UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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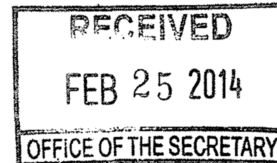
ADMINISTRATIVE PROCEEDING
File No. 3-15446



In the Matter of

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

Respondents.

THE DIVISION OF ENFORCEMENT'S INITIAL POST-HEARING BRIEF

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I. INTRODUCTION

At the hearing from January 6 to 10, 2014, the Division of Enforcement ("Division") conclusively established that respondents J.S. Oliver Capital Management, L.P. ("J.S. Oliver"), a registered investment adviser, and its principal Ian O. Mausner ("Mausner") violated the federal securities laws by engaging in "cherry-picking" of favorable stock trades for their benefit and to the detriment of clients, and by the misuse of client "soft dollar" commission credits. The Division also established that respondent Douglas F. Drennan ("Drennan"), a long-time employee of J.S. Oliver, aided, abetted, and caused J.S. Oliver and Mausner's soft dollar abuses.

A. The Cherry-Picking Scheme

The evidence established that from June 2008 to November 2009, Mausner and J.S. Oliver engaged in a fraudulent trade allocation, or "cherry-picking" scheme, in which Mausner disproportionately allocated profitable trades to six accounts including J.S. Oliver's affiliated hedge funds, and disproportionately allocated unprofitable trades to three clients' accounts, including a charitable foundation and a 78-year-old widow. Mausner and J.S. Oliver were able to cherry-pick favorable trades because Mausner could wait to allocate trades to specific accounts until long after the trades were made, and in many instances until after the close of trading or the following day. By waiting to allocate the trades, Mausner knew which trades had been profitable and which had been unprofitable from the time they were executed until the time of allocation.

The Division's expert, Dr. Paul Glasserman, a Professor of Business at Columbia Business School, presented a robust statistical analysis that concluded that the only explanation for the observed disproportionate allocations was a deliberate effort by Mausner to cherry-pick trades. Indeed, Professor Glasserman's basic and generally-accepted statistical methods showed that the likelihood that the observed difference in allocation between profitable and unprofitable

trades to the favored and disfavored accounts occurred by chance is approximately 1 in one quadrillion (10^{15}), and that the extreme bias in trade allocations was due to cherry-picking by Mausner and J.S. Oliver. Professor Glasserman's unrebutted analysis was corroborated by the testimony of one of J.S. Oliver's clients, Christopher Anderson, who performed an analysis of his charitable foundation's account and testified that the most actively traded stocks significantly underperformed in the account, which caused Mr. Anderson to terminate his relationship with J.S. Oliver.

Mausner directly benefitted from his cherry-picking scheme because he was personally invested in at least one of the favored hedge funds for which he cherry-picked trades. He also benefited from the additional fees generated from the cherry-picking in the then-new J.S. Oliver Concentrated Growth Fund. Indeed, Mausner used the cherry-picking scheme to boost this new fund's performance, and then touted its performance in mass emails to current and prospective investors in an effort to raise funds. For example, in November 2008, Mausner touted to current and prospective clients that this new fund had gained almost 13% during a period that the S&P declined by 17%. The Division's expert provided evidence that Mausner's cherry-picking scheme caused harm of $10.9 million to the three disfavored clients.

In response to the Division's evidence, Mausner claimed that different trading strategies accounted for the allocations, and even submitted documents which purported to show that one of the cherry-picked accounts had a positive return while declining in value by millions of dollars. But Professor Glasserman addressed each of Mausner's claims and established that Mausner's explanations lacked any merit. Thus, the evidence conclusively supports the cherry-picking allegations in the OIP.

B. The Misuse of Soft Dollars

The evidence also showed that Mausner and J.S. Oliver, aided and abetted by Drennan, misused client soft dollar credits. Soft dollars, or client commission credits, are generated when an investment adviser negotiates to pay commissions that exceed the amount normally paid to compensate the broker for executing trades. Soft dollars are assets of the clients, not of the investment adviser. Under the "safe harbor" of Section 28(e) of the Securities Exchange Act of 1934 ("Exchange Act"), soft dollars may be used to pay for "brokerage and research services" for an investment adviser's managed accounts under certain circumstances without breaching its fiduciary duties to clients. Soft dollars may also be used to pay for other legitimate expenses of an investment adviser if the use of soft dollars is in the clients' best interest and is disclosed to clients with sufficient specificity so that the client can understand what benefit is being obtained with its soft dollars. But soft dollars cannot be used to pay personal expenses or to pay the salary of an employee under the guise of Section 28(e) research payments.

Mausner and J.S. Oliver, with Drennan's help, improperly used client soft dollar credits in four separate ways: (1) to pay Mausner's personal obligation to his ex-wife, (2) to funnel cash into Mausner's pocket under the guise of rent payments, (3) to pay Mausner's personal obligations on a timeshare in New York City, and (4) to pay Drennan a substantial salary and bonuses. Indeed, Drennan was the prime mover in putting J.S. Oliver's soft dollar program into place and he played a crucial role in putting together a false document to be submitted in support of a $329,365 misuse of soft dollars to pay Mausner's spousal support obligations to his ex-wife. Mausner and J.S. Oliver, facilitated by Drennan, misused over $1.1 million in client soft dollar credits from January 2009 through November 2011. Given the overwhelming evidence presented at trial, there is no question that the respondents misused soft dollars and engaged in deceptive activity to accomplish their goals.

First, to obtain an improper June 2009 reimbursement of $329,365 in soft dollars to Gina Kloes, Mausner's ex-wife, Mausner and Drennan conspired to alter language from the Mausners' marital settlement agreement and falsely represented that they were presenting an "excerpt" of a contract between J.S. Oliver and Mausner's ex-wife. Except no such contract existed, and the "excerpt" was fabricated by Mausner and Drennan working together to create false documentation to fool J.S. Oliver's broker. The evidence was clear that the money paid to Mausner's ex-wife was to satisfy his personal marital obligations. Indeed, while Mausner and Drennan both claimed that the ex-wife received the payment because she worked at J.S. Oliver, Drennan admitted that the ex-wife, Gina Kloes, was not an employee when he left in 2008 and was not an employee when he came back in 2009. Mausner gave sworn testimony that Ms. Kloes did not work at J.S. Oliver after 2005, which he simply contradicted at trial. Most tellingly, Ms. Kloes testified that she had not any done work for J.S. Oliver after 2007, and that the payment to her simply constituted "getting paid for a divorce." (Trial Tr. (Kloes) 520:22-25.)

While Mausner and Drennan repeatedly claimed to be acting on advice of counsel, they presented no testimony from any of their lawyers, presented no documents from their lawyers corroborating the purported advice, and otherwise did nothing to substantiate such a claim. Indeed, on June 1, 2009 (the day they created the purported contract "excerpt"), neither Mausner nor Drennan consulted any lawyers as they fabricated the fake "excerpt" used to obtain the soft dollar payments.

Second, client soft dollar credits were used to pay excessive "office" rent at Mausner's home, which he then pocketed. Shortly after J.S. Oliver started using soft dollars to pay rent to Mausner's company for J.S. Oliver's office, which was in Mausner's residence, Mausner raised the rent from $6,000 a month to $10,000 a month (retroactively for two months), and then to $15,000 a month, even though the monthly mortgage and expenses had not changed over this

roughly four-month period. Mausner then funneled in total more than $200,000 in excess "rent" payments directly to his personal bank account.

Third, the evidence also showed that J.S. Oliver and Mausner improperly used client soft dollar credits to pay over $40,000 in maintenance fees on Mausner's personal timeshare at the St. Regis luxury hotel in New York City.

Fourth, soft dollars were impermissibly used to pay Drennan, and the evidence showed that he was intimately involved in the misuse of soft dollars at J.S. Oliver. In fact, Drennan was paid well for setting up the soft dollar program at J.S. Oliver, earning more than $480,000 in 2009 and 2010 under the Section 28(e) safe harbor, purportedly for providing independent research services to J.S. Oliver. But the evidence established that Drennan, a former employee of J.S. Oliver, was doing much more than providing independent research. Remarkably, J.S. Oliver's former controller testified that Drennan told her that he had received a $100,000 bonus, paid with client soft dollars, for his work in setting up J.S. Oliver's soft dollar arrangements. (Trial Tr. (Kartes) 649:20-651:5.) Moreover, even as he was setting up the soft dollar program starting in December 2008, Drennan moved back into his old desk at J.S. Oliver, was given complete access to its computers and client files, was listed as J.S. Oliver's "trader" on account opening documents, was given trading authority and, in fact, traded in client accounts at Mausner's direction, supervised J.S. Oliver's accounting and financial reporting, and was given the duties and responsibilities of a "team leader" at the firm. As one J.S. Oliver employee testified, Drennan sometimes acted as a team leader even when Mausner was present. Indeed, Drennan's intimate involvement in fabricating an "excerpt" of a non-existent contract that was submitted to obtain soft dollars shows he was not an independent research provider. It was, quite simply, a fraud for Drennan and Mausner to obtain soft dollar payments for Drennan under the guise of the Section 28(e) safe harbor.

