

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of

J.S. OLIVER CAPITAL
MANAGEMENT, L.P.,
IAN O. MAUSNER, and
DOUGLAS F. DRENNAN

INITIAL DECISION
August 5, 2014

APPEARANCES: David J. Van Havermaat, John B. Bulgozdy, and Ronnie B. Lasky
for the Division of Enforcement, Securities and Exchange Commission

Ian O. Mausner, pro se and for J.S. Oliver Capital Management, L.P.

Bahram Seyedin-Noor and James de los Reyes, Alto Litigation, PC,
for Douglas F. Drennan

Jonathan S. Pressman, Wilmer Cutler Pickering Hale & Dorr LLP,
for non-party, Instinet, LLC

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

The Securities and Exchange Commission (Commission) instituted this proceeding with an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on August 30, 2013, pursuant to Section 8A of the Securities Act of 1933 (Securities Act); Section 21C of the Securities Exchange Act of 1934 (Exchange Act); Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (Advisers Act); and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). During a five-day hearing in January 2014, the Division of Enforcement (Division) presented thirteen witnesses, including two experts. Approximately 280 exhibits were admitted into evidence. The last brief was filed on April 11, 2014.¹

¹ I will cite to the transcript of the hearing as “Tr. __.” I will cite to the Division and Respondents’ exhibits as “Div. Ex. __,” “Mausner Ex. __,” or “Drennan Ex. __.” I will use similar designations in citations to the post-hearing filings. As to bates-stamped pages of exhibits, I will cite to those pages without reference to the prefix.

Issues

The issues presented are whether (1) from June 2008 to November 2009 (Relevant Period),² J.S. Oliver Capital Management, L.P. (J.S. Oliver), and Ian O. Mausner (Mausner) willfully violated the antifraud provisions of the Securities Act, Exchange Act, Advisers Act, and rules issued pursuant to those statutes by ‘cherry-picking’ favorable trades for favored client accounts to the detriment of other, unfavored client accounts; (2) from January 2009 through November 2011, J.S. Oliver and Mausner willfully violated the antifraud provisions by misusing client commission credits called “soft dollars” earned through certain broker-dealers; (3) Douglas F. Drennan (Drennan) willfully aided and abetted and caused J.S. Oliver’s violations as to certain soft dollar payments; and (4) J.S. Oliver willfully violated the Advisers Act and Advisers Act rules, and Mausner willfully aided and abetted and caused the violations. OIP at 2, 8-9.

Findings of Fact

The factual findings and legal conclusions are based on the entire record. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 101-04 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

J.S. Oliver Capital Management, L.P., and Ian O. Mausner

J.S. Oliver is a registered investment adviser, founded in 2004. Tr. 1203-05. Most of its clients are individuals and families or related entities. Tr. 1207-08; Div. Ex. 89 at 357; Div. Ex. 86 at 372. During the time at issue, J.S. Oliver was the investment manager of four affiliated hedge funds: J.S. Oliver Investment Partners I, L.P. (Fund 1),³ J.S. Oliver Investment Partners II, L.P. (Fund 2), and J.S. Oliver Offshore Investments, Ltd. (Offshore Fund), each of which opened in 2004; and J.S. Oliver Concentrated Growth Fund, L.P. (CGF), which opened in June 2008.⁴ Tr. 1235, 1241, 1243, 1245; Div. Exs. 135 at 1, 160 at 1, 411 at 1, 412 at 1. An affiliate of J.S. Oliver, J.S. Oliver Partners, LLC, was the general partner of each fund. Div. Exs. 135 at 1, 160 at 1, 411 at 1, 412 at 1. J.S. Oliver’s assets under management were approximately \$200 million in the 2005 to 2007 period, approximately \$142 million in 2008, and ranged between approximately \$98 to \$133 million in the 2009 to 2011 period. Div. Ex. 696 at Porten Ex. 2.

² More precisely, as referenced by the Division and one of its experts, the Relevant Period is the eighteen-month period from June 1, 2008, to November 30, 2009. See Div. Initial Br. at 68-69; Ex. 695a at Glasserman Ex. 1 n.1. Respondents have not objected to interpreting the OIP’s allegation in this manner.

³ Fund 1 closed in 2011 or 2012. Tr. 1239.

⁴ In this Initial Decision, Fund 1, Fund 2, and Offshore Fund are collectively referred to as the J.S. Partners Funds. Fund 1, Fund 2, Offshore Fund, and CGF are collectively referred to as the J.S. Oliver Funds.

Mausner is J.S. Oliver's co-founder; he was the firm's chief executive officer, portfolio manager, and ultimate decision maker during the time at issue; and he was the firm's chief compliance officer during the 2008 to 2009 period.⁵ Tr. 1205-07; Div. Ex. 89 at 364. Gina Maria Mausner, now Gina Kloes (Gina Mausner or Kloes), was married to Mausner from 1994 to 2005, helped him start J.S. Oliver, and was its chief financial officer (CFO) from 2004 to 2005. Tr. 475-76.

Starting around 2005, J.S. Oliver operated out of one room, in the first floor of a luxury home in San Diego, California. Tr. 571-72, 723, 1203-04. The home—which also served as Mausner's personal residence at times—was owned by J.O. Samantha LLC (J.O. Samantha), an entity owned by Mausner. Tr. 573, 1204-05, 1309. It was a small working environment, with just a handful of employees and a few consultants; working conditions were such that conversations were heard by all. Tr. 723, 735. Mausner was frequently not in the office, but he was always reachable. Tr. 579, 747-48.

In 2009 through mid-2011, the employees included Mausner; Nina Babaie (Babaie), an administrative and personal assistant to Mausner; Melanie Kartes (Kartes), who worked at J.S. Oliver as a controller/junior trader, but mostly did accounting; and Jim Donahue (Donahue), a staff accountant. Tr. 565-66, 574-81, 735, 877, 895, 1103; Div. Exs. 419, 558.

Douglas F. Drennan

Drennan worked for J.S. Oliver from its formation in 2004 to 2008, where he was an investment adviser, portfolio manager in charge of trading and allocations, and “perhaps director of research,” making \$140,000, plus a bonus, annually.⁶ Tr. 832-34, 891, 1061, 1063. Drennan left in 2008 because J.S. Oliver suffered weak performance in 2007 and there was no performance bonus. Tr. 834-35, 892. When Drennan left, J.S. Oliver had just two employees, including Mausner. Tr. 894-95. The firm Drennan joined after leaving J.S. Oliver announced staff reductions in August or September 2008, and Drennan asked Mausner to rehire him at a lunch meeting in early December 2009, but Mausner was reluctant. Tr. 835-36, 1068-69, 1261-62. Drennan raised the possibility of starting his own research consulting business and having J.S. Oliver as one of his clients, which would pay him using soft dollars to do research. Tr. 837-38. Drennan testified that from about January 2009 to mid-2011, he was an employee of Powerhouse Capital (Powerhouse), a research firm he founded in February 2009, whose only

⁵ Mausner received a bachelor of arts degree in economics from Amherst College in 1982 and a master of business administration (MBA) degree from Stanford Business School in 1985. Tr. 1200. From 1985 to 2004, Mausner was employed by Morgan Stanley, Kidder Peabody, and Montgomery Securities (now Banc of America Securities). Tr. 1200-03; Div. Ex. 89 at 364.

⁶ Drennan received a bachelor of science degree in finance from the University of Illinois in 1994 and has worked in the securities industry since that time. Tr. 828, 1060-61. He was a chartered financial analyst from approximately 2001 to mid-2014, and he held a series 65 securities license from 2000 to 2003. Tr. 829; Div. Ex. 86 at 379-80. Drennan previously worked for Merrill Lynch in Chicago, Merrill Lynch Canada, TD Securities in Montreal, and YCMNET Advisors in California. Tr. 830-832.

client was J.S. Oliver. Tr. 873-74, 956-62; Div. Ex. 80. Powerhouse did not have a written contract with J.S. Oliver. Tr. 889.

During the January 2009 to mid-2011 time period, Powerhouse was paid for Drennan's services using soft dollars generated from J.S. Oliver accounts with various brokers; Drennan, in turn, was paid by Powerhouse. Tr. 873-75, 895-97, 959-62. Beginning in mid-2011, J.S. Oliver employed Drennan as its chief compliance officer and portfolio manager, and paid Drennan as an employee of the firm, initially with soft dollars. Tr. 873-74, 1155. Drennan closed Powerhouse in 2012. Tr. 876.

Cherry-Picking Scheme

Trading Allocation

Mausner was the only one who could make the determination that J.S. Oliver would do a block trade, the shares of which Mausner would then allocate among different accounts. Tr. 1209-11. After executing trades with an executing broker, J.S. Oliver used its prime broker, BNP Paribas Prime Brokerage, Inc. (BNP), to allocate or distribute shares among accounts using BNP's Order Management System (OMS).⁷ Tr. 139-41, 147-48, 1211. With OMS, an investment adviser can use a predefined allocation schema, which is a preset methodology for distributing shares among accounts that is established prior to stock purchases; implementation of an allocation schema protects against allocation errors. Tr. 141-42, 147, 155; see Div. Ex. 278. During the Relevant Period, Mausner frequently overrode the preset allocation and, instead, manually allocated trades on many occasions. Tr. 150-59, 1213-14; Div. Exs. 601, 602. Mausner performed the vast majority of allocations in OMS, or other J.S. Oliver employees performed them at his instruction. Tr. 1212-13.

Use of BNP's OMS does not exclude the possibility of cherry-picking because an investment adviser could change the allocation schema or manually allocate trades after they are purchased; however, this is not the general practice.⁸ Tr. 164-66. On the other hand, manual allocations do not necessarily indicate wrongdoing when an allocation schema is in place, but manual allocations tend to be an exception rather than a rule. Tr. 172.

J.S. Oliver's compliance manual called for allocations on a fair and equitable basis and provided that where an aggregate order is executed in a series of transactions at various prices on a given day, each participating account's proportionate share of such order would reflect the

⁷ "Hedge fund managers frequently prefer to trade with several executing brokers, yet receive centralized custody, clearing and settlement, financing, recordkeeping and other services from one source, known as the 'prime broker[.]'" Thomas P. Lemke et al., Hedge Funds and Other Private Funds: Regulation and Compliance § 2:3 (West 2014). BNP provides a variety of services to its customers, generally investment managers and hedge funds. Tr. 138. J.S. Oliver was a BNP customer from October 2008 to March 2012. Tr. 147, 152-53.

⁸ As used in this Initial Decision, the term cherry-picking means deliberately allocating the most profitable securities among block transactions to particular J.S. Oliver customers.

average price paid or received of the total order. Tr. 1222-23; Div. Ex. 413 at 13814-15. Jason Radzik, a product manager with BNP's Global Equity Commodity Derivatives Department, testified that it is common for the same security to be purchased or sold multiple times and at different average prices, but if the same allocation schema is used for each trade, then the same ratio and percentage in terms of loss or gain will be applied to each account. Tr. 169.

J.S. Oliver had high trading levels in 2009, ranging from ten to fifty trades a day. Tr. 1064. J.S. Oliver was the subject of numerous, potential cherry-picking review reports from BNP during the Relevant Period. Tr. 161-64; Div. Ex. 402. BNP generated these reports to alert its clients, such as investment managers, to variances in how particular accounts were treated as to a specific security on a given day. Tr. 161; Div. Ex. 402. Mausner denied that he ever received such a report, but the record establishes that BNP reported more than 4,000 instances of potential cherry-picking at J.S. Oliver, and Mausner was forced to acknowledge that BNP emailed him one on November 6, 2009, regarding trades from October 26-27, 2009, that were allocated in a way that caused differences of over \$1,000 between different accounts. Tr. 1215-16; Div. Exs. 399, 695a at 16. To avoid such varied allocations in the future, BNP recommended that Mausner allocate with average prices. Div. Ex. 399. But, as Mausner testified, J.S. Oliver did not use average prices to allocate trades on many occasions. Tr. 1217. My independent review of the BNP potential cherry-picking reports reveals numerous, significant disparities in how shares were allocated, and the resulting dollar benefit or harm, among accounts for trades in the same stock on the same day. See Div. Ex. 402.

Division's Expert Witness on J.S. Oliver's Trading Activity

Professor Paul Glasserman (Glasserman), a professor at Columbia Business School, testified for the Division with respect to J.S. Oliver's trading activity.⁹ Tr. 109-10, 135; Div. Ex. 695a at 1, 3-5 & App. A at 1.¹⁰ Glasserman found overwhelming evidence that Mausner engaged in cherry-picking during the Relevant Period:

I find extremely strong statistical evidence that from June 2008 to November 2009, Mr. Mausner and J.S. Oliver systematically allocated a disproportionately large share of equity trades with positive first-day returns ("profitable trades") to six favored client accounts (the "Favored Accounts"), and systematically

⁹ Glasserman has been the Jack R. Anderson Professor of Business at Columbia Business School since 2000, has taught at Columbia since 1991, and presently teaches graduate courses in statistics and finance. Div. Ex. 695a at 1 & App. A; Tr. 109. He earned an undergraduate degree from Princeton University in mathematics and a Ph.D. in applied mathematics from Harvard University. Div. Ex. 695a at 1; Tr. 109.

¹⁰ The Division notified Respondents shortly before the hearing began that certain references had been deleted in two paragraphs of Glasserman's report; no new material was added to the report. Tr. 110-12, 116-17. Mausner claimed the deletions were significant and asked for additional time to study the changes and do some research. Tr. 112-15, 134-35. I ruled that we would proceed because the issue was the material being offered into evidence, not what might have been offered. Tr. 111-17, 134-35.

allocated a disproportionately large share of equity trades with negative first-day returns (“unprofitable trades”) to three other client accounts (the “Disfavored Accounts”). The Favored Accounts are the four J.S. Oliver Funds accounts, Status-One Investment Partners, and the Taube Family Trust. The Disfavored Accounts are the Coleman Trust, the Sapling Foundation, and Chelsey Capital. The Favored and Disfavored Accounts collectively accounted for approximately 98% of J.S. Oliver’s total trading volume during the Relevant Period. Thus Mr. Mausner’s conduct was not isolated, but rather affected virtually all of J.S. Oliver’s equity trading on behalf of its clients.

Div. Ex. 695a at 3.

Glasserman’s analysis considered whether intraday price changes influenced whether individual J.S. Oliver accounts received favorable or unfavorable shares based on their first-day returns. Tr. 126; Div. Ex. 695a at 5. Glasserman found a very strong link between intraday performance and allocation across accounts, that stock prices of multiple purchases of the same stock on the same day were allocated so as to systematically favor some accounts and disfavor other accounts, and that the Favored and Disfavored Accounts participated in substantially the same stock purchases and same trades. Tr. 123, 126; Div. Ex. 695a at 3-5, 18. He calculated that on an annualized basis, the average first-day returns on the Favored Accounts was 35%, compared with -96% for the Disfavored Accounts. Div. Ex. 695a at 4, 12-13. Glasserman found that the probability that the allocation of profitable and unprofitable trades between Favored and Disfavored Accounts occurred by chance was essentially zero, and that alternative explanations posited by Mausner for the different outcomes between accounts did not impact the statistical results. Id. at 3-5, 17-23.

Glasserman operated from the principle that in the absence of cherry-picking, the proportions of profitable and unprofitable transactions allocated to an individual account should be similar (Proportional Outcomes), i.e., if J.S. Oliver and Mausner allocated an account 20% of a block purchase, it would receive 20% profitable transactions and 20% unprofitable transactions.¹¹ Div. Ex. 695a at 6. To support the principle of Proportional Outcomes, Glasserman relied on empirical evidence that (1) in the seventeen months prior to the Relevant Period, the distribution of favorable and unfavorable transactions was roughly proportional across client accounts; and (2) the J.S. Oliver Funds and Disfavored Accounts traded in nearly identical sets of stocks, and the J.S. Oliver Funds participated in the vast majority of trades in which the Disfavored Accounts participated. Id. at 6-7. As further support, he cited testimony from employees and third-party financial services firms that worked with J.S. Oliver indicating that J.S. Oliver generally allocated trades proportionally across client accounts. Id. at 7. Glasserman explained that if J.S. Oliver and Mausner in fact allocated shares in a manner independent of first-day returns, then as a matter of statistics the proportion of shares from the most profitable and least profitable transactions allocated to an individual account should be approximately equal, and the summary measure of disproportionality should not be statistically different from zero. Id. at 8, 11.

¹¹ As explained supra, Mausner acting through J.S. Oliver made block purchases of trades, which Mausner then allocated to individual accounts.

Disparities in Allocation of Equity Transactions Across Client Accounts

In his statistical analysis, Glasserman rejected the null hypothesis, which is that no cherry-picking occurred, because he observed differences in the allocations to be statistically significant.¹² Div. Ex. 695a at 8, 10. First, Glasserman found that during the Relevant Period, J.S. Oliver and Mausner allocated a disproportionately large number of shares from profitable transactions to the Favored Accounts, and a disproportionately large number of shares from unprofitable transactions to the Disfavored Accounts.¹³ *Id.* at 9. Specifically, he found that Mausner allocated (1) to CGF 33.49% of shares from all transactions, but 37.10% of shares from all profitable transactions; (2) to the Sapling Foundation account 11.31% of shares from all transactions, but only 7.03% of shares from profitable transactions; (3) to the Chelsey Capital account 6.14% of shares from all transactions, but only 4.10% of shares from profitable transactions; and (4) to the Coleman Trust account 6.87% of shares from all transactions, but only 4.67% of shares from profitable transactions. *Id.* Although “these disparities may appear small in magnitude,” Glasserman concluded that “they are highly statistically significant and cannot be attributed to chance fluctuations.” *Id.* Glasserman found that the more profitable the trade, the more likely it was allocated to one of the J.S. Oliver Funds and the less likely it was allocated to the Disfavored Accounts. *Id.* at 10. For example, CGF, Fund 1, Offshore Fund, and Fund 2 received 37.53%, 13.34%, 11.42%, and 14.09%, respectively, of the most profitable transactions, while the Sapling Foundation account received 5.31%, the Chelsey Capital account received 2.79%, and the Coleman Trust account received 3.81%. *Id.* & Glasserman Ex. 1.

Second, Glasserman found that for the eight J.S. Oliver client accounts that collectively accounted for approximately 95% of the dollar volume of J.S. Oliver’s trading, the difference in the allocation of shares from the most profitable and the most unprofitable transactions was highly significant.¹⁴ Div. Ex. 695a at 11. If cherry-picking did not occur, then the Proportional Outcome would be that the proportion of profitable and unprofitable shares allocated to an

¹² In standard statistical methodology, the null hypothesis is assumed to hold unless the probability of observed data given this assumption is so low, generally less than 5%, that the null hypothesis is rejected as false. Div. Ex. 695a at 8 n.19.

¹³ Glasserman conducted this analysis (1) by computing first-day returns for all equity transactions that appear in the J.S. Oliver trade blotter from January 1, 2007, to November 30, 2009, which included more than 39,000 allocations of block trades executed on behalf of one or more J.S. Oliver clients during the Relevant Period and the prior seventeen-month period; and (2) by then computing and comparing, for each account, the fraction of shares from all transactions allocated to that account, and the fraction of shares from transactions with positive first-day returns allocated to the same account. Div. Ex. 695a at 9.

¹⁴ To reach this conclusion, Glasserman constructed a summary measure of the disproportionality in allocation of transactions across accounts; for each account, Glasserman computed the difference between (a) the proportion of shares allocated to the account from the most profitable trades (those in the top 25%) and (b) the proportion of shares allocated to the account from the most unprofitable trades (those in the bottom 25%). Div. Ex. 695a at 10.

account should be approximately equal. Id. Glasserman found that this did not occur. For example, each J.S. Oliver Fund was allocated between 9.53% and 33.49% of all transactions, but received from 11.42% to 37.53% of the most profitable trades, and between 6.72% and 25.34% of the least unprofitable trades; whereas, the Sapling Foundation account was allocated 11.31% of all transactions, but received 5.31% of the most profitable trades and 20.62% of the least profitable trades. Id. & Glasserman Ex. 2. The probability of each of these individual outcomes occurring by chance was either zero or less than 0.50%. Id. at Glasserman Ex. 2. Glasserman observed that the chance occurrence of these disparities in the allocation of most profitable and least profitable trades was approximately one in one quadrillion (1 in 10^{15}). Id. at 11.

Third, Glasserman found that the average first-day returns on equity transactions varied widely across J.S. Oliver accounts during the Relevant Period and were distributed in three clusters:

- (1) The Favored Accounts realized the highest first-day returns of all client accounts, averaging first-day returns of 0.12%, or 35.2% on an annualized basis, and accounting for more than 78% of trading volume on a dollar basis. Div. Ex. 695a at 12.
- (2) The Disfavored Accounts realized the lowest first-day returns across all twenty-five client accounts, averaging first-day returns of -1.31%, or -96% on an annualized basis, and accounting for approximately 20% of trading volume. Id. at 13.
- (3) An additional sixteen accounts that collectively accounted for a very small fraction of trading volume during the Relevant Period had mixed results and were deemed neutral. Id.

Further, Glasserman summarized allocation proportions and first-day returns at an aggregate level: the Favored Accounts received 73% of shares from all transactions, but 82% of profitable transactions (i.e., with a positive or zero first-day return) and 65.9% of shares of unprofitable transactions (i.e., with negative first-day return); whereas, the Disfavored Accounts received 24.3% of shares from all transactions, but 15.8% of shares of profitable transactions and 31.1% of shares of unprofitable transactions. Div. Ex. 695a at 13 & Glasserman Ex. 4. Glasserman found that the difference in average first-day returns between the Favored and Disfavored Accounts was 1.43%. Id. & Glasserman Ex. 4. The probability that these results occurred by chance is zero. Id. & Glasserman Ex. 4.

Glasserman also found that the relationship between first-day returns for the Favored and Disfavored Accounts changed dramatically in June 2008, the beginning of the Relevant Period. Tr. 130; Div. Ex. 695a at 13-14 & Glasserman Ex. 5. In sixteen of seventeen months during the January 2007 through May 2008 period (i.e., immediately prior to the Relevant Period), the average first-day returns of the Favored and Disfavored Accounts tended to move in the same direction, but during the Relevant Period from June 2008 to November 2009, the relationship changed. Div. Ex. 695a at 13-14 & Glasserman Ex. 5. In fourteen of eighteen months during the Relevant Period, the monthly average first-day returns for the Favored and Disfavored Accounts were of the opposite sign, in that the Favored Accounts had positive returns while the Disfavored Accounts had negative returns, and the magnitude of negative returns for Disfavored Accounts

was generally larger than from January 2007 to May 2008. Id. at 14 & Glasserman Ex. 5. Because the Favored and Disfavored Accounts comprised 98.6% of the dollar volume of all J.S. Oliver equity trading during the Relevant Period, the scope of the alleged cherry-picking involved the entire enterprise. Id. at 14-15.

