

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4701 / May 5, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-17968

In the Matter of

**TELLONE MANAGEMENT
GROUP, INC. and
DEAN C. TELLONE,**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTIONS 203(e), 203(f)
AND 203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940 MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS AND A CEASE-AND-DESIST
ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Tellone Management Group, Inc. (“TMG”) and Sections 203(f) and 203(k) of the Advisers Act against Dean C. Tellone (“Tellone”) (together, “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the “Offers”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondents and the subject matter of these proceedings, which are admitted, TMG and Tellone consent to the entry of this Order Instituting Administrative and Cease-And-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-And-Desist Order (“Order”), as set forth below.

III.

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

SUMMARY

1. From January 2010 to August 2015 (the "Relevant Period"), TMG and Tellone allocated profitable day trades in a manner that was sometimes inconsistent with TMG's disclosure to clients. TMG's Forms ADV disclosed that the adviser would use a rotation method for allocating block trades to its clients' accounts so that over time the clients would receive roughly equal access and equal participation in limited trading opportunities. TMG and Tellone, however, had a practice of allocating day trades with a profit of \$300 or less to a single client account (the "Day Trade Account") that had negotiated commission free trades with a third-party brokerage firm. TMG's other clients received all other trades and therefore generally paid a higher price for their trades and bore the risk of the Day Trade Account that only received profitable day trades. As a result, TMG did not always follow the practice for trade allocation that it described in its Form ADV filings.

RESPONDENTS

2. Tellone Management Group, Inc. ("TMG") is a California corporation with a principal place of business in Anaheim Hills, California. Since July 1987, TMG has been registered with the Commission as an investment adviser (File No. 801-29982).

3. Dean C. Tellone ("Tellone"), 68, is a resident of Anaheim Hills, California. Tellone is the founder and president of TMG.

FACTS

4. During the Relevant Period, TMG's clients' accounts were in custody at a third-party brokerage firm. TMG had a master account at this brokerage firm that it used to make block trades that TMG would allocate to its clients' accounts at the end of the trading day. Because TMG utilized a trading software designed for block trading, TMG used the master account to make block trades for all of its clients.

5. On or around March 18, 2011, March 31, 2012, March 31, 2013, March 31, 2014, and March 31, 2015, Tellone signed, and TMG filed, a Form ADV Part 2A firm brochure describing how it would allocate block trades to its clients. These forms stated, in pertinent part:

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

To reinforce the objective nature in which trades are allocated, TMG will use a rotational method for allocating block trades to a group of client accounts. The rotation method is used to assure that all accounts have roughly equal access to limited trading opportunities over time. Client accounts will be grouped based upon investment profiles, risk tolerance, account features such as option and margin trading, cash availability, and commission pricing. For example, if a block trade fits a group of “aggressive growth” accounts, such accounts will be selected to participate in a rotational manner, ultimately creating equal participation by account.²

6. Likewise, TMG’s policies and procedures provided that it would identify the client accounts that would be allocated a block trade before executing a block trade, and that final allocation would be made no later than the close of market trading.

7. During the Relevant Period, TMG and Tellone used a trading strategy that resulted in two types of trades in the master account to be allocated to clients: (1) profitable day trades, and (2) buy and hold trades. At the beginning of a trading day, Tellone would make a block purchase of a security through the master account for a group of clients that followed a particular investment strategy. After the block purchase, Tellone monitored the price of the security during the trading day. If the price went up, Tellone would sometimes make a block sale of at least some of the security, thereby making a profitable day trade in the master account. Later in the day, Tellone would repurchase the amount sold through the master account, so that at the end of the day TMG had enough of the security in the master account to allocate to the group of clients for which it had initially purchased the security. As a result, clients who received the buy and hold trades generally paid a higher price for their shares of the security than they otherwise would have if TMG had not made a profitable day trade in the security.

8. During the Relevant Period, TMG allocated trades in a manner that was sometimes inconsistent with its Form ADV disclosures and failed to follow its compliance policies. In particular, TMG typically allocated the day trades with a profit of less than \$300 to the Day Trade Account even though TMG never identified the Day Trade Account as an account to be allocated a block trade before executing the block trade.

9. As a result, the Day Trade Account received risk-free and profitable day trades while TMG’s other clients effectively bore all the market risk of the Day Trade Account. Because TMG made the profitable day trade only if the price of the purchased security went up during the day, TMG’s subsequent repurchases of enough of the same security to allocate to buy and hold clients for which it had initially purchased the security generally caused those clients to purchase the security at a higher price. The Day Trade Account had an average first-day return of 0.163%, while all other TMG’s client accounts had an average first-day return of only 0.051%. The Day Trade Account therefore received \$281,009 in profits that it would not have received if it had

² TMG used a similar disclosure before March 18, 2011 in its ADV Part II client brochures.

received the 0.051% average first-day return for all other TMG clients. In addition, TMG allocated the Day Trade Account 5,861 trades, of which 99.4% were profitable day trades. By contrast, of the 20,384 trades TMG allocated to its other clients, including the other accounts owned by the individual associated with the Day Trade Account, only 61.1% had profitable first-day returns.

10. TMG and Tellone considered from time to time whether their practice of allocating only profitable day trades to the Day Trade Account unfairly benefitted the Day Trade Account.³ However, in concluding that the Day Trade Account was not unfairly benefited because the account's annual profits were generally consistent with the return of TMG's other clients, TMG failed to consider that the Day Trade Account almost always received risk-free profits, while TMG's other clients bore all the risk on the Day Trade Account's behalf. TMG and Tellone also failed to consider that its treatment of the Day Trade Account was not consistent with the disclosures in TMG's Form ADV Part 2A.

11. In approximately September 2015, TMG stopped using a day trading strategy. TMG now uses a trading tool that requires TMG to identify in advance those clients that will be allocated some of any purchase made through the master account. TMG has updated its Form ADV Part 2A to reflect these changes.

VIOLATIONS

12. Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging "in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client." A violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* As a result of the conduct described above, TMG willfully⁴ violated Section 206(2) of the Advisers Act, and Tellone caused TMG's violation.

13. Section 207 of the Advisers Act makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with

³ The Day Trade Account was for the benefit of an individual who had other accounts managed by TMG and who was not affiliated with TMG or Tellone. These other accounts were among the TMG accounts that generally paid a higher price for their trades and bore the risk of the Day Trade Account. TMG's purported reason for allocating less profitable day trades to the Day Trade Account was because the owner of the account had independently negotiated with a third-party brokerage firm for commission free trades in this account.

⁴ A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein.” As a result of the conduct described above with respect to filing misleading Forms ADV, TMG and Tellone willfully violated Section 207 of the Advisers Act.

IV.

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

Accordingly, pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

- A. Respondents shall cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 207 of the Advisers Act.
- B. Respondent TMG shall be and hereby is censured.
- C. Respondent Tellone shall be and hereby is censured.
- D. TMG shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$75,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

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

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

Payments by check or money order must be accompanied by a cover letter identifying Tellone Management Group, Inc. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert Baker, Assistant Regional Director, Boston Regional Office, Division of Enforcement, Securities and Exchange Commission, 33 Arch Street, 24th Floor, Boston, MA 02110.

E. Tellone shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$25,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

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

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

Payments by check or money order must be accompanied by a cover letter identifying Dean C. Tellone as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert Baker, Assistant Regional Director, Boston Regional Office, Division of Enforcement, Securities and Exchange Commission, 33 Arch Street, 24th Floor, Boston, MA 02110.

F. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payments of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order

granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

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

By the Commission.

Brent J. Fields
Secretary