UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2038 / June 20, 2002

ADMINISTRATIVE PROCEEDING
File No. 3-10807

In the Matter of PORTFOLIO ADVISORY SERVICES, LLC, AND CEDD L. MOSES, Respondents.

ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDING, MAKING FINDINGS, AND IMPOSING SANCTIONS AND CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that a public administrative and cease-and-desist proceeding be instituted against Portfolio Advisory Services, LLC ("PAS") pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and against Cedd L. Moses ("Moses") pursuant to Sections 203(f) and 203(k) of the Advisers Act.

II.

In anticipation of the institution of this proceeding, Respondents have submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings contained herein, except that PAS and Moses admit the jurisdiction of the Commission over them and over the subject matter of this proceeding, PAS and Moses consent to the entry of this Order Instituting Public Administrative and Cease-and Desist Proceeding, Making Findings, and Imposing Sanctions and Cease-and-Desist Order ("Order").

Accordingly, IT IS ORDERED that a proceeding pursuant to Sections 203(e), (f), and (k) of the Advisers Act be, and hereby is, instituted.

III.

On the basis of this Order and the Offer, the Commission finds that:

A. PAS, located in Los Angeles, California, is an investment adviser that registered with the Commission as an investment adviser in 1989 (File No. 801-33630).

B. Moses, age 41, co-founded PAS and is currently its president, a director, and 90% owner. Moses has been PAS's only portfolio manager since inception.

C. From 1993 to 2000, PAS failed to seek best execution in securities transactions for certain advisory clients by systematically interposing a broker-dealer between clients and a market maker on over-the-counter (OTC) trades to compensate the broker-dealer for referring clients to PAS. The interposed broker-dealer received commissions despite having no role in executing the trades. Clients therefore paid unnecessary commissions over and above the markups or markdowns already charged by the market maker.

D. PAS began this interpositioning practice in 1993, shortly after forming a hedge fund (the "Fund") for which it became the investment adviser. To find investors for the Fund, PAS entered into oral arrangements with five registered representatives (the "referring brokers") to direct commissions to them in return for referring clients to the Fund. Under these referral arrangements, PAS directed commissions to the referring brokers on Fund trades in both OTC and listed securities. The target annual referral fee to be paid by PAS to the referring brokers was commissions equal to 1.75% of the net assets raised by each referring broker.

E. For Fund trades in OTC securities, PAS would direct the trade to the market maker that displayed the best price at the time of the order. When the market maker confirmed execution of the trade, PAS would report the trade to its prime broker, which provided clearance, custodial, and other back office services for PAS. PAS would also instruct the prime broker to add a five-cent per share commission on the trade to a referring broker, even though the referring broker's firm had no role in executing the trade. From 1993 to 2000, PAS caused clients to pay approximately $1.7 million in unnecessary commissions as a result this interpositioning practice.

F. PAS generally disclosed to clients that it could direct commissions to referring brokers, but failed to disclose that those commissions were paid after certain trades had already been completed on a principal basis, that the referring broker provided no execution services, and that those commissions were in addition to markups or markdowns already imposed by the market maker. PAS's 1999 Form ADV filing, which was signed by Moses, also falsely stated that PAS would seek best execution of client trades.

G. Moses knew that commissions were being paid on OTC trades to compensate referring brokers, but did not question or change this practice until May 2000, when the Commission's Pacific Regional Office ("PRO") conducted a regulatory examination of PAS and raised questions about the practice.

H. Following the PRO's May 2000 regulatory examination, Moses caused PAS to stop the interpositioning practice. In November 2000, Moses caused PAS to revise its Form ADV to disclose that it had engaged in the interpositioning practice and caused PAS to send letters to all Fund investors offering to rescind any investment with interest. In January 2001, Moses caused PAS to reimburse $1.7 million to Fund investors, representing the amount overpaid by the Fund investors as a result of the interpositioning practice.