Allocation of Same-day, Same-Security Transactions

Glasserman opined that his analysis of Mausner's allocation of same-day, same-security transactions provided "further statistical evidence of cherry-picking," as they involved specific instances of allocation of the same securities to different J.S. Oliver accounts at different prices on the same day. Div. Ex. 695a at 15 (formatting altered). In support, Glasserman detailed allocations on January 27, 2009, October 15, 2008, and March 23, 2009, that were identified in compliance reports generated by BNP, which showed that rather than allocate shares at the average price obtained over the course of the day, one or more of the Disfavored Accounts would receive the shares purchased at the higher price. Id. at 15-16.

As Glasserman noted, BNP reported more than 4,000 transactions of potential cherry-picking during the Relevant Period. Div. Ex. 695a at 16. Based on the BNP data, Glasserman found that from October 1, 2008, through November 30, 2009, the Favored Accounts had a 83.7% share of all transactions, 90.4% share of favorable transactions, and 77.5% share of unfavorable transactions; whereas, the Disfavored Accounts had a 14.9% share of all transactions, 8.3% share of favorable transactions, and 21.1% share of unfavorable transactions. Id. at 17 & Glasserman Ex. 7. The probability that these outcomes occurred by chance is one in one quadrillion, or zero. Id. at Glasserman Ex. 7. On an annualized basis, the average first-day returns for the same-day, same-security trades showed that the Favored Accounts realized a return of 22%, while the Disfavored Accounts realized a negative return of -99.7%; the probability that these outcomes occurred by chance is less than one in one quadrillion. Id. at 16. Glasserman opined that this statistical evidence demonstrates that the underlying pattern of transaction allocation in same-day, same-security transactions was not random but systematic. Id. at 17.

Controlling for Differences in Stocks

To assure that his conclusions were robust, Glasserman did additional analyses demonstrating that both results—biased trade allocations and a large disparity in first-day returns—persist at high levels after controlling for differences in stocks traded by the Favored and Disfavored Accounts. Div. Ex. 695a at 17-19. Moreover, the Favored and Disfavored accounts traded substantially the same stocks and trades: the stocks traded by the Disfavored Accounts as a group accounted for 97% of the total dollar volume of the equity trading in the Favored Accounts during the Relevant Period; and the trades in which the Sapling Foundation, Coleman Trust, and Chelsey Capital were allocated shares accounted for over 81%, 90%, and 87%, respectively, of the trades in which shares were also allocated to one or more Favored Accounts. Id. at 18 & Glasserman Ex. 8; Tr. 121, 128-29, 131.

Glasserman further concluded that systematic, disproportionate allocation of profitable transactions caused the disparity in average first-day returns between Favored and Disfavored

Accounts: “The Disfavored Accounts realized first-day returns of -1.31%, while the Favored Accounts realized first-day returns of 0.11% *from the same set of stocks.*” Div. Ex. 695a at 19 & Glasserman Ex. 9.

Considering Other Potential Explanations

Glasserman found that Mausner’s explanations for the differences in allocations did not explain or account for the bias allocation that Glasserman observed in the statistical data. Div. Ex. 695a at 19-23. First, insofar as Mausner asserted that CGF had a different strategy and was a “short-oriented” fund that relied on short sales, the use of put options,¹⁵ and a larger cash position, Glasserman (1) opined that the use of put options is irrelevant because his analysis excluded options and focused solely on first-day returns on equity trades; and (2) controlled for the purported effects of a short-oriented strategy in two ways—by excluding from the analysis CGF and all short positions that appear in the J.S. Oliver trade blotter—and yet found no material effect on the results. *Id.* at 20-21 & Glasserman Ex. 10.

Second, insofar as Mausner asserted that different clients may have received the same stock on the same day at different prices because it was not his practice to allocate different same-day, same-security trades at average prices if the trades were executed in support of different investment strategies (such as long-term, buy-and-hold strategy), Glasserman found that controlling for this practice magnified rather than mitigated his findings. *Id.* at 21. Specifically, after excluding allocations of same-day, same-security trades held by the Favored Accounts for less than ten days (thus eliminating purported disparity in allocations attributable to the difference between short-term trading and long-term investments), the average first-day return for same-day, same-security trades held by the Favored Accounts for ten days or more was 1.33% per day (or an astronomical 2692% on an annualized basis), whereas the first-day return to the Disfavored Accounts was -1.91% per day (or -99% on an annualized basis). *Id.* at 22 & Glasserman Ex. 11.

Third, insofar as Mausner asserted that discrepancies in allocations resulted from market volatility, Glasserman controlled for volatility by excluding—from the analysis of same-day, same-security trades—those trades that were executed on the ten days during the Relevant Period in which the Dow Jones Industrial Average changed by 500 points or more, and found no impact on the results. *Id.* at 22-23 & Glasserman Ex. 12.

Fourth, in response to Mausner’s questions on cross-examination whether various trading strategies and considerations (such as specific margin limits, risk tolerance, asset allocation, and trade and frequency preferences) were addressed in Glasserman’s report, Glasserman testified that those issues were not relevant. Tr. 124-26. Glasserman reiterated that the Favored and Disfavored Accounts participated in substantially the same stocks and trades. Tr. 126, 128-29, 131. Glasserman also testified that regardless of what may have led to such purchase decisions, once the block trades were executed, the question his analysis addressed was whether the change in price over the course of a day influenced trade allocation among the accounts. Tr. 126-27.

¹⁵ Options comprised less than 1% of the dollar volume of trading by the Disfavored Accounts. Div. Ex. 695a at 6.

Impact

Finally, Glasserman computed the impact of J.S. Oliver's cherry-picking—the difference between the Disfavored Accounts' first-day profits and what those profits would have been absent cherry-picking—at approximately \$10.9 million.¹⁶ Div. Ex. 695a at 23 & Glasserman Ex. 13.

Performance of the Sapling Foundation Account

Christopher Anderson (Anderson) transferred funds of the non-profit Sapling Foundation (Sapling) to J.S. Oliver's management in 2006 and 2007, totaling approximately \$30 million.¹⁷ Tr. 30, 69-70. Sapling funds were invested in a separate account and not in any of the J.S. Oliver Funds. Tr. 35-36, 49-51. Anderson signed an investment management agreement with J.S. Oliver, but his relationship with Mausner was based on trust and he considered Mausner a friend.¹⁸ Tr. 16, 26-27, 74; Div. Ex. 4.

Anderson wanted Sapling funds invested in companies that would achieve growth over the long term, and Anderson and Mausner agreed on an approach in how to allocate the funds. Tr. 20-21, 70. Anderson understood that Mausner would select high quality equities and invest in them over the long term, and that Mausner would not invest the funds in options or take unnecessary risks to the account. Tr. 85. Anderson relied on Mausner as his investment adviser for the Sapling account and received occasional emails from Mausner in 2006 and 2007 indicating that the account was doing quite well.¹⁹ Tr. 30-34; see, e.g., Div. Ex. 8.

Anderson had a face-to-face meeting with Mausner in October 2008 and was frustrated that Mausner, "charming" as usual, could not provide any specific information on the Sapling account, not even the account balance. Tr. 37-38. Shortly thereafter, Anderson requested that Mausner provide him with regular reports that showed, at a minimum, the balance in the account

¹⁶ The Sapling Foundation lost nearly \$6 million, Chelsey Capital lost approximately \$2.7 million, and Coleman Trust lost approximately \$2.2 million. Div. Ex. 695a at Glasserman Ex. 13.

¹⁷ Anderson is an Oxford University graduate. Tr. 73-74. He is curator of Sapling, a foundation whose goal is to leverage the power of ideas, media, and technology to make a global impact on issues that matter. Tr. 12-13. He also heads the TED (Technology Entertainment Design) organization, which was purchased by Sapling in 2001. Tr. 11. As curator of Sapling, he leads TED's team of 120 people who manage TED conferences and Internet talks. Tr. 13.

¹⁸ During the 1998 to 2000 period, Mausner, then associated with Montgomery Securities, did quite well in managing Anderson's personal account and the Sapling account in a rising market. Tr. 13-14, 77-78, 85.

¹⁹ Bank of America sent monthly account statements to Sapling, which Anderson sent to an accountant and did not review monthly. Tr. 31.

and how the funds had performed, as compared with both domestic and global benchmarks. Tr. 38. As Anderson would later learn, Mausner reported to investors in November 2008 that one of the J.S. Oliver Funds, the CGF, gained 12.87% despite market declines, while the Sapling account lost 15% in October 2008.²⁰ Tr. 65-66, 1260-61; Div. Exs. 13, 378.

In January 2009, Mausner sent Anderson the first monthly update, reporting that for the prior year, “the portfolio was down 37.6% versus 38.48% and 47.3% for the S&P 500 and the blended world index,” but that for December 2008, “the portfolio was up 2.35% versus only .78% for the S&P 500 and 2.2% for the blended world index.” Div. Ex. 10; Tr. 39. The account balance, Mausner reported, was just over \$15 million. Div. Ex. 10. Anderson was shocked that the portfolio had lost \$10 million in value, but attributed the loss to market conditions, not management of the portfolio. Tr. 39; Div. Ex. 10. As Anderson learned in the summer of 2009, the information Mausner provided for 2008 was inaccurate; in 2008, the account actually lost 47% to 48%, not 37.6%, which “was massively worse than the S&P 500” and in line with the fall in the world index. Tr. 39-42.

Anderson became really concerned when he received an email from Mausner in April 2009, stating that the account had a value of about \$12 million and was up 2.97% so far in April, essentially flat in March, and still down for the year. Tr. 43; Div. Ex. 11. Anderson’s personal funds and the rest of the market had done well in March, so he had expected the Sapling account to rebound. Tr. 43. Later, Anderson learned that the Sapling account lost money in March 2009, whereas the market was up 15% to 20%. Tr. 43-44. When Anderson asked Mausner what had happened to the account’s value when the market was “up 20% from its lows,” Mausner provided a one sentence response: “your account is up considerably from its lows so it has had a good move!” Tr. 44; Div. Ex. 11. Anderson considered Mausner’s response ridiculous, and requested consistent reporting on performance versus the S&P 500 and the MSCI global equity index, as well as an asset breakdown by sectors. Tr. 44; Div. Ex. 11. Mausner replied with an apology and one-page explanation, which Anderson later learned bore no relation to the truth. Tr. 45; Div. Ex. 11.

In May 2009, Anderson was shocked when a friend raved about how, when the market was plunging in 2008, Mausner’s new fund had grown 60%. Tr. 46-48. Anderson asked Mausner in early June 2009, how his “main fund ha[d] done really, really well relative to the market, both last year and this [year]. Why the difference?” Div. Ex. 15; Tr. 46-48. Mausner replied that the “entire difference was due to options.” Div. Ex. 15. Anderson found this to be “a puzzle.” Tr. 48-49. He testified that although the investment management agreement gave Mausner permission to trade options in the Sapling account, they agreed that the Sapling funds should be subject to limited risk so that aggressive strategies like options should not be used. Tr. 48-49, 85.

Anderson was “shocked beyond measure” when Mausner reported on August 6, 2009, that the Sapling account was down 9.46% for the year when he understood that the S&P 500 and

²⁰ During his testimony, Anderson refers, at times, to Mausner’s fund or to a J.S. Oliver fund, but did not know the fund’s name; based on the other record evidence, such references are understood to mean the CGF.

global benchmark were up 7% or 8%, respectively. Tr. 52-54; Div. Ex. 12. When Anderson pointed out to Mausner that the account underperformed 17% compared to the global market's benchmark, Mausner suggested that Anderson consider adding options as an investment strategy. Div. Ex. 12. Anderson rejected the suggestion and asked for a report, by the week's end, of every position bought and sold, and the gains and losses in each instance from the time Mausner took over the account. Div. Ex. 12. Anderson testified: "This was basically the moment where every red flag was waving, alarm bells ringing." Tr. 55.

On August 18, 2009, Anderson repeated his request for a report on the Sapling account's performance for March 2009, as it seemed that the year's disastrous performance stemmed from that month, and he asked how the J.S. Oliver fund did in March. Div. Ex. 14. Mausner dismissed Anderson's concerns and stated that his numbers were incorrect because, according to Mausner, the S&P 500 was up 8.54% in March 2009 and Sapling was down 2.08%. Id. Mausner stated that although how his fund did was proprietary information, the fund did well, mostly from options, and he suggested a meeting with Anderson. Id.; Tr. 57.

Anderson responded that he was too upset and wanted answers; he asked Mausner to specifically tell him what he was able to do in his fund that he could not do in the Sapling account in March 2009. Div. Ex. 14. Mausner replied: "The main difference between the fund and your account is options trading and hedging. **Otherwise, other than a higher allocation to emerging and international markets, they are virtually identical.**" Div. Ex. 16 (emphasis added); Tr. 58. Anderson found Mausner's explanation "baffling" and could not understand how trading in equity securities could produce a result "dramatically one way," while the strategy of trading in securities plus options could produce a result "dramatically the other way." Tr. 58-60.

To answer that question, Anderson prodded Mausner for trading data, which Anderson obtained, put into spreadsheets, and analyzed around August 2009. Tr. 60-61. Anderson's detailed study of the Sapling account records revealed that:

- 1) From as early as 2007, Mausner's reports on the account's status had been misleading, as there had been a divergence between performance and benchmarks. Tr. 61.
- 2) Trading volume in the account increased as the value of the account dropped; the account held securities under a buy-and-hold strategy that had done well, while other securities were actively traded, and losses occurred in the actively traded portion of the account. Tr. 61-62, 78-79.
- 3) In 2008, Mausner aggressively shorted some securities in the Sapling account and he lost money in almost every situation; however, shorts on the same securities held in Mausner's fund made substantial money. Tr. 62-64.
- 4) In March 2009, when the Sapling account was valued at about \$13 million, Mausner engaged in aggressive day trading and lost \$400,000 on one stock in the account, Apollo; but in the same month, Mausner's fund made substantial money trading on the same stock. Tr. 63-64, 83.

In September 2009, Anderson closed the Sapling account, which was valued at \$11.5 million, and initiated an arbitration proceeding. Tr. 67-68, 70, 1345. In connection with Anderson's legal action, an expert found overwhelming evidence of cherry-picking and other instances of malfeasance by Mausner. Tr. 68. For example, of the twenty trades of Apollo in March 2009, the expert found that nine trades with the worst losses were allocated to the Sapling account and the eight most profitable trades were allocated to the J.S. Oliver fund.²¹ Tr. 68-69. Anderson testified that according to the expert the chance of this happening randomly was one in a trillion. Tr. 69. Also, according to the expert, the J.S. Oliver hedge funds had lost money on option trades and those funds had performed well because of the cherry-picking strategy. Tr. 69.

Anderson estimated that the Sapling account lost about \$12.5 million as result of Mausner's actions. Tr. 69-70. The original investment was \$30 million and \$4 million was withdrawn for grants; Anderson testified that a reasonable return on the \$26 million during the time period, considering the agreed upon investment strategy, would have resulted in a fund value of \$24 million at the time the account was closed. Tr. 70. Anderson disagreed with Mausner that a falling market caused the losses. According to Anderson, while Mausner was advising the Sapling account, the markets initially went up, then down sharply, and then recovered strongly. Tr. 86. Anderson settled with Mausner for \$7 million when Mausner threatened to file for bankruptcy, but received less than \$5 million after Mausner threatened to file for bankruptcy a second time. Tr. 71, 89.

Creation, Promotion, and Performance of the CGF Fund

Mausner formed CGF around June 2008 as a new fund, with an investment of his own money. Tr. 1246, 1249; Div. Ex. 189. Over the next several months, Mausner emailed current and prospective investors to promote CGF's positive monthly returns during the economic crisis, and he strongly recommended that they invest in the fund. Tr. 34-35, 808-21, 1250-61; Div. Exs. 9, 374-79. For example, in November 2008, Mausner sent an email stating that CGF had gained 12.87% when the S&P 500 declined almost 16.9% during the same period. Tr. 1260-61; Div. Ex. 378.

For 2008, CGF paid J.S. Oliver \$224,600 in performance fees. Tr. 1247-48; Div. Ex. 189. CGF paid a performance fee of 20% of net profits and a 2% annual management fee; the J.S. Partners Funds paid performance fees of 20% of net profits (or net asset value) and a 1% annual management fee. Tr. 1239-44, 1246-47; Div. Ex. 135 at 3, 13; Div. Ex. 160 at 2, 4; Div. Ex. 411 at 2, 4; Div. Ex. 412 at 4, 15. Fund 1 was profitable in only one or two of its early years before 2008, and, overall, the J.S. Partners Funds were not profitable after 2008; the result was that J.S. Oliver could not earn performance fees from the J.S. Partners Funds after June 2008. Tr. 1240-44. Meanwhile, CGF was profitable in 2008 and received a sizable portion of profitable trades during the Relevant Period. Tr. 1247-48. Separately managed client accounts,

²¹ Apollo trades in March 2009 were the subject of BNP potential cherry-picking reports, some of which show massive disparities in harm incurred to one or more of the Disfavored Accounts versus the benefit incurred to one or more of the Favored Accounts on the same day. See Div. Ex. 402, Reports dated 3/4/09, 3/12/09, 3/16/09, 3/17/09.

such as the Sapling account, generally paid lower management or advisory fees, or had caps on the performance fees. Tr. 1230-33; Div. Ex. 4 at 2-3.

Impact on Investment Decisions

The record primarily focuses on the benefits incurred by the Favored Accounts and harms incurred by the Disfavored Accounts as a result of J.S. Oliver and Mausner's trading practices. Even so, investor testimony establishes that such trading practices, if known, would have affected investment decisions by investors in the Favored Accounts. Lynn Hall (Hall), an investor in Fund 1, testified that it would have absolutely mattered to her if J.S. Oliver was allocating favorable priced trades to certain clients and unfavorable trades to other clients. Tr. 787-89, 795; Div. Ex. 363. She would have pulled out her money immediately if she knew that such disproportionate trading allocation was taking place, even if she was receiving the favorable allocations. Tr. 795-96. Hall emphasized that she invested with J.S. Oliver because she trusted Mausner and expected fair treatment. Tr. 795.

Soft Dollar Misuses

Overview

“The term ‘soft dollars’ is not specifically defined in any rule or statute and at times is used expansively to describe a variety of brokerage trading practices.” Thomas P. Lemke and Gerald T. Lins, Soft Dollars and Other Trading Activities § 1:1 (West 2013). Generally, soft dollars are client commission credits generated from transactions in funds and client accounts, under an arrangement between a broker-dealer and investment adviser, which the adviser, in turn, uses to pay for research, brokerage, or other products, services, or expenses.²² See Thomas P. Lemke et al., Hedge Funds and Other Private Funds: Regulation and Compliance § 6:6 (West 2014) (Regulation and Compliance); S Squared Tech. Corp., Advisers Act Release No. 1575 (Aug. 7, 1996), 62 SEC Docket 1560, 1561. Soft dollars are assets of the client, not the investment adviser.²³ Tr. 253, 1267; see Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, 71 Fed. Reg. 41978,

²² “The Commission has defined soft dollar practices as arrangements under which products or services other than execution of securities transactions are obtained by an adviser from or through a broker-dealer in exchange for the direction by the adviser of client brokerage transactions to the broker-dealer.” Commission Office of Compliance, Inspections and Examinations, Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers, and Mutual Funds § II (Sept. 22, 1998), available at <http://www.sec.gov/news/studies/softdollar.htm>. Under soft dollar arrangements such as those at issue here, the investment adviser causes its funds or client accounts to pay a commission that is higher than the lowest commission rate available from other broker-dealers that provide only basic execution services. Regulation and Compliance § 6:6; Tr. 253, 1267.

²³ Soft dollars contrast to “hard dollars,” which refers to “when a fund manager [or investment adviser] pays for research or ancillary brokerage services directly with its own money, rather than using commissions from fund or client accounts.” Regulation and Compliance § 6:6.

41978-80 (July 24, 2006) (Commission Guidance). Exchange Act Section 28(e), 15 U.S.C. § 78bb(e)(1), “establishes a safe harbor that allows money managers to use client funds to purchase ‘brokerage and research services’ for their managed accounts under certain circumstances without breaching their fiduciary duties to clients.” Commission Guidance, 71 Fed. Reg. at 41978.

At issue and as detailed below, the Division challenges the following soft dollar uses: (1) a \$329,365 reimbursement to J.S. Oliver for a lump-sum payment to Kloes (Kloes payment); (2) \$482,381 in payments to Powerhouse in 2009 and 2010, for Drennan’s purported research services to J.S. Oliver (Powerhouse payments); (3) \$300,000 in rent payments to J.O. Samantha (rent payments); and (4) \$40,094 in payments to cover fees for Mausner’s timeshare at the St. Regis Residence Club in New York City (timeshare payments).

J.S. Oliver Expands Its Soft Dollar Activity

Prior to 2009, J.S. Oliver used approximately \$100,000 in soft dollars annually; in 2009, its use of soft dollars increased dramatically to pay a lot of its expenses.²⁴ Tr. 632, 647, 680, 898; Div. Ex. 39; Div. Ex. 696 at Porten Ex. 5. In early 2009, Drennan, with Mausner’s approval, negotiated soft dollar commission accounts with executing brokers Instinet and BTIG, whereby clients paid a commission consisting of an execution fee that the broker kept and a soft dollar component that was set aside in the client’s account.²⁵ Tr. 397, 526, 844-45, 897, 1265-66; Div. Exs. 306, 456. Soft dollar credits were generated through trading in J.S. Oliver fund accounts and individual client accounts. Tr. 1267. Instinet honored J.S. Oliver’s request to use soft dollars for expenses that fell both within and outside of Section 28(e), whereas BTIG limited its soft dollar program to expenses within Section 28(e). Tr. 528, 1269.

Mausner approved all soft dollar submissions either in person or by authorizing the use of a signature stamp; Kartes, at either Mausner or Drennan’s direction, would create and submit invoices for soft dollar payment. Tr. 600-06, 656, 694, 727-29. On receipt of the invoice, someone at Instinet or BTIG would review the request, and then post the invoice to an online soft dollar system for J.S. Oliver to authorize payment. Tr. 256, 289, 539-40, 603-04, 945. Instinet’s

²⁴ In 2005, J.S. Oliver adopted a soft dollar policy, stating that its policy was to use soft dollars in a “conservative manner,” and that it intended to enter into soft dollar transactions “solely in the best interests of its clients and in compliance with Federal Securities regulations.” Div. Ex. 209. There is no evidence that a soft dollar committee, as called for by the policy, was ever established or that J.S. Oliver considered the policy’s criteria. Tr. 907-08. Drennan did not consider J.S. Oliver’s soft dollar policy when he worked on the firm’s soft dollar program. Tr. 908.