C. The Sanctions

Thus, the vast preponderance of the evidence at the hearing proved that Mausner and J.S. Oliver violated the antifraud and investment adviser fraud provisions of the federal securities laws, and that Drennan aided, abetted, and caused their violations in connection with the soft dollar misuses.[1] The evidence also showed that J.S. Oliver violated, and Mausner aided and abetted its violations of, the books and records and written policies and procedures provisions of the Investment Advisers Act of 1940 ("Advisers Act"), and that Mausner and J.S. Oliver violated the false Form ADV provisions.

The egregious nature of the respondents' violations warrants the imposition of significant sanctions against Mausner, Drennan, and J.S. Oliver. The Division requests that a cease-and-desist order be entered against each respondent; that J.S. Oliver and Mausner, jointly and severally, be ordered to pay disgorgement totaling $1,376,440 (the amount they benefited from improper soft dollar payments and performance fees paid by CGF in 2008), plus prejudgment interest in the amount of $136,639; that Drennan be ordered to pay disgorgement of $482,381 (the amount he received in improper soft dollar payments), plus prejudgment interest in the amount of $47,886; that Mausner be ordered to pay third-tier civil penalties for each of his violations, totaling $3.3 million; that Drennan be ordered to pay third-tier civil penalties for each of his violations, totaling $450,000; and that J.S. Oliver be ordered to pay third-tier civil penalties for each of its violations, totaling $15.95 million. In addition, to prevent future violations, the Division seeks revocation of J.S. Oliver's status as an investment adviser, and industry bars against Mausner and Drennan.

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[1] Proof by preponderance of the evidence is the standard in administrative proceedings. *In the Matter of Sandra K. Simpson*, AP File No. 3-9458, 2002 SEC Lexis 1278, *57 (May 14, 2002); *Steadman v. SEC*, 450 U.S. 91, 102-03 (1980).

II. FACTS

A. Background of J.S. Oliver and Its Operations

J.S. Oliver is a registered investment adviser that provides investment management services to separately-managed client accounts; its clients are mainly individuals and families, along with some trusts and foundations. (Trial Tr. (Mausner) 1205:4-6; 1207:5-23.) During the period at issue in this matter the firm also managed four affiliated hedge funds: J.S. Oliver Investment Partners I, L.P. ("Fund 1"), J.S. Oliver Investment Partners II, L.P. ("Fund 2"), J.S. Oliver Offshore Investments, Ltd. ("Offshore Fund") (collectively, the "J.S. Partners Funds"), and J.S. Oliver Concentrated Growth Fund ("CGF") (together with the J.S. Partners Funds, the "J.S. Oliver Funds"). (*Id.* 1235:6-14.) CGF began trading on June 1, 2008. (*Id.* 1245:11-18; 1254:24-1255:15.)

Mausner is the founder of J.S. Oliver and served as its president, head portfolio manager, control person, and chief compliance officer during the period at issue. (Trial Tr. (Mausner) 1205:7-8; 1205:21-1206:9.) Mausner testified that he was ultimately responsible for all business decisions of J.S. Oliver. (*Id.* 1206:19-1207:4.)

Drennan was registered as an investment adviser representative with J.S. Oliver from 2005 to 2008. (Trial Tr. (Drennan) 832:25-833:3.) Drennan has been an employee of J.S. Oliver since 2004 except for a six-month period beginning in May 2008 when he went to work as an analyst for a different investment adviser. (*Id.* 832:19-24; 834:13-19; 850:8-851:5.) Within two months of leaving J.S. Oliver, Drennan's new employer informed him that they were going to be cutting their workforce. (*Id.* 835:14-17.) Drennan began looking for a new job in September 2008. (*Id.* 835:18-20.) In late 2008, Drennan contacted Mausner about returning to work at J.S. Oliver. (*Id.* 835:24-836:10.) At the time, Mausner told Drennan that he was not interested in hiring him back as an employee, but Mausner agreed to take Drennan back after the two

discussed structuring Drennan's compensation so that he could be paid with client soft dollars. (*Id.* 836:11-837:8.)

B. J.S. Oliver and Mausner Engaged in Cherry-Picking

From at least June 2008 through November 2009, Mausner and J.S Oliver engaged in fraudulent trade allocation by "cherry-picking" favorable trades for J.S. Oliver's affiliated hedge funds and two other accounts (the "favored accounts") to the detriment of three client accounts (the "disfavored accounts").[2] (Div. Ex. 695A, ¶ 12.) Mausner's and J.S. Oliver's cherry-picking scheme caused losses of $10.9 million to the disfavored accounts, and benefited Mausner, who had invested in CGF and who received performance fees based upon the inflated performance of the hedge funds, particularly CGF. (Div. Ex. 695A, ¶¶ 15, 62 and Ex. 13.)

1. Mausner and J.S. Oliver were able to allocate trades after learning which trades were profitable and unprofitable

To perpetrate the cherry-picking scheme, Mausner and J.S. Oliver made block trades in accounts that they maintained at J.S. Oliver's executing brokers. (Trial Tr. (Mausner) 1209:14-1211:2.) J.S. Oliver reported the block trades to its prime broker, BNP Paribas Prime Brokerage, Inc. ("BNP"), and then allocated the shares among the client accounts through BNP's online system. (*Id.* 1211:9-22; Trial Tr. (Radzik) 139:19-141:21; 148:5-14.) Indeed, Mausner was the only person at J.S. Oliver who could make the determination to do a block trade. (Trial Tr. (Mausner) 1211:4-7.) Mausner facilitated the cherry-picking by using different executing brokers to execute J.S. Oliver's trades and then using BNP's online order management system to

[2] The favored accounts were the four J.S. Oliver Fund accounts, Status-One Investment Partners, and the Taube Family Trust; the disfavored accounts were the Coleman Trust, the Sapling Foundation, and Chelsey Capital. (Div. Ex. 695A at ¶ 12; Trial Tr. (Glasserman) 127:24-128:4.) The Sapling Foundation is a charitable foundation and the trustee of the Coleman Trust account is Harriet Coleman, a widow in her 70s. (Trial Tr. (Mausner) 1208:19-1209:2; Trial Tr. (Anderson) 13:16-18.)

allocate the block trades to client accounts, often overriding previously determined allocation schema to manually allocate the trades. (Trial Tr. (Radzik) 148:5-14; Trial Tr. (Mausner) 1213:22-1214:1.) All of the trade allocations were performed either by Mausner personally, or by J.S. Oliver employees at Mausner's explicit direction. (Trial Tr. (Mausner) 1213:3-10.)

The manager of BNP's product development team, Jason Radzik, testified that BNP's online system could allow an investment adviser to delay allocating trades until long after they had been executed. (Trial Tr. (Radzik) 164:18-166:7.) Such delays in allocating the trades would have allowed Mausner first to determine which securities had appreciated or declined in value before he allocated the trades to specific accounts. Indeed, spreadsheets derived from BNP's database confirm that many of J.S. Oliver's allocations were made after the close of trading, and sometimes on the next business day. (Div. Exhs. 601, 602.)

Additionally, BNP generated reports called "potential cherry-picking review" reports about J.S. Oliver's trade allocation activity. (Trial Tr. (Radzik) 161:5-164:8; Div. Ex. 402.) These reports were a form of "exception reports," which were intended to alert BNP when its software detected unusual activity in the allocation of securities. (Trial Tr. (Radzik) 163:9-17.) BNP made Mausner aware of certain cherry-picking reports that were generated regarding J.S. Oliver and recommended how such variations in allocations could be avoided in the future (such as through the use of average prices). Mausner, however, did not adopt BNP's recommendations. (Trial Tr. (Mausner) 1215:17-1217:17; Div. Ex. 399.)