I. An investment adviser's fiduciary duty includes the requirement to seek best execution of client securities transactions. Kidder Peabody & Co., Inc., Edward B. Goodnow, Advisers Act Rel. No. 232 (October 16, 1968). To fulfill this duty, investment advisers should "periodically and systematically" evaluate the execution they are receiving for clients. Interpretive Release Concerning Scope of Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Rel. No. 34-23170 (April 23, 1986). The Commission has repeatedly sanctioned investment advisers that have failed to seek best execution of client trades involving referral arrangements. See In the Matter of Founders Asset Management LLC, Advisers Act Rel. No. 1879 (June 15, 2000) (adviser breached its duty to seek best execution by directing commissions to a broker that charged higher rates in return for client referrals); In the Matter of Fleet Investment Advisers, Advisers Act Rel. No. 1821 (September 9, 1999) (adviser breached its duty to seek best execution by failing to seek the best available price on certain fixed-income transactions for clients).

J. Section 206(2) of the Advisers Act prohibits an investment adviser from engaging in "any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Interpositioning violates the antifraud provisions of the federal securities laws when it results in clients incurring unnecessary brokerage charges. Edgemont Asset Management Corp. and Bowling Green Securities Inc., Advisers Act Release No. 1280 (June 18, 1991) (investment adviser and an affiliated broker-dealer engaged in fraudulent interpositioning). Based on the conduct alleged in paragraphs III. C. through G. above, PAS violated its duty to seek best execution by systematically interposing a broker-dealer between clients and market makers on

OTC principal trades. PAS falsely stated in Item 12 of Part II on Form ADV that it would seek best execution of client trades. In addition, although PAS generally disclosed to clients that it could direct commissions to referring brokers, it failed to disclose that those commissions were paid after certain trades had already been completed on a principal basis, that the referring broker provided no execution services, and that those commissions were in addition to markups or markdowns already imposed by the market maker. PAS therefore willfully violated Section 206(2) of the Advisers Act. Moses was PAS's president, director, portfolio manager, and 90% owner. He also trained and co-supervised PAS's head trader. In these capacities, Moses substantially assisted and was aware of the payment of commissions to referring brokers and should have been aware that, in the case of OTC principal transactions, such payments resulted in clients paying unnecessary brokerage charges. Moses therefore willfully aided and abetted and caused PAS's violation of Section 206(2) of the Advisers Act.1

K. Section 207 of the Advisers Act makes it unlawful for any person to willfully make any untrue statement of material fact, or omit any material fact required to be stated, in any Commission filing, including Form ADV. PAS's 1999 Form ADV, signed by Moses, failed to disclose PAS's interpositioning practice, and falsely stated that PAS would seek best execution in conducting trading activities and directing commissions to referring brokers. In fact, PAS failed to seek best execution as a result of the interpositioning practice. Accordingly, PAS and Moses willfully violated Section 207 of the Advisers Act.

IV.

Based on the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by PAS and Moses. In determining to accept the Offer, the Commission considered remedial acts undertaken (as described in paragraph III. H. above) and cooperation afforded the Commission staff during the investigation.

Accordingly, IT IS ORDERED that:

A. PAS and Moses are censured;

B. PAS and Moses shall cease and desist from committing or causing any violation and any future violation of Sections 206(2) and 207 of the Advisers Act; and

C. PAS and Moses shall, within ten days of the date of this Order, pay on a joint and several basis a civil penalty in the amount of fifty thousand dollars ($50,000) to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check, or bank money order; (B) made payable to the Securities and Exchange Commission; (C) transmitted to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Virginia 22312-0003; and (D) submitted under a cover letter that identifies PAS and Moses as respondents in this proceeding, and sets forth the file number of this proceeding, a copy of which cover letter and money order or check shall be sent to Andrew Petillon, Pacific Regional Office, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036.

By the Commission.

Jonathan G. Katz
Secretary

Footnote

1 "Willfully" as used in this Order means intentionally committing the act which constitutes the violation, see Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.