²⁵ J.S. Oliver’s arrangement with Instinet provided, typically, for a three-cent-per-share commission for equity trades, with .75 cent per share for execution and 2.25 cents per share for soft dollars. Div. Ex. 559; Tr. 255-26, 1072. For options, the execution cost was one cent and any amount of commission over the execution cost went to soft dollars. Div. Ex. 559; Tr. 289-91. J.S. Oliver’s arrangement with BTIG provided for a three-cent-per-share commission, with two cents per share for execution and one cent per share for soft dollars. Tr. 533-34.

soft dollar department would approve payment of J.S. Oliver's soft dollar requests, and BTIG would review invoices for reasonableness to determine if they fell within Section 28(e). Tr. 269, 371, 384-85, 539-44. Instinet and BTIG's agreements with J.S. Oliver put the burden on J.S. Oliver to comply with applicable laws and determine whether its soft dollar uses were authorized by its clients. Tr. 424-26; Div. Ex. 306 at 396240; Div. Ex. 456 at 14386-87.

Drennan's Involvement in Establishing J.S. Oliver's Soft Dollar Accounts

Drennan initiated and oversaw the setup of J.S. Oliver's Instinet account that permitted the accumulation of soft dollars. Tr. 607-09, 645-46, 845, 901-03; see Div. Ex. 306. Neil Driscoll (Driscoll), Instinet's account representative who handled the J.S. Oliver account, testified that Drennan was his first contact at J.S. Oliver; in fact, Drennan was always his primary contact at J.S. Oliver and frequently communicated with Driscoll by instant message. Tr. 245-51, 278, 294-95, 1324-25; see, e.g., Div. Exs. 330, 332, 335. Mausner acknowledged that Drennan was the primary contact in setting up J.S. Oliver's account with Instinet and that Drennan was the "point person" in handling J.S. Oliver's soft dollar activities. Tr. 1265-66. Moreover, the January 2009 new account form between J.S. Oliver and Instinet lists Drennan as J.S. Oliver's primary contact, includes Drennan's J.S. Oliver email address and J.S. Oliver phone number as contact information, and describes his position as "trader." Div. Ex. 306 at 396224; Tr. 421-22, 846-47, 1326. Drennan represented to Driscoll that he was a portfolio manager at J.S. Oliver. Tr. 249. Upon learning of Instinet's reimbursement to J.S. Oliver for employee salaries and other expenses in February 2009, Drennan's response was "Yeah baby!"²⁶ Div. Ex. 419; see Tr. 629-31, 952-53.

In early 2009, Drennan helped with the first few invoices for soft dollar payments, but he then explained to Kartes how to submit invoices and she took over submitting the soft dollar invoices. Tr. 597, 1050. By mid-2009, Kartes took over Drennan's task of authorizing soft dollar payments in Instinet's online soft dollar system, but Drennan still had the ability to authorize payments.²⁷ Tr. 604, 687-90, 949-51; Div. Ex. 533.

The use of soft dollars for services not covered by Section 28(e) was a change at J.S. Oliver in 2009; according to Mausner and Drennan, Instinet brought up the idea, and encouraged J.S. Oliver's use of non-Section 28(e) soft dollars and educated Drennan about disclosures when an invoice did not come within Section 28(e). Tr. 1045, 1049-50, 1268. However, less than 5% of Instinet's customers pay for services using soft dollars for services outside of Section 28(e). Tr. 402. In February 2009, Drennan received from Driscoll detailed information about services

²⁶ At one point, the employee salaries covered by soft dollars included Babaie, Donahue, Kartes, and Mausner, who was later removed. Tr. 953.

²⁷ Kartes is a 2001 graduate of the University of North Dakota with degrees in financial management and international studies. Tr. 564-65. She has never held any securities licenses. Tr. 565. The evidence is that Kartes and Drennan worked closely together. Kartes called Drennan when she was subpoenaed to give investigative testimony; they talked two or three times, and Drennan mentioned to Kartes that the lawyers had approved everything about soft dollars. Tr. 781-83.

that were eligible and ineligible under Section 28(e). Div. Ex. 137; Tr. 909. According to Drennan, he did not feel comfortable with the non-Section 28(e) soft dollars, so he relied on advice from Mark Whatley (Whatley), J.S. Oliver's attorney at the Howard Rice law firm (Howard Rice or the Law Firm). Tr. 704, 1046, 1098.

Drennan was also key to J.S. Oliver opening an account with BTIG in February 2009. Tr. 897; see Div. Ex. 706. Drennan approved the soft dollar client agreement that J.S. Oliver entered into with BTIG in February 2009, after which Kartes applied Mausner's signature stamp. Tr. 651-53; Div. Exs. 456, 682. Also, Drennan was the backup contact for J.S. Oliver on its account with BTIG, and he was authorized to place trades on the J.S. Oliver account that allowed the accumulation of soft dollars. Tr. 531-32, 1325; Div. Exs. 418, 706.

Drennan told Kartes that Powerhouse received a \$100,000 bonus in 2009, for bringing the idea of these soft dollar arrangements to the firm.²⁸ Tr. 649-51, 656-57.

J.S. Oliver's Soft Dollar Disclosures

Mausner testified that he relied on lawyers at Howard Rice for the language contained in J.S. Oliver's offering memoranda and Forms ADV, Part II. Tr. 1225-26, 1236-37, 1274. Drennan and Kartes testified that the Law Firm was involved in any changes to the offering memoranda and Forms ADV. Tr. 706, 709-10, 715, 717-19, 752, 1048. Mausner reviewed the offering memoranda and Forms ADV, and he understood that J.S. Oliver needed to disclose to its clients how it would use soft dollars to pay expenses. Tr. 1228-30, 1274-76.

Kartes understood that Howard Rice advised that soft dollar uses were acceptable as long as they were expressed in the offering memoranda. Tr. 612, 722. Kartes testified that the non-Section 28(e) expenses were discussed with the Law Firm, she never heard the attorneys advise J.S. Oliver that its actions were illegal, and Mausner's position on the J.S. Oliver's soft dollar activity was to do it if the attorneys said it was OK and in the documents. Tr. 717-22, 740-43, 748-49.

Forms ADV

J.S. Oliver's March 2007 Form ADV, Part II, provided that "[t]he investment management agreements for the Clients authorize the Firm to use Clients' soft dollars for a wide range of purposes, notwithstanding the conflicts of interest those uses may involve."²⁹ Div. Ex. 86 at 383. Further, the 2007 Form ADV provided that "[t]he extent of the conflict of interest

²⁸ Drennan, however, testified that he told Kartes the \$100,000 bonus was for research. Tr. 980-81. Instinet asked for a sample of the services provided for the \$100,000 invoice because it could not find any information about Powerhouse. Tr. 658. In response to Instinet's inquiry, Mausner represented to Instinet that Powerhouse provided J.S. Oliver with "extensive verbal equity and economic research and analysis." Div. Ex. 319; see Tr. 659-60.

²⁹ "Clients" refers to both J.S. Oliver's investment partnerships or hedge funds, and separately managed accounts. Div. Ex. 86 at 377.

arising out of the use of soft dollars depends in large part on the nature and uses of the services and products acquired with soft dollars, which may include the items discussed [in the Form ADV].” *Id.* Specifically, the 2007 Form ADV disclosed that J.S. Oliver may use soft dollars to acquire “Research and Brokerage” services pursuant to Exchange Act Section 28(e), for which the firm’s clients would not otherwise be required to pay.³⁰ *Id.* at 384. It further provided that soft dollars may be used for “Other Services and Products” outside Section 28(e):

The Firm may also use Clients’ soft dollars to acquire services and products that provide benefits to the Firm or its affiliates and that may not qualify as research or brokerage and/or to pay expenses otherwise payable by the Firm. These may include (but are not limited to): expenses of and travel to professional and industry conferences and hardware and software used in the Firm’s or its affiliates’ administrative activities. They may even include such “overhead” expenses as telephone charges, legal and accounting expenses of the Firm or its affiliates and office services, equipment and supplies. The use of soft dollars to pay costs of these types may not be directly proportionate to the benefits to the Client from which the soft dollars were generated. Using soft dollars for these purposes would not be protected by Section 28(e) and the Firm will have a

³⁰ The “Research and Brokerage” disclosure provided:

The Firm may also use Clients’ soft dollars to acquire a variety of “research” and “brokerage” services and products for which the Clients would not otherwise be required to pay. A federal statute, Section 28(e) of the Securities Exchange Act of 1934, recognizes the potential conflict of interest involved in this activity but protects investment managers such as the Firm from claims that the activity involves a breach of fiduciary duty to advisory clients—even if the brokerage commissions paid are higher than the lowest available—if certain conditions are met. Services or products generally constitute “research” under Section 28(e) if they constitute advice, analyses or reports any of which express reasoning or knowledge as to the value of or investing in or trading securities, or as to issuers, industries, economic factors and trends, portfolio strategy or performance, but only to the extent the Firm uses them for lawful and appropriate assistance in making investment decisions for its Clients. . . . To be protected under Section 28(e), we must, among other things, determine that commissions paid are reasonable in light of the value of the “brokerage” and “research” services and products acquired. . . . The types of “research” we expect to acquire include (but are not limited to): reports on or other information about particular companies or industries; economic surveys and analyses; recommendations as to specific securities; financial publications; portfolio evaluation services; financial database software and services; computerized news, pricing and statistical services; analytical software; proxy analysis services and systems (to the extent used to assist in making investment decisions); and other products or services that may enhance the Firm’s investment decision making.

conflict of interest if it does so, as it will have an incentive to use Transacting Parties [(e.g., brokers that execute or enter into portfolio transactions on behalf of Clients)] who provide or pay for products and services for which the Firm would otherwise have to pay cash and, if soft dollars are limited, it may have an incentive to cause those expenses to be paid with soft dollars while the Funds pays their own expenses with cash.

Id. at 384-85; see id. at 382.

J.S. Oliver's amended Form ADV, Part II, dated March 2009, contained soft dollar disclosures for "Research and Brokerage" and "Other Services and Products" similar to the 2007 Form ADV, but such disclosures were limited to soft dollars earned from trading in J.S. Oliver hedge funds—specifying that each limited partner, by signing the subscription application and entering into the partnership agreement, consents to the soft dollar uses described in the Form ADV. Div. Ex. 89 at 362, 366-68. Regarding "Other Services and Products," the 2009 Form ADV provided:

The Investment Manager may also use the Fund's soft dollars to acquire services and products that provide benefits to the Investment Manager or General Partner and that may not qualify as research or brokerage and/or to pay expenses otherwise payable by the Investment Manager. These may include (but are not limited to): expenses of and travel to professional and industry conferences and hardware and software used in the General Partner's administrative activities. They may even include such "overhead" expenses as telephone charges, legal and accounting expenses of the Investment Manager or General Partner and office services, equipment and supplies. The Investment Manager may or may not use other clients' soft dollars to pay costs of these types and, if it does, that use may not be directly proportionate to the benefits to the Fund and those other clients. Using soft dollars for these purposes would not be protected by Section 28(e) and the Investment Manager will have a conflict of interest if it does so, as it will have an incentive to use Transacting Parties who provide or pay for products and services for which the Investment Manager would otherwise have to pay cash and, if soft dollars are limited, it may have an incentive to cause those expenses to be paid with soft dollars while the Fund pays its own expenses with cash.³¹

Id. at 368. The 2009 Form ADV did not provide for use of soft dollars earned from trading in separately managed accounts. See generally id.

J.S. Partners Funds' Offering Memoranda

The J.S. Partners Funds' June 2006 offering memoranda contained soft dollar disclosures along the same lines as its Forms ADV. See Div. Ex. 160 (Fund 1) at 1374-76; Div. Ex. 411

³¹ The referenced Investment Manager is J.S. Oliver and the General Partner is an affiliate, J.S. Oliver Partners, LLC. Div. Ex. 89 at 362, 364.

(Fund 2) at 1162-64; Div. Ex. 412 (Offshore Fund) at 1113-15. The Fund 1 offering memorandum provided that soft dollar uses for “Other Services and Products”

may include (but are not limited to): expenses of and travel to professional and industry conferences and hardware and software used in the General Partner’s administrative activities. They may even include such “overhead” expenses as telephone charges, legal and accounting expenses of the Investment Manager or General Partner and office services, equipment and supplies.

Div. Ex. 160 at 1375-76. The Fund 2 offering memorandum is identical as to this disclosure; the Offshore Fund offering memorandum is substantively similar. Div. Ex. 411 at 1163; Div. Ex. 412 at 1114.

CGF Offering Memorandum

CGF’s August 2008 offering memorandum had different language regarding soft dollar uses for “Other Services and Products,” as shown in bold:

[Non-research or non-brokerage services] may even include such “overhead” expenses as **office rent, salaries, benefits and other compensation of employees or of consultants to the Investment Manager**, telephone expenses, legal and accounting expenses of the Investment Manager and office services, equipment and supplies.

Div. Ex. 135 at p. 30 (emphasis added).

Drennan Sends Instinet the CGF Offering Memorandum

Drennan referred to Instinet’s representative Driscoll as his soft dollar guru. Tr. 277; Div. Ex. 51. Instinet’s position was that use of soft dollars was appropriate as long as it was disclosed in J.S. Oliver’s offering memorandum. Tr. 273, 356, 914-16; Div. Ex. 335 at 396440. On February 6, 2009, Driscoll asked Drennan for a copy of “J.S. Oliver’s L[imited] P[artner] Agreement or Offering Memorandum.” Div. Ex. 335 at 396440; Tr. 1074-76. Drennan received a copy of the Fund 2 offering memorandum from Kartes. Tr. 1080. After looking at the section on soft dollars, Drennan messaged Driscoll: “**dude . . . our offering mem is out of hand.**” “**I could probably buy weed with soft lol.**” Div. Ex. 335 at 396440 (emphasis added); Div. Ex. 709 at 25883; see Tr. 263, 914, 1086. It seemed to Drennan that the offering memorandum language was “very, very broad, including a wide number of things that could have been reimbursed with non-[Section] 28(e) expenses to the funds.” Tr. 915.

However, instead of sending Driscoll the Fund 2 offering memorandum, Drennan sent CGF’s offering memorandum to Driscoll on February 9, 2009. Tr. 260, 262-63, 390, 1080, 1092-93; Div. Ex. 331. Drennan testified that one reason he did not send the Fund 2 offering memorandum, which was for J.S. Oliver’s largest fund, was because it had outdated

information.³² Tr. 922-23, 935. However, Drennan admitted that the CGF offering memorandum also had outdated information, as it showed him as a J.S. Oliver employee and director of research and portfolio manager, which was not true when the offering memorandum was issued or when Drennan provided it to Instinet. Tr. 935-36; Div. Ex. 331 at 25902.

Soft Dollar Payment to Kloes

In June 2009, Instinet reimbursed J.S. Oliver \$329,365 for payment to Kloes, using soft dollars. Tr. 415-16, 432, 1022; Div. Ex. 140 at 15518.

The 2005 Marital Settlement Agreement and Kloes's Subsequent History with J.S. Oliver

Kloes testified that around the time she and Mausner were going through their separation in 2005, Mausner “wanted [her] out” and another J.S. Oliver employee was taking over her role as CFO at the firm. Tr. 475-76. In October 2005, Mausner and Kloes executed a marital settlement agreement (2005 marital settlement or the agreement). See Div. Ex. 22. The agreement provided that Mausner “shall cause” J.S. Oliver to make a series of payments to Kloes “in lieu of spousal support,” which included payments equal to an annual salary of \$250,000 for the January to December 2006 pay period; and payments equal to an annual salary of \$125,000 for the January 2007 to December 2010 pay period. Div. Ex. 22 at 1053-54; Tr. 478. The agreement also included provisions requiring Mausner to cause J.S. Oliver to continue to pay for several personal expenses for Kloes, including country club memberships, housecleaners, and a part-time assistant. Div. Ex. 22 at 1055.

Under the 2005 marital settlement, Kloes had no obligation to perform any work for J.S. Oliver from 2007 forward, as the agreement provided only that Kloes would be reasonably available to assist with the completion of financial statements and tax returns for 2006. Tr. 491, 512-13; Div. Ex. 22 at 1053-54. Although the 2005 marital settlement required that Mausner would pay Kloes through J.S. Oliver, Kloes testified that she “wasn’t an employee there.” Tr. 502-03. Indeed, Kloes and Mausner agreed that Kloes would be paid an hourly rate for additional work beyond 2006, as that was not within the scope of the agreement. Tr. 491-94; Div. Ex. 23 at 1391-94. Kloes testified that she could not recall doing any work for J.S. Oliver in 2007, and definitively did not do any work in 2008 or 2009. Tr. 494-95, 505-06. Kartes, who worked at J.S. Oliver from 2008 to 2011, corroborated Kloes’s testimony: Kartes testified that she never had any meetings or telephone conversations with Kloes, and that Kloes never came into the J.S. Oliver office during the time Kartes worked at the firm. Tr. 565-66, 617.

³² On the other hand, Drennan testified that at the time he sent Driscoll the CGF offering memorandum, he believed the disclosures and other information contained in J.S. Oliver’s offering memoranda were the same, and that he did not compare the soft dollar language in the CGF offering memorandum against the Fund 2 memorandum. Tr. 941, 1093-95. Although the Fund 2 offering memorandum does not disclose rent as a soft dollar use, Drennan testified that he thought there was such disclosure. Tr. 927-29; see Div. Ex. 411 at 1162-64.

Further, the evidence calls into question Mausner's position that he considered Kloes an employee. In November 2005, Mausner emailed Kloes: "One request please. Since you are no longer with JSO, could you stop using the firm email or any other firm stuff." Div. Ex. 24 at 1509; Tr. 484-85, 1285-86. Mausner turned off Kloes's J.S. Oliver email address around that time. Tr. 483-85. In 2008, Mausner instructed one J.S. Oliver employee: "Gina's not allowed anywhere in here. You're not allowed to talk to her. She's not allowed to be anywhere near the place." Tr. 505. In a sworn declaration dated March 2009, made in a subsequent divorce proceeding, Mausner stated: "Gina was requesting that J.S. Oliver continue to pay her even though she was no longer working for the firm. And then 'in lieu of spousal support,' I agreed to pay her \$125,000 a year through 2010 and expenses based upon her representation of the firm's finances." Tr. 1341 (formatting altered; internal quotation marks added). Further, in his March 2010 deposition testimony in connection with the Sapling arbitration proceeding, Mausner stated that Kloes had stopped working for J.S. Oliver around the time of their divorce in 2005. Tr. 1288-90.

The 2009 Marital Settlement Agreement and Request for Soft Dollar Reimbursement

In 2009, Mausner began efforts to renegotiate the 2005 marital settlement. Tr. 1098. Mausner and Kloes entered into a new marital settlement agreement "as of May 15, 2009" (2009 marital settlement or the new agreement), to modify the 2005 marital settlement. Div. Ex. 26; Tr. 1278. The new agreement provided that "Mausner shall direct [J.S. Oliver] to pay [Kloes] a one-time net after-tax salary payment of \$214,500," in exchange for Kloes waiving her right to the entire amount due under certain provisions of the 2005 marital settlement and any spousal support that may be due. Div. Ex. 26 at 1131; Tr. 1278-79. The 2005 and 2009 marital settlements were between Kloes and Mausner; J.S. Oliver was not a party to either agreement. Tr. 511, 513, 1278; see Div. Exs. 22, 26. In fact, Kloes testified that the payment that Mausner was obliged to cause J.S. Oliver to pay her under the agreements constituted "getting paid for a divorce." Tr. 520.

Around the same time that Mausner entered into the new agreement with Kloes, Mausner and Drennan began their efforts to use soft dollars to reimburse J.S. Oliver for payment made to Kloes. On May 8, 2009, Drennan inquired with Instinet whether J.S. Oliver could use soft dollars to pay Kloes a one-time payment of \$275,000 to be a consultant for the next three years. Tr. 987-88, 1281-82; Drennan. Ex. 1313 at 3-4. Drennan then informed Mausner of Instinet's position that payments to Kloes would require a consulting agreement in place between Kloes and J.S. Oliver. Drennan Ex. 1313 at 1-2. In response, Mausner asked whether this would not apply "if we run it through normal payroll," as employees were being paid with soft dollars at the time. Div. Ex. 1313 at 1; Tr. 992-93. Drennan confirmed that there would be no need for a consulting contract if Kloes was paid through payroll. Div. Ex. 1313 at 1; Tr. 1116.

On May 12, 2009, Mausner emailed Drennan and other J.S. Oliver employees that "we have signed and settled," which appears to be a reference to the 2009 marital settlement, and that "we need to have a payroll check issued for \$317,778 (after 32.5% tax equals \$214,500)." Div. Ex. 339 at 301156; Tr. 993-95. On May 15, 2009, Drennan calculated that a pre-tax payroll

amount of approximately \$317,778³³ would result in an after-tax payment to Kloes of \$214,597, close to the \$214,500 amount due to Kloes under the new agreement. Div. Ex. 592; Tr. 995-96, 999-1000.

On May 26, 2009, Mausner sent Instinet the following email, which Drennan had drafted at Mausner's request:

I am writing this to clarify the employee payroll. Gina Mausner was the CFO and CCO of J.S. Oliver Capital Management from inception January 2004 through August 2005. Gina Mausner has remained an employee of J.S. Oliver offering advice on organizational and accounting issues. Gina and J.S. Oliver have an agreement to pay a specified salary through 2011.

J.S. Oliver is paying out the remaining salary due to Gina in a lump sum payment that is processed as payroll for the amount of \$329,308.38.

The J.S. Oliver Offering Memorandum clearly states under Other Services and Products that "salaries, benefits and other compensation of employees or of consultants to the Investment Manager" are disclosed as qualified use of soft dollars.

Please let me know if you have any questions.³⁴

Div. Ex. 545; see Div. Ex. 344; Tr. 1005-07, 1010, 1283-84. Mausner's position that J.S. Oliver had an agreement to pay Kloes a salary through 2011 is based on his claim that the agreement he signed with Kloes "incorporated an agreement for J.S. Oliver to pay [her] salary." Tr. 1293-94. Mausner testified that J.S. Oliver's payment to Kloes was pursuant to the 2009 marital settlement, but the purported provision to pay Kloes through 2011 is not in the 2009 marital settlement. Tr. 1307; Div. Exs. 26, 545.

