numbers. TR pg 1041, lines 13-24. Mr. Bauchle, the number two man at the firm for the past 18 years, testified that he was unaware of any errors in the performance numbers in the advertisements. TR pg 363, lines 8-24. Max Zavanelli testified there were no errors in the performance numbers in the advertisements. TR pg 1395, lines 19-25. More importantly, testimony was elicited from the SEC that the GIPS disclosure presentation was available on the firm's website (TR pg 547, 548) and quarterly performance for all composites was posted on the website. TR pg 549, lines 15-25.

Through the OIP, The SEC contends that by failing to provide period to date information in the October, November and December 2008 *Smart Money* advertisements as required by the

GIPS standards, there were omissions of material facts. However, this ignores the fact that any person who would have read one of the advertisements would have also been provided with extensive information (including period to date performance of the composites) before becoming a client of ZPR. This information existed on the firm's website and was sent in marketing packages to prospective clients. Finally all clients received a fully compliant GIPS presentation before becoming a client. It is also important to note that the evidence was overwhelming that clients were not generated from these advertisements.

While the two newsletters were advertisements by definition, Mr. Zavanelli, at the time the newsletters were published, believed these were not marketing materials since he used them to comment on what had happened in the marketplace that month. Again, the evidence was overwhelming that absent the claim of GIPS compliance in the newsletters, there was nothing inaccurate or misleading in these advertisements. In fact, in the second newsletter at issue (December 2009), it was specifically stated the newsletter was not GIPS compliant. In the April 2009 newsletter where GIPS compliance was asserted it was done in the context of explaining the "uptick" rule and its impact on trading and not for the purpose of promoting performance.

The *Morningstar* reports are not advertisements notwithstanding the SEC's contention. The information was provided by the firm on a voluntary basis and no funds were paid to *Morningstar* for providing the information. The reports were not available to the public and could only be accessed by institutional investors who purchased subscriptions from *Morningstar*. When the firm advertised that it had a five star *Morningstar* rating for performance, the evidence was again overwhelming that the statement was true; the firm had a five star rating from *Morningstar*. When the firm advertised that rating through other publications, it was then obligated to pay *Morningstar* a fee for that privilege.

The evidence was clear from the testimony of Mr. Bauchle that he alone was in charge of updating the information at *Morningstar* and had simply used the wrong default program which continued to state that Ashland was the firm's GIPS verifier when it was not. Mr. Bauchle also testified that he believed there was no need to check the box on the screen indicating the firm was under investigation by the SEC since no charges had been filed and this information was required on the *Morningstar* screen.

Finally and most importantly, there was not one shred of evidence that any customer of the firm ever read one of the advertisements or the *Morningstar* report. While the SEC is not required to prove reliance (*see SEC v. Simpson Capital Mgmt., Inc.*, 586 F. Supp. 2d 196, 201 (S.D.N.Y. 2008)), it is required to show that the misrepresentation or omission was communicated to someone and that some harm or loss resulted. Nearly every witness in the proceeding testified that there were no customer losses arising from any of the advertisements.

B. Scienter

It is hornbook law that scienter is a "mental state embracing the intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976) and recklessness will suffice. *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-9 (9th Cir. 1990). Recklessness has been defined in the context of securities fraud as an extreme departure from ordinary care. *See Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1977).

The Respondents did not depart from any standard of ordinary care. The evidence showed that the initial advertisements were created by and submitted to Ashland, the GIPS verifier, to ensure the advertisements did not run afoul of those requirements. When the firm was advised by Ashland that the word "audit" could not be used in the footnote in the advertisements, the firm corrected the error and the mistake was never made again. In connection with the

advertisements that ran in the fall of 2008 (October, November and December 2008 issues of *Smart Money*), Max Zavanelli testified that he thought the original format that had been approved by Ashland was being utilized and was shocked when he was shown the advertisements by the SEC during its examination of ZPR in 2009. He had given instructions to his staff to do the best it could with the ad formatting, but not to change the footnote since Ashland had approved it.

