In the Matter of F.X.C. Investors Corp. and Francis X. Curzio

INITIAL DECISION RELEASE NO. 218

ADMINISTRATIVE PROCEEDING
FILE NO. 3-10625

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

In the Matter of F.X.C. INVESTORS CORP. and FRANCIS X. CURZIO

INITIAL DECISION
December 9, 2002

Appearances:

Doria G. Bachenheimer and Rachel L. Izower for the Division of Enforcement, Securities and Exchange Commission.

Robert G. Heim for Respondents.

Before: James T. Kelly, Administrative Law Judge.

On October 18, 2001, the Securities and Exchange Commission (SEC or Commission) issued an Order Instituting Public Administrative and Cease-and-Desist Proceedings (OIP) against F.X.C. Investors Corp. (FXC) and Francis X. Curzio (Curzio) pursuant to Sections 203(e), 203(f), 203(i), and 203(k) of the Investment Advisers Act of 1940 (Advisers Act).

The OIP alleges that from December 1996 through December 1998, FXC distributed to prospective clients materially misleading advertisements concerning FXC's historic annual performance results. It specifically charges that FXC submitted its newsletter performance to the publisher of an investment guide that, under the false impression that the returns reflected the performance of actual managed accounts, ranked FXC favorably against other investment advisers. The OIP alleges that FXC then sent the misleading rankings to prospective clients as part of its marketing material. It also asserts that FXC's advertisements were improper because they indicated that the displayed performance was the actual performance of FXC's advisory clients, when, in fact, they reflected the hypothetical returns that would have been earned by certain model portfolios described in newsletters published by FXC. The OIP further claims that the advertisements failed to make other required disclosures. Curzio is charged with responsibility for and participation in FXC's misconduct.

The OIP accuses FXC of willfully violating Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Advisers Act Rule 206(4)-1(a)(5). It alleges that Curzio willfully aided and abetted and/or caused FXC's violations. As relief for this misconduct, the Commission's Division of Enforcement (Division) seeks cease-and-desist orders and civil monetary penalties against both Respondents. The Division also seeks to bar Curzio from association with any investment adviser.

I held a public hearing in New York City on April 8 and 9, 2002. The parties have filed proposed findings of fact, conclusions of law, and briefs, and the matter is ready for decision.1 I have based my findings and conclusions on the entire record and the demeanor of the witnesses who testified at the hearing. I have applied "preponderance of the evidence" as the applicable standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). I have considered and rejected all arguments, proposed findings, and proposed conclusions that are inconsistent with this decision.

Findings of Fact

Respondents

FXC is a New York corporation that was registered with the Commission as an investment adviser from 1974 to 2001 (Ans. ¶ 4; Stip. ¶¶ 1, 3; Tr. 13). FXC is a subsidiary of F.X.C. Investment Group, Inc., a Delaware holding company (Ans. ¶ 4; Stip. ¶ 2). At the time in question, FXC's staff consisted of Curzio, his wife, their three adult children, and several hourly employees (Ans. ¶ 6).

Curzio, age fifty-eight, resides in Queens, New York (DX 36). He is the founder, president, and chief financial officer of FXC (Ans. ¶ 5; Tr. 13). At all relevant times, Curzio was solely responsible for managing FXC's business, including marketing and compliance (Ans. ¶ 5; Tr. 13, 265). Curzio earned an associate's degree in accounting from New York City Community College in 1968 (Tr. 261; DX 36). Before becoming an investment adviser, Curzio was employed as a supervisory accountant at National Distillers Chemical Corporation and as an assistant controller at Lone Star Industries (Tr. 41, 260-61; DX 4 at BA 118).

Twice a month, FXC publishes a newsletter that makes securities trading and investment strategy recommendations (Ans. ¶ 4; Stip. ¶ 5; Tr. 192, 196; RX A, RX B). From 1974 through 1987, the newsletter was FXC's only relevant business. The newsletter had 1,479 subscribers as of December 31, 1996, and 1,661 subscribers as of December 31, 1997 (DX 36, DX 39). In August 1987, the newsletter correctly predicted the stock market crash of October 1987 (Tr. 192-93). That prediction generated a great deal of favorable television and newspaper publicity (Tr. 192-93). In 1988, FXC launched its managed account business (Stip. ¶ 7; Tr. 194).

From 1988 to the present, FXC has managed client accounts for a fee (Stip. ¶ 7; Tr. 13, 28). FXC's money management business has at all times consisted of individual client accounts, not pooled funds or accounts. FXC has never taken possession of managed account assets (Stip. ¶ 7). As of December 31, 1996, FXC managed 268 client accounts with an aggregate market value of $36 million (DX 36). As of December 31, 1997, FXC managed 319 client accounts with an aggregate market value of $49 million (DX 39).

FXC utilized the strategies set forth in its newsletter as guidelines for its managed accounts. From December 1996 through December 1998, the newsletter contained two categories of securities recommendations: aggressive and conservative. The newsletter also explained how to follow a balanced strategy by investing a percentage of assets in aggressive securities and the remainder in conservative securities (Stip. ¶ 9). Any time FXC recommended the purchase or sale of a security, it printed the recommendation in its newsletter and sent it out to all subscribers (Tr. 196). All managed account clients received complimentary copies of the newsletter (DX 36).

The general practice at FXC was that Curzio would place clients in the same stocks as recommended in the newsletter. However, clients could customize their accounts by instructing Curzio that they wished to follow the newsletter's aggressive recommendations, the newsletter's conservative recommendations, or some combination of the two strategies. In addition, clients would at times retain stocks that were not part of the newsletter's recommendations and would also designate some specific stocks or investment areas (such as tobacco stocks) that were part of the newsletter's recommendations, as unacceptable for their accounts (Ans. ¶ 13; Stip. ¶ 10; Tr. 20-21, 207).

Once the investing public learned of the Commission's concerns, FXC began to lose client accounts (Tr. 203-04). After a long period of decline, the amount of money managed by FXC dropped beneath the Commission's registration cut-off of $25 million (Ans. ¶ 7). FXC withdrew from Commission registration on July 27, 2001, two months before the Commission issued the OIP (Stip. ¶ 3; DX 42).2 FXC's staff presently consists of Curzio, his wife, one son, and two hourly employees (Ans. ¶ 9). FXC now has approximately $14 million in client assets under management (Ans ¶ 7). Its newsletter currently has about 1,000 subscribers (Tr. 205).

FXC Provides Inaccurate Information to RogersCasey, Inc.

In the mid-1990s, FXC attempted to market its advisory services to institutional clients, such as pension funds (Tr. 254-56, 328). Curzio learned that such institutions relied on data provided by investment consulting services that measure and compare the performance of money managers (Tr. 254). Curzio requested applications from fifteen to twenty such services and he completed about seven to ten applications (Tr. 255). In relevant part, the OIP alleges that FXC offered misleading answers to the questionnaires provided by RogersCasey, Inc. (RogersCasey), an investment consulting firm in Darien, Connecticut.

RogersCasey supplied investment managers, including FXC, with a one-page instruction sheet for completing its questionnaires (Stip. ¶ 18; DX 3, DX 6). The instruction sheet advised investment managers that performance information should be based on actual trading in assets under management (Tr. 124-25, 127-29, 141-42). In particular, the instructions in DX 3 and DX 6 stated:

> Simulated or backtested paper portfolio performance will not be included in the database. Prior firm performance must be clearly described. Any divergence from the proposed [Association for Investment Management and Research ("AIMR")] Performance Presentation Standards should be fully described.3

Curzio read these instructions before completing the questionnaires (Tr. 16, 18, 21, 23, 51). For the years ending December 31, 1996, and December 31, 1997, FXC submitted the completed questionnaires to RogersCasey (Stip. ¶ 19; DX 4, DX 7). FXC also submitted updated performance information to RogersCasey for each quarter of 1996 and 1997 (Stip. ¶ 20; DX 9).

Performance information that FXC reported to RogersCasey for its aggressive strategy was based solely on the performance of the newsletter's recommendations (Stip. ¶ 11). Performance information that FXC reported to RogersCasey for its conservative strategy was similarly based on the performance of the newsletter's recommendations (Stip. ¶ 11). Curzio reported performance information for FXC's balanced portfolio by adding the performance for the aggressive and conservative strategies and dividing by two (Stip. ¶ 12; Tr. 320). In order to calculate performance for the newsletter's recommendations, Curzio used the price of a security on the date on which the newsletter was published (Stip. ¶ 13; Tr. 14). The managed accounts did not necessarily pay or receive the same price used to calculate the newsletter's performance: some paid less, and some paid more (Stip. ¶ 13; Tr. 70, 322-23). FXC inaccurately told RogersCasey that the hypothetical performance information it supplied was the actual performance of its managed accounts (Tr. 14-15, 22). In response to a specific question as to whether the performance information included simulated or backtested numbers, FXC inaccurately answered "no" (DX 4 at BA 125, 135, 143, 151, DX 7 at BA 53, 63, 70).