After receiving the email from Mausner, Instinet requested an in-person meeting to obtain more information regarding the reimbursement request. Tr. 295-98, 428-29. Driscoll called Drennan to set up the meeting appointment. Tr. 297. On the morning of June 1, 2009,

³³ As noted infra, this amount was later adjusted to \$329,365.

³⁴ In his investigative testimony, Drennan testified that the above sentence in the email Mausner sent to Instinet—namely, that "Gina Mausner has remained an employee of J.S. Oliver offering advice on organizational and accounting issues"—was inaccurate. Tr. 1008-10. Further, at the hearing, Drennan did not name Kloes as one of the J.S. Oliver employees when he left the firm in 2008 or returned in 2009. Tr. 894-95. On the other hand, Drennan testified he "knew" that Kloes remained a J.S. Oliver employee because she was a consultant from 2006 through 2008, she was on the payroll through February 2009, and she had to comply with the firm's employee trading policy. Tr. 1006-08, 1097. Drennan considered Kloes an employee "by definition of that contract," which appears to refer to the 2005 marital settlement, and that Howard Rice had confirmed to him that she was an employee. Tr. 1058-59.

Driscoll and another Instinet representative met with Mausner at J.S. Oliver's office. Tr. 297, 1295-96; Div. Ex. 70; Div. Ex. 599 at 372. During the meeting, the Instinet representatives requested a copy of the purported agreement between J.S. Oliver and Kloes that required the lump sum payment. Tr. 298; Div. Ex. 70.

Shortly after the meeting that same day, Drennan—at Mausner's request—cut and pasted three paragraphs of the 2005 marital settlement into an email. Tr. 1011-12; Div. Ex. 345. A few minutes later, he asked another J.S. Oliver employee to convert the excerpted language into an Adobe PDF document and onto J.S. Oliver letterhead; Drennan then forwarded the PDF to Mausner. Div. Exs. 346, 347, 348; Tr. 1012-16. At Mausner's direction, Drennan then changed the description of the excerpt—which previously stated that the excerpt was “from the contract between Ian Mausner and Gina Mausner”—to read that the excerpt was “from the contract between J.S. Oliver Capital Management, L.P. and Gina Mausner.”³⁵ Compare Div. Exs. 349A and 349C with Div. Ex. 348; Tr. 1016-17, 1128.

Around noon on June 1, 2009, after the exchange with Drennan over the contract language, Mausner forwarded the altered language to Instinet to support the reimbursement request for payment to Kloes. Tr. 1301-02; Div. Ex. 70. The attached excerpt from the purported contract stated:

The following excerpt is from the contract between J.S. Oliver Capital Management, L.P. and Gina Mausner. The lump sum of \$329,308.38 represents the remaining benefits to be paid and the accrued benefits that had been deferred.

C. “For the pay period beginning January 1, 2006 through December 31, 2006, Ian shall continue to cause the Firm to make payments to Gina to equal an annual salary of \$250,000. Ian shall cause the firm to provide Gina benefits consistent with the Firm's past practices during the twelve (12) months immediately prior to the effective date of this Agreement and annual personal expenses not to exceed \$40,000. Gina will submit an (sic) expense reports for such expenses within 3 months of such expense being incurred. During this time, Gina will be reasonably available to assist with the completion of the financial statements for 2006, completion of administration and reporting for the hedge funds and separate accounts, and completion of the maintenance of legal and general business documents and other filings.”

D. “For the pay period beginning January 1, 2007 through December 31, 2010, Ian shall cause the Firm to make payments to Gina equal to an annual salary of \$125,000. Ian shall also cause Firm to provide Gina benefits consistent with the Firm's past practices during the twelve (12)

³⁵ According to Drennan, Mausner told him that J.S. Oliver was a party to the 2005 marital settlement. Tr. 1128-29, 1132, 1135. Drennan testified that he “helped with the excerpt of the contract as [he] understood it.” Tr. 1126. He concentrated on salary and eliminated reference to personal expenses. Tr. 1137, 1304-05.

months immediately prior to the effective date of this Agreement and annual personal expenses not to exceed a yearly average of \$2,500 per month. Gina will submit expense reports for such expenses within 3 months of such expense being incurred.”

E. “Ian shall cause all payments and other benefits to Gina to be made consistent with the Firm’s current payroll policies as of the effective date of this Agreement (i.e., semi-monthly). While Gina receives or has the right to receive a salary from the Firm, Ian shall cause the Firm to provide Gina with medical/dental benefits consistent with the then-current plan(s) maintained by the Firm. In the event that Gina cannot reasonably be reinsured after December 31, 2010, the Firm will provide Gina with medical and dental benefits until Gina is able to obtain comparable insurance coverage at comparable rates.”

Div. Ex. 70 at 33465-66.

At either Mausner or Drennan’s direction, Kartes submitted a \$329,365 invoice to Instinet to pay “employee compensation,” with the same purported contract excerpt.³⁶ Div. Exs. 147, 349A; Tr. 673-75, 774-75, 1018-19. Drennan approved the payment on J.S. Oliver’s behalf in Instinet’s online soft dollar system, and Instinet paid J.S. Oliver the submitted amount based on Mausner’s representation that it was employee compensation. Tr. 415-16, 432-33, 1022; Div. Ex. 140 at 15518.

Drennan “believe[d]” that he had received advice from Whatley that it was appropriate to describe the 2005 marital settlement as being between J.S. Oliver and Gina Mausner, but he has no written material to support this representation, and Whatley did not approve the language that was ultimately sent to Instinet. Tr. 1021-22, 1108. Drennan also testified that Howard Rice was involved in the 2005 marital settlement and Whatley approved the payment to Kloes because, “per the agreements,” she was an employee and her salary could be paid in soft dollars. Tr. 1040-41, 1043, 1118.

Mausner insists that he relied on Howard Rice for the legitimacy of the purported contract excerpt sent to Instinet, but he has nothing in writing to support his position. Tr. 1276-77, 1279-81, 1294-95, 1305-06. The record does not reflect that much discussion occurred between J.S. Oliver and Howard Rice in the time leading up to the Kloes payment. For legal services rendered from April to May 31, 2009, regarding the “investment adviser,” Howard Rice billed J.S. Oliver a total of 4.3 hours; the only reference to soft dollars is a May 15, 2009, conversation with Mausner on unspecified soft dollar questions that lasted 0.4 of an hour, and there is no invoice regarding the investment adviser for June 1, 2009, the day that the purported contract excerpt was created and sent to Instinet.³⁷ Drennan Ex. 1103 at 299860-62; Mausner

³⁶ Although the invoice is dated May 30, 2009, Kartes testified that she did not know if that was just the date she created the invoice or if she was told to put that date. Tr. 775; Div. Ex. 147.

³⁷ Mausner Ex. 15A is 82 pages of Howard Rice bills, with various dates and subject descriptions.

Ex. 15A at 50-51, 62. Drennan has not seen any legal bills for communication with Howard Rice in connection with preparing the attachment sent to Instinet to support the soft dollar request. Tr. 1174. In fact, Drennan conceded that he did not obtain advice from counsel to determine what portion of the 2005 marital settlement to excerpt, and Mausner did not recall whether he provided Whatley with the excerpt to review before sending it to Instinet. Tr. 1011-12, 1299-1301.

Soft Dollar Payments to J.O. Samantha for Rent

In 2009 and 2010, J.S. Oliver used soft dollars to pay \$300,000 in rent to J.O. Samantha, Mausner's entity that owned the home out of which J.S. Oliver operated. Div. Exs. 311, 312, 417, 452, 454; Div. Ex. 140 at 15497-15504; Tr. 270, 573, 601-02. Mausner was solely responsible for setting the monthly rent that J.S. Oliver paid to J.O. Samantha. Tr. 733-34, 1309, 1312. Moreover, after his 2005 divorce from Kloes, Mausner controlled the J.O. Samantha bank account. Tr. 1309. In November or December 2008, Drennan and Mausner discussed using soft dollars for J.S. Oliver's rent payments to J.O. Samantha. Tr. 1262-65. Mausner knew that these payments fell outside Section 28(e)'s safe harbor, as did Drennan based on information he received. Tr. 1265; Div. Ex. 137 at 10834. Before soft dollars were used to pay J.O. Samantha rent, J.S. Oliver paid about \$6,000 in monthly rent to J.O. Samantha with non-soft dollars. Tr. 1309-11. J.O. Samantha, in turn, made monthly mortgage payments of \$5,444 on the home in 2009; Mausner did not recall the mortgage payment increasing. Tr. 1309-10; Div. Exs. 415, 416.

J.S. Oliver paid \$6,000 in rent to J.O. Samantha for January and February 2009. Tr. 623-25, 1311; Div. Ex. 311. Following its contract with Instinet, J.S. Oliver began using soft dollars to pay J.O. Samantha's rent, beginning with the January and February 2009 rent payments. Tr. 274-75, 625-27, 1309; Div. Exs. 48, 307. Mausner retroactively increased the monthly rent paid to J.O. Samantha to \$10,000, effective January 2009. Tr. 623-25, 1311-12; Div. Ex. 311, 535A. Thus, Drennan sent Instinet rental invoices for \$10,000, each for January and February 2009. Tr. 937-38; Div. Ex. 42. On February 13, 2009, about the time when Instinet made the first soft dollar reimbursement for rent, Drennan emailed Mausner with the subject line: **"The eagle has landed in JO Samantha!!!!"** Div. Ex. 424 (emphasis added); see Tr. 620-21. J.O. Samantha reimbursed J.S. Oliver \$12,000 for the January and February rent that had already been paid. Tr. 621-22, 946-48; Div. Exs. 311, 424.

In March 2009, Drennan obtained Instinet's approval for J.S. Oliver to submit rent invoices of \$10,000 per month for the rest of 2009, which were paid from soft dollars when the rent was due.³⁸ Tr. 283-87, 663; Div. Exs. 55, 56. Drennan is listed as the client approver, on J.S. Oliver's behalf, for the payment of at least two rent invoices in Instinet's online soft dollar system. Div. Ex. 140 at 15497; Div. Ex. 307.

Beginning in May 2009, J.O. Samantha transferred money to Mausner's personal account. That month, Mausner informed Kartes that "now we can move funds from J.O. Samantha to my account at Wells Fargo" and directed her to complete the transaction the next

³⁸ In July 2009, Drennan informed Mausner that Instinet was paying J.O. Samantha directly, which eliminated the need for reimbursement requests. Drennan Ex. 1226.

day. Div. Ex. 351; Tr. 664-65. In response to Mausner's confirmation that the funds could be moved to his account, Drennan's reaction was "Yeah baby!!!" Div. Ex. 351; Tr. 664. As the first disbursement to Mausner, Kartes moved \$18,000 from the J.O. Samantha account to Mausner's personal account. Tr. 665-66; Div. Ex. 308.

Effective July 2009, Mausner further increased the rent to \$15,000.³⁹ Tr. 683, 1312; Div. Ex. 307 at 474. This rent increase resulted in an excess amount in the J.O. Samantha account after making the monthly mortgage payments. Tr. 1312-13. That excess amount—generated from soft dollars credits that originated from the higher commissions paid by J.S. Oliver clients—was regularly transferred to Mausner's personal account. Tr. 1313-14. At the end of 2009 and beginning of 2010, Mausner received a regular monthly transfer of \$10,000 from the accumulated excess in the J.O. Samantha account; he directed Kartes to make these transfers. Tr. 666-68, 1312-14; Div. Exs. 309, 310. In sum, J.O. Samantha transferred \$163,000 to Mausner's personal bank account in 2009 and 2010, and \$37,279.66 more was transferred from January through November 2011, for a total of \$200,279.66.⁴⁰ Div. Exs. 311, 312, 313.

Mausner testified that it was his understanding from counsel that rent payments were disclosed in J.S. Oliver's documents and a legitimate soft dollar expense, but he could not recall any specific conversation; in prior investigative testimony, Mausner did not remember whether he consulted with counsel about whether it would be appropriate to transfer money left over in the J.O. Samantha account, after it made mortgage payments, to Mausner's personal account. Tr. 1314-17.

Soft Dollar Payments to Powerhouse

In 2009 and 2010, J.S. Oliver used soft dollars to pay Powerhouse \$482,381 for Drennan's purported research pursuant to Section 28(e). Tr. 892, 895-97, 1324; Div. Ex. 83; Div. Ex. 140 at 15574-84; Div. Ex. 181; Div. Ex. 708 at 105-13. Drennan contends that if he worked directly for J.S. Oliver, his compensation would have been covered through soft dollars as an employee. Tr. 1155. In fact, after he transitioned from being a purported Powerhouse employee to a direct J.S. Oliver employee in 2011, his employee salary was initially paid with soft dollars. Tr. 1155.

³⁹ Subsequently, the rent payments to J.O. Samantha decreased to \$10,000 in August 2010 and then to \$7,500 in November 2010. Div. Ex. 307 at 1065, 1205; Div. Ex. 535a; see Tr. 699.

⁴⁰ In 2009, J.O. Samantha made six transfers to Mausner, in the range of \$9,000 to \$19,000 for each transfer. Div. Ex. 311. In 2010, J.O. Samantha made eleven transfers to Mausner, in the range of \$4,000 to \$10,000 for each transfer. Div. Ex. 312. And from January to November 2011, J.O. Samantha made ten transfers to Mausner, in the range of \$1,500 to \$9,905 for each transfer. Div. Ex. 313.

Drennan's Role in Establishing Soft Dollar Payments for Powerhouse

Drennan claims that Driscoll told him that he could be paid as a consultant using soft dollars, which caused Drennan to form Powerhouse.⁴¹ Tr. 1156-58. Mausner asked Drennan to establish the soft dollar account with Instinet, so that Drennan's compensation could be paid with soft dollars from day one. Tr. 842, 1270; Div. Ex. 325 at 10539-40.

After facilitating the arrangement with Instinet to pay Powerhouse using soft dollars, Drennan approved—on J.S. Oliver's behalf—Instinet's initial payments to Powerhouse, after the invoices were posted to Instinet's online soft dollar system. Div. Ex. 140 at 15575-76; see Tr. 840, 845, 1265-66, 1270-71; Div. Ex. 325. As of February 2009, Drennan and Mausner were the only persons who would approve payment of J.S. Oliver-related soft dollar invoices in Instinet's online system. Tr. 950. Drennan also drafted the Powerhouse invoices for Kartes to submit to Instinet. Tr. 957. Drennan explained to Kartes the process of submitting invoices to have expenses paid with soft dollars. Tr. 596-97. After Drennan submitted his first invoice to J.S. Oliver for the month of January 2009, Kartes submitted the invoice to Driscoll at Instinet with the request that payment be made directly to Drennan, but quickly reversed herself and asked that the payment be made to Powerhouse. Tr. 635-39; Div. Exs. 316A, 316B, 316D.

Powerhouse began receiving soft dollar payments from J.S. Oliver's account with BTIG in mid-2009. Tr. 653, 691-92, 1182. BTIG paid Powerhouse using soft dollars as it was led to believe that Powerhouse was a research provider, based on representations made by J.S. Oliver and Powerhouse, as well as the research provider consulting agreement (RPCA) that Drennan signed on behalf of Powerhouse. Tr. 537-38, 543, 546-47; Div. Exs. 660, 708. An attachment to the RPCA specified that salaries, including for research staff, are ineligible as research under Section 28(e). Div. Ex. 660 at Attach. A; Tr. 538. Moreover, BTIG's soft dollar client agreement required that a client's soft dollar requests to pay a vendor be "compensation solely for qualifying research services, and no portion of any such qualifying fees is intended to provide, or will provide, any pecuniary or other benefit to client, directly or indirectly, other than in compliance with the Section 28(e) Safe Harbor." Div. Ex. 456 at 14386 (capitalization altered); Tr. 534. Drennan knew that BTIG allowed soft dollars payments only for services within the Section 28(e) safe harbor. Tr. 897.

As a result of the soft dollar arrangements, Powerhouse received \$312,381 in soft dollar payments in 2009. Div. Ex. 83; Tr. 895-96. Although the monthly rate for Powerhouse was \$12,500, totaling about \$150,000 a year, Mausner told Drennan that the additional amount in 2009 was for "good work." Tr. 891-92, 897. In 2010, Powerhouse received monthly soft dollar payments of \$12,500 for January and February, and monthly payments of \$14,500 for the

⁴¹ Mausner and Drennan initially discussed paying Drennan directly as a research consultant using soft dollars. Tr. 957-59. In January 2009, Drennan was directly paid, as an individual, \$50,000 from one of J.S. Oliver's brokers, Screaming Eagle, and he received \$12,500 from Instinet that month too, all for purported research services. Tr. 957-61, 1271-74.

remainder of the year, for a total of \$170,000 in 2010.⁴² Div. Ex. 140 at 15574-84; Div. Ex. 708 at 105-113.

Drennan Functioned as a J.S. Oliver Employee

Drennan went to J.S. Oliver's office almost daily beginning in January 2009. Tr. 850, 872-73, 877, 889. Mausner did not think there was much difference between what Drennan did before he left J.S. Oliver and what he did when he came back in January 2009, purporting that Drennan's primary role beforehand and then with Powerhouse was research. Tr. 1329. In prior investigative testimony, Mausner expressed that "any time you can get a great employee back for free, I don't care what your financial situation is, you jump at the opportunity." Tr. 1330-31. Mausner came into the office less frequently after Drennan returned in early 2009. Tr. 581. Drennan testified that his research for J.S. Oliver consisted of reviewing the news and markets, focusing on long-term research projects such as whether companies had earnings, listening to conference calls related to earnings, and reading company filings. Tr. 1139-40. In prior investigative testimony, Drennan similarly stated that his research consisted of listening to conference calls, reading company filings, talking to friends, following the markets, and using Bloomberg, Google, and other Internet resources. Div. Ex. 696 at 28. Drennan testified that he usually talked back and forth all day, or through instant messenger, with Mausner, as a typical example of the way Drennan reported his research to Mausner. Tr. 1140-41. The record does not contain any written reports that Powerhouse prepared for J.S. Oliver as a research consultant.

Drennan acted as a J.S. Oliver employee in almost every conceivable way. Drennan used a J.S. Oliver email account and telephone number for his communications, had a desk in the J.S. Oliver office, and had access to the firm's computer system and confidential client files. Tr. 850-52, 889-90. The signature on emails sent from Drennan's J.S. Oliver account did not identify him as a Powerhouse employee. Tr. 890. Further, Drennan acted as "team leader," organized tasks for others to perform with a weekly meeting task list, and resolved and mediated conflicts.⁴³ Tr. 579, 582-592, 647-48; Div. Ex. 356. Drennan reviewed, and assisted with, J.S. Oliver's accounting and cash reports. Tr. 647-48, 697-98, 882-84; Div. Exs. 205, 421, 426-27, 549, 550, 553, 556, 565-68, 575-76, 578. In February 2009, Drennan told Kartes that certain changes should be made to the Fund 2 offering memorandum, which Kartes then relayed to Howard Rice. Tr. 708-09, 1087-88; Drennan Exs. 1306, 1309. Also, Drennan admitted that his discussions with Driscoll about J.S. Oliver's soft dollar disclosures had nothing to do with his purported job as a research consultant with Powerhouse, and that his work for Mausner, in trying to understand Kartes's role at the firm, was outside of Section 28(e). Tr. 917, 951.

⁴² Tellingly, Drennan was paid \$140,000 a year when he left J.S. Oliver in 2008, and there was minimal discussion between Drennan and Mausner concerning what would be an appropriate amount for Powerhouse to be paid for its services. Tr. 891-93.

⁴³ Drennan and Mausner testified that a life coach gave Drennan the title team leader; according to Mausner, the life coach helped J.S. Oliver "optimize interrelationships among the employees." Tr. 1167, 1327.

Moreover, Drennan performed various tasks on J.S. Oliver's behalf with respect to trades and commissions. Div. Exs. 357-60, 435, 438, 440-42, 445-51, 459-60, 470, 494, 496-97, 502-03, 508, 510, 514-15, 554-55. At Mausner's direction, Drennan placed trades in the J.S. Oliver account at Instinet in 2009 and 2010, and Drennan interacted with BNP on trading issues for J.S. Oliver. Tr. 682, 853, 1326; Div. Ex. 519. Either Mausner or Drennan filled out the trade blotter. Tr. 1342-43. In a May 2009 email, one Instinet employee referred to Drennan as J.S. Oliver's "head trader." Drennan Ex. 1117 at 299953; Tr. 1100. Drennan signed documents as a trader for J.S. Oliver with BTIG in February 2009, giving him trading authorization in the J.S. Oliver account. Tr. 1325; Div. Ex. 418. Drennan admitted that when he relayed orders to trading desks on behalf of Mausner and when he allocated trades among client accounts at Mausner's direction, these were non-Section 28(e) activities. Tr. 900-01, 1065.

Drennan does not dispute that from January 2009 through mid-2011, he provided services to J.S. Oliver outside of Section 28(e). Tr. 961, 1160. Drennan admitted that Powerhouse did not allocate between services covered by Section 28(e) and services outside Section 28(e), but testified that soft dollars were used only for Section 28(e) services and the non-Section 28(e) services were "compensated otherwise." Tr. 962. According to Drennan, it became evident in January 2009 that Mausner looked to him for non-research support, and he then consulted with Howard Rice attorney Whatley; Whatley purportedly told him that J.S. Oliver could compensate Powerhouse for his research with soft dollars and for non-research activities with hard dollars. Tr. 962, 1159-62. Drennan testified that as the result of discussions between him, Mausner, and Whatley, it was decided that his use of J.S. Oliver's office, phone, computer, computer network, and Bloomberg terminal was the hard dollar compensation for his non-research activities, which Drennan estimated took about 5% of his time. Tr. 1161-62. Another Howard Rice attorney purportedly confirmed that Drennan could be compensated for research work via Powerhouse with soft dollars, yet still perform non-research activities, as long as those activities did not consume a significant amount of time. Tr. 1163-64. The Howard Rice attorneys did not represent Powerhouse or Drennan, however. Tr. 1180-81. Powerhouse never retained or consulted with its own counsel to advise it concerning how it could appropriately be reimbursed for Section 28(e) and non-Section 28(e) services provided to J.S. Oliver. Tr. 963.

Soft Dollar Payments for Mausner's Timeshare at the St. Regis

In August 2008, Mausner purchased a fractional time share in his name for a two bedroom unit at the St. Regis Residence Club in New York City. Tr. 1320-21; Div. Ex. 414. The purchase price was \$575,000, plus \$13,659 in estimated closing costs. Div. Ex. 414 at 1. There were maintenance fees and real estate taxes on the timeshare in 2009 and 2010. Tr. 1321.