In connection with the newsletters, Max Zavanelli testified that after he spoke with the Ashland personnel in March 2010, he believed that they had accepted his argument that the newsletter was not an advertisement and, therefore, the firm's GIPS disclosure presentation did not need to be attached. He also testified that until his testimony before the SEC was taken in June 2011, he had never seen the undated letter from Ashland to Mr. Bauchle which provided two options regarding GIPS compliance and the newsletter.

In regard to the *Morningstar* report, Max Zavanelli testified that he never had access to this account which could only be accessed by Mr. Bauchle. Both Max Zavanelli and Mr. Bauchle testified that until the SEC charges had been filed there was no need to check the box "yes" concerning the SEC investigation since no charges had been filed until the OIP was issued.

Finally, it must be reiterated that the missing period to date information was available from other sources at the company and was being provided to prospective clients. If, in fact, the firm and Max Zavanelli were trying to deceive or defraud clients regarding performance, why would they be giving information to clients that provided full and fair disclosure of all material facts? The answer is quite simple — they were not acting with scienter.

C. Materiality

The SEC is also required to show that if there were misrepresentations, the statements or omitted facts were material. SEC v. Mannion, 789 F. Supp. 2d 1321, 1340 (N.D. Ga. 2011). This standard required under Section 206 is whether or not a reasonable investor would have considered the information important in deciding whether or not to invest. See SEC v. Steadman, 967 F.2d at 643.

Decisions of the United States Supreme Court have repeatedly emphasized that materiality is to be viewed by examining the “total mix” of information both for omissions and misrepresentations of facts. See TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449, 96 S. Ct. 2126, 48 L. Ed 2d 757 (1976), *accord, e.g.*, Amgen, Inc. v. Conn. Ret. Plans & Trust Funds, ___ U.S. ___, 133 S. Ct. 1184, 185 L. Ed 308 (2013) (*dissenting opinion n. 5*); Matrixx Initiatives, Inc. v. Siracusano, ___ U.S. ___, 131 S. Ct. 1309, 179 L. Ed 398 (2011); Basic, Inc. v. Levinson, 485 U.S. 224, 231-32, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988).

Common sense dictates that investment performance is the ultimate factor in selecting an investment adviser. The record is replete with testimony that no client of the firm was permitted to become a client until they were thoroughly inundated with performance numbers including a fully compliant GIPS presentation. As a result, simply viewing the advertisements in isolation distorts the mix of information that was actually being delivered to a prospective client.

When the totality of the information that was being provided to a client is examined, it is clear the advertisements standing alone were not material. Period to date information was posted on the website and was provided in the marketing packages that were sent directly to prospective clients. Additional information was again provided by ZPR in the form of the fully compliant GIPS presentations. It is impossible to conclude that the advertisements at issue in the OIP were

material when evaluating the total mix of other information being provided to prospective clients by ZPR. The advertisements may have been the starting point in the process but any omission of period to date information would have been remedied with the additional disclosures that followed consistent with the firm's protocol to provide detailed information about ZPR and historical performance results. This argument is equally true for the newsletters, which again were simply a part of the disclosure process utilized by the firm.

The *Morningstar* reports are more problematic if viewed as advertisements, which point the Respondents contest. Failing to disclose the SEC investigation should be measured by the standards required under the IAA and Form ADV. There is no contention by the SEC that the firm's disclosures about the SEC investigation under the IAA were not timely. If the disclosures were timely under the IAA, how can the failure to disclose the investigation in a *Morningstar* report be material especially since only select institutional clients have access to this information? Put another way, if the disclosure was material under IAA it would be material in an advertisement but it was not required under the IAA until the Wells notice was sent to ZPR.

Finally, the SEC contends that the GIPS voluntary standards are material and impose strict liability on a firm who falls short of meeting all of the GIPS standards, this position is unprecedented. If, in fact, the SEC has concluded that all of the GIPS standards are material even in the absence of intentional or willful misconduct, it should provide notice of this fact to the industry it regulates.