2. The unrebutted statistical evidence showed that Mausner and J.S. Oliver cherry-picked favorable trades for favored accounts

The Division presented unrebutted statistical evidence that showed that Mausner and J.S. Oliver systematically allocated a disproportionately large share of profitable equity trades to six "favored" accounts (which included the J.S. Oliver Funds) and systematically allocated a

disproportionately large share of unprofitable equity trades to three "disfavored" accounts.[3] (Trial Tr. (Glasserman) 121:11-18; Div. Ex. 695A, ¶¶ 12, 22-27 and Ex. 1.) The statistical evidence proved that the disparities in Mausner's and J.S. Oliver's allocation of trades were the result of cherry-picking, and not the result of random variations. Indeed, the evidence showed that, using basic and generally-accepted statistical methods, the probability that the disparity in performance between the favored and disfavored accounts arose by chance is approximately 1 in one quadrillion (10^{15}). (Div. Ex. 695A, ¶¶ 28-31; Trial Tr. (Glasserman) 124:11-17.)

Mausner's primary method to accomplish his cherry-picking scheme was to allocate disproportionately to the favored accounts trades that had increased in value during the trading day, and to allocate trades that decreased in value during the day to the disfavored accounts. (Div. Ex. 695A, ¶¶ 23-27.) By waiting to allocate trades after execution, Mausner was able to assess accurately which trades had been profitable and which had been unprofitable before he allocated them. (Div. Exhs. 601, 602.) Mausner also cherry-picked the most favorable trades when there were multiple trades in a single security over the course of the day. (Div. Ex. 695A, ¶¶ 38-42.)

The evidence also clearly showed that the greater the profitability of a trade, the more likely that Mausner would allocate it to one of the J.S. Oliver Fund accounts and the less likely that he would allocate it to one of the disfavored accounts. (Div. Ex. 695A, ¶¶ 26-27 and Exhs. 1, 2.) For example, from June 2008 to November 2009, the J.S. Oliver Investment Partners II account was allocated 10.71% of shares from all trades, but 14.09% of shares from the most

[3] The favored and disfavored accounts collectively accounted for approximately 98% of J.S. Oliver's total trading volume during the period in which the cherry-picking occurred. (Div. Ex. 695A, ¶ 12.)

profitable transactions.[4] (Div. Ex. 695A, ¶ 27 and Exhs. 1, 2.) In contrast, the account of the Sapling Foundation, one of the disfavored accounts, was allocated 11.31% of shares from all trades but only 5.31% of shares from the most profitable transactions during the same period. (*Id.*)

The effect of Mausner's and J.S. Oliver's cherry-picking was reflected in the dramatically different first-day returns realized by the favored and disfavored accounts.[5] (Div. Ex. 695A, ¶¶ 32-37 and Exhs. 3, 4, 5, 6.) The evidence showed that the favored accounts realized an average first-day return of 0.12%, which correlates to an annualized return of 35%, and the disfavored accounts suffered an average first-day loss of -1.31%, or a loss of 96% on an annualized basis. (Div. Ex. 695A, ¶ 33 and Ex. 3.)

3. The performance of Mr. Anderson's Sapling Foundation account showed the effects of Mausner's cherry-picking

J.S. Oliver's and Mausner's cherry-picking scheme manifested itself in the enormous losses suffered by the disfavored accounts, which included Chris Anderson's Sapling Foundation ("Sapling") account. Mr. Anderson testified that in August 2009 Mausner informed him that the Sapling account was down more than 9.4% for the year, even though the overall markets had risen by 7 to 8 percent over the same period. (Trial Tr. (Anderson) 52:19-53:14; 54:11-17; Div. Ex. 12.) Mr. Anderson testified that he was "shocked beyond measure" when he learned this, and the realization of what had happened made him "sick to [his] stomach." (*Id.* 53:13-14; 55:6-

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[4] For purposes of this example, the "most profitable" trades are defined as the top 25% most profitable trades. (Div. Ex. 695A, ¶¶ 26, 27, 29, and Ex. 1.)

[5] The first-day return for a stock purchase is the percentage difference between the closing price for the stock on the day it was purchased and the price at which it was purchased. (Div. Ex. 695A, ¶¶ 14, 17.) For example, a stock purchased at $100 per share would have a positive first-day return of 1% if the stock closed at $101 per share on the day it was purchased, and a first-day loss of -1% if the stock closed at $99 per share. The same methodology is used for stock sales. To account for differences in trade sizes, first-day returns are calculated on a dollar-weighted basis. (Div. Ex. 695A, ¶ 14 and fn.8.)

8; Div. Ex. 12.) Mr. Anderson decided "to dig into what on earth was going on," and he asked Mausner to provide a detailed explanation of what had happened. (Trial Tr. (Anderson) 55:9-25.)

Mausner attempted to dismiss Mr. Anderson's concerns by claiming falsely that Mr. Anderson's "numbers [were] incorrect." (Trial Tr. (Anderson) 57:3-5; Div. Ex. 14.) He also argued that the poor performance of the Sapling account was caused primarily by the inability to trade options in that account. (Trial Tr. (Anderson) 56:24-57:2; Div. Exhs. 14, 16.) But Mausner conceded that, aside from "options trading and hedging," Mausner's fund (which had been performing extremely well) and the Sapling account (which had suffered enormous losses) were "virtually identical." (Div. Ex. 16; Trial Tr. (Anderson) 58:16-22.) Mr. Anderson testified that he could not understand "how simply the addition of options would make a difference between one account going massively in one direction [and] one account going the other direction." (Trial Tr. (Anderson) 58:23-59:11.)

To answer that question, Mr. Anderson prodded Mausner for detailed trading data, which Mr. Anderson obtained and analyzed carefully. (Trial Tr. (Anderson) 60:17-61:7.) Based on that analysis, Mr. Anderson found the explanation for Sapling's bad performance in the trading data. For example, Mr. Anderson discovered that although Mausner had engaged in an aggressive shorting strategy in 2008, when the market had plunged, "every single stock that [Mausner] had aggressively shorted on account of Sapling during that year had actually lost money for Sapling." (Trial Tr. (Anderson) 61:8-63:18.) Mr. Anderson also found that one particular stock, "Apollo," which Mausner traded aggressively in March 2009, resulted in losses of $400,000 in the Sapling account that month, and he later learned that Mausner's fund profited substantially from trades in Apollo the same month. (Trial Tr. (Anderson) 63:10-64:13.) Mr. Anderson later hired an expert who came to the conclusion that the Sapling account had been the

victim of a cherry-picking scheme. Mr. Anderson's expert confirmed that of 20 trades that Mausner made in Apollo in March 2009, "the nine worst losers were allocated to Sapling and … the eight most profitable trades were allocated to the fund." (Trial Tr. (Anderson) 68:13-69:8.) Although Mausner continued to argue that the difference was due to options, Mr. Anderson, based on his careful review of the trade data, considered Mausner's rationalizations to be "nonsense" and "bologna," and so Mr. Anderson closed his J.S. Oliver account. (Trial Tr. (Anderson) 64:18-65:8.)

4. The evidence disproved Mausner's theories for the disparities in performance, such as different trading strategies between the favored and disfavored accounts or options trading

In an effort to explain away the Division's overwhelming evidence of cherry-picking, at the hearing Mausner introduced several alternative explanations for the widely disparate performance between the favored and disfavored accounts. Mausner claimed that the vast disparity in performance between the favored and disfavored accounts was attributable to investments in different stocks. But the evidence showed that, for the most part, the favored and disfavored accounts traded in the same stocks. (Trial Tr. (Glasserman) 120:24-127:14; Div. Ex. 695A, ¶¶ 38, 43-50 and Exhs. 7, 8, 9.) In fact, stocks traded by the three disfavored accounts as a group accounted for 97% of the dollar volume of trading in the favored accounts from June 2008 to November 2009, thus disproving Mausner's contention. (Trial Tr. (Glasserman) 125:20-126:25; Div. Ex. 695A, ¶ 45 and Ex. 8.) The evidence also showed that, after excluding stocks that were not traded by the disfavored accounts, the statistical likelihood of cherry-picking persisted at extremely high levels. (Div. Ex. 695A, ¶¶ 49, 50 and Ex. 9.)