In January 2009, Kartes, at Mausner's direction, submitted an invoice to Instinet for soft dollar reimbursement of \$19,128 for Mausner's timeshare expenses that consisted of the 2009 maintenance fee and real estate taxes. Div. Ex. 219; Tr. 671-73, 1322-23. In December 2009, Kartes, again at Mausner's direction, submitted an invoice to Instinet for soft dollar reimbursement of \$20,966 for Mausner's timeshare expenses that consisted of the 2010 maintenance fee and replacement reserves. Div. Ex. 186; Tr. 670-71, 1324. Both invoices described the purpose of the expenses as "evaluating potential investment opportunities including travel, meals, and lodging and out of pocket expenses involved in soliciting

prospective investors.” Div. Exs. 186, 219. Instinet’s records show approval for both payments to J.S. Oliver, totaling \$40,094. Div. Ex. 140 at 15515, 15529.

Mausner used the timeshare for both personal and purported business uses, and he failed to identify how he apportioned his personal versus business use of the timeshare, testifying vaguely that he “had a very good understanding because the trips were very specific in terms of who I met with [and] what I was doing.” Tr. 1322-23. Mausner “tr[ie]d to remember” whether he used the timeshare to meet with prospective clients, testifying that it was possible he “had some prospective clients as well as . . . existing clients.” Tr. 1323.

The disclosures in J.S. Oliver’s Forms ADV and Partner Funds’ offering memoranda provided that soft dollars may be used to reimburse travel expenses related to professional and industry conferences. Div. Ex. 86 at 384-85; Div. Ex. 89 at 368; Div. Ex. 160 at 1375-76; Div. Ex. 411 at 1163; Div. Ex. 412 at 1114. The disclosure in the CGF offering memorandum permitted soft dollar payments for travel, meals, and lodging related to evaluating potential investment opportunities. Div. Ex. 135 at 64. However, there is no credible evidence that Mausner used the timeshare to attend any conferences or evaluate potential investment opportunities.

According to Mausner, he could spend forty-nine nights at the St. Regis per year when he traveled to New York, and this enabled him to stay in New York at a cheaper rate than a hotel. Tr. 1321-22, 1373; Mausner Ex. 18. Based on the 2009 and 2010 timeshare expenses that totaled \$40,094, see Div. Exs. 186, 219, forty-nine nights per year (or ninety-eight nights for the two-year period) cost approximately \$409 a night. To support his argument that he realized savings with the St. Regis timeshare, Mausner submitted hotel bills from the Ritz-Carlton in New York City, showing hotel room costs in the range of \$485 to \$795 per night, during the October 2006 to April 2008 period. Mausner Ex. 19. His assertion that he realized savings with the St. Regis timeshare is unconvincing, however, as it was not established that he actually stayed at the St. Regis even close to forty-nine nights per year, and such purported savings are in comparison to the cost of staying at the Ritz-Carlton.

Investor Testimony on Soft Dollars

Anderson

Anderson, who invested the Sapling funds with J.S. Oliver, had several discussions and emails with Mausner about the fee arrangements, during which Mausner never mentioned to Anderson that soft dollars were generated through trades in the Sapling account. Tr. 22-30, 35-36, 49-51, 71-72, 75. Moreover, Anderson testified that it would have been “horrible” if J.S. Oliver generated soft dollars by trading in the Sapling account and then used some of those soft dollars to pay Mausner’s ex-wife for spousal support or to pay excessive rent to a company controlled by Mausner, because Anderson had negotiated with Mausner the fees that the Sapling

account paid. Tr. 24, 71-72. Anderson believed that fee structure was generous.⁴⁴ Tr. 24. Anderson wondered if soft dollars might account for “some of the freneticism of the trading” in the Sapling account. Tr. 72. Anderson testified that he regarded the various account documents he received, such as the Form ADV, to be boilerplate and at the time he signed the investment management agreement, Mausner had no discussion with him about soft dollars. Tr. 75. Anderson now understood that some of the documentation mentioned soft dollars, but he did not know that at the time and would have objected had he known. Tr. 75.

Hall

Hall met Mausner in 1989 and was impressed with his academic and work background; she considered him a top-class investment adviser.⁴⁵ Tr. 786-87. In 2005, she invested \$950,000 in Fund 1.⁴⁶ Tr. 787-89; Div. Ex. 363. Hall withdrew \$240,00 from her account in 2009 because she heard through other investment advisers that Mausner had a cherry-picking issue while he was with Montgomery Securities, she received a letter that the Commission was auditing J.S. Oliver, and she wanted funds for home improvement. Tr. 790-91. Hall’s account increased in value in 2006 but lost value in 2007 through 2009 and she expected that it would recover value in 2009. Tr. 792-93. When Hall closed her J.S. Oliver account in 2010, she received \$224,970.⁴⁷ Div. Ex. 367; Tr. 791-92.

Hall testified that J.S. Oliver was compensated with a 1% fee of the asset value in her account, which she believed was standard for money managers. Tr. 790. No one at J.S. Oliver ever told Hall that J.S. Oliver generated soft dollar credits by executing trades on her behalf. Tr. 793-94. Hall considered that information important because she agreed to pay J.S. Oliver the 1% fee, and the use of soft dollars to pay Mausner’s personal expenses sounded unethical to her. Tr. 790, 794. Hall further testified that she would have thought differently about investing her money with J.S. Oliver if she had known that J.S. Oliver generated credits from trading with her funds and then paid Mausner’s personal expenses with those credits, stating that she wants her financial manager to be fair and ethical. Tr. 794.

⁴⁴ Sapling agreed to pay J.S. Oliver an annual advisory fee of 0.5% of the value of the assets of the account and a performance fee of 25% of profits made in the account. Tr. 1231-32; Div. Ex. 4 at 3428-29.

⁴⁵ Hall earned a bachelor of arts degree in studio art from the Western College for Women and an MBA in international marketing from New York University. Tr. 785. Hall retired in 2010 from a position in market development. Tr. 785.

⁴⁶ It appears that Hall received a 46-page offering memorandum for Fund 1. Tr. 796-97; Drennan Ex. 1316. The document contains a soft dollar disclosure consistent with the offering memoranda described supra. Drennan Ex. 1316 at 24-25. She did not read the document and testified that she would not have understood it if she had read it given its legal verbiage. Tr. 799.

⁴⁷ The J.S. Oliver Funds all had negative annual returns in 2010. Div. Ex. 696 at Porten Ex. 8.

David Mahler (Mahler)

Mahler met Mausner in 1995, at which time Mausner, then working for Montgomery Securities, assisted with the initial public offering of a software startup co-founded by Mahler.⁴⁸ Tr. 801-02. In 2004, Mahler and his wife invested approximately \$8 million in Fund 2.⁴⁹ Tr. 802-06; Div. Exs. 371, 372. Mahler understood that J.S. Oliver's management fee was 1%. Tr. 807, 823. In 2010, after discovering that Fund 2 had suffered massive losses, Mahler immediately withdrew the remaining funds, which stood at \$2 million, or 75% less than his initial investment. Tr. 821-22.

Mahler never heard the term soft dollars before being contacted by the Division; no one at J.S. Oliver ever mentioned the term soft dollars to him. Tr. 822-23. It was Mahler's understanding that the 1% management fee was "the sum total of all fees [to] be paid as part of the business relationship," and he viewed soft dollars as an additional fee that he "unwittingly" paid to J.S. Oliver. Tr. 823. Mahler would not have invested with J.S. Oliver if he had known that J.S. Oliver was using soft dollar credits earned through trading with his funds to pay Mausner's personal expenses, because Mahler has spent his entire business career trying to do the right thing and such soft dollar practices did not fit with his personal ethics. Tr. 824.

Division's Expert Witness on Soft Dollars

Charles Porten (Porten), president of CZP Associates, a registered investment adviser and litigation consulting firm, testified as an expert for the Division on: (1) disclosures made by J.S. Oliver related to the use of soft dollars; (2) how J.S. Oliver and Mausner used soft dollars and whether that use breached J.S. Oliver and Mausner's fiduciary duty to clients; and (3) whether Drennan's related actions comported with industry standards with respect to the challenged soft dollar payments.⁵⁰ Div. Ex. 696 at 3, 5.

Porten opined that (1) J.S. Oliver and Mausner breached their fiduciary duty to clients by misusing soft dollars in connection with the Kloes payment, Powerhouse payments, rent

⁴⁸ Mahler earned a bachelor of science degree in electrical engineering from Case Western Reserve University. Tr. 800. He has worked in computer engineering, and, in 2007, founded USA Together, a non-profit for severely wounded military service members returning from Iraq and Afghanistan. Tr. 800-01.

⁴⁹ Mahler received but did not read the entire inch-thick Fund 2 offering memorandum; rather, he asked Mausner to explain the fund and costs associated with it. Tr. 827.

⁵⁰ Porten is a graduate of the University of Pennsylvania with a degree in mechanical engineering, and he earned an MBA degree in finance from Harvard Business School in 1959. Tr. 175-76; Div. Ex. 696 at 3. He is a chartered financial analyst and has held series 7 and 63 licenses. Tr. 176; Ex. Div. 696 at 3. Porten has thirty-one years' experience in the securities industry and his former employment includes chief investment officer and group executive for IBJ Schroder Bank and Trust, portfolio manager at Neuberger Berman, various positions at Citibank, and senior analyst and unit head at J.P. Morgan. Div. Ex. 696 at 3 & App. A.

payments, and timeshare payments, and by failing to adequately disclose their use of soft dollars to clients for these uses; and (2) Drennan acted in a manner inconsistent with professional and industry standards by assisting with some of these payments. Div. Ex. 696 at 5. Porten opined that soft dollars are client assets that should be fully disclosed and used to benefit clients, but none of the challenged soft dollar payments were in the clients' best interests; the amounts were excessive; and the soft dollar payments presented conflicts of interests for J.S. Oliver, Mausner, and Drennan, as each benefited from certain payments. Div. Ex. 696 at 6.

Recordkeeping Violations

At the hearing, Mausner testified that J.S. Oliver's handwritten trade blotter for a "specific period" could not be found, but he could not recall exactly which period. Tr. 1342-43. In prior investigative testimony, however, Mausner testified that he did not keep J.S. Oliver's trade blotter pertaining to a six-to-nine-month period because he thought that BNP maintained the "official record" of trades, and therefore J.S. Oliver "didn't need to keep them." Tr. 1343-44.

J.S. Oliver also failed to maintain originals of Mausner's email messages and, in particular, the persons to whom Mausner sent emails, by blind carbon copy, touting the performance of CGF and encouraging investments in that fund; according to Mausner, he thought J.S. Oliver's email archive was retaining records as to whom he sent the emails, but later discovered that such records did not exist. Tr. 1252-61; see Div. Exs. 375-77.

Arguments of the Parties

Division's Opening Brief

First, the Division argues that Mausner and J.S. Oliver violated Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-8 (collectively, the antifraud provisions) as a result of: (1) their cherry-picking scheme in allocating profitable trades to the Favored Accounts and unprofitable trades to the Disfavored Accounts; and (2) their soft dollar practices with respect to the Kloes payment, rent payments, timeshare payments, and Powerhouse payments. Div. Initial Br. 40-60. Second, the Division argues that Drennan aided and abetted and caused J.S. Oliver's violations of the antifraud provisions, specifically regarding the soft dollar practices with respect to the Kloes payment, rent payments, and Powerhouse payments. Id. at 60-62.

Third, the Division argues that J.S. Oliver violated: (1) Advisers Act Section 204 by failing to make and keep appropriate records in the course of conducting its business, and, specifically, Rule 204-2(a)(3) by failing to maintain trade blotters and Rule 204-2(a)(7) by failing to maintain originals of Mausner's emails that promoted CGF's performance and contained his recommendation that the email recipients invest in that fund; and (2) Advisers Act Section 206(4) and Rule 206(4)-7 by failing to implement the firm's policies and procedures, as to trade allocations, designed to prevent Advisers Act violations. Id. at 62-63. Fourth, the Division argues that Mausner aided and abetted and caused J.S. Oliver's violations of these Advisers Act provisions. Id. at 64.

Fifth, the Division argues that Mausner and J.S. Oliver violated Advisers Act Section 207 because the firm's March 2009 Form ADV made material false statements about how it used soft dollars, and violated Advisers Act Rule 204-1(a)(2) by failing to amend J.S. Oliver's March 2007 and March 2009 Forms ADV to update information concerning its soft dollar practices.⁵¹ *Id.* at 64-65.

J.S. Oliver and Mausner's Brief

J.S. Oliver and Mausner argue that their soft dollar practices did not violate the antifraud provisions because they did not act with the requisite scienter, as they purport that Mausner reasonably relied on the advice of counsel and Instinet, and both counsel and Instinet vetted every soft dollar activity. Mausner Br. 42-45; *see id.* at 10, 24-30. As to their soft dollar practices, J.S. Oliver and Mausner contend: (1) the 2005 marital settlement agreement contained a "contract" between J.S. Oliver and Kloes, committing the firm to pay her salary over several years; (2) counsel brought to their attention that the firm was undercharging for rent and could raise or lower it within a range within their discretion, and the Division offers no proof to show what the appropriate rent would be per market rates or neighborhood-specific research; (3) the timeshare reduced hotel business expenses for Mausner's trips to New York; and (4) the majority of Drennan's work through Powerhouse was research related. *Id.* at 11-14, 30-37. Further, they argue that Porten's expert report is filled with errors and inaccuracies. *Id.* at 37-41.

Regarding the cherry-picking allegations, J.S. Oliver and Mausner argue that Glasserman's expert report is flawed because: (1) it does not examine all of the trades but a mere subsection of them, whereas the "performance reports" (i.e., the website printouts in Mausner Exhibits C and D) showed no difference between the so-called favored and disfavored accounts; and (2) it spends a great deal of time discussing disproportionate allocations, but such allocations in and of themselves "should exist between accounts of different size and different orientation." *Id.* at 45; *see id.* at 8-10, 18-20, 23-24. They contend that neither the Division nor the Glasserman report offered any proof that disproportionate allocations occurred "after the fact and caused harm," and the performance report and "Drennan's report" (i.e., Drennan's December 2008 email chart in Mausner Exhibit B) prove that there was no harm to the so-called disfavored accounts versus the so-called favored accounts. *Id.* at 45-47; *see id.* at 20-23.

Drennan's Brief

Drennan argues that he did not aid, abet, or cause J.S. Oliver's violations. Drennan Br. at 1-2, 29-67, 74. As to the Powerhouse payments, he contends that the evidence showed that, as a non-attorney who lacked formal training in the legal requirements of soft dollars, he had no reason to believe that he was contributing to an illegal scheme by providing Powerhouse invoices to Instinet. *Id.* at 49. Among other arguments, he asserts that: he provided research to J.S. Oliver that came within Exchange Act Section 28(e)'s safe-harbor provision and believed there

⁵¹ The OIP, however, alleges that J.S. Oliver willfully violated, and Mausner willfully aided and abetted and caused J.S. Oliver's violations of Advisers Act Section 204 and Rule 204-1(a)(2); the OIP does not allege a primary violation against Mausner for failure to update the firm's Forms ADV under these provisions. OIP at 9.

was sufficient support, including J.S. Oliver's disclosures, for payment for non-research activities; to the extent he performed non-research work, the firm's disclosures specifically anticipated non-research services; he sought advice from J.S. Oliver's counsel and repeatedly asked Instinet if such payments were proper; and he did not substantially assist or cause any primary violation because he was a third-party with no control over J.S. Oliver, was not an officer or employee of J.S. Oliver, and had no responsibility to maintain the firm's books and records. Id. at 29-51.

As to the Kloes payment, Drennan contends that he had no substantive involvement with this transaction, acted in good faith, and lacked information to conclude that that payment was improper because: he believed the 2005 marital settlement agreement created a contractual obligation of J.S. Oliver to Kloes; he acted in a mere clerical role and put into a more formal format the contractual obligation by typing the excerpt that was ultimately sent to Instinet; he believed that Instinet understood and vetted whether the payment was appropriate; and he believed that J.S. Oliver's counsel had agreed that the Kloes payment was proper. Id. at 51-64.

Last, Drennan contends that he acted reasonably and in good faith in working with Instinet on J.S. Oliver's rent payments because: he submitted the CGF memo, rather than the Fund 2 memo, to Instinet because the Fund 2 memo had factual errors, and, in any event, the rent payments were covered by soft dollar disclosures for other J.S. Oliver funds and in its Form ADV; he took reasonable steps to consult with J.S. Oliver's counsel and Instinet about the propriety of the rent payments; and the Division failed to prove that the rent payments were inflated. Id. at 65-67.

Division's Reply

In its Reply, the Division argues that Respondents fail to present any valid defense. Reply at 1. First, the Division contends that Mausner and J.S. Oliver's arguments against the evidence of cherry-picking are without merit because: the website printouts and Drennan email that they use to contest the Division's evidence are unreliable and were discredited by Drennan and Mausner's testimony; and their assertions that Glasserman only examined selected trades and did not determine whether the cherry-picking caused harm are belied by the evidence and Glasserman's report. Id. at 6-13.

Second, the Division contends that Respondents' arguments against liability for their soft dollar practices are unsupported. Specifically, the Division asserts: (1) Respondents fail to prove reliance on counsel and, in particular, they fail to show that they made complete disclosures to counsel about their soft dollar practices to support that defense and counsel did not approve the soft dollar practices at issue; (2) their soft dollar practices were not adequately disclosed to J.S. Oliver clients or fund investors; and (3) Drennan played a significant role in the rent payments, the evidence of Drennan's scienter with respect to the Powerhouse payments is strong, Drennan's contention that his work was almost entirely research related is contradicted by the evidence, and contrary to his assertion, there is no requirement for aiding and abetting liability that the respondent control the entity that committed the primary violation. Id. at 13-32. Last, the Division notes that J.S. Oliver and Mausner do not contest the remaining alleged violations. Id. at 32-33.

Legal Conclusions

As investment advisers, J.S. Oliver and Mausner were legally obligated as fiduciaries to act always in their clients' best interests, but they did not do so. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 189-91 (1963). The fraud perpetrated by J.S. Oliver and Mausner—deliberately allocating favorable trades to certain accounts to the detriment of other accounts, and misusing client assets known as soft dollars—strikes at the core of their fiduciary obligations. Drennan aided and abetted and caused several of J.S. Oliver's soft dollar misuses, which involved glaring conflicts of interest and fell outside Exchange Act Section 28(e)'s safe harbor.

Credibility

Neither Mausner nor Drennan was a credible witness. On several key facts, Mausner either did not remember or denied facts until the Division confronted him with prior testimony or exhibits demonstrating otherwise. He was argumentative and showed a lack of candor even when asked basic questions. One example of Mausner's lack of honesty is he maintained that his ex-wife was a J.S. Oliver employee during the time at issue. The overwhelming evidence and Mausner's own prior statements, however, establish that Kloes did not work for J.S. Oliver during the time at issue and performed virtually no work for J.S. Oliver after her 2005 divorce from Mausner. Moreover, Mausner's disingenuous statements to investors further undercut his credibility.

Drennan's testimony on several key points was implausible. Drennan claimed that he spent 95% of his time doing research, yet he did not produce one research paper, memorandum, or analysis that he authored or directed. Rather, Drennan performed extensive non-research activities. His lack of honesty is further demonstrated by his direct involvement in fabricating a non-existent contract between J.S. Oliver and Kloes, and drafting an email on Mausner's behalf representing that Kloes was an employee when he knew that the statements in the email were false. In fact, when questioned at the hearing, Drennan did not include Kloes in his list of J.S. Oliver employees.

J.S. Oliver and Mausner willfully violated the antifraud provisions by cherry-picking favorable trades for certain accounts to the detriment of other accounts and by misusing client soft dollar commissions

Applicable Law

J.S. Oliver and Mausner are charged with violating the antifraud provisions of Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-8. See 15 U.S.C. §§ 77q(a), 78j(b), 80b-6(1), (2), (4); 17 C.F.R. §§ 240.10b-5, 275.206(4)-8. The conduct violating one of the antifraud provisions may also violate other provisions, as they proscribe similar misconduct. See United States v. Naftalin, 441 U.S. 768, 773 n.4, 778 (1979); SEC v. Monarch Funding Corp., 192 F.3d 295, 308 (2d Cir. 1999); SEC v. Rana Research, Inc., 8 F.3d 1358, 1363 n.4 (9th Cir. 1993); SEC v.

Berger, 244 F. Supp. 2d 180, 192 (S.D.N.Y. 2001); SEC v. Blavin, 557 F. Supp. 1304, 1315 (E.D. Mich. 1983), aff'd, 760 F.2d 706 (6th Cir. 1985).

Securities Act Section 17(a) makes it unlawful for any person in the offer or sale of any securities to (1) employ any device, scheme, or artifice to defraud; (2) obtain money or property by means of material misstatements or omissions; or (3) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. 15 U.S.C. § 77q(a).

Exchange Act Section 10(b) and Rule 10b-5 make it unlawful for any person in connection with the purchase or sale of any security to (a) employ any device, scheme, or artifice to defraud; (b) make material misstatements or omissions; or (c) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5; see SEC v. Zandford, 535 U.S. 813, 816 n.1 (2002) (the scope of Rule 10b-5 is coextensive with Section 10(b)).

In relevant part, Advisers Act Section 206 makes it unlawful for any investment adviser to (1) employ any device, scheme, or artifice to defraud any client or prospective client; or (2) engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. 15 U.S.C. § 80b-6(1), (2).

Advisers Act Section 206(4) and Rule 206(4)-8 make it unlawful for any investment adviser to a pooled investment vehicle to (1) make material misstatements or omissions to any investor or prospective investor in the pooled investment vehicle; or (2) otherwise engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle. 15 U.S.C. § 80b-6(4); 17 C.F.R. § 275.206(4)-8.

Scienter is required to establish violations of Securities Act Section 17(a)(1), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Section 206(1); a showing of negligence is sufficient to establish violations of Securities Act Sections 17(a)(2) and 17(a)(3), Advisers Act Sections 206(2) and 206(4), and Advisers Act Rule 206(4)-8. Aaron v. SEC, 446 U.S. 680, 695-97, 701-02 (1980); SEC v. Steadman, 967 F.2d 636, 641 & n.3, 643 & n.5, 647 (D.C. Cir. 1992); SEC v. Yorkville Advisors, LLC, No. 12-cv-7728, 2013 WL 3989054, at *3 (S.D.N.Y. Aug. 2, 2013).

Material misstatements and omissions violate the antifraud provisions; the standard of materiality is whether a reasonable investor would have considered the information important in deciding whether to invest. See Basic, Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). To the extent liability is premised on material misstatements or omissions, J.S. Oliver and Mausner were the makers of the fraudulent statements because they had ultimate authority and legal control over such statements and responsibility for them. See Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302 (2011).