If FXC had answered these aspects of the questionnaires accurately, i.e., if it had informed RogersCasey that it was presenting simulated or model results from its newsletter, its performance information would not have been included in the RogersCasey database (Tr. 135-36, 147-48).

FXC provided inaccurate information on other aspects of the questionnaires. For example, it informed RogersCasey that its performance information had been audited externally (Ans. ¶ 20; DX 4 at BA 125, 135, 143, 151, DX 7 at BA 53, 63, 70). In fact, FXC's performance information had not been audited externally, and Curzio, a trained accountant, understood that fact at the time (Tr. 41-42).

FXC also informed RogersCasey that it had no previous judgments against it (DX 4 at BA 116, DX 7 at BA 47). In 1985, however, FXC and Curzio had been permanently enjoined from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 (Securities Act), Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), Exchange Act Rule 10b-5, Section 206(4) of the Advisers Act, and Advisers Act Rule 206(4)-1 (Tr. 31-34; DX 33 (consent injunction, entered without findings of fact and without admitting or denying the allegations in the Commission's complaint)). Curzio testified that he did not know what "previous judgments" meant (Tr. 31). I reject that testimony as incredible.

Finally, FXC informed RogersCasey that its data presentations complied with the AIMR's Performance Presentation Standards (Tr. 35; DX 4 at BA 125, 135, 143, 151, DX 7 at BA 53, 63, 70).4 These responses were inaccurate because the AIMR Performance Presentation Standards required that investment managers not link simulated or model portfolio results with actual performance results (Tr. 38; DX 14 at AIMR 41 ("Firm composites must include only actual assets under management. Model results may be presented as supplementary information, but the model results must be identified as such and must not be linked to actual results."), DX 15 at AIMR 216). At the hearing, Curzio stubbornly insisted that the data he provided to RogersCasey complied with AIMR's Performance Presentation Standards (Tr. 35-36, 40, 49, 225, 259, 314-16). In light of overwhelming evidence to the contrary (Stip. ¶¶ 15, 16; Tr. 290-300; DX 19, DX 45, DX 46), Respondents have abandoned that position in their posthearing pleadings.

RogersCasey Forwards FXC's Performance Information to Pensions & Investment Newspaper, Which Publishes Favorable Rankings

RogersCasey forwarded the performance information in its database to Crain Communications, Inc. (Crain), the publisher of Pensions & Investments (Tr. 123). Pensions & Investments, a fortnightly newspaper, tracked the success of investment managers and each quarter published its Pension Investment Performance Evaluation Report (PIPER) and Top Ten Rankings (Tr. 123). Qualifications for PIPER included a minimum of four quarters of real returns, without simulated or model results (DX 3, DX 6).5

On January 1, 1998, Crain took over data collection for PIPER from RogersCasey (Stip. ¶ 21; DX 12). In response to a request by Pensions & Investments, FXC submitted performance information from its newsletter for the year ending December 31, 1997 (Stip. ¶ 21; DX 12). FXC also submitted quarterly performance updates, based on information from its newsletter, for the first three quarters of 1998 for inclusion in the database maintained by Crain (Stip. ¶ 22; DX 10).

PIPER results that included FXC's performance data were published in issues of Pensions & Investments dated March 4, 1996, June 10, 1996, August 19, 1996, November 25, 1996, March 3, 1997, June 9, 1997, September 1, 1997, December 8, 1997, March 9, 1998, June 15, 1998, and September 7, 1998 (Stip. ¶ 25; DX 31.A-DX 31.K). The issues published in 1997 and 1998 are most relevant here.6

The PIPER and Top Ten Rankings in Pensions & Investments show that, for certain five-year and one-year periods ending as early as December 31, 1995, and as late as June 30, 1998, FXC had the highest or near-highest performance returns for an investment manager in its categories (DX 31.A at 2, DX 31.B at 2, DX 31.C at 2, 13, DX 31.D at 2, 11, DX 31.E at 2, 13, DX 31.F at 2, DX 31.G at 2, DX 31.H at 2, DX 31.I at 2, DX 31.J at 2, DX 31.K at 2).

FXC Created Advertisements and Distributed Them to the Investing Public

From December 1996 through December 1998, FXC created and distributed four types of advertising materials to the investing public (Stip. ¶ 27; DX 20-DX 30). First, FXC purchased reprints from Pensions & Investments that showed the rankings of the top-performing investment managers in several different categories (DX 27-DX 30) ("Ranking Reprints"). The Ranking Reprints included bar charts comparing money managers, and showed that FXC achieved the highest or one of the highest rates of return among the money managers in various categories. Second, FXC created several brochures entitled "The F.X.C. Management Program" (DX 20-DX 23) ("Management Brochures"). The Management Brochures described FXC and displayed performance returns for the years ending December 31, 1996, December 31, 1997, the first three quarters of 1998, the previous three years, the previous five or six years, and since inception. Third, FXC created two different brochures on glossy paper containing graphs and comparative information concerning "F.X.C.'s Aggressive Performance" for various historical periods (DX 25, DX 26) ("Glossy Brochures"). Fourth, FXC created a leaflet entitled "F.X.C. Investors Corp. Performance Record Since Inception 1978" that displayed aggressive and conservative returns and listed the specific stock and bond recommendations on which FXC based its advertised performance record (DX 24) ("Performance Record").

Curzio was responsible for the contents of the Management Brochures, the Glossy Brochures, and the Performance Record (Stip. ¶ ¶ 27-28; Tr. 68, 78-79, 92, 94, 98, 103). Curzio purchased the Ranking Reprints from Pension & Investments (Tr. 55-61). Because the rankings were based on information that FXC had provided to RogersCasey, and that RogersCasey had provided to Pensions & Investments, I find as a fact that Curzio was also responsible for the portrayal of FXC in the Ranking Reprints.

From December 1996 through December 1998, FXC distributed these advertisements to existing newsletter subscribers, individuals referred to it by brokers, prospective clients, and others (Ans. ¶ 15; Stip. ¶¶ 27, 29; Tr. 55-56, 68, 78-80, 92, 98).7 Even though the rankings in Pension & Investments were produced by an unrelated third party and published as news, I find that the rankings became advertisements once FXC reprinted them and distributed them to clients and/or prospective clients.

FXC's Advertisements Contained False and/or Inaccurate Information

FXC's advertisements failed to disclose that the performance results were based on hypothetical or model results of newsletter recommendations, and not on results achieved by actual clients (Stip. ¶¶ 26, 28, 30; Tr. 14-15, 54-55, 70-73, 76, 78-79, 99, 104; DX 2, DX 20-DX 30). Curzio assumed that the other money managers who were supplying information to the databases were providing the actual performance of their managed accounts (Tr. 329). In his judgment, FXC's managed accounts "were doing probably the ball park figures of what [the] newsletter was doing" (Tr. 329).

FXC's newsletter occasionally recommended that clients keep a portion of their assets in cash or money market funds (RX B, Vol. 21, No. 9 at 4) (recommending 20% in cash). Nonetheless, the performance results appearing in the advertisements were based on the assumption that FXC's hypothetical or model client accounts always remained fully invested in the market (Tr. 319-20, 322-23, 330-31; DX 2).

From December 1996 through December 1998, FXC charged its clients an advisory fee of between 0.6% and 1.2%, depending on the size of the managed account (Stip. ¶ 8). The performance results in FXC's advertisements did not deduct for such advisory fees or other expenses, and did not inform the reader that the results were gross of fees (Stip. ¶ 31; Tr. 100; DX 20-DX 30). The performance of the hypothetical or model accounts displayed in the advertisements was therefore inflated by the amount of the advisory fees, compounded over time. Some of FXC's advertisements did inform the reader that brokerage commissions had been excluded from the performance results (DX 20 at 3, DX 21 at 3, DX 22 at 3, DX 24 at 1, 5; Div. Prop. Find. #105; Div. Br. at 23). However, most of FXC's advertisements omitted any mention of whether the performance results included or excluded brokerage commissions (DX 23, DX 25-DX 30).