Mausner also claimed that the purported use of options trading, "defensive" or "short-oriented" trading strategies for the CGF account, "buy-and-hold" strategies, or market volatility effects accounted for the difference in performance between the favored and disfavored

accounts. Again, the evidence disproved Mausner's explanations. First, with regard to options trading, those trades constituted less than 1% of the total dollar volume of trading by the disfavored accounts from June 2008 to November 2009 and, consequently, any impact of options trading on the statistical significance of the results would be *de minimis*. (Div. Ex. 695A, ¶ 18.) Second, the effect, if any, of options trading is irrelevant to the conclusion that Mausner and J.S. Oliver cherry-picked trades in equities. (*Id.*)

Moreover, Professor Glasserman testified that his conclusion that "purchase prices [that] were allocated across the different accounts systematically favored some accounts and systematically disfavored other accounts" could not be explained by "questions of margin, asset allocation, [or] risk tolerance[] because there's already been a decision to buy or sell those stock on that day." (Trial Tr. (Glasserman) 122:23-123:21.) Professor Glasserman explained that those issues were

> not relevant to the analysis that [he] did because [he] look[ed] at the allocation of trades and ...97 percent of the stocks that [were] traded in the disfavored accounts [were] also traded in the favored accounts. 80 to 90 percent of the time, when a disfavored [was] participating in a block trade, one of the favored accounts [was] participating simultaneously in the same block trade. So whatever issues of risk tolerance, asset allocation, may have led to those purchase decisions, once they're being executed in a single block trade ... the question is, does the change in the price over the course of the day influence which accounts get allocated how much. And [he] found overwhelming evidence that, indeed, there's a very strong link between how -- the intraday performance of the stock and the allocation across accounts.

(Trial Tr. (Glasserman) 125:22-126:25.) Thus, as detailed in Professor Glasserman's report, the statistical findings do not change when he (1) controlled for defensive strategies, either by excluding from the analysis CGF, which purportedly employed a defensive strategy, or by excluding short sales across all accounts, (Div. Ex. 695A, ¶¶ 53-56); (2) controlled for long-term, buy-and-hold strategies by excluding stocks that were held for at least ten days (Div. Ex. 695A,

¶¶ 57-59); or (3) controlled for market volatility by excluding from the analysis trades on highly volatile market days. (Div. Ex. 695A, ¶¶ 60-61.) In every case, the statistical evidence of cherry-picking remained overwhelmingly high. (Div. Ex. 695A, ¶¶ 51-52; Trial Tr. (Glasserman) 124:18-126:25.) Dr. Glasserman testified that he found that the "overwhelming statistical evidence [of] the disparities cannot be explained by any sort of chance fluctuations. The level of statistical significance on all the disparities is extremely stringent, essentially ruling out any possibility that these differences are due to chance fluctuations." (Trial Tr. (Glasserman) 124:4-17.)

5. The cherry-picking benefited Mausner directly because he invested in CGF, and indirectly because he earned performance fees based on the performance of CGF

Mausner had two strong financial motives to prefer the favored accounts over the disfavored accounts: Mausner benefited directly by the inflated performances, particularly of the CGF Fund, through performance fees, and Mausner was personally invested in CGF.

J.S. Oliver earned performance fees for the management of the Funds, up to a 20% performance fee, which was substantially higher than the fees paid by the disfavored individual accounts. (Trial Tr. (Mausner) 1240:2-5; 1242:6-11; 1244:4-9; 1247:2-4; Div. Exhs. 135, 160, 411, 412.) Although the three J.S. Partners Funds also paid performance fees, they were subject to provisions whereby the performance fee would only be paid to the extent that the net asset value of the fund had increased from its previous highest level. (Trial Tr. (Mausner) 1240:2-15; 1242:6-11; 1244:4-9.) By June 2008, the J.S. Partner Funds had performed poorly and were well below their high-water marks, delaying when, if ever, J.S. Oliver could earn performance fees from them. (Trial Tr. (Mausner) 1240:16-22; 1242:12-20; 1244:10-16.) In addition, the disfavored separate client accounts generally paid lower fees or had caps on the performance fees J.S. Oliver could earn (*e.g.*, Coleman's advisory agreement did not provide for the payment of

any performance fees; Sapling's advisory agreement permitted performance fees but they were capped at 1% of the assets in the account). (Trial Tr. (Mausner) 1231:10-1233:10; Div. Ex. 4.)

Conveniently, Mausner formed CGF in June 2008 as a new fund. Mausner began CGF at that time with an investment of his own money. (Trial Tr. (Mausner) 1249:1-6; Div. Ex. 189.) Over the next five months, Mausner emailed many current and prospective investors to tout CGF's inflated positive monthly returns and to make a "strong" recommendation that they invest in CGF. (Trial Tr. (Anderson) 34:14-35:21; Trial Tr. (Mausner) 1250:22-1251:14; 1252:18-21; 1253:9-1255:25; 1256:19-1257:16; 1257:25-1259:24; Trial Tr. (Mahler) 808:23-821:1; Div. Exhs. 9, 374, 375, 376, 377, 378, 379.) For example, relying on the profits generated through his cherry-picking scheme, a November 2008 email sent by Mausner to induce investments in CGF touted that CGF had gained almost 13% when the S&P declined almost 17% during the same period. (Trial Tr. (Mausner) 1260:4-1261:11; Trial Tr. (Mahler) 816:24-819:14; Div. Ex. 378.) Thus, Mausner used his cherry-picking to inflate CGF's performance with the goal of luring new money into his new fund.

In addition, when Mausner formed CGF, he structured the fees differently than in his earlier funds. CGF paid J.S. Oliver a performance fee of 20% of fund profits, and it also paid J.S. Oliver a management fee of 2% of the fund assets, whereas the J.S. Partners Funds paid only a 1% management fee. (Trial Tr. (Mausner) 1246:11-1247:4; Div. Ex. 135.) This new, more lucrative fee structure, coupled with the fact that the other funds were under their high water marks, gave Mausner ample reason to pump up CGF's performance to get existing clients to move into the new fund, as well as to entice new clients. For 2008, CGF paid J.S. Oliver $224,600 in performance fees. (Trial Tr. (Mausner) 1247:8-1248:14; Ex. 189.)

C. Mausner and J.S. Oliver Misused Client Soft Dollar Credits, and Drennan Aided, Abetted, and Caused Their Violations

1. J.S. Oliver's soft dollar arrangement with its brokers, Instinet and BTIG

Beginning in January 2009, Mausner and J.S. Oliver misused over $1.1 million of client assets in the form of soft dollar credits. Soft dollars are client commission credits that are generated when an investment adviser negotiates to pay commissions that exceed what is necessary to compensate the broker for executing trades for the adviser. (Div. Ex. 696, ¶¶ 18-21.) Because clients' commission dollars generate soft dollar credits, soft dollars are assets of the clients, not of the investment adviser. (Trial Tr. (Mausner) 1267:20-1268:1; Trial Tr. (Driscoll) 252:21-253:18; Div. Ex. 696, ¶ 19.)

Investment advisers may use soft dollars in accordance with Section 28(e) of the Exchange Act, which provides a "safe harbor" that allows investment advisers to use client funds to purchase "brokerage and research services" for their managed accounts under limited circumstances without breaching their fiduciary duties to clients. (Div. Ex. 696, ¶ 23.) Expenses that do not qualify for the 28(e) safe harbor include the following:

> … expenses for travel, entertainment, and meals associated with attending seminars, and travel and related expenses associated with arranging trips to meet corporate executives, analysts, or other individuals who may provide eligible research orally …, salaries (including research staff), rent ….

(Div. Ex. 696, ¶ 24.) [6]

Soft dollars may also be used to pay for other legitimate expenses of an investment adviser if such use is in the best interest of clients and express disclosures are made to clients with sufficient specificity so that the client can understand what benefit is being obtained with its

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[6] *See* Securities and Exchange Commission, 17 C.F.R. Part 241, Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, July 18, 2006, p. 32.

soft dollars. (Div. Ex. 696, ¶ 26.) Such disclosure is required because the use of soft dollars is otherwise an undisclosed use of clients' assets – a conflict of interest – and, if not adequately disclosed, is a breach of fiduciary duty when it puts the adviser's interests ahead of its clients' interests. (Div. Ex. 696, ¶ 26.)