To form the basis of a violation under the antifraud provisions, the misconduct must be committed by jurisdictional means. 15 U.S.C. §§ 77q(a), 78j, 80b-6.

J.S. Oliver and Mausner were investment advisers

J.S. Oliver is a registered investment adviser. During the time at issue, Mausner was J.S. Oliver's CEO, portfolio manager, and ultimate decision maker on trade allocations and soft dollars. Mausner received compensation in connection with managing clients' funds and giving investment advice. He therefore is an investment adviser within the meaning of Advisers Act Section 202(a)(11) and, together with J.S. Oliver, may be charged as a primary violator under Advisers Act Section 206. See 15 U.S.C. § 80b-2(a)(11); Abrahamson v. Fleschner, 568 F.2d 862, 870 (2d Cir. 1977); Donald L. Koch, Exchange Act Release No. 72179, 2014 SEC LEXIS 1684, at *73-74 & n.196 (May 16, 2014). Because J.S. Oliver and Mausner made investment decisions on behalf of the J.S. Partner Funds and CGF—all pooled investment vehicles—each was an investment adviser to a pooled investment vehicle for purposes of liability under Advisers Act Section 206(4) and Rule 206(4)-8. See 15 U.S.C. § 80b-2(a)(11); 17 C.F.R. § 275.206(4)-8(a)-(b).

J.S. Oliver and Mausner's cherry-picking scheme constituted fraud, and involved material misstatements and omissions

J.S. Oliver and Mausner's cherry-picking scheme constituted fraudulent misconduct under the antifraud provisions. See SEC v. K.W. Brown & Co., 555 F. Supp. 2d 1275, 1303 (S.D. Fla. 2007) ("In nearly every conceivable way the cherry-picking scheme operated as a 'device, scheme, or artifice to defraud' and operated 'as a fraud or deceit upon' investors" under the Securities Act and Exchange Act antifraud provisions.); id. at 1308-09 (cherry-picking scheme also violated Advisers Act antifraud provisions).

Mausner was the only person at J.S. Oliver who could make the determination to order block trades and had final authority over allocating individual trades or shares among client accounts.⁵² In many cases, Mausner manually allocated trades among accounts instead of using the pre-set allocation system in BNP's OMS. Although manual allocations alone do not establish fraud, Glasserman's statistical analysis provides overwhelming evidence that cherry-picking occurred in the allocation of J.S. Oliver's block trades and that equity securities that had higher first-day returns were deliberately allocated to certain accounts to the detriment of three disfavored accounts. Glasserman's analysis and conclusions have not been seriously challenged. In addition, Glasserman's expert opinion is supported by the unchallenged testimony of

⁵² A corporation acts through individuals, such as its officers, directors, and employees. See Cohen v. Joint Health Ventures, 107 F. App'x 714, 718 n.1 (9th Cir. 2004); C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988); Stuart K. Patrick, 51 S.E.C. 419, 421 (1993), aff'd, 19 F.3d 66 (2d Cir. 1994); Restatement (Third) of Agency § 7.03, cmt. c. Given his position and authority at J.S. Oliver during the time at issue, Mausner's conduct is attributable to J.S. Oliver. See SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1089 n.3, 1096-97 nn.16-18 (2d Cir. 1972). Thus, references to either Mausner or J.S. Oliver's conduct encompass both Mausner and J.S. Oliver.

Anderson that another expert, engaged by Sapling in connection with its arbitration claim against J.S. Oliver and Mausner, found overwhelming evidence of cherry-picking by Mausner and financial harm to Sapling. Further, BNP's potential cherry-picking reports show disparities in trade allocations among accounts during the Relevant Period. Mausner's claim that he never received such reports is disingenuous.

The only logical inference from this evidence is that the disparities in trade allocations did not occur by mere happenstance or negligence, but by Mausner's deliberate scheme. The cherry-picking scheme compromised investment decisions and resulted in numerous trades not being made in clients' best interests. In fact, as Glasserman found, the cherry-picking caused about \$10.9 million in harm to the disfavored accounts. In turn, J.S. Oliver earned performance fees in 2008 from CGF that would not have been received but for the cherry-picking scheme.

Moreover, J.S. Oliver and Mausner's cherry-picking scheme involved material misstatements and omissions. Under the federal securities laws, an investment adviser is a fiduciary and therefore has an affirmative obligation of utmost good faith to avoid misleading clients; this duty includes disclosure of all material facts, possible conflicts of interest, and the adviser's personal interests when making recommendations to clients. See Capital Gains Research Bureau, 375 U.S. at 194, 201; Vernazza v. SEC, 327 F.3d 851, 859 (9th Cir. 2003), op. amended by 335 F.3d 1096 (9th Cir. 2003); Laird v. Integrated Res., Inc., 897 F.2d 826, 835 (5th Cir. 1990). False statements "can encompass participating in a course of business that operates as a fraud on the buyers or sellers of stock," as well as investors. K.W. Brown & Co., 555 F. Supp. 2d at 1304, 1308. The failure to disclose the practice of allocating favorable trades to certain accounts to the detriment of other accounts violates the antifraud provisions. Id. at 1304-05, 1308-09.

Mausner never disclosed to investors the manner in which he was allocating trades among client accounts, which unquestionably was material information. Rather, Mausner misled investors to believe that he was acting in clients' best interests. Hall testified that even if she was invested in a favored fund, the fact that trades were being allocated unfairly would have affected her investment decision.

When confronted by Anderson, Mausner falsely claimed that the lack of options trading accounted for the Sapling account's poor performance compared to J.S. Oliver hedge funds. Anderson's testimony also established that Mausner made material misrepresentations about Sapling's performance against market benchmarks. See Seaboard Inv. Advisers, Inc., 54 S.E.C. 1111, 1118 (2001) (misrepresentations overstating performance against market benchmarks are material). Further, in promoting the CGF fund and advising clients to invest in that fund, Mausner made representations about the fund's inflated performance without disclosing the cherry-picking scheme underlying such performance. Additionally, J.S. Oliver and Mausner, either directly or indirectly, obtained money as a result of management or performance fees from investors by means of these material misstatements and omissions.

Lastly, J.S. Oliver and Mausner's violations were willful. Mausner intentionally and oftentimes manually allocated trades among client accounts. See Wonsover v. SEC, 205 F.3d

408, 414 (D.C. Cir. 2000) (a finding of willfulness does not require intent to violate the law, but merely intent to commit the act which constitutes the violation).

J.S. Oliver and Mausner’s defense to the cherry-picking allegations

J.S. Oliver and Mausner’s criticism of Glasserman’s report is unsuccessful. Glasserman’s study criteria are sound. Glasserman considered the first-day returns for all equity transactions that appeared in the J.S. Oliver trade blotter from January 1, 2007, to November 30, 2009, which included more than 39,000 allocations of block trades executed on behalf of one or more J.S. Oliver clients during the Relevant Period and the prior seventeen-month period. Glasserman controlled for the various strategies that Mausner claimed were the reasons for the disparities and refuted Mausner’s theories. Mausner’s cross-examination of Glasserman revealed that he had no credible or serious challenge to Glasserman’s report. Mausner has no reasonable explanation for how block trades that occurred on the same day were disproportionately allocated among accounts.

Mausner’s exhibits are unpersuasive. Mausner Exhibit B, a purported “report” from Drennan, is an email Drennan sent to Mausner in early December 2013—a month before the hearing. Although Drennan’s email purports to show some figures related to the disfavored accounts, the exhibit does not reveal where he obtained the information. Mausner Exhibits C and D—which contain purported valuation analysis reports and figures for certain accounts or funds—are printouts from a website with no testimony regarding the source of the information and calculations contained on the website, the identity of the person who allegedly prepared the data or made the calculations, the manner in which the documents were prepared, or what the documents purportedly represent.

J.S. Oliver and Mausner’s soft dollar misuses constituted fraud, and involved material misstatements and omissions

This case shows that the real world application of Exchange Act Section 28(e) and use of soft dollars for purported non-Section 28(e) expenses can be, as it is here, a travesty. When fixed commission rates for executing security transactions on the exchanges were abolished in 1975, there was concern that broker-dealers would no longer be compensated for brokerage services and research, factors on which they used to compete, if orders were routed to broker-dealers that provided execution-only services at lower rates. See Commission Guidance, 71 Fed. Reg. at 41980. The result was that “Congress included a safe harbor in the 1975 Amendments,” codified as Exchange Act Section 28(e). Id.

The safe harbor provides generally that a money manager does not breach his fiduciary duties under state or federal law solely on the basis that the money manager has paid brokerage commissions to a broker-dealer for effecting securities transactions in excess of the amount another broker-dealer would have charged, if the money manager determines in good faith that the amount of the commissions paid is reasonable in relation to the value of the brokerage and

research services provided by such broker-dealer.⁵³ Id.; see 15 U.S.C. § 78bb(e)(3). As relevant here, a person provides research services insofar as he

(A) furnishes advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities; [or]

(B) furnishes analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts[.]

15 U.S.C. § 78bb(e)(3)(A)-(B); see Commission Guidance, 71 Fed. Reg. at 41985.

“Section 28(e) thus provides a limited exception from fiduciary standards for the use of client commissions to obtain brokerage and research services. It does not protect an adviser that uses a client’s commissions to pay for any other kind of services it receives.” Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. 904, 908 (1993). “Section 28(e) also does not insulate any person who engages in conduct that violates the antifraud provisions of the securities laws. Nor does it eliminate whatever disclosure obligations might arise under other provisions of the securities laws.” Id. at n.14. “Moreover, the adviser may not use its client’s assets for its own benefit without prior consent, even if it costs the client nothing extra.” Id. at 907.

Soft dollar arrangements are material because of the potential conflict of interest arising from an adviser’s receipt of some benefit in exchange for directing brokerage on behalf of client accounts, and thus must be disclosed. See Kingsley, 51 S.E.C. at 909-10; Commission Guidance, 71 Fed. Reg. at 41984; Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, 51 Fed. Reg. 16004-01, 16008 (Apr. 30, 1986) (Interpretive Release); cf. IMS/CPAs & Assocs., Securities Act Release No. 8031 (Nov. 5, 2001), 76 SEC Docket 669, 683 (“economic conflicts of interest . . . are material facts that must be disclosed”), pet. denied sub nom., Vernazza v. SEC, 327 F.3d 851 (9th Cir. 2003). An adviser must “state the types of products, research, or services obtained with enough specificity so that clients can understand what is being obtained. Disclosure to the effect that various research reports and products are obtained would not provide the specificity required.” Interpretive Release, 51 Fed. Reg. at 16008 n.29.

⁵³ The Commission has interpreted Section 28(e) to permit money managers to use client commissions to pay for research produced by someone other than the executing broker-dealer, in certain circumstances (referred to as “third-party research”), and has clarified that research provided in third-party arrangements is eligible under Section 28(e) even if the money manager participates in selecting the research services or products that the broker-dealer will provide. Commission Guidance, 71 Fed. Reg. at 41994. However, the Commission emphasized “that the safe harbor was not meant to allow money managers to use Section 28(e) arrangements to conceal the payment of client commissions to intermediaries (including broker-dealers) that provide benefits only to the money manager.” Id.

Expenses that fall outside Section 28(e) include travel expenses, “salaries (including research staff),” and rent. Commission Guidance, 71 Fed. Reg. at 41987. More detailed disclosure may be necessary when the adviser receives products or services that fall outside Section 28(e). Cf. id. at 41984. The Commission has warned that “[c]onduct not protected by Section 28(e) may constitute a breach of fiduciary duty as well as a violation of the federal securities laws.” Id. at 41981.

The three J.S. Oliver clients who testified had no knowledge of J.S. Oliver’s soft dollar practices, and as a result, they unwittingly paid more commissions than what they understood they had agreed to pay. Each was outraged when they learned what had happened. Even if they read all the fine print of the offering memoranda, client agreements, and Forms ADV, the documents would not have made any reasonable investor aware that Mausner radically increased J.S. Oliver’s use of soft dollars beginning in January 2009 or that soft dollars were being used in the specific ways at issue.

Kloes Payment. It is outrageous that the \$329,365 reimbursement payment to J.S. Oliver for Kloes, as purported employee compensation, was treated as an appropriate use of soft dollars. First, employee salaries are not eligible for soft dollar treatment under Exchange Act Section 28(e), and second, Kloes had not been a J.S. Oliver employee for several years when the payment was made.

The 2005 marital settlement obligated Mausner, in lieu of spousal support, to cause J.S. Oliver to make payments to Kloes. There was never a bona fide contract between J.S. Oliver and Kloes that obligated J.S. Oliver to pay Kloes any amount. Given his education and background, Mausner’s belief that there was a contract is simply incredible. Rather, Mausner directed Drennan to create a fake contract excerpt using language from the 2005 marital settlement and sent that excerpt to Instinet to support a lump-sum reimbursement request using client assets. Even if the divorce payment to Kloes could be considered salary, the payment was excessive and not in any client’s best interest given the lack of work Kloes performed for the firm during the time at issue.

Moreover, this use of soft dollars was never disclosed to clients, and it would have been undoubtedly material. Only the CGF offering memorandum disclosed salaries as a potential use of soft dollars, but such disclosure was woefully deficient. The three investors who testified were not in the CGF fund, and Fund 2 was the largest fund.

Rent Payments. J.S. Oliver and Mausner’s use of soft dollars to pay rent to J.O. Samantha, totaling \$300,000 in 2009 and 2010, was a fraudulent scheme and practice in every sense.

First, the rent payments to J.O. Samantha were excessive. Aside from Mausner’s self-serving testimony, nothing supports the rent levels unilaterally set by him. Once rent began being paid with soft dollars, Mausner increased the rent considerably, without any credible

justification.⁵⁴ I accept Porten's research that during the time at issue, rents in the San Diego area were far below the monthly rent paid to J.O. Samantha. Div. Ex. 696 at 33-34.

Second, substantial sums of money from the excess rent payments were transferred from J.O. Samantha to Mausner's personal bank account on a regular basis. It is the obligation of the investment adviser to determine that such use of client assets were in the clients' best interests, and Mausner did not do so. Rather, Mausner fraudulently and deliberately misappropriated client assets for his own benefit.

Moreover, this use of client assets and the fact that excessive sums were transferred to Mausner's bank account were not disclosed to clients. Mausner knew that J.S. Oliver's rent payments to J.O. Samantha fell outside Exchange Act Section 28(e). The March 2009 Form ADV, Part II, and J.S. Partners Funds' offering memoranda disclosed that certain overhead expenses may be paid with soft dollars, but the disclosures did not mention rent. Although the CGF offering memorandum disclosed that soft dollars may be used for rent, it did not disclose that such payments would be funneled to an entity owned and controlled by Mausner, and that large sums would be transferred to Mausner's personal bank account. See SEC v. Syron, 934 F. Supp. 2d 609, 629 (S.D.N.Y. 2013) (a party has a duty to be both accurate and complete so as to avoid rendering statements misleading). If disclosed, such information would have caused any reasonable investor to question whether to invest their funds under J.S. Oliver and Mausner's management.

Powerhouse Payments. J.S. Oliver and Mausner's use of soft dollars to pay Drennan through the sham entity Powerhouse, totaling \$482,381 from January 2009 to December 2010, was fraud.

The evidence is that Mausner rehired Drennan in 2009 solely because Drennan arranged to have his salary paid with soft dollars under the guise of Exchange Act Section 28(e). In Mausner's own words, this arrangement allowed him to hire back an employee for "free." Indeed, Drennan functioned as a J.S. Oliver employee, and his work did not come within Section 28(e)'s safe harbor as a person who performs research services. Further, J.S. Oliver and Mausner failed to make a good faith determination that: (1) the amount of commissions its customers paid was reasonable in relation to the value of the purported brokerage and research services provided, and (2) the expenses were suitable for the application of soft dollars. J.S. Oliver and Mausner should have considered whether: (1) the product or service fell within the definition of research or brokerage as defined in Exchange Act Section 28(e); (2) the eligible product or service actually provided lawful and appropriate assistance in J.S. Oliver's decision-making responsibilities; and (3) the amount of client commissions paid was reasonable in light of the value of the products or services provided. Commission Guidance, 71 Fed. Reg. at 41985.

Drennan's purported research consisted entirely of providing oral reports to Mausner. No credible evidence indicates that Drennan provided advice, analyses, or reports within the meaning of Section 28(e). See Commission Guidance, 71 Fed. Reg. at 41985-86 (although the

⁵⁴ Even without the rent increases, using client assets to cover the entire mortgage payment on the home, while J.S. Oliver operated out of only one room, would have been excessive as well.

Commission indicated that oral discussions may constitute eligible research, it “note[d] that an important common element among ‘advice,’ ‘analyses,’ and ‘reports’ is that each reflects substantive content—that is, the expression of reasoning or knowledge”). Various persons, including Drennan, testified that between 2009 and mid-2011, Drennan performed numerous administrative and trading tasks necessary for J.S. Oliver’s daily operations. In these circumstances, it was fraudulent for J.S. Oliver and Mausner to use soft dollars to pay Drennan as a research consultant under Section 28(e).

Moreover, this use of soft dollars was never disclosed to J.S. Oliver’s clients. As I found, Drennan essentially functioned as a J.S. Oliver employee. The CGF offering memorandum disclosed that J.S. Oliver may use soft dollars to pay salaries. However, the J.S. Partners Funds’ offering memoranda and the March 2009 Form ADV, Part II, did not. The disclosure in the CGF offering memorandum did not provide the specificity required and revealed nothing about the potential salary range, bonuses, and other material information about Drennan’s arrangement with the company.

Timeshare Payments. The use of soft dollars to pay \$40,094 in expenses for Mausner’s St. Regis timeshare has no credible justification as a Section 28(e) soft dollar expense and was a misuse of client assets for Mausner’s personal benefit, a blatantly fraudulent scheme and practice.

J.S. Oliver and Mausner never disclosed that soft dollars would be used to pay the timeshare expenses, and such payments were not in the best interests of J.S. Oliver’s clients. The disclosures in J.S. Oliver’s March 2009 Form ADV, Part II, and J.S. Partners Funds’ offering memoranda provided that soft dollars may be used to reimburse travel expenses related to conferences, and the CGF offering memorandum disclosed that soft dollars may be used for travel and other expenses related to a potential investment opportunity. There is no credible evidence that Mausner used the timeshare for such purposes and, in any event, he did not credibly apportion timeshare expenses based on business versus personal use.

J.S. Oliver and Mausner’s soft dollar misuses constituted fraudulent misconduct under the antifraud provisions. Such misuses also involved material misstatements and omissions.

Lastly, J.S. Oliver and Mausner’s soft dollar violations were willful; Mausner, either directly or by directing others to do so, sought soft dollar reimbursement or payment for each of the soft dollar misuses.

J.S. Oliver and Mausner’s defenses to the soft dollar allegations

J.S. Oliver and Mausner’s primary defenses to the soft dollar allegations are that: (1) they informed clients of their soft dollar uses in their Forms ADV, Part II, and in offering memoranda; and (2) executing brokers and attorneys approved the soft dollar uses.⁵⁵ I reject J.S. Oliver and Mausner’s first defense because, as discussed in the context of each of the soft dollar

⁵⁵ To the extent Drennan makes similar arguments, my conclusions apply equally to him.

misuses, there was inadequate disclosure. Even under the broadest document, the CGF offering memorandum, clients would not have received adequate disclosure.

I also reject J.S. Oliver and Mausner's reliance-on-counsel defense. Reliance on the advice of counsel is not a complete defense to liability, but a consideration in evaluating a respondent's scienter. Howard v. SEC, 376 F.3d 1136, 1147 (D.C. Cir. 2004). A valid defense of reliance on counsel requires a showing that the respondent (1) made a complete disclosure to counsel; (2) requested counsel's advice as to the legality of the contemplated action; (3) received advice that it was legal; and (4) relied in good faith on that advice. SEC v. Goldfield Deep Mines Co. of Nev., 758 F.2d 459, 467 (9th Cir. 1985); SEC v. Savoy Indus., Inc., 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981).

J.S. Oliver and Mausner fail to meet this standard. They did not fully disclose to counsel that: (1) Kloes performed virtually no work for J.S. Oliver since 2005; (2) the excessive nature of the rent paid to J.O. Samantha and that substantial sums benefited Mausner; (3) Drennan functioned as a J.S. Oliver employee; and (4) Mausner's timeshare was used for various personal purposes. Moreover, there is no credible evidence, and certainly no written material, showing that Howard Rice or any other counsel approved the soft dollar payments at issue.

J.S. Oliver and Mausner's reliance on Instinet for purportedly approving the soft dollar payments is unpersuasive. As fiduciaries, the obligation of complying with the federal securities laws lies with the investment adviser. J.S. Oliver and Mausner's representation that they relied on Instinet for disinterested advice is disingenuous. Instinet had a mutually beneficial relationship with J.S. Oliver and Mausner; more trades caused more commissions for Instinet and soft dollars credits that J.S. Oliver and Mausner could use for various expenses. In an instant message to Instinet's soft dollar group in February 2009, Driscoll stated, "Its (sic) funny, this crappy little account I brought on 2 weeks ago turned into our biggest option account. They are averaging 5k to 10k contracts a day." Drennan. Ex. 390 (formatting and capitalization altered); Tr. 351. Although this communication was not conveyed to Respondents, the communications between Instinet and Respondents only reinforce the fact that the relationship was one of mutual benefit and, in some circumstances, J.S. Oliver and Mausner made false or misleading representations to Instinet. Aesop got it right, the fox, whatever he claims, does not intend to guard the hen house. Cf. The Fox, the Cock, and the Dog, Aesop's Fables 63 (retold by Joseph Jacobs; Hayes Barton Press 2005).

J.S. Oliver and Mausner used jurisdictional means

To perpetrate the cherry-picking scheme, Mausner, or others acting at his direction, executed block trades and allocated individual trades or shares among accounts, and made representations to investors, all through the means and instruments of interstate commerce, including electronic means and the Internet. See SEC v. Tourre, No. 10-cv-3229, 2013 WL 2407172, at *11 (S.D.N.Y. June 4, 2013); Heyman v. Heyman, 356 F. Supp. 958, 969 (S.D.N.Y. 1973); cf. Rita J. McConville, 58 S.E.C. 596, 619-20 (2005), pet. denied, 465 F.3d 780 (7th Cir. 2006). Likewise, to perpetrate the soft dollar misuses, Mausner, or others acting at his direction, generated soft dollar credits in client accounts by executing trades, submitted soft dollar invoices and authorized soft dollar payments in Instinet's online soft dollar system, and promoted the

CGF fund and made other representations to investors, all through the means and instruments of interstate commerce, including electronic means and the Internet. Thus, J.S. Oliver and Mausner's antifraud violations were committed by jurisdictional means.