The Performance Record and the Glossy Brochures claimed that FXC had been managing money "for over twenty years" and presented FXC's performance record since 1978 (DX 24, DX25, DX 26). In fact, FXC had only been managing client accounts for ten years, i.e., since 1988 (Stip. ¶ 7; Tr. 95-96, 98-99, 104).

The Management Brochures, DX 20 through DX 22, stated on page three that: "The charts below represent the performance history of the situations recommended in the FXC Newsletter. 80% of FXC's Managed Portfolio Accounts include these situations." Curzio admitted that 80% was "just a ball park figure" (Tr. 72-73). The fact that FXC had no mathematical basis for the 80% figure was not disclosed in the Management Brochures.

Conclusions of Law

The OIP alleges that FXC willfully violated Sections 206(1), 206(2), and 206(4) of the Advisers Act, as well as Rule 206(4)-1(a)(5). It further alleges that Curzio willfully aided and abetted and/or caused FXC's violations. Willfulness is shown where a person intends to commit an act that constitutes a violation. There is no requirement that the actor also be aware that he is violating any statutes or regulations. See 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).

The Legal Standards Applicable to the Primary Violations Charged in the OIP

Section 206(1) of the Advisers Act makes it unlawful for an investment adviser to employ any device, scheme, or artifice to defraud any client or prospective client. Section 206(2) makes it unlawful for an investment adviser to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. Section 206 establishes "federal fiduciary standards" to govern the conduct of investment advisers. See Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979) (collecting cases). As a fiduciary, FXC owes its clients "an affirmative duty of utmost good faith, and full and fair disclosure of all material facts." SEC v. Capital Gains Research Bureau, 375 U.S. 180, 194 (1963). The failure to disclose such facts is deemed a fraud or deceit within the meaning of Sections 206(1) and 206(2) of the Advisers Act. Id.at 200.

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision and if disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Materiality is a mixed question of law and fact. TSC Indus., 426 U.S. at 450.

Proof of scienter is required to establish a violation of Section 206(1). See SEC v. Steadman, 967 F.2d 636, 641-43 & n.3 (D.C. Cir. 1992); Steadman v. SEC, 603 F.2d 1126, 1134 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). Proof of scienter is not required under Section 206(2). See Capital Gains Research, 375 U.S. at 195; SEC v Steadman, 967 F.2d at 643 n.5.

Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). It may be established by a showing of recklessness. David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997) (citing Hollinger v. Titan Capital Corp., 914 F.2d 1564, 11568-69 (9th Cir. 1990) (en banc)). The en banc Ninth Circuit adopted the standard of recklessness articulated by the Seventh Circuit in Sunstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044-45 (7th Cir. 1977): "[A] highly unreasonable omission, involving not merely simple, or inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." Scienter is a question of fact and can be proved by circumstantial evidence. SEC v. Hasho, 784 F. Supp. 1059, 1107 (S.D.N.Y. 1992) (collecting cases).

Section 206(4) of the Advisers Act prohibits an investment adviser from engaging "in any act, practice, or course of business which is fraudulent, deceptive or manipulative." It also gives the Commission broad authority to adopt rules "reasonably designed to prevent" fraud. The Commission used that authority in 1961 to promulgate Advisers Act Rule 206(4)-1, a comprehensive provision regulating advertising. Pursuant to Advisers Act Rule 206(4)-1(a)(5), "it shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business" within the meaning of Section 206(4) of the Advisers Act for a registered investment adviser, directly or indirectly, "to publish, circulate or distribute any advertisement . . . which contains any untrue statement of a material fact, or which is otherwise false or misleading." Proof of scienter is not required to establish a violation of Section 206(4). See SEC v. Steadman, 967 F.2d at 647.

Advisers Act Rule 206(4)-1(b) defines an "advertisement" as including a written communication addressed to more than one person that offers any investment advisory service with regard to securities. The parties agree that the written communications at issue here, DX 20 through DX 30, are "advertisements" (Stip. ¶ 27).

The Legal Standards Applicable to the Aiding, Abetting, and Causing Charges in the OIP

Because Section 206 of the Advisers Act proscribes fraudulent conduct by an investment adviser (here, FXC), the OIP has charged Curzio as an aider and abetter and/or a cause. To show that one respondent willfully aided and abetted the violation of another, the Division must establish three elements: (1) another party has committed a securities law violation; (2) the accused aider and abetter has a general awareness that his role was part of an overall activity that was improper or illegal; and (3) the accused aider and abetter knowingly and substantially assisted the principal violation. See Abraham & Sons Capital, Inc., 75 SEC Docket 1481, 1492 (July 31, 2001).

Irrespective of the level of proof required to establish the primary violation, the Commission has made clear that the accused aider and abetter must have acted with scienter. See Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. 904, 911 & n.28 (1993) (holding a registered investment adviser liable for willful violations of Section 206(2) of the Advisers Act, but ruling that good faith by the firm's officer "preclude[s] a finding of scienter necessary to hold that . . . [the officer] aided and abetted [the firm's] various violations"); Sheldon, 51 S.E.C. at 66-67 (holding the president of a firm liable as an aider and abetter because he "acted with the requisite knowledge," i.e., recklessly, even though the underlying misconduct by the firm involved the net capital rule, a non-scienter violation).

The Commission has stated that a showing of recklessness will satisfy the "substantial assistance" prong of the aiding and abetting test. See Sharon M. Graham, 53 S.E.C. 1072, 1084-85 (1998), aff'd, 222 F.3d 994, 1004 (D.C. Cir. 2000); Russo Sec., Inc., 53 S.E.C. 271, 278 (1997). In footnote 16 of Russo, the Commission also stated:

> Courts use various formulations of the second two elements of the standard for aiding and abetting . . . . As a result, courts are not uniform as to the precise degree of intent required for each of these two elements. The formulation we have used here is intended as a synthesis of current case law, and reflects the spectrum of analyses.

The Commission has held that one who aids and abets a primary violation is necessarily a cause of the violation. See Graham, 53 S.E.C. at 1085 n.35; Adrian C. Havill, 53 S.E.C. 1060, 1070 n.26 (1998).

Settlement Orders, Staff No-Action and Interpretive Letters, Speeches by Members of the Commission, and Default Orders Are Not Binding Precedent

The distribution of false or misleading performance advertisements by an investment adviser violates Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder. See Valicenti Advisory Servs., Inc., 53 S.E.C. 1033, 1040 (1998), aff'd, 198 F.3d 62 (2d Cir. 1999); cf. Seaboard Inv. Advisers, Inc., 74 SEC Docket 201 (Jan. 10, 2001). Clients of investment advisers who maintain that they have been victimized by false or misleading performance advertising have no express or implied private right of action under Section 206. Cf. Transamerica Mortgage Advisors, 444 U.S. at 19. Thus, oversight by the Commission constitutes the only real tool for scrutiny of advertising practices by investment advisers.

Apart from Valicenti and Seaboard, the Commission has not issued opinions in contested adjudicatory cases involving false or misleading performance advertising. With two exceptions that are not relevant here, the Commission has not engaged in notice-and-comment rulemaking to amend Advisers Act Rule 206(4)-1 since 1961.8

The Division recognizes the paucity of genuine precedent on the subject of performance advertising by investment advisers. It attempts to fill the void by citing to settled cases, staff no-action and interpretive letters, a speech by a member of the Commission, and even a default order entered by an Administrative Law Judge. This "precedent" is of limited value here.

The Division's reliance on settlement orders is misplaced. In the absence of an opinion stating the Commission's views on the issues raised, settlements are of dubious value as precedent. See Carl L. Shipley, 45 S.E.C. 589, 591-92 n.6 (1974). Settlements involving so-called "speaking orders" are particularly suspect. See Geoffrey F. Aronow, Distinctions With Some Differences: CFTC and SEC Enforcement, 21 Futures & Derivatives L. Rept. 15, 18-19 (Oct. 2001):

> [Speaking orders] are orders that discuss both the facts and the applicable law. Some observers object to the use of these orders in settled matters on the grounds that the Commission[is] effectively making or interpreting the law in a context in which there is no adversarial briefing and, where, indeed, there are often limited or even skewed incentives on the part of respondents to debate the language of the proposed settlement order. For instance, an individual respondent who is not likely to have a future run-in with the Commission may not see any value in paying his or her counsel to debate the staff over its proposed discussion of the law, even if it unduly expands on previous interpretation or precedent. Even more troubling, a respondent will normally fight for the most benign recitation of the facts possible, even if the net result is an order that suggests that relatively mild misconduct can result in harsh sanctions.