J.S. Oliver used two brokers for its trading activity, Instinet, LLC ("Instinet") and BTIG, LLC ("BTIG"). It earned and used client soft dollar credits primarily through Instinet and to a lesser extent at BTIG, generating the credits through equity and options trading. (Trial Tr. (Driscoll) 254:22-258:17; Trial Tr. (Endres) 533:25-534:7.) Although J.S. Oliver used an omnibus account at Instinet under its own name, the trading that generated the soft dollar credits at issue was conducted on behalf of its four hedge funds and its individual client accounts. (Trial Tr. (Mausner) 1267:14-19; Div. Ex. 696 at ¶ 35.) J.S. Oliver had sole discretion regarding what soft dollar rate it wanted to establish, and it had discretion to raise or lower the soft rate. (Trial Tr. (Driscoll) 253:19-254:10; Trial Tr. (Kellner) 398:8-21; Trial Tr. (Endres) 526:22-24.) Under J.S. Oliver's oral soft dollar arrangement with Instinet, Instinet accrued a soft dollar credit of $0.02 for every $0.03 of brokerage commissions generated per share by the majority of J.S. Oliver's equity trades. (Trial Tr. (Driscoll) 255:9-256:3.) For options, the soft dollar credit varied (Trial Tr. (Driscoll) 289:25-291:11.) J.S. Oliver had a similar soft dollar arrangement with BTIG. (Trial Tr. (Endres) 534:3-7.) Mausner approved each soft dollar invoice before it was submitted to Instinet. (Trial Tr. (Kartes) 602:12-19.)

With Instinet, J.S. Oliver used client soft dollar credits for expenses that fell both within and outside the Section 28(e) safe harbor. (Trial Tr. (Mausner) 1269:4-10.) BTIG had an internal policy that limited its soft dollar program to research and brokerage expenses covered by the 28(e) safe harbor. (Trial Tr. (Endres) 528:16-23.)

2. **Drennan was instrumental in establishing J.S. Oliver's soft dollar arrangements**

Drennan was integral in establishing J.S. Oliver's soft dollar relationship with Instinet. Neil Driscoll, the Instinet account representative who handled the J.S. Oliver account, testified that Drennan was his first contact at J.S. Oliver in late 2008 and, in fact, that Drennan was always his primary contact at J.S. Oliver. (Trial Tr. (Driscoll) 247:5-6; 278:1-3.) Mausner confirmed that Drennan was J.S. Oliver's primary contact in setting up the account with Instinet, and testified that Drennan was the "point person" who handled day-to-day issued regarding J.S. Oliver's soft dollar activities. (Trial Tr. (Mausner) 1265:15-18; 1266:11-19.) Mr. Driscoll never communicated with Mausner before J.S. Oliver became an Instinet client. (Trial Tr. (Driscoll) 251:9-13.) In fact, during the entire time that Mr. Driscoll served as the account representative for the J.S. Oliver account, he only communicated with Mausner twice and with J.S. Oliver's controller Melanie Kartes a "couple" of times. (*Id.* 249:16-250:6.) Every other interaction that Mr. Driscoll had with J.S. Oliver was handled by Drennan. (*Id.* 250:7-11.) Drennan frequently communicated with Mr. Driscoll by instant message. (*See, e.g.*, Div. Exhs. 330, 332, 335; Trial Tr. (Driscoll) 249:12-15.)

Drennan's extensive involvement in J.S. Oliver's soft dollar relationship is supported by contemporaneous documentary evidence. For example, in the new account form that J.S. Oliver used to establish its account with Instinet, J.S. Oliver lists Drennan as the primary contact and describes his position as "trader." (Div. Ex. 306 at INST-5th 396224; Trial Tr. (Kellner) 421:3-422:8.) In fact, Mr. Driscoll testified that, at the time Drennan established the relationship with Instinet on behalf of J.S. Oliver, Drennan represented that he was a portfolio manager for J.S. Oliver. (Trial Tr. (Driscoll) 249:1-8.)

The evidence established that Drennan's ability to set up the soft dollar relationship with Instinet was the primary motivating factor behind Mausner agreeing to rehire Drennan. Drennan had left J.S. Oliver in May 2008 to begin work with another investment adviser. (Trial Tr. (Drennan) 832:19-24; 834:13-15.) Within two months of leaving J.S. Oliver, Drennan's new firm informed him that they were going to be downsizing. (*Id.* 835:14-17.) Drennan began looking for a new job in September 2008. (*Id.* 835:18-20.)

In December 2008, Drennan contacted Mausner about returning to work at J.S. Oliver. (*Id.* 835:24-836:10.) At the time, Mausner told Drennan that he was not interested in hiring him back as an employee, but Mausner later agreed to take Drennan back after the two discussed structuring Drennan's compensation so that it could be paid with client soft dollars. (*Id.* 836:11-837:8.)

Mausner and Drennan met on or about December 9, 2008 and, within two days, Drennan had contacted Instinet and reported back to Mausner regarding the details of setting soft dollar rates and soft dollar invoicing. (Trial Tr. (Mausner) 1262:14-20; Div. Ex. 598 at MAUSNER 000314; Div. Ex. 325 at JSO 101540.) On December 15, 2008, Mausner asked Drennan whether he could "arrange with [Instinet] to set it up with us so your comp[ensation] can be soft dollared from day one when and if you start..." (Div. Ex. 325 at JSO 010539-540; Trial Tr. (Mausner) 1271:3-9.)

Drennan was paid handsomely for his role in creating the soft dollar program. Apparently to help tide Drennan over financially while he was setting up the soft dollar arrangement with Instinet, Mausner authorized a soft dollar payment of $50,000 to Drennan in January 2009 from J.S. Oliver's then-broker, "Screaming Eagle." (Trial Tr. (Mausner) 1272:20-25; 1273:6-1274:5 ; Trial Tr. (Drennan) 960:14-25.) In addition, Ms. Kartes testified that

Drennan told her that he received a $100,000 bonus (paid with client soft dollars) for his work in establishing J.S. Oliver's soft dollar arrangements. (Trial Tr. (Kartes) 649:20-651:5.)

3. J.S. Oliver's specific soft dollar disclosures

Mausner and J.S. Oliver provided limited disclosure of their use of client soft dollar credits in J.S. Oliver's Form ADVs, Part II, filed March 30, 2007 and March 3, 2009, for its separate accounts, and in the offering memoranda for its four hedge funds. Mausner conducted the final review and approval of J.S. Oliver's Forms ADV, Part II and offering memoranda. (Trial Tr. (Mausner) 1228:9-14; 1229:22-1230:3; 1274:13-1275:22.) Each of the documents had language disclosing that soft dollars may be used for research and brokerage payments under the Section 28(e) safe harbor. The Forms ADV, Part II and offering memoranda contained additional limited soft dollar disclosure as described below.

a) J.S. Oliver's Forms ADV

For the separate accounts, J.S. Oliver's Form ADV, Part II (which was provided to clients and prospective individual clients), filed March 30, 2007, provided that clients' soft dollars may be used for:

> ... expenses of and travel to professional and industry conferences and hardware and software used in the Firm's or its affiliates' administrative activities ... [and] 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.

(Div. Ex. 86 at JSO 000384-385.) J.S. Oliver amended the 2007 disclosure in its Form ADV, Part II, filed March 3, 2009, but the amendment actually narrowed the soft dollar disclosure. In particular, in the March 2009 filing J.S. Oliver disclosed only that it may use soft dollars earned from trading in the hedge funds, with no disclosure provided for the use of soft dollars generated from trading in its separately managed client accounts. (Div. Ex. 89 at JSO 000366-368.) J.S.

Oliver did not revise any language concerning the allowed uses of soft dollars to include additional permissible uses for soft dollars consistent with how it was actually using soft dollars. (*Id.*)

b) The J.S. Partners Funds' offering memoranda

The soft dollar disclosure in the J.S. Partners Funds' offering memoranda was the same as the disclosure in J.S. Oliver's 2007 Form ADV, Part II. The J.S. Partners Funds' disclosures provided that soft dollars may be used for:

> ... expenses of and travel to professional and industry conferences and hardware and software used in the General Partner's administrative activities ... [and] 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 JSO 001375-76 (Fund 1 Offering Memorandum); Div. Ex. 411 at JSO 001163 (Fund 2 Offering Memorandum); Div. Ex. 412 at JSO 00114 (Offshore Fund Offering Memorandum.))

c) The CGF offering memorandum

The disclosures in the CGF offering memorandum provided, in relevant part, that soft dollars may be used for:

> ... evaluating potential investment opportunities (including travel, meals and lodging related to such evaluation) ... and may even include such 'overhead' expenses as office rent, salaries, benefits and other compensation of employees or of consultants to the Investment Manager ....