Nexus requirement

J.S. Oliver and Mausner's cherry-picking scheme related to how purchased and sold securities were allocated among clients, and to how offered securities were promoted to prospective and current clients. J.S. Oliver and Mausner's soft dollar misuses related to how purchased and sold securities generated soft dollar credits in client accounts, and how securities were offered without adequate soft dollar disclosures. Thus, the cherry-picking and soft dollar violations were committed in the offer or sale of securities under Securities Act Section 17(a), and in connection with the purchase or sale of a security under Exchange Act Section 10(b) and Rule 10b-5. See Zandford, 535 U.S. at 819-20, 825 (Exchange Act Section 10(b)'s nexus requirement is to be construed broadly and flexibly and satisfied by a fraudulent scheme in which the securities transactions and breaches of fiduciary duty coincide); Naftalin, 441 U.S. at 778 (Securities Act Section 17(a) was intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading).

Scienter

Mausner acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud." Aaron, 446 U.S. at 686 n.5 (internal quotation marks omitted); cf. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341 (2005) (describing scienter as a "wrongful state of mind"). Scienter may be established by extreme recklessness—an extreme departure from the standards of ordinary care that presents a danger of misleading buyers, sellers, or investors that is either known to the respondent or is so obvious that he must have been aware of it. See SEC v. Steadman, 967 F.2d at 641-42; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990) (en banc). Scienter may be inferred from circumstantial evidence. Herman & MacLean v. Huddleston, 459 U.S. 375, 390-91 n.30 (1983).

Mausner apportioned individual trades or shares among client accounts or directed others to do so. As found, the only logical inference from Glasserman's report and BNP's reports is that Mausner allocated trades after the market close to benefit certain accounts to the detriment of others. He lied to Anderson that the Sapling account's performance was due to options, and provided Anderson with disingenuous explanations to cover-up why the Sapling account did poorly. Mausner promoted a newly created fund, CGF, to investors, the peak performance of which was due to the cherry-picking scheme.

Mausner's use of soft dollars to pay Kloes establishes a high level of scienter. He worked with Drennan to fabricate a contract between J.S. Oliver and Kloes, based on the 2005 marital settlement, and used that falsified document in order to submit a reimbursement request to Instinet. Also, after the arrangement with Instinet was in place to pay rent with soft dollars, Mausner repeatedly increased the rent paid to J.O. Samantha, an entity that Mausner controlled, and personally directed large sums to be transferred to his bank account on a regular basis. As to

the Powerhouse payments, Mausner knew that he was using client assets to pay an employee, not an independent research consultant, and the six-figure salary to Drennan plus bonuses was excessive. Drennan produced no credible research for J.S. Oliver and essentially functioned as a trader, accountant, and administrative assistant. Finally, Mausner knew he was using client assets to pay for his St. Regis timeshare expenses.

Mausner's scienter is imputed to J.S. Oliver. See Manor Nursing Ctrs., 458 F.2d at 1096-97 nn.16-18; Clarke T. Blizzard, 57 S.E.C. 696, 708 & n.16 (2004).

Drennan willfully aided and abetted and caused J.S. Oliver's antifraud violations as to the soft dollar misuses related to the Kloes payment, rent payments, and Powerhouse payments⁵⁶

The criteria for aiding and abetting liability are that: (1) a principal committed a primary violation; (2) the alleged aider and abettor provided substantial assistance to the primary violator; and (3) the alleged aider and abettor provided such assistance with the necessary scienter, i.e., that he rendered such assistance knowingly or recklessly.⁵⁷ See Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000); Phlo Corp., Exchange Act Rel. No. 55562 (Mar. 30, 2007), 90 SEC Docket 1089, 1103.

To satisfy the substantial assistance prong, it must be established that the alleged aider and abettor in some sort associated himself with the venture, that he participated in it as in something that he wished to bring about, and that he sought by his action to make it succeed. SEC v. Apuzzo, 689 F.3d 204, 206-07 (2d Cir. 2012). The scienter requirement is satisfied by actual knowledge of the wrongdoing or extreme recklessness.⁵⁸ Howard v. SEC, 376 F.3d 1136, 1142-43 & n.10 (D.C. Cir. 2004); Graham, 222 F.3d at 1000. "A secondary violator may act recklessly, and thus aid and abet an offense, even if he is unaware that he is assisting illegal

⁵⁶ Specifically, as to these soft dollar misuses, Drennan willfully aided and abetted and caused J.S. Oliver's violations of Securities Act Sections 17(a)(1) and (2); Exchange Act Section 10(b) and Rule 10b-5; and Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-8.

⁵⁷ This test has also been formulated as: "1) another party has committed a securities law violation; 2) the accused aider and abettor had a general awareness that his role was part of an overall activity that was improper; and 3) the accused aider and abettor knowingly and substantially assisted the principal violation." Investors Research Corp. v. SEC, 628 F.2d 168, 178 (D.C. Cir. 1980). The requirement that "the aider and abettor had a general awareness that his role was part of an overall activity that was improper" has been reformulated under the scienter requirement under more recent case law. See Howard v. SEC, 376 F.3d 1136, 1142-43 (D.C. Cir. 2004); Graham, 222 F.3d at 1000 (explaining that the aiding and abetting test has been "variously formulated" and citing Investors Research, among other circuit precedent, for the D.C. Circuit's more recent articulation of the test).

⁵⁸ At least one court has held that if there is no fiduciary duty, the scienter requirement increases, such that the aider and abettor acted with intent. See Ross v. Bolton, 904 F.2d 819, 824 (2d Cir. 1990).

conduct.” Howard, 376 F.3d at 1143; see Sharon M. Graham, 53 S.E.C. 1072, 1084 n.33 (1998) (a person cannot escape aiding and abetting liability by claiming ignorance of the securities laws), aff’d, 222 F.3d 994 (D.C. Cir. 2000). This is because “[e]xtreme recklessness . . . may be found if the alleged aider and abettor encountered red flags, or suspicious events creating reasons for doubt that should have alerted him to the improper conduct of the primary violator, or if there was a danger . . . so obvious that the actor must have been aware of the danger.” Howard, 376 F.3d at 1143 (internal quotation marks and citations omitted). In other words, scienter may be established by the aider and abettor’s reckless disregard of the wrongdoing and his role in furthering it. Phlo, 90 SEC Docket at 1103 & n.49. A respondent who aids and abets a violation is a cause of the violation. See Zion Capital Mgmt., LLC., 57 S.E.C. 99, 116 (2003).

First, J.S. Oliver violated the antifraud provisions by misusing soft dollars, thus a primary violation has been committed.

Second, Drennan provided substantial assistance as to J.S. Oliver’s soft dollar misuses related to the Kloes payment, rent payments, and Powerhouse payments. Drennan was the moving force in establishing J.S. Oliver’s soft dollar arrangements. As to the Kloes payment, Drennan helped prepare the excerpt of a non-existent contract between J.S. Oliver and Kloes, knew that Kloes had not actually worked for J.S. Oliver during the time at issue, and approved the Kloes payment on J.S. Oliver’s behalf in Instinet’s online soft dollar system. His alleged belief that the 2005 marital settlement created a contract between J.S. Oliver and Kloes and his contention that he had no substantive involvement in this transaction are belied by the record. As to the rent payments, Drennan discussed with Mausner using soft dollars for J.S. Oliver’s rent payments, sent rent invoices to Instinet, approved on J.S. Oliver’s behalf at least a few of the rent payments in Instinet’s online soft dollar system, and knew that funds from the excessive rent payments were being transferred from J.O. Samantha to Mausner’s bank account.⁵⁹

As to the Powerhouse payments, Drennan proposed to Mausner that he be paid with soft dollars via Powerhouse; knew that he was receiving salary via Powerhouse in the form of soft dollars under the guise of Section 28(e) when, in fact, he was performing significant non-research-related activities; drafted the Powerhouse invoices; and, in at least a few instances, approved payment to Powerhouse in Instinet’s soft dollar system.⁶⁰

⁵⁹ Tellingly, Drennan’s various remarks reflect that he wanted the misconduct to succeed. See, e.g., Tr. 620-21, Div. Ex. 424 (Drennan’s response after Instinet’s first soft dollar rent reimbursement: “The eagle has landed in JO Samantha!!!!”); Tr. 664, Div. Ex. 351 (Drennan’s response that funds could be moved to Mausner’s personal account: “Yeah baby!!!”).

⁶⁰ Contrary to Drennan’s suggestion, no authority supports the proposition that aiding and abetting liability is not found where the respondent did not control the entity that committed the primary violation. Drennan’s reliance on Douglas W. Powell, Initial Decision Release No. 255, 2004 SEC LEXIS 1796, at *63-64 (Aug. 17, 2004), is misplaced because, in that initial decision, the law judge dismissed the aiding and abetting charges because there was no primary violation under Exchange Act Section 15(b)(1) and Rule 15b7-1.

Third, Drennan had a high level of scienter. He had actual knowledge of the misconduct at issue and intended to further such misconduct through his substantial assistance. Moreover, Drennan acted with extreme recklessness. Drennan was a well-educated securities professional. Drennan knew that most of these soft dollar misuses fell outside Section 28(e); as to the Powerhouse payments, he knew that salaries for an adviser's research staff were not eligible research under Section 28(e). He was reckless in setting up the soft dollar payments for Powerhouse without obtaining an independent legal opinion. Drennan puts weight on the fact that he is not a lawyer, however, even a basic reading of the information provided by various sources, including Instinet and BTIG, made plain the requirements of Section 28(e).

Drennan's contention that he purportedly consulted with J.S. Oliver and Mausner's counsel Howard Rice, instead of obtaining independent legal advice, does not bolster his defense. Rather, it demonstrates that Drennan was not independent from J.S. Oliver and Mausner, but one and the same.

Lastly, Drennan acted willfully; he intentionally facilitated the use of soft dollars for the Kloes payment, rent payments, and Powerhouse payments.

J.S. Oliver willfully violated Advisers Act Section 204 and Rules 204-2(a)(3) and 204-2(a)(7), and Mausner willfully aided and abetted and caused J.S. Oliver's violations

Advisers Act Section 204 requires every investment adviser to "make and keep" records as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. 15 U.S.C. § 80b-4(a). Advisers Act Rule 204-2(a)(3) requires investment advisers to make and keep "[a] memorandum of each order given by the investment adviser for the purchase or sale of any security," and Advisers Act Rule 204-2(a)(7) requires investment advisers to maintain originals of all written communications received and sent by the investment adviser relating to "any recommendation made or proposed to be made and any advice given or proposed to be given." 17 C.F.R. § 275.204-2(a)(3), (7).

J.S. Oliver willfully violated Advisers Act Section 204 and Rule 204-2(a)(3) by failing to maintain trade blotters memorializing each order by J.S. Oliver for the purchase or sale of securities. As Mausner was forced to acknowledge, he testified during the investigation that he did not keep the trade blotter for a six-to-nine-month period because he thought BNP kept a record.⁶¹

J.S. Oliver also willfully violated Advisers Act Section 204 and Rule 204-2(a)(7) by failing to maintain originals of email messages promoting CGF's performance and recommending that current and prospective investors invest in CGF. As Mausner admitted, no original copy of such communications was saved, and the emails do not reflect the recipients.

⁶¹ Although the exact time period of the violation is not clear from Mausner's testimony, it can be inferred that the missing trade blotter occurred in the time period shortly after October 2008, which is when J.S. Oliver became a client of BNP. Tr. 147.

Mausner willfully aided and abetted and caused J.S. Oliver's violations. See Zion Capital Mgmt. LLC, 57 S.E.C. at 116. He had complete control over J.S. Oliver and the firm's course of conduct. He acknowledged that he did not keep the trade blotter for a period of time and, in fact, discarded it, which was extremely reckless.

Mausner also personally sent the emails to investors without taking any steps to ensure that originals were maintained, which was at minimum a reckless disregard to his duties as J.S. Oliver's sole person in control.

J.S. Oliver willfully violated Advisers Act Section 206(4) and Rule 206(4)-7, and Mausner willfully aided and abetted and caused J.S. Oliver's violations

Advisers Act Section 206(4) makes it unlawful for an investment adviser to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative; and directs the Commission to promulgate rules reasonably designed to prevent such fraudulent acts, practices, and courses of business. 15 U.S.C. § 80b-6(4). Under Advisers Act Rule 206(4)-7, it is unlawful for an investment adviser to provide investment advice to clients unless the adviser (a) adopts and implements written policies and procedures reasonably designed to prevent violation, by the adviser and supervised persons, of the Advisers Act and Rules; (b) review, no less frequently than annually, the adequacy of the policies and the effectiveness of their implementation; and (c) designate an individual (who is a supervised person) responsible for administering the policies and procedures. 17 C.F.R. § 275.206(4)-7.

Although J.S. Oliver had a compliance manual, it essentially ignored its written policies and procedures on trade allocations, never implemented such policies, and had no review procedures in place. Mausner simply claimed to be the chief compliance officer for a period of time. Contrary to J.S. Oliver's written policies, it did not allocate trades in a fair and equitable manner to clients. As a result, J.S. Oliver willfully violated Advisers Act 206(4) and Rule 206(4)-7.

Mausner willfully aided and abetted and caused J.S. Oliver's violations. He had complete control over J.S. Oliver and the firm's course of conduct. In addition, as J.S. Oliver's chief compliance officer during the 2008 to 2009 period, Mausner was responsible for overseeing J.S. Oliver's compliance procedures, but recklessly, if not intentionally, failed to implement or follow them.

J.S. Oliver and Mausner willfully violated Advisers Act Section 207; and J.S. Oliver willfully violated Advisers Act Section 204 and Rule 204-1(a)(2), violations that Mausner willfully aided and abetted and caused

Under Advisers Act Section 207, it is unlawful for any person willfully to make any untrue statements of material fact, or material omissions, in certain applications or reports with the Commission, such as a Form ADV. 15 U.S.C. § 80b-7; see Vernazza, 327 F.3d at 858; Montford & Co., Advisers Act Release No. 3829, 2014 SEC LEXIS 1529, at *68 (May 2, 2014). Moreover, Advisers Act Section 204 and Rule 204-1(a)(2) require an investment adviser, in addition to an annual amendment, to amend its Form ADV "[m]ore frequently, if required by the

instructions to Form ADV.” 17 C.F.R. § 275.204-1(a)(2). “The instructions to the Form ADV specify that a registrant must, in addition to the annual amendment, update its Form ADV *promptly* if information provided in Part II becomes materially inaccurate.” K.W. Brown & Co., 555 F. Supp. 2d at 1310. The Commission has “stated that Form ADV and its amendments embody a basic and vital part in our administration of the Advisers Act, and it is essential in the public interest that the information required by the application form be supplied completely and accurately.” Montford & Co., 2014 SEC LEXIS 1529, at *68 (internal quotation marks and alteration brackets omitted). Scierter is not required to find a violation of these provisions. Id. The failure to make a required report, even if inadvertent, constitutes a willful violation. Lowe Mgmt. Corp., 47 S.E.C. 546, 549 n.5 (1981).

J.S. Oliver’s March 2009 Form ADV, Part II, made material false statements about how it used soft dollars because although the form stated that soft dollars may be used for certain expenses, J.S. Oliver used soft dollars for unspecified and undisclosed expenses such as employee salaries; rent to an entity owned by Mausner; payments to Mausner’s ex-wife, who performed virtually no work for J.S. Oliver after her 2005 divorce from Mausner; and payments to a luxury timeshare. The Form ADV did not disclose that soft dollars generated from separately managed individual client accounts (non-hedge fund accounts) would be used to pay J.S. Oliver and Mausner’s expenses. This was material information that investors were entitled to know. As a result, J.S. Oliver willfully violated Advisers Act Section 207. Mausner is liable as a primary violator under Advisers Act Section 207, as he had final responsibility over the Form ADV and thus was a maker of the statements.

J.S. Oliver also failed to amend its Forms ADV, Part II, dated March 2007 and March 2009, to update information concerning its soft dollar practices, including the soft dollar misuses at issue and that it significantly expanded its use of soft dollars beginning in January 2009. As a result, J.S. Oliver willfully violated Advisers Act Section 204 and Rule 204-1(a)(2). Mausner willfully aided and abetted and caused these violations, as he controlled J.S. Oliver, had final approval over the forms and their content, and knew about and oversaw J.S. Oliver’s change in its soft dollar practices. See K.W. Brown & Co., 555 F. Supp. 2d at 1310.

Sanctions

Revocation of J.S. Oliver’s registration and industry bars for Mausner and Drennan

The Division recommends that J.S. Oliver’s investment adviser registration be revoked, and that Mausner and Drennan be subject to industry bars.

In relevant part, Advisers Act Section 203(e) authorizes the Commission to revoke an investment adviser’s registration if the sanction is in the public interest and the adviser, or any person associated with it, (1) has willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission; or (2) has willfully violated, or willfully aided and abetted violations of, certain provisions of the securities laws. 15 U.S.C. § 80b-3(e)(1), (5), (6).

Advisers Act Section 203(f) authorizes the Commission to bar any person from the securities industry if such person was associated with an investment adviser at the time of the alleged misconduct, such sanction is in the public interest, and such person (1) has willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission; or (2) has willfully violated, or willfully aided and abetted violations of, certain provisions of the securities laws.⁶² 15 U.S.C. § 80b-3(f), (e)(1), (5), (6); see John W. Lawton, Advisers Act Release No. 3513 (Dec. 13, 2012), 105 SEC Docket 61722, 61732 n.30, 61737.

Advisers Act Sections 203(e) and 203(f) apply because J.S. Oliver and Mausner willfully violated the antifraud provisions of the securities laws; J.S. Oliver and Mausner willfully made and caused to be made materially false and misleading statements and omissions in the March 2009 Form ADV, Part II; Mausner willfully aided and abetted and caused J.S. Oliver's other Advisers Act violations; and Drennan willfully aided and abetted and caused several of J.S. Oliver's violations of the antifraud provisions. Mausner and Drennan were both associated with an investment adviser during the time of the alleged misconduct. I will therefore consider whether revocation of J.S. Oliver's registration and sanctions against Mausner and Drennan are in the public interest.

In determining whether sanctions are in the public interest, the Commission considers the Steadman factors: the egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his conduct; and the likelihood that the respondent's occupation will present opportunities for future violations. Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981); Montford & Co., 2014 SEC LEXIS 1529, at *77. The Commission also considers the deterrent effect of administrative sanctions. See Schild Mgmt. Co., Exchange Act Release No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862 & n.46. "The Commission's inquiry into the appropriate sanction to protect the public interest is a flexible one, and no one factor is dispositive." Montford & Co., 2014 SEC LEXIS 1529, at *77 (internal quotation marks and alteration brackets omitted); see Ross Mandell, Exchange Act Release No. 71668, 2014 SEC LEXIS 849, at *7-9, *14 (Mar. 7, 2014).

J.S. Oliver and Mausner's willful violations of the antifraud provisions were egregious and recurrent. The Commission has "repeatedly held that conduct that violates the antifraud provisions of the securities laws is especially serious and subject to the severest of sanctions under the securities laws." Peter Siris, Exchange Act Release No. 71068, 2013 SEC LEXIS

⁶² If the criteria under Advisers Act Section 203(f) are satisfied, the Commission is authorized to bar the person from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. This list is collectively referred to as an industry bar. Investment Company Act Section 9(b) authorizes certain bars on association with an investment company. 15 U.S.C. § 80a-9(b)(1), (2), (3). Although the Division references Section 9(b) in its brief in passing, it does not request Section 9(b) bars. Div. Initial Br. at 65-67. I therefore deem any Section 9(b) remedy abandoned.

3924, at *23 (Dec. 12, 2013) (internal quotation marks omitted). Mausner allocated trades with the most profitable first-day returns to certain accounts to the detriment of three disfavored accounts from June 2008 to November 2009, a practice that harmed the disfavored accounts by \$10.9 million. Additionally, Mausner drastically changed J.S. Oliver's soft dollar practices beginning in early 2009, using client assets to pay for inappropriate expenses. The soft dollar misuses totaled over \$1 million in 2009 and 2010. Both the cherry-picking and soft dollar misuses were repeated, not isolated or technical offenses. Investment advisers have an "affirmative duty of utmost good faith, and full and fair disclosure of all material facts." Capital Gains Research Bureau, 375 U.S. at 194 (internal quotation marks omitted). Mausner failed to abide by such standards.

Moreover, as discussed supra, Mausner acted with a high degree of scienter, and his misconduct and scienter is imputed to J.S. Oliver. Although Mausner claims that J.S. Oliver has since adopted a more conservative soft dollar policy, the Commission has repeatedly declined to credit a respondent whose misconduct stopped only after it was detected by regulators. See Donald L. Koch, 2014 SEC LEXIS 1684, at *81.

Mausner received a top-notch business education and has high-level securities industry experience. The knowledge, demeanor, and understanding Mausner exhibited during this proceeding leave no doubt that he acted knowing that what he was doing personally, and through J.S. Oliver, was wrong. Mausner's failure to come to grips with what he did is shown by his futile attempts to blame a law firm and executing brokers for his misconduct. Mausner shows no remorse. If Mausner were to continue in his current occupation, it would undoubtedly present the opportunity for future violations.

Drennan's misconduct was egregious and recurrent. As a college graduate, with years of industry experience, and as a chartered financial analyst at the time of the misconduct, it is implausible that Drennan did not understand his wrongdoing. J.S. Oliver's expanded use of soft dollars—which Drennan initiated, encouraged, and facilitated—was totally inappropriate. Contrary to Drennan's disingenuous explanation, Instinet's rationale that disclosure made any expenses eligible for soft dollar treatment was questionable and inapplicable because J.S. Oliver did not disclose to its clients how its use of soft dollars had radically changed or the specific uses at issue. In early 2009, Drennan received a list prepared by a reputable law firm showing eligible and ineligible research and brokerage products and services. Drennan ignored this information and instead enabled J.S. Oliver's soft dollar misuses over a span of at least two years. Drennan provided Instinet with only the CGF offering memorandum and did not provide copies of other fund offering memoranda with different disclosure language. His contention that he did so only because the other offering memoranda contained outdated information is incredible. The executing brokers claimed they relied on Mausner and Drennan's representations that J.S. Oliver's use of soft dollars was legitimate.

Drennan has shown no understanding that his actions were wrong or contrition for the financial harm suffered by J.S. Oliver clients as a result of the soft dollar misuses. Like Mausner, Drennan blames lawyers and executing brokers for his misconduct. If permitted to remain in the securities industry, Drennan's occupation would present the opportunity for future violations.