The Division also contends that no-action and interpretive letters issued by the Commission's Division of Investment Management on the topic of performance advertising constitute binding precedent. In fact, the Division goes so far as to chastise Respondents for "fail[ing] to address" the no-action letters cited in its opening brief (Div. Legal Reply at 8). The Division's position on this issue lacks merit.

Commission staff no-action and interpretive letters are not expressions of the Commission's views and do not have the force of law. See New York City Employees' Ret. Sys. v. SEC, 45 F.3d 7, 12-13 (2d Cir. 1995) (discussing the nature and effects of no-action letters). As the Commission itself has noted, "no-action and interpretive responses by the staff are subject to reconsideration and should not be regarded as precedents binding on the Commission." Public Availability of Requests for No-Action and Interpretive Letters and Responses Thereto by the Commission's Staff, Securities Act Rel. No. 5098 (Oct. 29, 1970), 35 Fed. Reg. 17779 (Nov. 19, 1970). The views expressed in a no-action letter are only those of the Division issuing it. They are not necessarily the views of any other Division, office, or unit of the Commission.

Staff interpretations contained in opinion letters do not warrant judicial deference under Chevron, U.S.A. v. Natural Res. Def. Council, 467 U.S. 837 (1984), are not binding on the courts, and have no value beyond their own persuasive weight. See, e.g., Christensen v. Harris County, 529 U.S. 576, 586-88 (2000); Amalgamated Clothing & Textile Workers Union v. SEC, 15 F.3d 254, 257-58 n.3 (2d Cir. 1994); Roosevelt v. E.I. Du Pont de Nemours & Co., 958 F.2d 416, 427 n.19 (D.C. Cir. 1992). Even when the federal courts rule in accord with no-action letters, they almost always analyze the issues independently of the letters. See New York City Employees' Ret. Sys., 45 F.3d at 13 (citing cases).

The Division next maintains that a speech by a member of the Commission to a Practising Law Institute seminar offers precedent for certain issues in this case (Div. Br. at 40; Div. Legal Reply at

16). That notion is put to rest by the disclaimer appearing prominently on the first page of the speech in question:

> These remarks reflect solely the personal views of [the speaker] and do not necessarily reflect the views of the Commission, the individual members of the Commission, or the Commission's staff.

Finally, the Division asserts that there is precedential value in a default order. Indeed, the Division even goes so far as to characterize one particular default order as a "litigated" case that is "highly relevant" to the present proceeding (Division's Amended Prehearing Brief at 20 n.9; Tr. 335; Div. Br. at 27 n.5). That argument is utterly frivolous. An Administrative Law Judge issued the default order in question after a respondent failed to answer an OIP, failed to respond to an order to show cause, and failed to oppose a request for sanctions. The default order cited by the Division has no relevance whatsoever to any issue in this proceeding.

Fraud against Prospective Clients, Not Current Clients, Is the Only Issue for Decision

As noted above, Sections 206(1) and 206(2) of the Advisers Act prohibit fraud by an investment adviser against "any client or prospective client." Section 206(4) and Advisers Act Rule 206(4)-1(a)(5) prohibit false or misleading advertisements by registered investment advisers, but without identifying the target audience.

The OIP is not a model of clarity as to whether Respondents are accused of defrauding prospective clients, current clients, or both. Paragraphs II.A, II.D, II.K, and II.L of the OIP allege that Respondents defrauded only "prospective investors" and "prospective clients." In contrast, Paragraph II.F of the OIP alleges that Respondents routinely mailed FXC's advertisements to "one or more" categories of persons, including "existing newsletter subscribers." Paragraphs II.M and II.N of the OIP allege that Respondents defrauded both "clients and prospective clients," but those two paragraphs simply paraphrase the relevant statutory language.

Respondents presented the testimony of Marshall Rosenstein (Rosenstein), a resident of New York City (Tr. 179-90). Rosenstein is a longstanding subscriber to FXC's newsletter and Curzio has managed Rosenstein's account for about fifteen years (Tr. 179, 181). Rosenstein is satisfied with FXC's advisory services (Tr. 189). He emphasized that the performance advertising at issue in this proceeding did not influence his decision to remain as an advisory client of FXC (Tr. 183-90). Although Rosenstein was a last-minute witness, I find and conclude that the Division had a fair opportunity to interview him before he testified (Tr. 6-11).

In its posthearing pleadings, the Division acknowledges that the aggregate performance information in the advertisements "was not likely to have been material" to Rosenstein because he received monthly brokerage statements showing the actual performance of his own accounts (Div. Br. at 31; Div. Fact Reply at 15-16; Div. Legal Reply at 9). This is a significant concession. It undercuts whatever argument the Division might have made as to fraud on current clients.

I conclude that the wording of OIP ¶¶ II.A, II.D, II.K, and II.L forecloses the Division from arguing that FXC defrauded its current advisory clients. In the alternative, if fraud against Respondents' current advisory clients was ever properly a part of the OIP, I conclude that the Division abandoned that issue in its posthearing pleadings. The only issue properly before me is the OIP's allegation that FXC defrauded prospective advisory clients. I agree with the Division that Rosenstein was not representative of prospective clients.

FXC's Advertisements Were Materially Misleading to Prospective Clients and Violated Advisers Act Sections 206(1), 206(2), 206(4), And Rule 206(4)-1(a)(5) Thereunder

FXC distributed a series of advertisements which, taken as a whole, created the impression that, during specified periods of time, FXC had achieved a remarkable success rate. The advertisements were deceptive to prospective clients for several reasons. Some of these violations were not particularly subtle, including the claim that FXC had been managing client money for twenty years, the implication that clients remained fully invested in the market at all times, and the failure to disclose that advisory fees had not been deducted from the results portrayed in the advertisements. Such representations were highly inaccurate, and I conclude that each one of them involved a matter that was material to prospective clients.

Most of the skirmishing at the hearing focused on the Division's claim that the advertisements involved the hypothetical returns of model portfolios, and Curzio's claim that his newsletter recommendations were "real recommendations," and thus, not model results. FXC did not place actual trades in client accounts at the price and time implied. In other words, the claimed performance results were based solely on recommendations. In essence, the advertisements described what FXC believed "could have happened" if a client had traded in accordance with its recommendations at the instant Curzio made the recommendations. I agree with the Division that the advertisements depicted the performance of a model portfolio.

Curzio insists that the newsletter recommendations were "real recommendations," and that FXC's performance claims were based on neither hypothetical nor simulated transactions. In support of this argument, he notes that FXC's performance results were based on the actual results of newsletter recommendations, rather than the post hoc application of a trading model to historical market conditions. In effect, he argues that FXC's "real recommendations" are more like actual transactions than hypothetical or model results. His argument ignores the material distinction between what "was actually traded" and what "might have been traded." In view of the evidence that FXC's managed account clients did not actually place orders, execute trades, and earn profits touted in the advertisements, the record supports the violations charged in the OIP.

The OIP also alleges that FXC's advertisements were materially misleading because they failed to disclose the limitations inherent in model results. Advisers Act Rule 206(4)-1(a)(5) is a catch-all provision. It does not attempt to catalog all species of fraud. The language of the rule is sufficiently broad to encompass advertisements that tout transactions that are not actually executed in the market when the investment adviser implies they have been executed. When trades are not actually executed, the published performance results may under- or over-compensate for the potential impact of certain market factors, such as lack of liquidity. This limitation is clearly applicable to the recommended transactions underlying FXC's performance claims. Thus, disclosure would serve to alert potential clients to the limited predictive value of the performance results touted in the advertisements. On this record, I conclude that FXC's advertisements were materially false and misleading because they failed to disclose the limitations inherent in the performance presented.

For purposes of Section 206(1) of the Adviser's Act, Curzio's scienter (discussed below) may be imputed to FXC. See SEC v. Blinder, Robinson & Co., 542 F. Supp. 468, 476 n.3 (D. Colo. 1982). I conclude that FXC willfully violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4) thereunder.

Curzio Acted With Scienter and He Aided, Abetted, and Caused FXC's Violations

The clearest evidence of Curzio's scienter is found in his failure to follow the instructions for completing RogersCasey's database questionnaires. Curzio told RogersCasey that FXC was not presenting simulated results, that FXC's performance data were AIMR-compliant, and that the performance data had been externally audited. Each representation was false, and, for someone with Curzio's extensive experience, at least reckless.