D. Willful Violations

The SEC seeks sanctions pursuant to Section 9(b) of the ICA and Sections 203(e), (f) and (k) of the IAA. To impose sanctions under these sections, ZPR and Max Zavanelli's violations must be willful. 15 U.S.C §80a-9(b) (2010); 15 U.S.C. §§ 80b-3(f) and (i)(2010); *see also* David

E. Zilkha, Initial Decision Release No. 415 (Apr. 13, 2011), 2011 W.L. 1425710, 13. A finding of willfulness does not require intent to violate the law, but merely the intent to do the act which constitutes a violation of the law. Wonsover v. SEC, 205 F. 3d 408, 414 (D.C. Cir. 2000); Arthur Lipper Corp. v. SEC, 547 F. 2d 171, 180 (2d Cir. 1976).

While the evidence is clear that ZPR and Max Zavanelli intended to run the advertisements and to claim the firm was GIPS compliant, this was not being done for the purpose of overstating the performance of the firm or its composites. The advertisements at issue in the OIP that did not disclose certain performance periods became GIPS deficient. However, this can be attributed more to ignorance or mistake rather than willful conduct which the evidence clearly supported. Therefore, ZPR and Max Zavanelli did not act willfully.

IX. SANCTIONS

A. Associational Bar for Max Zavanelli and ZPR

The SEC contends that ZPR and Max Zavanelli should receive a permanent associational bar for the advertisements in question. In determining whether this is in the public interest, the Steadman, supra, factors come into play and must be closely examined.

(i) **Egregiousness of the Actions.** The evidence was overwhelming that Respondents were not attempting to perpetrate any type of massive advertising fraud on the investment public. The evidence demonstrated that absent the claim of GIPS compliance the advertisements were not misleading, not deceptive and not fraudulent. To the contrary, the evidence showed that all of the performance numbers utilized in the advertisements were accurate. The SEC contends the advertisements were being run because the firm was in dire financial straits that required Max Zavanelli to make loans to the firm in 2009. The reality is that in the fall of 2008 every financial institution in

America was in dire financial straits and the advertisements placed by the firm at that time attracted no new capital for the firm. And yes, Max Zavanelli made loans to the firm to keep it afloat operational. In fact, if this was the motive for running the advertisements, why were the advertisements so benign? If the Respondents' objective was to defraud the investment public, they surely would have misrepresented the firm's investment performance. But the evidence shows all of the investment performance numbers were accurate and had also been verified by the SEC. The Respondents did not act in an egregious manner as they were simply trying to raise assets in a very difficult financial environment and as noted earlier, the advertisements were unsuccessful.

(ii) Isolated or Recurrent Nature of the Violation. From 1987 to 2007, the firm did not engage in any type of advertising campaign that the evidence showed to be deceptive or fraudulent. For that matter, the firm engaged in negligible advertising during that period of time. There were 10 advertisements run between October 2008 and May 2011, as alleged in the OIP, which assumes the two newsletters and the *Morningstar* reports are advertisements. In light of these limited and isolated instances over a period of 26 years, the Respondents did not engage in recurrent violations of the IAA or IAC. These occurrences also took place when ZPR's claim of the GIPS compliance had been verified and, therefore, these 10 instances were isolated in nature.

(iii) The Degree of Scienter. This factor assumes that Max Zavanelli and ZPR were attempting to defraud or deceive the investing public by conducting a fraudulent advertising campaign, which they clearly were not, as the evidence demonstrated. This Steadman factor also assumes the ZPR performance numbers were being intentionally hyped or manipulated in order to attract clients but as the evidence

showed, all of the performance numbers utilized in ZPR's advertisements were accurate. Absent the claim of GIPS compliance, there is nothing wrong or inaccurate with the advertisements so there is no degree of scienter attributable to the Respondents.

(iv) Respondents' Assurance Against Future Violations. Max Zavanelli testified that he has relinquished control of the firm to his son, Mark Zavanelli, and is only involved in the research and investment activities of tracking thousands of American and international stocks. Mark Zavanelli, the son of Max Zavanelli, is a Wharton graduate. He is a CFA member, which is the same organization that administers and oversees GIPS. He has previously worked as a portfolio manager for OppenheimerFunds and has been recognized as a distinguished investment manager by various Wall Street publications including *Barron's*. Mark Zavanelli has testified that the firm has retained an independent consultant for compliance on all advisory issues including advertising. Additionally, the firm's policies and procedures now mandate that all advertisements are required to be approved by its GIPS verification firm and by NCS, its outside consultant, before being run. As a result of these actions, there is no likelihood of future violations regarding advertisements placed by ZPR or Max Zavanelli.