“Because the securities industry presents continual opportunities for dishonesty and abuse, and depends heavily on the integrity of its participants and on investors’ confidence, it is essential that the highest ethical standards prevail in every facet of the securities industry.” Donald L. Koch, 2014 SEC LEXIS 1684, at *86 (internal quotation marks omitted). The antifraud provisions that J.S. Oliver and Mausner violated, and that Drennan aided and abetted and caused, apply broadly to the conduct of all participants in the securities industry. See id. Moreover, it is apparent that Respondents “do not understand the regulatory and fiduciary responsibilities of an investment adviser” and associated persons. Seaboard Inv. Advisers, 54 S.E.C. at 1120.

Applying the Steadman factors and considering the need to deter others from similar misconduct, it is in the public interest to revoke J.S. Oliver’s registration as an investment adviser. See Piper Capital Mgmt., Inc., 56 S.E.C. 1033, 1082, 1085 (2003) (revoking investment adviser’s registration, among other sanctions, for “fraudulent and deceitful conduct, as well as deliberate and reckless disregard of various regulatory requirements”), pet. denied, No. 03-1349 (D.C. Cir. 2004). For similar reasons, industry bars to the fullest extent are imposed against Mausner and Drennan.

Cease and desist

The Division recommends that cease-and-desist orders be issued against each Respondent.

Securities Act Section 8A, Exchange Act Section 21C, and Advisers Act Section 203(k) authorize the Commission to issue a cease-and-desist order against any person who has violated the Securities Act, Exchange Act, or Advisers Act, respectively, or any rule or regulation thereunder; or against any person who caused the violation due to an act or omission the person knew or should have known would contribute to such violation. 15 U.S.C. §§ 77h-1(a), 78u-3(a), 80b-3(k)(1). Although there must be some likelihood of future violations whenever the Commission issues a cease-and-desist order, the required showing is “significantly less than that required for an injunction.” KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1185, 1191 (2001), pet. denied, 289 F.3d 109 (D.C. Cir. 2002). Absent evidence to the contrary, a single past violation ordinarily suffices to establish a risk of future violations. Id. at 1185, 1191.

In determining whether to issue a cease-and-desist order, the Commission’s considerations are essentially the same as the Steadman factors. See id. at 1192. In addition, the Commission considers “whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings.” Id. The Commission weighs these factors in light of the entire record, and no one factor is dispositive. Id.; accord Montford & Co., 2014 SEC LEXIS 1529, at *88.

As already found, the Steadman factors weigh heavily in favor of sanctions. Respondents betrayed their fiduciary responsibilities in a blatant, self-serving manner. Although the violations occurred a few years ago, the misconduct related to the cherry-picking and soft dollar

misuses was repetitive and ongoing. Looking to the future, there is a high possibility for future violations because despite overwhelming evidence that they committed the violations, Respondents gave no indication that they recognized their actions were wrong and have not voiced any remorse.

Both the cherry-picking scheme and soft dollar misuses involved harm to investors and the marketplace. Regarding the cherry-picking scheme, Glasserman found that the three disfavored accounts suffered, individually, millions of dollars in losses, which together totaled \$10.9 million. Also, investors in favored accounts, including CGF, were materially misled and not given full disclosure. Confidence in the marketplace is undermined by trading allocation practices such as those perpetrated by J.S. Oliver and Mausner. Regarding the soft dollar misuses, over \$1 million in soft dollars were misused in 2009 and 2010 as a result of Respondents' violations. Such soft dollar practices harmed every J.S. Oliver client, including Anderson, Hall, and Mahler.

With respect to the remaining Advisers Act violations related to books and records, the Form ADV, Part II, disclosures, and failed compliance procedures, J.S. Oliver and Mausner demonstrated a reckless disregard of their duties and basic requirements of the securities laws.

Even considering the other sanctions in this proceeding, cease-and-desist orders will serve the public interest by specifying that Respondents can no longer engage in such flagrant misconduct and put others on notice that similar misconduct will not be tolerated. For these reasons, cease-and-desist orders against each Respondent for their violations are in the public interest.

Disgorgement

Securities Act Section 8A(e), Exchange Act Section 21C(e), and Advisers Act Section 203(k)(5) authorize disgorgement, including reasonable interest, in cease-and-desist proceedings. 15 U.S.C. §§ 77h-1(e), 78u-3(e), 80b-3(k)(5). Exchange Act Section 21B(e), Investment Company Act 9(e), and Advisers Act Section 203(j) authorize disgorgement in proceedings in which a penalty may be imposed under such sections. 15 U.S.C. §§ 78u-2(e), 80a-9(e), 80b-3(j). Penalties may be imposed under such sections for willful violations, or willfully aiding and abetting violations, of the securities laws, which I have found have been committed by Respondents. 15 U.S.C. §§ 78u-2(a), 80a-9(d), 80b-3(i).

Disgorgement of ill-gotten gains “is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws.” Montford & Co., 2014 SEC LEXIS 1529, at *94 (quoting SEC v. First City Fin. Corp., 890 F.2d 1215, 1230 (D.C. Cir. 1989)); see SEC v. Whittemore, 659 F.3d 1, 7 (D.C. Cir. 2011). “When calculating disgorgement, ‘separating legal from illegal profits exactly may at times be a near-impossible task.’” Montford & Co., 2014 SEC LEXIS 1529, at *94 (quoting First City, 890 F.2d at 1231). “As a result, disgorgement ‘need only be a reasonable approximation of profits causally connected to the violation.’” Id. (quoting SEC v. Patel, 61 F.3d 137, 139 (2d Cir. 1995)). “Once the Division shows that the disgorgement is a reasonable approximation, the burden shifts to the respondent to show that the amount of disgorgement is not a reasonable approximation.” Id.

(citing SEC v. Happ, 392 F.3d 12, 32 (1st Cir. 2004)). “The risk of uncertainty in calculating disgorgement should fall on the wrongdoer whose illegal conduct created that uncertainty.” Id. (quoting Happ, 392 F.3d at 31); accord SEC v. Platforms Wireless Int’l Corp., 617 F.3d 1072, 1096 (9th Cir. 2010).

The Division recommends that J.S. Oliver and Mausner be ordered to, jointly and severally, disgorge:

- \$329,365 for the June 2009 reimbursement payment to J.S. Oliver for Kloes;
- \$300,000 for the improper rent payments to J.O. Samantha in 2009 and 2010;
- \$482,381 for the payments to Powerhouse in 2009 and 2010;
- \$40,094 for the improper payments for the St. Regis timeshare, made in 2009; and
- \$224,600 for CGF’s performance fees earned in 2008,

a total of \$1,376,440, plus prejudgment interest.

The Division also recommends that Drennan be ordered to, jointly and severally with J.S. Oliver and Mausner, disgorge \$482,381, for the payments to Powerhouse in 2009 and 2010, plus prejudgment interest.

Most of the components of the total \$1,376,440 were improper soft dollar expenses, and each amount is causally connected to the violations. The Kloes payment was an extreme misuse of client assets to pay for the amount Mausner owed Kloes pursuant to a divorce agreement. The entire \$300,000 in rent payments should be disgorged. Client assets were improperly used to pay rent as clients received either no disclosure or inadequate disclosure that soft dollars would be used to pay rent for the reasons discussed supra. Thus, Mausner’s argument that the Division has not shown what the appropriate rent should have been is misplaced. The soft dollar payments to cover Mausner’s timeshare expenses were an improper financial benefit to Mausner. Because Mausner was J.S. Oliver’s CEO and in complete control of J.S. Oliver’s soft dollar practices, and it is through Mausner’s conduct that J.S. Oliver’s violations occurred, joint and several liability is appropriate against Mausner and J.S. Oliver. See Donald L. Koch, 2014 SEC LEXIS 1684, at *100 n.246.

Disgorgement of improper soft dollar payments to Powerhouse in the amount of \$482,381 is reasonable. It is the sum of the soft dollars Powerhouse received in 2009 and 2010, and represents the amount of improper salary, in effect, paid to Drennan. J.S. Oliver and Mausner are jointly and severally liable for this amount with Drennan, as it represents the amount they believed Drennan should have been paid for his work and thus the ill-gotten gains realized by J.S. Oliver and Mausner as a result of having a free employee who performed numerous accounting, trading, and administrative functions for the firm, all paid with client assets. Cf. SEC v. First Pac. Bancorp, 142 F.3d 1186, 1191 (9th Cir. 1998) (“[W]here two or more individuals or entities collaborate or have a close relationship in engaging in the violations of the securities laws, they have been held jointly and severally liable for the disgorgement of illegally obtained proceeds.”).

It is appropriate to order disgorgement of the \$224,600 in CGF fees, because CGF was the primary account that benefited from J.S. Oliver and Mausner's cherry-picking. Noteworthy is the fact that CGF was the only J.S. Oliver fund that was profitable in 2008. Glasserman's expert report shows that CGF was allocated 37.10% of all profitable transactions and 37.53% of the top quarter of profitable transactions during the Relevant Period. Div. Ex. 695a at Glasserman Ex. 1. It is reasonable to conclude that CGF's profits in 2008, which generated these fees, were causally connected to Mausner's improper cherry-picking, and Mausner has failed to show otherwise. See Montford & Co., 2014 SEC LEXIS 1529, at *94; cf. SEC v. Cross Fin. SVC, 126 F. App'x 790, 791 (9th Cir. 2005) (circumstantial evidence may support finding that money was derived from improper sources to support disgorgement).

Respondents argue that they did not commit the violations; they have not, however, shown that the disgorgement amounts are unreasonable.

Based on these findings and pursuant to Commission Rule of Practice 600, 17 C.F.R. § 201.600, (1) J.S. Oliver and Mausner must, jointly and severally, disgorge \$1,376,440, plus prejudgment interest calculated from January 1, 2011, through the last day of the month preceding the month in which disgorgement is paid; and (2) Drennan must, jointly and severally with J.S. Oliver and Mausner, disgorge \$482,381, the amount of soft dollars Powerhouse received, plus prejudgment interest calculated from January 1, 2011, through the last day of the month preceding the month in which disgorgement is paid. I will define the prejudgment interest rate in the below Ordering paragraphs.⁶³

Civil penalties

Exchange Act Section 21B(a) and Advisers Act Section 203(i) authorize the Commission to impose civil monetary penalties against any person where such penalties are in the public interest and the Commission has found that such person (1) has willfully violated, or aided and abetted violations of, certain provisions of the securities laws; or (2) has willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required

⁶³ The Division calculated \$136,639 in prejudgment interest for J.S. Oliver and Mausner, and \$47,886 in prejudgment interest for Drennan. See Van Havermaat Decl. & Ex. 1. The Division calculated prejudgment interest from January 1, 2011, which the Division says is after the time period of the improper payments for which the Division seeks disgorgement, to February 21, 2014, the date on which the Division filed its Initial Brief. See id. "Prejudgment interest shall be due from the first day of the month following each such violation through the last day of the month preceding the month in which payment of disgorgement is made." 17 C.F.R. § 201.600(a). Although the OIP alleges misconduct through November 2011, the payments at issue all occurred or were earned before January 1, 2011. Thus, it is reasonable to calculate prejudgment interest from January 1, 2011. However, as the Division's methodology for calculating the rate of interest is not clear, I decline to adopt its figures. Under Commission Rule of Practice 600, "[i]nterest on the sum to be disgorged shall be computed at the underpayment rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. [§] 6621(a)(2), and shall be compounded quarterly." 17 C.F.R. § 201.600(b). I require this rate of interest in the Ordering paragraphs.

to be filed with the Commission.⁶⁴ 15 U.S.C. §§ 78u-2(a), 80b-3(i). The statutes set out a three-tiered system for determining the maximum civil penalty for each act or omission. A maximum third-tier penalty is permitted if (1) the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and (2) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.⁶⁵ 15 U.S.C. §§ 78u-2(b)(3), 80b-3(i)(2)(C).

To determine whether a penalty is in the public interest, the statutes call for consideration of: (1) whether the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) harm caused to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. 15 U.S.C. §§ 78u-2(c), 80b-3(i)(3).

From the beginning of Respondents' misconduct to March 3, 2009, the maximum amount of civil penalty for each act or omission in violation of the antifraud provisions of the securities statutes at the third tier was \$130,000 for a natural person and \$650,000 for any other person. See 17 C.F.R. § 201.1003, Subpt. E, Table III. After March 3, 2009, to the end of the misconduct at issue, the maximum amount of civil penalty for each act or omission at the third tier was \$150,000 for a natural person and \$725,000 for any other person. See 17 C.F.R. § 201.1004, Subpt. E, Table IV. Within any particular tier, the Commission has the discretion to set the amount of the penalty. See Brendan E. Murray, Advisers Act Release No. 2809 (Nov. 21, 2008), 94 SEC Docket 11961, 11978; Phlo Corp., 90 SEC Docket at 1113.

Respondents' conduct meets the criteria for a penalty at the third-tier level and the public interest considerations set out in the Exchange Act and Advisers Act in connection with the assessment of penalties. The Division's requested civil penalties relate to J.S. Oliver and Mausner's antifraud violations as to their cherry-picking scheme and soft dollar misuses, and Drennan's aiding and abetting and causing of the violations related to certain soft dollar misuses. A third-tier penalty is authorized because Respondents' violations involved fraud, deceit, manipulation, and deliberate and reckless disregard of regulatory requirements, and resulted in substantial losses for investors as well as substantial pecuniary gain to Respondents. 15 U.S.C. §§ 78u-2(b)(3), 80b-3(i)(2)(C). The cherry-picking scheme caused \$10.9 million in harm to the

⁶⁴ To the extent civil penalties are sought under Securities Act Section 8A(g), 15 U.S.C. § 77h-1(g), that provision was not in effect for a substantial portion of the misconduct at issue, and I therefore decline to impose civil penalties under that provision. See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, Title IX, §§ 4, 929P(a)(1), 124 Stat. 1376, 1390, 1862-63 (July 21, 2010). To the extent the OIP authorized civil penalties under Investment Company Act Section 9(d), 15 U.S.C. § 80a-9(d), the Division does not seek civil penalties under this provision and I therefore deem any Section 9(d) remedy abandoned. Div. Initial Br. at 68.

⁶⁵ "To impose second-tier penalties, the Commission must determine how many violations occurred and how many are attributable to each person." Rapoport v. SEC, 682 F.3d 98, 108 (D.C. Cir. 2012). Presumably, the same approach should be taken with respect to civil penalties at the third-tier level.

three disfavored accounts, and Anderson's testimony provides further proof of the harm suffered as a result of the cherry-picking. Also, J.S. Oliver earned substantial performance fees in 2008 as a result of the scheme. The soft dollar misuses resulted in over \$1 million in improper soft dollar payments in 2009 and 2010, each of which benefited Respondents and cost J.S. Oliver's clients.

The fact that J.S. Oliver and Mausner were investment advisers and Drennan was an associated person is of paramount importance. In these roles, Respondents had a fiduciary duty to put clients' interest ahead of their own. They failed to do so, instead they took advantage of their positions of trust to benefit themselves and harm their clients. Respondents were unjustly enriched as a result of their violations, and the need for deterrence counsels in favor of the maximum penalty. The lack of prior violations does not outweigh the other public interest considerations, given the egregious nature of Respondents' misconduct.

I accept as reasonable the Division's position that because the cherry-picking activities of J.S. Oliver and Mausner occurred over the eighteen-month Relevant Period, from June 2008 to November 2009, each month of such continuous misconduct should count as one unit of violation. See K.W. Brown & Co., 555 F. Supp. 2d at 1314-15 (stating that it would be reasonable to assess a penalty for each month cherry-picking scheme occurred). However, I do not agree with the Division's calculation of penalties, which uses the pre-March 3, 2009, rates for the entire eighteen-month period. Rather, from June 2008 to March 2009 (ten months), at \$130,000 per violation for a natural person, this totals \$1,300,000 for Mausner, and at \$650,000 per violation for any other person, this totals \$6,500,000 for J.S. Oliver.⁶⁶ From April 2009 to November 2009 (eight months), at \$150,000 per violation for a natural person, this totals \$1,200,000 for Mausner, and at \$725,000 per violation for any other person, this totals \$5,800,000 for J.S. Oliver. Thus, for the cherry-picking violations, this totals \$2,500,000 for Mausner and \$12,300,000 for J.S. Oliver.

I also accept as reasonable the Division's proposed approach to consider each of the soft dollar misuses at issue as a single unit of violation. This results in four violations for J.S. Oliver and Mausner based on the Kloes payment, rent payments, Powerhouse payments, and timeshare payments. However, as before, I do not agree with the Division's calculation of penalties, which uses the pre-March 3, 2009, rates for all violations. Three of these violations began before March 2009: the rent, Powerhouse, and timeshare payments. Accordingly, these three violations will be assessed at \$130,000 per violation for a natural person, which is \$390,000 for Mausner, and at \$650,000 per violation for any other person, which is \$1,950,000 for J.S. Oliver. The Kloes payment occurred in June 2009, and therefore a penalty will be assessed at \$150,000 for Mausner and at \$725,000 for J.S. Oliver. Thus, for the soft dollar misuses, this totals \$540,000 for Mausner and \$2,675,000 for J.S. Oliver.

Drennan will be assessed a third-tier penalty for three violations related to the soft dollar misuses involving the Kloes payment, rent payments, and Powerhouse payments. Drennan was instrumental in setting up and administering the soft dollar program, and was directly involved in the misconduct involving these three soft dollar misuses. Calculating the penalty using the same

⁶⁶ As each month is considered a single unit of violation, March 2009 will be assessed using the pre-March 3, 2009, rate.

approach as articulated above, Drennan will be assessed two penalties at the \$130,000 level for the rent and Powerhouse payments and one penalty at the \$150,000 level for the Kloes payment. Thus, for the soft dollar misuses, this totals \$410,000 for Drennan.

In conclusion, although I differ on the calculation of penalties, I agree with the Division that civil penalties at the maximum level are in the public interest and find that its approach is reasonable in determining the statutory unit of violations. See Rapoport, 682 F.3d at 108. In total, J.S. Oliver is assessed a civil penalty of \$14,975,000; Mausner is assessed a civil penalty of \$3,040,000; and Drennan is assessed a civil penalty of \$410,000.

Drennan's alleged inability to pay

Drennan filed a Disclosure of Assets and Financial Information Form. Based on my review of the submitted material, I reject Drennan's position of inability to pay the monetary sanctions. In any event, even if Drennan were unable to pay, I decline to waive the monetary sanctions given the egregious nature of his misconduct and misuse of client assets for his personal benefit. See David Henry Disraeli, Securities Act Release No. 8880 (Dec. 21, 2007), 92 SEC Docket 852, 883 & n.125, pet. denied, 334 F. App'x 334 (D.C. Cir. 2009); Philip A. Lehman, Exchange Act Release No. 54660 (Oct. 27, 2006), 89 SEC Docket 536, 549-50; cf. SEC v. Warren, 534 F.3d 1368, 1370 (11th Cir. 2008).

Fair Fund

Pursuant to Commission Rule of Practice 1100, 17 C.F.R. § 201.1100, I will require that the amount of disgorgement, prejudgment interest, and civil money penalties be used to create a Fair Fund for the benefit of J.S. Oliver's clients harmed by the violations.

Record Certification

Pursuant to Commission Rule of Practice 351(b), 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Record Index issued by the Secretary of the Commission on June 20, 2014.

Order

I ORDER that, pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, and Section 203(k) of the Investment Advisers Act of 1940:

J.S. Oliver Capital Management, L.P., shall cease and desist from committing or causing violations, and any future violations, of Section 17(a) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5; and Sections 204, 206(1), 206(2), 206(4), and 207 of the Investment Advisers Act of 1940 and Advisers Act Rules 204-1(a)(2), 204-2(a)(3), 204-2(a)(7), 206(4)-7, and 206(4)-8;

Ian O. Mausner shall cease and desist from committing or causing violations, and any future violations, of Section 17(a) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5; and Sections 204, 206(1), 206(2), 206(4), and 207 of the Investment Advisers Act of 1940 and Advisers Act Rules 204-1(a)(2), 204-2(a)(3), 204-2(a)(7), 206(4)-7, and 206(4)-8; and

Douglas F. Drennan shall cease and desist from committing or causing violations, and any future violations, of Sections 17(a)(1) and 17(a)(2) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5; and Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 and Advisers Act Rule 206(4)-8.

I FURTHER ORDER that, pursuant to Section 8A(e) of the Securities Act of 1933, Sections 21B(e) and 21C(e) of the Securities Exchange Act of 1934, Sections 203(j) and 203(k)(5) of the Investment Advisers Act of 1940, and Section 9(e) of the Investment Company Act of 1940:

J.S. Oliver Capital Management, L.P., and Ian O. Mausner shall disgorge, jointly and severally, \$1,376,440, plus prejudgment interest; and

Douglas F. Drennan shall disgorge, jointly and severally with J.S. Oliver Capital Management, L.P., and Ian O. Mausner, \$482,381, plus prejudgment interest. Payment by J.S. Oliver Capital Management, L.P., and Ian O. Mausner of the \$482,381 amount shall reduce by an equal amount, jointly and severally, the \$1,376,440 amount due, not to exceed \$482,381.

Prejudgment interest shall be calculated at the underpayment rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), shall be compounded quarterly, and shall run from January 1, 2011, through the last day of the month preceding the month in which payment is made. 17 C.F.R. § 201.600.

I FURTHER ORDER that, pursuant to Section 21B(a) of the Securities Exchange Act of 1934 and Section 203(i) of the Investment Advisers Act of 1940:

J.S. Oliver Capital Management, L.P., shall pay a civil monetary penalty in the amount of \$14,975,000;

Ian O. Mausner shall pay a civil monetary penalty in the amount of \$3,040,000; and

Douglas F. Drennan shall pay a civil monetary penalty in the amount of \$410,000.

I FURTHER ORDER that, pursuant to 17 C.F.R. § 201.1100, any funds recovered by way of disgorgement, prejudgment interest, or penalties shall be placed in a Fair Fund for the benefit of investors harmed by the violations.

I FURTHER ORDER that, pursuant to Section 203(e) of the Investment Advisers Act of 1940:

The investment adviser registration of J.S. Oliver Capital Management, L.P., is revoked.

I FURTHER ORDER that, pursuant to Section 203(f) of the Investment Advisers Act of 1940:

Ian O. Mausner and Douglas F. Drennan are permanently barred from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Payment of disgorgement, prejudgment interest, and civil penalties shall be made no later than twenty-one days following the day this Initial Decision becomes final, unless the Commission directs otherwise. Payment shall be made by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission. The payment, and a cover letter identifying the Respondent(s) and Administrative Proceeding No. 3-15446, shall be delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Bld., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

Brenda P. Murray
Chief Administrative Law Judge