In his defense, Curzio asserts that FXC's advertisements relied on instructions in a manual authored by the Commission; that he believed in good faith that he was using the "most honest way" to present FXC's performance data; and that he verbally advised a reporter for Pension & Investments that FXC's performance data had been based on the newsletter's recommendations

(Tr. 210-12, 221-23, 248-50). Curzio also testified that he informed prospective clients that the advertisements reflected newsletter recommendations, and that their own performance results could differ by 4% to 5% (Tr. 209-10). I did not find these self-serving and generalized claims to be particularly credible, and Respondents provided no corroborating evidence from other sources.

The first and second elements of aiding and abetting liability are clearly present here. FXC committed the primary violations charged, and Curzio knew that his role was part of an overall activity that was improper or illegal. The final element, knowing and substantial assistance, is also satisfied, because Curzio's conduct was at least reckless. As a willful aider and abetter, Curzio was also necessarily a cause of FXC's violations under the reasoning of Graham and Havill.

Sanctions

After the hearing, the Division sought cease-and-desist orders and civil penalties of $100,000 against both Respondents (Div. Br. at 37, 42, 45-50). It also requested an order barring Curzio from association with an investment adviser (Div. Br. at 37, 42-44). In the alternative, if Curzio is allowed to remain in the securities industry, the Division urged me to issue an order requiring both Respondents to submit all advertisements to an independent consultant for review for the duration of Curzio's career. It also sought an order requiring both Respondents to send a copy of the final decision in this proceeding to all current clients and to prospective clients and ranking agencies for one year (Div. Br. at 37, 44-45).

Curzio's Deteriorating Health

At the hearing, Curzio appeared to be in reasonably good health. The parties litigated the case and briefed the sanctions issues with the expectation that Curzio intended to continue performing investment advisory services into the indefinite future. Within the past week, however, new information has surfaced to invalidate that assumption. On December 3, 2002, Curzio provided a letter from his treating physician, Dr. Daniel Yellon. Dr. Yellon states that Curzio has recently been diagnosed with Stage IV small cell lung cancer with diffuse metastasis to the bones. The condition is terminal.

Curzio also filed an affidavit (Affidavit) stating that his deteriorating health will permanently prevent him from continuing to work in the investment advisory field and from having any future role in FXC. He explained that he is undergoing chemotherapy treatments and taking several different medications. He regularly requires the use of oxygen and finds it extremely difficult to travel outside his home. Curzio intends to resign from FXC in early January 2003 and to have his two adult sons take over the business. Both sons are knowledgeable about investment advisory services and neither has any sort of disciplinary record. Once the transition is complete, Curzio will no longer participate in the operations, management, or work of FXC or any successor entity.

By letter dated December 4, 2003, the Division expressed sympathy for Curzio's unfortunate medical condition, but reiterated its position that meaningful sanctions are warranted. In short, the Division has not modified its request for sanctions in any way.

The Public Interest

The public interest analysis requires that several factors be considered, including: (1) the egregiousness of the respondents' actions; (2) the isolated or recurrent nature of the infractions; (3) the degree of scienter involved; (4) the sincerity of the respondents' assurances against future violations; (5) the respondents' recognition of the wrongful nature of their conduct; and (6) the likelihood that the respondents' occupation will present opportunities for future violations. See Steadman v. SEC, 603 F.2d at 1140. The severity of sanctions depends on the facts of each case and the value of the sanctions in preventing a recurrence of the violative conduct. See Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963). Sanctions should demonstrate to the particular respondent, the industry, and the public generally that egregious conduct elicits a harsh response. See Arthur

Lipper, 547 F.2d at 184. Registration sanctions are not intended to punish a respondent, but to protect the public from future harm. See Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

Respondents' Prior Violations

Twice previously, FXC and Curzio have been found in violation of the antifraud provisions of the Advisers Act relating to false and misleading advertising. The first episode involved conduct occurring between September 1977 and January 1980. On July 15, 1981, FXC and Curzio settled administrative charges that they had willfully violated Section 206(4) of the Advisers Act and Advisers Act Rule 206(4)-1 (DX 32). In that proceeding, the Commission alleged that advertisements for the FXC newsletter "were calculated to arouse investors' illusory hopes for substantial and imminent profits" and "erroneously reported the prices at which securities were recommended for purchase" (DX 32). Without admitting or denying the charges, FXC and Curzio accepted an order of censure. In addition, the Commission required FXC and Curzio for six months to submit FXC's advertisements to counsel for pre-publication review, to ensure compliance with the provisions of the Advisers Act.

The second episode occurred on April 30, 1985, when the Commission charged FXC and Curzio with violations of the registration provisions of the Securities Act, the antifraud provisions of the Exchange Act, and the antifraud provisions of the Advisers Act relating to false advertising. See SEC v. F.X.C. Inv. Group, Inc., 33 SEC Docket 81 (May 9, 1985). Without admitting or denying the Commission's allegations, FXC and Curzio consented to the entry of a permanent injunction (DX 33).

Respondents have also been sanctioned twice for violations of state securities laws. On November 26, 1984, the Commissioner of Commerce of the State of Minnesota issued a consent order requiring FXC and Curzio to cease and desist from offering and/or selling unregistered securities to Minnesota residents, and fining them $500 (Tr. 106, 109-10, 271-72; DX 34). FXC and Curzio neither admitted nor denied the allegations.

In March 1995, FXC and Curzio filed applications for registration as an investment adviser and investment adviser agent, respectively, with the Securities and Business Division of the Department of Banking for the State of Connecticut (DX 35). One of the supporting documents required the applicants to disclose whether: (a) any court had ever enjoined them in connection with any investment-related activity; (b) the SEC had ever found them to have been involved in a violation of investment-related regulations or statutes; and (c) any state regulatory agency had ever found them to have been involved in a violation of investment regulations or statutes. Notwithstanding the 1981 Commission settlement, the 1984 Minnesota consent order, and the 1985 federal court injunction, Curzio answered the questions under oath by checking the boxes marked "no" (Tr. 110-15; DX 35).

On June 22, 1995, the Banking Commissioner of the State of Connecticut issued a notice of intent to deny FXC's and Curzio's applications for registration (DX 35). Among other things, the Banking Commissioner alleged that FXC and Curzio had filed applications for registration that contained false and misleading statements. On September 26, 1995, the parties reached a stipulation and agreement. Without admitting or denying the truth of the Banking Commissioner's allegations, FXC and Curzio agreed to retain a consultant to review FXC's supervisory and compliance procedures, to pay a fine of $500, and to reimburse the State of Connecticut $500 for its investigative costs (DX 35). For his part, the Banking Commissioner agreed to grant registration to both FXC and Curzio (Tr. 110-14; DX 35).

Respondents dispute the Division's efforts to portray them as recidivists. They observe that, from 1977 to 1987, FXC only published its newsletter; it did not begin managing client accounts until 1988. Respondents argue that the administrative proceeding leading to the Commission's 1981 censure could not have been brought after the Supreme Court's decision in Lowe v. SEC, 472 U.S. 181 (1985). On that basis, they contend that the 1981 censure should be given no weight here

(Resp. Br. at 8-9). The Division replies that the 1981 censure remains relevant because Respondents violated the law as it was thought to exist at the time; and because the Commission arguably could bring the same cause of action today, even after Lowe(Tr. 106-08; Div. Br at 40-41; Div. Legal Reply at 15).

In Lowe, the Supreme Court majority opinion determined that an individual fell within the publisher's exclusion from investment adviser registration, and therefore, neither the individual's unregistered status nor a Commission order barring him from associating with an investment adviser provided a justification for restraining the future publication of his newsletters. Lowe, 472 U.S. at 211. The concurring opinion expressed the view that the individual was an investment adviser subject to regulation and sanction under the Advisers Act, but reasoned that preventing him from publishing at all would be inconsistent with the First Amendment. Id.at 234-36.