(v) Respondents' Recognition of the Wrongful Conduct. The Respondents are still trying to figure out what they did wrong that would bar them permanently from the industry. Respondents realize the advertisements raised in the OIP were technically not GIPS compliant but the failure to adhere to the advertising standards was not done to deceive the investing public. Notwithstanding these facts, Max Zavanelli has relinquished control of the firm in order to better serve the clients of the firm. The Respondents realize the advertisements were not GIPS compliant and have remedied the situation

through significant corrective actions that have been taken since Mark Zavanelli joined the firm in October 2011 as its President and CCO.

(vi) **The Likelihood of Future Violations.** Since Max Zavanelli has relinquished control of the firm, the likelihood of future violations is minimal. Max Zavanelli only wants to do what he has always done, research companies and identify investment opportunities that will benefit ZPR's clients. The firm has a stellar record – no arbitrations, no civil suits and minimal customer complaints over the past 26 years and most importantly, it has provided tremendous returns for the clients. To bar Max Zavanelli or ZPR would be a travesty of justice and a disservice to their clients. The testimony observed by the ALJ of Max Zavanelli demonstrates he is a combative and strong principled individual, but he is not dishonest, immoral or unethical. He is competitive and simply wanted to advertise his performance results against his peers to the world. He did not mislead, deceive or engage in any type of fraudulent activity regarding the advertisements at issue.

B. Cease and Desist

Section 203(k) of the IAA authorizes the SEC to impose a cease and desist order for violations of the IAA. The SEC must provide some likelihood of future violations before imposing a cease and desist order. KPMG Peat Marwick, LLP, Exchange Act Release No. 43862 (Jan. 19, 2001), 54 S.E.C. 1135, 1185, *motion for reconsideration denied*, Exchange Act Release No. 44050 (March 5, 2001), 53 S.E.C. 1, *petition denied*, 289 F. 3d 109 (D.C. Cir. 2002).

While a “finding of [past] violation raises a sufficient risk of future violations”, *Id.* at 1185, this is not necessarily conclusive that there will be repetition. The firm has implemented

extensive procedures to ensure that any advertisement is now reviewed both externally and internally. Not one but two outside consultants review any advertisement which is then reviewed by Mark Zavanelli, a C.F.A. and the Chief Compliance Officer of the firm. As a result of these procedures being implemented, a cease and desist order is not warranted.

C. Civil Penalty Factors and Determination of Public Interest

The SEC has requested a civil penalty under Section 9(b) of the ICA since penalties may be awarded under Section 9(d) thereof. The SEC does not seek penalties under Section 203(i) of the IAA and, therefore, the three-tiered system under the ICA is applicable rather than three-tiered system under the IAA. *See* OIP, III(D), p 7.

In order to assess a penalty under Section 9(d) of the ICA, it must be shown the penalty is in the public interest and the SEC may consider a number of factors:

(i) **Did the Act or Omission Involve Fraud, Deceit, Manipulation, or Deliberate or Reckless Disregard of a Regulatory Requirement.** While it is clear the advertisements did not satisfy the GIPS Advertising Guidelines, there has been no showing that this represents a statutory violation under the IAA. Additionally, the evidence established that both the firm and Mr. Zavanelli attempted on numerous occasions to comply with the GIPS Advertising Guidelines and that they have taken necessary action to ensure compliance in the future.

(ii) **The Harm to Other Persons.** The evidence demonstrated there has been no harm to any other person.

(iii) **Unjust Enrichment.** Neither the firm nor Mr. Zavanelli have been enriched as a result of the advertisements. The evidence demonstrated the advertisements did not attract new clients to the firm.