(Div. Ex. 135 at INST 000064.)

d) Respondents provided Instinet only with the CGF offering memorandum

J.S. Oliver, through Drennan, provided Instinet with only the CGF offering memorandum to support respondents' requests for reimbursement and payment using soft dollar credits.[7] (Trial Tr. (Driscoll) 260:3-8; 262:18-263:15; 264:11-265:8; Div. Ex. 331.) Drennan did so even though J.S. Oliver also earned soft dollar credits through the trades of individual clients and the J.S. Partner Funds, and the individual clients and J.S. Partners Funds investors did not receive the CGF offering memorandum. (Trial Tr. (Mausner) 1236:14-1237:8; 1267:14-19.) Respondents thereby provided Instinet with a disclosure document that would give the firm the most leeway in its use of soft dollar credits, even though the soft dollar disclosures in the J.S. Partner Funds' offering memoranda and Forms ADV were narrower than those in the CGF offering memo, and the CGF offering memorandum was not provided to J.S. Oliver's individual clients or to investors in the J.S. Partners Funds. As described below, however, even the CGF offering memorandum did not adequately disclose the expenses for which J.S. Oliver sought and received soft dollar payments.

4. Mausner and J.S. Oliver used client soft dollar credits for expenses that were not in their clients' best interests, nor disclosed to clients or fund investors

The evidence established that Mausner and J.S. Oliver used more than $1.1 million of client soft dollar credits to pay for expenses that were not in their clients' best interests and were not disclosed to its hedge funds' investors or to its individual clients. As described below, J.S. Oliver and Mausner used soft dollars: (1) to pay $329,365 to Mausner's ex-wife as part of their

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[7] While Instinet paid soft dollar credits for non-Section 28(e) items, BTIG's agreement with J.S. Oliver provided that it would not pay for items outside the Section 28(e) safe harbor. (Trial Tr. (Endres) 528:16-23.) Thus, the limited soft dollar disclosures in the Forms ADV, Part II, and in the Funds' offering memoranda were immaterial to J.S. Oliver's soft dollar requests through BTIG.

divorce settlement; (2) to pay $300,000 in inflated "rent" on Mausner's home, with Mausner pocketing $200,000 in excess payments; (3) to pay over $40,000 in maintenance fees on Mausner's personal timeshare at the luxury St. Regis Hotel in New York; and (4) to pay Drennan more than $480,000 in salary and bonuses under the Section 28(e) safe harbor.

Each of the investor witnesses who testified at trial stated that J.S. Oliver and Mausner did not communicate to them that the firm was generating soft dollar credits from their trading accounts. (Trial Tr. (Hall) 793:10-794:25; Trial Tr. (Anderson) 24:5-10, 71:16-72:1; Trial Tr. (Mahler) 822:21-823:25.) Lynn Hall, who invested in Fund 2, testified that she had agreed to pay Mausner one percent to invest her money and that it seemed unethical and it would have mattered to her had she known that J.S. Oliver generated credits from her securities trades and paid Mausner's personal expenses with those credits. (Trial Tr. (Hall) 794:6-15.) Ms. Hall also testified that she would have thought differently about investing her money with J.S. Oliver had she known about the respondents' soft dollar misuses. (*Id.* 794:17-25.)

David Mahler, who invested in Fund II, testified that no one from J.S. Oliver told him that the firm was generating soft dollar credits when executing trades on his behalf and, when he first heard the term during his SEC testimony, he was "surprised and did not understand even what the term meant." (Trial Tr. (Mahler) 823:5-18.) In retrospect, Mr. Mahler viewed the soft dollar payments as an additional fee that he "unwittingly" paid to J.S. Oliver in addition to the one percent management fee to which he had agreed. (Trial Tr. (Mahler) 823:23-25.) Mr. Mahler testified that he would not have invested with J.S. Oliver had he known that J.S. Oliver was using soft dollar credits earned through his trading to pay for Mr. Mausner's personal expenses because he did not feel that the practice fit with his personal ethics. (Trial Tr. (Mahler) 824:1-10.)

Mr. Anderson, who invested money with J.S. Oliver through his charitable foundation, the Sapling Foundation, testified that Mausner had no discussions with him that soft dollars were generated through his trades. He believed that the management fee he negotiated with Mausner was "generous" and that and that their agreement was "represented by the fees [they] negotiated." Mr. Anderson testified that it would "have been horrifying" to him if J.S. Oliver and Mausner generated soft dollar credits by trading in the Sapling account and then used those funds to make a payment to Mr. Mausner's ex-wife in lieu of spousal support. (Trial Tr. (Anderson) 24:11-19; 71:16-72:22.)

a) Soft dollar credits to pay Mausner's divorce settlement with his ex-wife

In June 2009, Instinet paid J.S. Oliver $329,365 using client soft dollar credits for reimbursement of a payment J.S. Oliver had made to Mausner's ex-wife, Gina Kloes, based on Mausner's misrepresentations that the payment was for employee compensation. (Trial Tr. (Kellner) 415:8-416:6; 434:1-435:25; Div. Exhs. 70, 140, 545.) Although Ms. Kloes had been a J.S. Oliver employee in 2004 and 2005, the Mausners divorced and she was not an employee of the firm after 2005, and was under no obligation to perform any work for J.S. Oliver as of December 31, 2006 and did not perform any work after 2007. (Trial Tr. (Kloes) 491:2-6; 505:11-24; 505:25-506:2.) The evidence showed conclusively that J.S. Oliver paid Mrs. Kloes the $329,365 not as part of any employment agreement, but rather to discharge Mausner's personal obligation pursuant to the Mausners' divorce agreement.

i. Mausner and Ms. Kloes's divorce

Mausner and Ms. Kloes were married from 1994 until 2005, when they divorced. (Trial Tr. (Kloes) 475:9-19.) Ms. Kloes helped Mausner start J.S. Oliver, and she served as the firm's CFO in 2004 until their 2005 divorce, at which time, Ms. Kloes testified, "Ian…wanted me out."

(Trial Tr. (Kloes) 475:20-476:13.) As part of their divorce in 2005, Mausner and Ms. Kloes entered into a marital settlement agreement (the "2005 MSA"), which provided for a series of payments Mausner would cause J.S. Oliver to pay Ms. Kloes "in lieu of" spousal support. (Div. Ex. 22 at GMM 1053; Trial Tr. (Kloes) 478:13-25.) The 2005 MSA included provisions requiring Mausner to cause J.S. Oliver to pay Ms. Kloes a purported annual "salary" for January 2007 to December 2010, as well as payments for a country club membership, a nanny for their children, a weekly housekeeper, and a part-time assistant for Ms. Kloes. (Div. Ex. 22 at GMM 1053-55.)

The 2005 MSA required Ms. Kloes to perform limited work for J.S. Oliver in 2005 and 2006, with no obligation for Ms. Kloes to perform any work from 2007 forward. (Trial Tr. (Kloes) 491:2-11; Div. Ex. 22 at GMM 1053-1054.) Indeed, when Ms. Kloes agreed to assist a J.S. Oliver employee with reconciling the firm's financial statements in early 2007, Ms. Kloes and Mausner agreed that she would be paid an hourly rate for additional work beyond 2006. (Div. Ex. 23 at GMM 1391-1394; Trial Tr. (Kloes) 491:13-494:14.)

Ms. Kloes testified that she could not recall doing any work for J.S. Oliver in 2007, and that she definitively did not do any work for J.S. Oliver in 2008 or 2009. (Trial Tr. (Kloes) 494:23-495:2; 505:11-24; 505:25-506:2.) Ms. Kloes also testified that although the 2005 MSA required Mausner to pay her "through the firm," she "wasn't an employee there." (Trial Tr. (Kloes) 502:11-503:6; 512:20-513:7.) Melanie Kartes, who worked as the controller at J.S. Oliver from 2008 to 2011, testified that during the entire time she worked at J.S. Oliver, she never had any telephone calls or meetings with Ms. Kloes, and Ms. Kloes never came to J.S. Oliver's office. (Trial Tr. (Kartes) 565:18-566:13; 617:4-19.)

Indeed, Mausner himself did not consider Ms. Kloes to be an employee of J.S. Oliver after 2005. Mausner "turned off" Ms. Kloes's email address at J.S. Oliver in 2005 when Ms.