The burden is not on the Division to show that, had the misconduct leading to the 1981 censure occurred today, it could still win the case it brought in 1981. If Respondents believed that the 1981 censure was no longer equitable after Lowe, the burden was on them to file a motion to vacate the 1981 sanction. Cf. SEC v. Caldicott, 258 F.3d 939, 941-45 (9th Cir. 2001) (applying Fed. R. Civ. Pro. 60(b)(5) and discussing the criteria for vacating an injunction entered nine years earlier). This is not the proper forum to attack the 1981 censure. Because Respondents have not filed a motion to vacate the censure, they cannot now be heard to argue that Lowe renders the 1981 censure automatically inapplicable. The same reasoning applies to the 1985 federal district court order, insofar as it enjoins FXC and Curzio from future violations of Section 206(4) of the Advisers Act and Advisers Act Rule 206(4)-1. For purposes of considering the public interest, specifically, the isolated or recurrent nature of Respondents' violations, I have given weight to both the 1981 censure and the 1985 injunction.

In contrast, the state agency sanctions carry much less weight here. Curzio testified that the 1984 Minnesota proceeding involved his failure to file a private placement exemption application with the State of Minnesota before FXC sold $500 worth of securities to an individual who had recently moved to Minnesota from New York (Tr. 271-72; DX 36). He further explained that the settlement terms were modest in comparison with the expected cost of defending the action (Tr. 271-72; DX 36). In Stonegate Secs., Inc., 76 SEC Docket 111, 119 n.24 (Oct. 15, 2001), the Commission found that a twelve-year-old order of censure and a $250 fine should be given little weight when determining the current sanction to be imposed against a respondent in the public interest. The reasoning of Stonegate is equally applicable here. The 1984 Minnesota proceeding has played a minimal role in the sanctions imposed in this Initial Decision.

Curzio characterized the 1995 Connecticut action as an example of regulatory overkill. He testified that he brought the violation to the attention of Connecticut officials and then promptly corrected it (Tr. 272-75). Under current Commission policy, Curzio is entitled to some consideration for the self-policing and self-corrective actions he took in 1995. See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, 76 SEC Docket 296 (Oct. 23, 2001). To the extent that the Division urges me to give Curzio's prompt cooperation with Connecticut officials no consideration whatsoever, I reject its argument.

I am more troubled by Curzio's efforts to brush off the Connecticut action after 1995. Curzio omitted mention of the 1995 Connecticut sanction in the Forms ADV that FXC filed with the Commission in 1997 and 1998 (Tr. 115-17; DX 36, DX 39). Item 11.D.4 of Form ADV requires an investment adviser to disclose actions by a state regulatory agency, including the entry of an order "against the applicant or an advisory affiliate in connection with an investment-related activity" (DX 36, DX 39). Item 11.D.5 of Form ADV requires an investment adviser to disclose if a state regulatory agency had "disciplined it by restricting its activities" (DX 36, DX 39). In my judgment, the fact that the State of Connecticut required FXC to retain a consultant and pay a fine is covered by this disclosure requirement.

At the hearing, Curzio contended that his decision not to disclose the Connecticut order on the Forms ADV was deliberate, and based on advice of counsel (Tr. 274-75). I doubt the credibility of this testimony. Curzio did not present documentary evidence in support of this affirmative defense. Nor did he offer the testimony of the attorney who purportedly rendered the advice. I am reluctant to give much weight to Curzio's uncorroborated testimony on the point.9 Curzio also attempted to minimize the significance of the inaccuracies on FXC's Connecticut registration application. He testified that the questions he answered incorrectly on the Connecticut registration application in 1995 were confined to the nondisclosure of discipline that had been imposed within ten years (Tr. 114-15). In fact, some of the questions on the Connecticut registration application required disclosure of discipline imposed at any time in the past (DX 35). I have not given much weight to the 1995 Connecticut sanction. I have given greater weight to Curzio's lack of candor on this subject in 1997, in 1998, and at the hearing.

Cease-and-Desist Orders

Section 203(k)(1) of the Advisers Act authorizes the Commission to impose a cease-and-desist order upon any person who "is violating, has violated, or is about to violate" any provision of the Advisers Act or any rule or regulation thereunder. That provision also permits the Commission to enter a cease-and-desist order against any other person who "is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation." The statute further authorizes the Commission to order such persons "to take steps to effect compliance" with such provision, rule, or regulation, "upon such terms and conditions and within such time as the Commission may specify."

In KPMG Peat Marwick LLP, 74 SEC Docket 384, 428-38 (Jan. 19, 2001), recon. denied, 74 SEC Docket 1351 (Mar. 8, 2001), petition denied, 289 F.3d 109 (D.C. Cir. 2002), the Commission considered the standard for issuing cease-and-desist relief. It concluded that it would continue to consider the Steadman factors in light of the entire record, noting that no one factor is dispositive. It explained that the Division must show some risk of future violation. However, it also ruled that such a showing should be "significantly less than" required for an injunction and that, "absent evidence to the contrary," a single past violation ordinarily suffices to establish that the violator will engage in the same type of misconduct in the future. See74 SEC Docket at 430, 435. On reconsideration, the Commission specifically disclaimed any notion that issuance of a cease-and-desist order is "automatic" on a finding of past violation. See74 SEC Docket at 1360.

The violations at issue here involved several different advertisements and a large number of potential clients. They continued over a two-year period. The Division does not suggest that these violations were the most egregious ever to be perpetrated on the public by an investment adviser, but it persuasively argues that the violations should be viewed as much more serious because they occurred while the 1985 injunction remained in effect. Curzio has never really acknowledged the wrongful nature of the conduct at issue. As to FXC, I conclude that future violations are likely to occur, and that a cease-and-desist order is plainly warranted.

Section 203(k)(1) of the Advisers Act provides that a cease-and-desist order may also require a violator to "take steps to effect compliance" with the provisions violated "upon such terms and conditions and within such time as the Commission may specify." FXC recently hired National Regulatory Services, Inc., an investment advisory compliance consultant, to review its advertisements, as well as the forms that it files with regulators (Tr. 309-10). Curzio anticipates that his sons will continue this consulting arrangement in the future (Affidavit ¶ 7). An order requiring FXC to continue to engage a qualified compliance consultant will benefit the public interest and will also be entered.10

If Curzio were physically able to continue working in the investment advisory field, I would not hesitate to impose a cease-and-desist order against him, as well. Notwithstanding his disciplinary history, Curzio's serious medical condition makes future violations highly unlikely. The Commission was quite clear in its order on reconsideration in KPMG that a cease-and-desist sanction is not "automatic" on a finding of past violation. See74 SEC Docket at 1360. If those words have any meaning at all, they should be applied in the case of a violator who is suffering from terminal lung cancer and is physically unable to continue working in the industry. I decline to impose a cease-and-desist order against Curzio.

Bar from Association with an Investment Adviser

In relevant part, Section 203(f) of the Advisers Act empowers the Commission to impose a sanction against a person associated with an investment adviser if such a person has willfully aided and abetted violations of the Advisers Act or the rules or regulations thereunder. Specifically, the Commission may censure, place limitations on the activities of such an associated person, suspend that person for a period not exceeding twelve months, or bar that person from being associated with an investment adviser if the Commission finds, on the record and after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest.

Section 202(a)(17) of the Advisers Act defines a "person associated with an investment adviser" as including "any employee of such investment adviser." FXC was registered as an investment adviser at all relevant times (Ans. ¶ 4; Stip. ¶ 3; Tr. 13). As an employee of FXC who willfully aided and abetted FXC's violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Advisers Act Rule 206(4)-1(a)(5), Curzio is subject to a sanction under Section 203(f) of the Advisers Act.

Although FXC is no longer registered with the Commission as an investment adviser, that fact does not deprive the Commission of jurisdiction to impose an associational bar on Curzio. Cf. Alexander V. Stein, 52 S.E.C. 296, 298-300 (1995) (holding that the Commission's authority to proceed under Section 203(f) does not rest on whether or not an entity or individual is registered). A bar prohibiting an individual from associating with an investment adviser applies to associations with all investment advisers, registered and unregistered. See Victor Teicher, 53 S.E.C. 581, 584-86 (1998), aff'd in relevant part, 177 F.3d 1016, 1018-19 (D.C. Cir. 1999). It also prevents the individual from acting as an unregistered investment adviser, as opposed to associating with an unregistered investment adviser. See Anthony J. Benincasa, 74 SEC Docket 924, 925-26 (Feb. 7, 2001).

If Curzio were physically able to continue working in the investment advisory field, I would not hesitate to order the associational bar the Division requests. However, after considering the Steadman factors, and giving due regard to Curzio's medical condition in light of Glassman, I conclude that Curzio should be censured, but not barred.