(iv) **Prior Violations of Securities Laws.** The firm has no prior violations of the securities laws. Mr. Zavanelli, in July of 1987, was censured by the SEC and prohibited from soliciting new advisory customers for a period of 180 days. *See* RX 32. The findings relating to that matter stated Mr. Zavanelli had advertised returns during a three year period where no actual trading occurred and the returns were hypothetical. *See* RX 32, p 2. Mr. Zavanelli testified that the “hypothetical” returns were actually institutions that purchased his research, traded based upon the research and generated the returns that were represented in the advertisements. The other findings in the settlement related to filing the Form ADV in which Mr. Zavanelli represented that he had a Doctor of Philosophy Degree from Columbia University. *See* RX 32, p 3. The actual Form ADV was admitted into evidence. *See* RX 33, Schedule D, last two pages of the exhibit. The form shows that Mr. Zavanelli did, in fact, attend the doctorate program at Columbia University for four years. The form also shows that Mr. Zavanelli did not receive a doctorate degree. As a result, this censure from 26 years ago involving no customer losses or enrichment should be given little, if any, weight.

(v) **The Need to Deter the Respondents.** There is no need to deter the Respondents. The firm has implemented policies and procedures to ensure all advertisements in the future are GIPS compliant by utilizing not one, but two outside consultants. Mr. Zavanelli has ceded control of the firm to his son, Mark Zavanelli, and now focuses on research exclusively.

(vi) **Other Matters as Justice May Require.** Since there has no harm to the public or any customer of the firm and the Respondents have not enriched themselves

from the conduct in question, it is not in the public interest to assess any penalty in this matter.

X. CONCLUSION

The cornerstone and very essence of the GIPS standards is to ensure that firms present full and fair disclosure of performance results to existing and prospective clients. With this objective in mind, however, GIPS recognizes that firms will make mistakes and errors will occur in their attempts to be GIPS compliant. The GIPS standards condones these situations through an error correction policy that is designed to allow firms to identify and correct issues without having those mistakes or errors adversely affecting a firm's overall claim of GIPS compliance. This policy is not only necessary since GIPS is an evolving set of standards that changes over time but is also essential to encourage firms to adopt and follow GIPS standards, which are considered within the investment industry to be best practices for purposes of disclosing performance results.

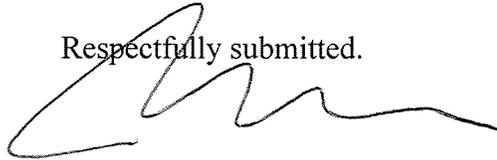
With these principles in mind, the Respondents acted in good faith and utilized their best efforts to provide accurate and truthful performance results to its existing and prospective clients. At times, the Respondents did not adhere to each and every requirement that GIPS imposed for advertising, but there was never any intent by the Respondents to withhold or falsify any information it provided or was required to provide to existing or prospective clients. Likewise and due largely to misunderstandings and miscommunications, the Respondents did not knowingly withhold any advertisements or other information from Ashland and there was no motivation or purpose to do so, given the voluntary election by firms to follow GIPS and the expense involved to retain a GIPS verification firm such as Ashland.

Scienter represents the benchmark under the federal securities laws to determine a party's intent or state of mind in complying with the law. The efforts that were made by the Respondents to provide full and fair disclosure of its performance results that complied with GIPS through information provided directly to existing and prospective clients and made available through its website removes any notion that a select number of advertisements that did not comply with GIPS were placed by Respondents willfully or intentionally to harm the public.

In addition, the numerous and repeated actions of the Respondents to identify and correct GIPS and other compliance issues that were raised in this proceeding further serve to illustrate their intent and desire to comply with GIPS and other applicable securities laws.

Respondents do not represent offenders of the law and while mistakes were made in compliance, evidence of their good faith efforts to address these problems never wavered. While Respondents have acknowledged these mistakes and have taken corrective actions to address them, its conduct in placing advertisements and providing information to *Morningstar* as addressed in the OIP, does not warrant the imposition of any civil monetary fine, sanction or any relief under Sections 203(e), 203(f) or 203(k) of the IAA or Section 9(b) of the ICA.

Respectfully submitted.



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