Kloes was terminated as CFO. (Trial Tr. (Kloes) 483:23-484:11.) In November 2005, Mausner wrote to Ms. Kloes, "Since you are no longer with JSO, could you stop using the firm email or any other firm stuff." (Div. Ex. 24 at GMM 1509; Trial Tr. (Kloes) 484:12-485:21; Trial Tr. (Mausner) 1285:9-1286:7.) Mausner instructed one J.S. Oliver employee in 2008 that "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." (Trial Tr. (Kloes) 505:11-24.) Mausner also testified previously under oath that Ms. Kloes stopped working for J.S. Oliver in 2005. In a 2010 deposition in an arbitration that Mr. Anderson brought against J.S. Oliver, in response to a question asking when Ms. Kloes stopped working for J.S. Oliver, Mausner testified "I don't know the exact date, but it was somewhere around, you know, when we got divorced, so it would have been in 2005." (Trial Tr. (Mausner) 1288:24-1290:20.)

In 2008, the relationship between Mausner and Ms. Kloes grew increasingly strained and, under the guise of J.S. Oliver's purported poor financial condition, Mausner cut off all payments to Ms. Kloes and terminated the health insurance for her and her oldest son, who has a lifelong medical condition. (Trial Tr. (Kloes) 500:7-18; Div. Ex. 21, 594.) During this time, Mausner sent Ms. Kloes "a lot of very hostile e-mails." (Trial Tr. (Kloes) 503:15-23.) Upon discovery of recording and bugging devices in her home in 2008, Ms. Kloes turned them on and heard the voice of Mausner talking with the person who had installed them; Ms. Kloes subsequently filed a police report. (Trial Tr. (Kloes) 503:24-504:6.) And in June 2008, Ms. Kloes called the police, alleging that Mausner unlawfully entered Ms. Kloes's residence, "shoved and hit" Ms. Kloes and a friend of hers, chased Ms. Kloes through the residence, damaged property inside the home, and made verbal death threats against Ms. Kloes. (Trial Tr. (Mausner) 1290:22-1292:22; Div. Ex. 705.) As a result of these encounters, Ms. Kloes obtained a restraining order against Mausner. (Trial Tr. (Mausner) 1293:2-9; Trial Tr. (Kloes) 505:6-7; Div. Ex. 26 at GMM 001134-001135.)

In May 2009, as a result of their ongoing disputes, Mausner and Ms. Kloes entered into a revised martial settlement agreement (the "2009 MSA"). (Div. Ex. 26; Trial Tr. (Kloes) 506:18-20.) In the 2009 MSA, Mausner agreed that J.S. Oliver would pay his ex-wife a lump-sum payout of $214,500 plus payroll taxes, in exchange for Ms. Kloes waiving her right to the entire amount due under the 2005 MSA and "any spousal support that may be due" Ms. Kloes. (Div. Ex. 26 at GMM 001131.) The 2009 MSA also restricted email communications between Mausner and Ms. Kloes to emergencies and issues regarding their parenting plan. (Div. Ex. 26 at GMM 001127; Trial Tr. (Kloes) 508:4-25.) Both the 2005 MSA and the 2009 MSA were between Ms. Kloes and Mausner; there was no agreement between Ms. Kloes and J.S. Oliver. (Trial Tr. (Kloes) 511:12-25; 513:9-21.) Ms. Kloes testified unequivocally that she "didn't have a contract with J.S. Oliver Capital Management" and that the payment that Mausner caused J.S. Oliver to make to Ms. Kloes under the 2009 MSA constituted her "getting paid for a divorce." (Trial Tr. (Kloes) 511:1-25; 513:18-21; 520:9-25.)

ii. The request that Instinet use client soft dollar credits to reimburse J.S. Oliver for its payment to Mausner's ex-wife

In May 2009, Mausner and Drennan requested that Instinet reimburse with client soft dollar credits J.S. Oliver's payment to Ms. Kloes. On May 8, 2009, Drennan contacted an Instinet employee, Jonathan Ranello and, at Mausner's direction, Drennan initially misrepresented to Instinet that the reason for the payment was that J.S. Oliver planned to keep Ms. Kloes on payroll as a consultant for tax or compliance-related issues. (Trial Tr. (Drennan) 987:8-18; Trial Tr. (Mausner) 1281:23-1282:7; Div. Exhs. 1313, 1314.) Drennan then informed Mausner that, based on his discussions with Instinet, in order to pay Ms. Kloes with soft dollars J.S. Oliver would need to provide Instinet with a copy of the purported contract between Ms. Kloes and J.S. Oliver stating the amount of money, and describing the time period of the

purported consulting agreement and a description of the consulting services to be provided. (Div. Ex. 1314 at p. 2 of 5.)

At Mausner's direction, Drennan calculated that a pre-tax payroll amount of approximately $318,000 (which was later adjusted to $329,965) would result in an after-tax payment to Ms. Kloes of approximately $214,500, which was the amount that Mausner was required to pay Ms. Kloes pursuant to the 2009 MSA. (Div. Ex. 592; Trial Tr. (Drennan) 995:12-996:4; 999:25-1000:14.)

Drennan, at Mausner's direction, subsequently drafted an email to Instinet that falsely represented that Ms. Kloes "has remained an employee of J.S. Oliver offering advice on organizational and accounting issues," and that "Gina and J.S. Oliver have an agreement" to pay Ms. Kloes a salary through 2011, and that J.S. Oliver planned to make a lump sum payment to Ms. Kloes for the "remaining salary" due to her through 2011. (Div. Ex. 344; Trial Tr. (Drennan) 1006:9-16; 1007:14-18.) Drennan made these representations even though he knew that Ms. Kloes had not been providing "advice on organizational and accounting issues." (Trial Tr. (Drennan) 1008:25-1010:2.) Indeed, Drennan admitted that Ms. Kloes was not a J.S. Oliver employee when he left in 2008 and was not a J.S. Oliver employee when he returned in 2009. (Trial Tr. (Drennan) 894:21-895:6.) Mausner sent Drennan's email to Instinet, and Drennan also forwarded Mausner's email to Mr. Driscoll at Instinet. (Div. Ex. 545; Trial Tr. (Drennan) 1010:12-19; Trial Tr. (Driscoll) 295:15-296:5.) Contrary to their representations, Ms. Kloes did no work for J.S. Oliver after 2007. (Trial Tr. (Kloes) 505:11-506:17)

After receiving the email from Mausner and Drennan in which they referenced the lump sum payment for Ms. Kloes's purported remaining salary, Instinet requested an in-person meeting with Mausner to obtain more information regarding the reimbursement request. (Trial Tr. (Kellner) 429:8-16.) Mr. Driscoll called Drennan to set up the meeting. (Trial Tr. (Driscoll)

297:17-18.) On June 1, 2009, Mr. Driscoll and another Instinet representative met with Mausner at J.S. Oliver's office. (Trial Tr. (Driscoll) 297:7-15; Trial Tr. (Mausner) 1295:22-1296:2; Div. Ex. 70.)

During the meeting, the Instinet representatives requested a copy of the agreement between J.S. Oliver and Ms. Kloes that required the purported lump sum payout of salary. (Trial Tr. (Driscoll) 298:7-12; Div. Ex. 70.) After the meeting with Instinet ended, Drennan and Mausner began working to create the purported "excerpt" that they would present to Instinet to justify paying Mausner's divorce settlement obligation to Ms. Kloes with soft dollars. On the morning of June 1, 2009, shortly after the meeting with Instinet, Drennan, at Mausner's request, first cut and pasted three subparagraphs of the 2005 MSA into an email. (Div. Ex. 345; Trial Tr. (Drennan) 1011:2-1012:3.) The pasted portion initially included the page number and Ms. Kloes' initials from the relevant page of the 2005 MSA. (Div. Ex. 345; Div. Ex. 22 at GMM 001053; Trial Tr. (Mausner) 1296:24-1297:8.) Several minutes later, Drennan had another J.S. Oliver employee convert the pasted language into Adobe PDF format, and onto J.S. Oliver letterhead, so that it could be forwarded to Instinet; Drennan promptly forwarded the PDF language to Mausner. (Div. Exhs. 346, 347, 348; 349a; 349b; 349c; 349d; 349e; 349f; 349g; Trial Tr. (Drennan) 1012:17-1013:24; 1014:7-10; 1014:19-1015:1.)