Distribution Requirement

The Division also urges that FXC and Curzio be required to distribute a copy of the final order in this proceeding to current and prospective clients and ranking agencies. Statutory authority for such a requirement may be found in Sections 203(e) and 203(f) of the Advisers Act, which authorize the Commission to "place limitations on" the activities of investment advisers and their associated persons. Additional statutory authority may be found in Section 203(k)(1) of the Advisers Act, which permits the Commission to "require future compliance or steps to effect future compliance." In Valicenti, 198 F.3d at 67, the Second Circuit held that such a distribution requirement might be an appropriate and reasonable limitation "in certain circumstances." But saying that such a distribution requirement is statutorily permissible is not the same as saying that it is always a necessary remedy for misleading performance advertising.

In essence, the proposed distribution requirement would require FXC to engage in negative advertising about itself. To warrant such relief, however, the Division must make a factual showing that (1) the deceptive advertising has played a "substantial role" in creating or reinforcing a false belief in the public's mind; and (2) the belief "lingered on" after the false advertising ceased. Cf. Novartis Corp. v. FTC, 223 F.3d 783, 787-88 (D.C. Cir. 2000); Nat'l Comm'n on Egg Nutrition v. FTC, 570 F.2d 157, 164 (7th Cir. 1977); Warner-Lambert Co. v. FTC, 562 F.2d 749, 762 (D.C. Cir.

1977). There is no such evidence here. The Division presented no expert testimony and no testimony from prospective advisory clients. The Division has conceded that FXC's advertisements were not materially misleading to FXC's existing advisory clients. The advertisements ceased when the Division brought its concerns to Curzio's attention.

Civil Monetary Penalties

Under Section 203(i) of the Advisers Act, the Commission may assess a civil monetary penalty if it finds that a respondent has willfully violated or has willfully aided and abetted a violation of the Advisers Act or the rules or regulations thereunder. The Commission must also find that such a penalty is in the public interest. Six factors are relevant to the public interest determination: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. See Section 203(i)(3) of the Advisers Act. Not all of the public interest factors may be relevant in a given case, and the six factors need not all carry equal weight. In its discretion, the Commission may consider evidence of a respondent's ability to pay. See Section 203(i)(4) of the Advisers Act.

Section 203(i)(2) of the Advisers Act specifies a three-tier system identifying the maximum amount of a penalty. For each "act or omission" by a natural person, the maximum amount of a penalty in the first tier is $5,000; in the second tier, it is $50,000; and in the third tier it is $100,000. For each "act or omission" by a corporation, the maximum amount of a penalty in the first tier is $50,000; in the second tier, it is $250,000; and in the third tier, it is $500,000.11

Second-tier penalties are statutorily permissible in this proceeding because the violations were willful and involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. The statutory maximum is not an overall limitation, but a limitation per violation. See United States v. Reader's Digest Ass'n, 662 F.2d 955, 966, 970 (3d Cir. 1981) (holding that each individual mailing constitutes a separate violation of an FTC consent order). The Division requests civil penalties of $100,000 as to each Respondent. Because multiple violations are involved, penalties at that level are within the statutory ceiling.

Of the six public interest factors identified in the Advisers Act, four may be resolved summarily. Respondents' violations involved fraud and the reckless disregard of a regulatory requirement. The harm to others was not great. FXC and Curzio did not enrich themselves financially. There were prior violations of federal and state securities laws in 1981, 1984, 1985, and 1995, discussed above.

The fifth public interest factor, the need for deterrence, presents a more complex question. Section 203(i)(3)(E) of the Advisers Act permits the Commission to consider "the need to deter [the violator] and other persons from committing such acts or omissions." The need to deter through a civil penalty is an abstract concept that is difficult to quantify. However, it cannot be considered in a vacuum, apart from the cease-and-desist order, the censure, and the order to engage a compliance consultant, already imposed. The issue to consider is whether these other sanctions, by themselves, provide inadequate deterrence. If so, then the marginal additional deterrence of civil penalty sanctions would be warranted in the public interest. Based on the facts and circumstances before me, I conclude that the need for deterrence has been fully satisfied by the cease-and-desist order, the censure, and the order to engage a compliance consultant.12

The sixth public interest factor permits the Commission to consider "such other matters as justice may require." See Section 203(i)(3)(F) of the Advisers Act. This is the statutory wild card, see First Secs. Transfer Sys., 52 S.E.C. at 396 n.15, and it plays an important role in this case. The penalties sought by the Division would be the heaviest ever imposed against a "mom-and-pop" advisor for advertising violations (Div. Amended Prehearing Br. at 36 & n.22; Div. Legal Reply at 21-23). I conclude that the $100,000 penalties sought by the Division in this proceeding are grossly disproportionate to the gravity of the proven offenses, and thus constitutionally excessive under the Excessive Fines Clause of the Eighth Amendment.13 That is a matter that justice requires me to consider.

Four of the six statutory factors favor FXC and Curzio. Although the antifraud violations were serious and there were prior violations, the facts and circumstances persuade me that a cease-and-desist order, a censure, and an order to engage a compliance consultant fully vindicate the public interest.

Respondents' inability to pay is also a factor to be considered here. FXC has a negative net worth. There is simply no valid regulatory purpose to be served by raiding Curzio's individual retirement account, his only liquid asset. The Division is aware that Curzio is applying for disability payments so that he can support himself financially through his illness (Affidavit ¶ 4). In these circumstances, the Division's insistence on massive penalties is unwarranted. I exercise my discretion and decline to impose civil penalties in any amount.

Record Certification

Pursuant to Rule 351(b) of the Commission's Rules of Practice, I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on June 4, 2002, as corrected on July 17, 2002.

Order

Based on the findings and conclusions set forth above,

IT IS ORDERED THAT F.X.C. Investors Corp. cease and desist from committing any violations or future violations of Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 and Advisers Act Rule 206(4)-1(a)(5);

IT IS FURTHER ORDERED THAT F.X.C. Investors Corp. engage an investment advisory consultant, acceptable to the Commission's Division of Enforcement, to review any advertising for a period of two years; and

IT IS FURTHER ORDERED THAT Francis X. Curzio is censured.

This Order shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice. Pursuant to that Rule, a petition for review of this Initial Decision may be filed within twenty-one days after service of the Initial Decision. It shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 360(d)(1) within twenty-one days after service of the Initial Decision on that party, unless the Commission, pursuant to Rule 360(b)(1), determines on its own initiative to review this Initial Decision as to that party. If a party timely files a petition for review, or the Commission acts to review on its own motion, the Initial Decision shall not become final as to that party.

James T. Kelly
Administrative Law Judge

Footnotes

1 Respondents' answer to the OIP, dated January 7, 2002, will be cited as "Ans. ___." On March 8, 2002, the Division and Respondents stipulated to certain undisputed facts and to the authenticity of certain documents. In this decision, the Stipulations will be cited as "Stip. ___." The official record of the hearing is captioned "Amended Transcript." The Amended Transcript, as further corrected by the parties' Joint Motion Accepting [The Amended] Transcript With Corrections, and by my Order of May 21, 2002, will be cited as "Tr. ___." The hearing exhibits offered by the Division and by Respondents will be cited as "DX ___" and "RX ___," respectively.

The Division's Proposed Findings of Fact and the Division's Proposed Conclusions of Law, both dated June 5, 2002, will be cited as "Div. Prop. Find. ___" and "Div. Br. ___," respectively. Respondents' Proposed Findings of Fact and Respondents' Proposed Conclusions of Law and Post-Hearing Brief, both dated July 8, 2002, will be cited as "Resp. Prop. Find. ___" and "Resp. Br. ___," respectively. The Division's Reply to Respondents' Proposed Findings of Fact and the Division's Post-Hearing Reply Memorandum, both dated July 30, 2002, will be cited as "Div. Fact Reply ___" and "Div. Legal Reply ___," respectively.

2 The National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, divided responsibilities for regulating investment advisers between the Commission and state securities authorities. Congress allocated to state securities authorities the primary responsibility for regulating smaller advisory firms that are essentially local businesses, and allocated to the Commission the primary responsibility for regulating larger advisers. Section 203A(a) of the Advisers Act effects this division by generally prohibiting advisers from registering with the Commission unless they have assets under management of not less than $25 million or unless they advise registered investment companies. FXC managed client assets of more than $25 million at all times relevant to this proceeding (Ans. ¶ 7; DX 38). Although FXC is now below the $25 million registration threshold, Respondents do not contend that the Commission lacks jurisdiction in this matter (Ans. ¶ 8).

3 AIMR issued proposed Performance Presentation Standards in 1993 and revised Performance Presentation Standards in 1997 (DX 14, DX 15). The Performance Presentation Standards are a set of guiding ethical principles, intended to promote full disclosure and fair representation by AIMR members in reporting their investment results (DX 14 at AIMR 32). A secondary objective is to ensure uniformity in reporting so that results are directly comparable among investment managers. Some aspects of the Performance Presentation Standards are mandatory for AIMR members and other aspects are recommended (DX 14 at AIMR 32-36).

4 At present, there is no such thing as a self-regulatory organization for investment advisers. Various trade groups, such as AIMR and the Investment Counsel Association of America, have established standards for their members to follow when including performance information in advertisements. The Commission has never required investment advisers to comply with such standards, and it has not endorsed the standards of any particular group. The theory of the OIP is simply that, if an investment adviser claims to be in compliance with such standards, the claim must be accurate.

5 OIP ¶ II.H alleges that Pensions & Investment required that the reported performance information be calculated in compliance with the standards established by AIMR and that the performance information be externally audited. There is no evidence to support these claims. In fact, the weight of the evidence refutes both claims (Tr. 152, 170-75).

6 The OIP focuses on misconduct occurring after December 31, 1996, the date as of which FXC submitted its first data questionnaire to RogersCasey. Four issues of Pensions & Investments were published earlier in 1996, and the Division has presented no evidence to show that the PIPER results in those four issues were inaccurate as to FXC. Three issues of Pensions & Investments appeared more than five years before the Commission issued the OIP.

7 There is no evidence to support the claim in OIP ¶ II.F that FXC also sent the advertisements to 25,000 individuals listed in FXC's own database (Tr. 332-33).

8 In 1968, the Commission proposed a rule to require written approval of any adviser advertisement by a designated supervisory person. See Proposal to Adopt Rule 206(4)-3 and to Amend Rule 206(4)-1, Investment Advisers Act Rel. No. 231, 1968 SEC LEXIS 1325 (Oct. 10, 1968). The Commission later withdrew the proposal. See Notice of Withdrawal of Proposed Rule 206(4)-3 and Proposed Amendments to Rule 206(4)-1, 9 SEC Docket 32 (Feb. 25, 1976). In 1997, the Commission adopted amendments to Rule 206(4)-1 to implement the provisions of the National Securities Markets Improvement Act of 1996. See Rules Implementing Amendments to the Investment Advisers Act of 1940, 64 SEC Docket 1525 (May 15, 1997).

9 In prior cases arising under the federal securities laws, the courts have developed a four-part test for evaluating the reliance on counsel defense. Its essential elements are that a person: (1) made a complete disclosure to counsel of the intended action; (2) requested counsel's advice as to the legality of the intended action; (3) received counsel's advice that the conduct was legal; and (4) relied in good faith on that advice. See Markowski v. SEC, 34 F.3d 99, 104-05 (2d Cir. 1994); C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1436 (10th Cir. 1988); SEC v. Goldfield Deep Mines Co., 758 F.2d 459, 467 (9th Cir. 1985); SEC v. Savoy Indus., Inc., 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981).

10 The Division correctly notes that the record provides very little information about National Regulatory Services. The omission is hardly the fatal defect the Division believes it to be. A review of the LEXIS database shows that National Regulatory Services is a frequent commenter in the Commission's rulemaking proceedings. A review of the no-action letters issued by the Division of Investment Management, so frequently cited by the Division on other issues in this case, provides further information about the firm. See National Regulatory Serv., Inc., 1992 SEC No-Act. LEXIS 1125 (Dec. 2, 1992); National Regulatory Serv., Inc., 1987 SEC No-Act. LEXIS 2246 (Jul. 27, 1987). Additional information is available from the company's internet site. See http://www.nrs-inc.com.

11 As required by the Debt Collection Improvement Act of 1996, the Commission increased the maximum penalty amounts for violations occurring after December 9, 1996, and, again, for violations occurring after February 2, 2001. See 17 C.F.R. §§ 201.1001, 201.1002. For a natural person, the adjusted maximum penalty amounts for misconduct occurring after December 9, 1996, and on or before February 2, 2001, were $5,500 (tier one), $55,000 (tier two), and $110,000 (tier

three), respectively. For a corporation, the adjusted maximum penalty amounts for misconduct occurring between those dates were $55,000 (tier one), $275,000 (tier two), and $550,000 (tier three), respectively. See 17 C.F.R. § 201.1001.

12 The Commission has imposed both associational bars and substantial civil penalties in aggravated cases. See Sandra K. Simpson, 77 SEC Docket 1983, 2009-10 (May 14, 2002); Quest Capital Strategies, Inc., 76 SEC Docket 131, 146 (Oct. 15, 2001); First Secs. Transfer Sys., Inc., 52 S.E.C. 392, 395-97 (1995). However, Sections 203(i)(1) of the Advisers Act makes it clear that civil penalty sanctions are discretionary, not mandatory. The public interest factors here are more in FXC's and Curzio's favor.

13 The Excessive Fines Clause of the Eighth Amendment to the United States Constitution reaches punitive sanctions levied in nominally civil proceedings. See United States v. Bajakajian, 524 U.S. 321, 331 n.6 (1998); Austin v. United States, 509 U.S. 602, 621-22 (1993). Two questions are pertinent: (1) is the statutory provision a fine, i.e., does it impose punishment? and (2) if so, is the fine excessive? The first question determines whether the Eighth Amendment applies, and the second determines whether the Eighth Amendment has been violated.

A fine that serves purely remedial purposes cannot be considered excessive under any circumstances. See Austin, 509 U.S. at 621-22. Unless a civil penalty solely serves a remedial purpose, however, it may be considered punitive and thus subject to scrutiny under the Excessive Fines Clause. See id. If a fine or forfeiture is punitive, the court must then determine whether it is constitutionally excessive. The test is whether the fine is grossly disproportional to the gravity of the offense. See Bajakajian, 524 U.S. at 334.

One court has already held that the civil penalty provisions in Section 20(d) of the Securities Act and Section 21(d) of the Exchange Act are not solely remedial under Austin. See United States v. Morse, 1997 WL 181043 at *3; Fed. Sec. L. Rep. (CCH) ¶ 99,488 at 97,305-06 (S.D.N.Y. Apr. 14, 1997).

Of course, civil penalties under the federal securities laws are not considered to be punishment for purposes of a Fifth Amendment double jeopardy claim. See SEC v. Palmisano, 135 F.2d 860, 864-66 (2d Cir. 1998); SEC v. McCaskey, Fed. Sec. L. Rep. (CCH) ¶ 91,747 at 98,506 (S.D.N.Y. Mar. 26, 2002) (Magistrate Judge); Boleslaw Wolny, 53 S.E.C. 590, 598 (1998). However, labels like "punishment" or "penalty" have different meanings in different contexts. See United States v. Ursery, 518 U.S. 267, 286 (1996) ("Austin, it must be remembered, did not involve the Double Jeopardy Clause at all. Austin was decided solely under the Excessive Fines Clause of the Eighth Amendment, a constitutional provision which we never have understood as parallel to, or even related to, the Double Jeopardy Clause of the Fifth Amendment."). See also Hudson v. United States, 522 U.S. 93, 102-03 (1997). Thus, Morse's application of Austin to the civil penalty provisions of the federal securities laws survives both Hudson and Palmisano.

The structure of Section 203(i) of the Advisers Act is identical to the structure of the two civil penalty provisions analyzed in Morse. Applying the reasoning of Morse in this proceeding, I conclude that Section 203(i) of the Advisers Act cannot be deemed solely remedial under Austin, and the Division's requested civil penalties are thus subject to analysis for "gross disproportionality." Cf. United States v. Mackby, 261 F.3d 821, 829-31 (9th Cir. 2001); Cole v. U.S. Dept. of Agriculture, 133 F.3d 803, 807-09 (11th Cir. 1998); United States v. Serfling, 1998 U.S. Dist. LEXIS 3566 at *15-17 (N.D. Ill. Mar. 3, 1998).

The Division's proposed civil penalties are not immune from scrutiny under the Excessive Fines Clause simply because they are beneath the tier-two maximum. A sanction that is within statutory limits can still be unconstitutional under the Eighth Amendment principle of proportionality. No sanction is per se constitutional. The limit stated by the legislature receives appropriate deference, but it is not a barrier to the reach of the Constitution. Cf. Marrero v. Dugger, 823 F.2d 1468, 1472 n.7 (11th Cir. 1987).