Drennan initially drafted additional language that represented that the "excerpt" was from a contract between Ms. Kloes and Mausner. (Div. Ex. 348.) But Mausner and Drennan then altered the language to hide the fact that the payout was Mausner's personal obligation to Ms. Kloes. Shortly after having the language converted to PDF, Drennan, at Mausner's direction, changed the description of the purported excerpt to read that the language was "from the contract between J.S. Oliver Capital Management, L.P. and Gina Mausner." (Trial Tr. (Drennan) 1017:6-17; Div. Ex. 349c at JSO 300693.)

In reality, both the 2005 and 2009 MSAs were between Mausner and his ex-wife; there was no contract between J.S. Oliver and Ms. Kloes. (Div. Exhs. 22, 26; Trial Tr. (Kloes) 513:9-21.) In addition, Mausner had instructed Drennan to delete from the "excerpt" references that were clearly personal in nature, including the country club memberships, nanny, weekly housekeeper, and Ms. Kloes's part-time assistant. (Div. Exhs. 22, 70, 346; Trial Tr. (Drennan) 1137:2-16.) When questioned about these alterations, Drennan testified that he "should have removed even more language." (Trial Tr. (Drennan) 1137:14-16.) Mausner forwarded the altered language to Instinet to support the respondents' claim that the payment to Ms. Kloes should be reimbursed with soft dollars. (Trial Tr. (Mausner) 1301:17-1302:3; Div. Ex. 70.)

Drennan created the excerpt as instructed by Mausner, even though Drennan knew that (1) the lump sum payment obligation arose from the Mausners' 2009 MSA, not any agreement between Ms. Kloes and J.S. Oliver (Div. Ex. 345); (2) Ms. Kloes was not working for, and had no obligation to work for, J.S. Oliver in exchange for the payment (Trial Tr. (Drennan) 894:21-895:6; Div. Ex. 22, 26); and (3) Mausner planned to provide the excerpt to Instinet in support of using soft dollar credits to reimburse J.S. Oliver for the payment. (Trial Tr. (Drennan) 1003:17-1004:21.) Drennan also approved the payment on J.S. Oliver's behalf in Instinet's online soft dollar system. (Trial Tr. (Kellner) 415:23-416:4; Trial Tr. (Drennan) 1022:20-25; Div. Ex. 140 at INST-4th 015518.) In June 2009, Instinet reimbursed J.S. Oliver the $329,365 using J.S. Oliver's clients' soft dollar credits. (Trial Tr. (Kellner) 432:11-23; 415:23-416:4.) Jonathan Kellner, Instinet's president, testified that if he had seen the language from the actual marriage settlement agreement, Instinet would not have made the payment because it "was spousal support, not employee compensation" that did not come from an agreement between J.S. Oliver and Ms. Kloes, but rather from a spousal agreement. (Trial Tr. (Kellner) 434:21-435:25; 438:13-23.)

Mausner and J.S. Oliver did not disclose to their clients or fund investors that they would use soft dollar credits to pay Mausner's ex-wife pursuant to Mausner's divorce agreement. None of J.S. Oliver's disclosures addressed such use. The evidence established conclusively that the soft dollar payment to Ms. Kloes was neither salary nor a consulting fee. Ms. Kloes was not obligated to do any work for the firm in exchange for the payment and she did not perform any work during the relevant timeframe. Moreover, even if the facts were different and the payment legitimately could be considered "salary," the use of soft dollars for salary was never disclosed to J.S. Oliver's individual clients or investors in the J.S. Partners Funds. Only the CGF offering memorandum disclosed salary as a potential use of soft dollars; the Forms ADV, Part II and the J.S. Partners Funds' offering memoranda did not. (Div. Exhs. 86, 89, 160.)

Although Mausner and Drennan repeatedly claimed to be acting on advice of counsel in preparing the altered language that they submitted to support the request to reimburse the payment to Ms. Kloes with client soft dollars, they presented no testimony from any of their lawyers, presented no documents from their lawyers corroborating the purported advice, or otherwise substantiated their claims. (Trial Tr. (Mausner) 1306:8-14.) Indeed, on June 1, 2009 (the day they created and sent the purported contract "excerpt" to Instinet), neither Mausner nor Drennan consulted any lawyers as they fabricated the fake "excerpt" used to obtain the soft dollar payments. (Trial Tr. (Mausner) 1299:18-1301:11; Trial Tr. (Drennan) 1011:23-1012:3.)

b) Soft dollars to pay excessive "rent" for Mausner's home and to funnel excess cash to his personal bank account

i. Soft dollars for rent on Mausner's home

Beginning in 2005, J.S. Oliver used a portion of Mausner's personal residence in a residential neighborhood in San Diego to conduct its business. (Trial Tr. (Mausner) 1204:11-21; Trial Tr. (Kartes) 570:25-571:24.) At the time, the home was owned by JO Samantha LLC ("JO

Samantha"), an entity owned by Mausner. (Trial Tr. (Mausner) 1309:12-17; Trial Tr. (Kartes) 573:11-21.) The J.S. Oliver business occupied a portion of the home, and Mausner used some of the home for personal use, including bedrooms for him and his children. (Trial Tr. (Mausner) 1204:22-1205:3.) The monthly mortgage on Mausner's home was approximately $5,445 per month. (Trial Tr. (Mausner) 1309:18-1311:12; Div. Exhs. 415, 416.)

Mausner set the amount of the monthly rent that J.S. Oliver would pay to JO Samantha. (Trial Tr. (Mausner) 1312:11-16.) Through February 2009, J.S. Oliver paid $6,000 per month in rent, which JO Samantha used to pay the full mortgage on Mausner's home and other small expenses. (Trial Tr. (Mausner) 1309:9-14.)

In mid-February 2009, Drennan submitted a request to Instinet to start paying J.S. Oliver's rent to JO Samantha with client soft dollar credits for the period beginning January 2009. (Trial Tr. (Mausner) 1308:25-1309:4.) Instinet thereafter began paying J.S. Oliver's rent to JO Samantha with soft dollars. (Trial Tr. (Mausner) 1309:5-8.)

ii. Huge increases in the monthly rent payments

Once Instinet agreed to begin paying rent on the home with client soft dollars, Mausner quickly and dramatically increased the monthly rent. J.S. Oliver had been paying rent of $6,000 per month to JO Samantha through February 2009. (Trial Tr. (Mausner) 1311:20-24.) But once Instinet agreed to pay the rent using soft dollars, Mausner retroactively raised the rent for January and February 2009 and future months from $6,000 to $10,000 per month, a 67% increase. (Trial Tr. (Mausner) 1311:25-1312:5.) After Instinet paid the $10,000 rent for those months, JO Samantha reimbursed J.S. Oliver the $6,000 payments it had previously made for rent. (Trial Tr. (Kartes) 620:22-622:13; Trial Tr. (Drennan) 946:22-948:11; Div. Ex. 424.) Drennan, on J.S. Oliver's behalf, approved the payment of at least three inflated rent invoices in Instinet's soft dollar system. (Div. Ex. 140 at INST-4th 015497; Div. Ex. 307.)

Just four months later, in July 2009, Mausner again raised the monthly rent, this time to $15,000, and instructed Instinet to pay that amount monthly in rent to JO Samantha. (Trial Tr. (Mausner) 1312:6-10; Div. Ex. 307.) Thus, in a span of only a few months, Mausner arbitrarily increased the monthly rent from $6,000 to $15,000, a 150% increase. Instinet thereafter began paying JO Samantha $15,000 in monthly rent. (Trial Tr. (Mausner) 1312:6-10; Div. Ex. 307.) In 2009 and 2010, Instinet paid JO Samantha a total of $300,000 in rent payments using J.S. Oliver's clients' soft dollar credits.[8] (Div. Exhs. 311, 312, 313, 417, 452, 453, 454, 455.)

Mausner had no basis to increase J.S. Oliver's rent other than to personally enrich himself. As a result of such increases, JO Samantha had a substantial amount of leftover money each month after making the mortgage payment on the house. (Trial Tr. (Mausner) 1312:17-25.) Beginning in May 2009, and continuing on an almost monthly basis, Mausner directed J.S. Oliver employees, including Drennan, to transfer any excess soft dollar funds from JO Samantha to his personal bank account. (Trial Tr. (Mausner) 1313:1-3; Trial Tr. (Kartes) 665:4-8; 666:18-21; Exhs. 308, 309, 310, 311.) In fact, Mausner began expecting and receiving a "usual monthly amount" of $10,000 in excess client soft dollar credits transferred to his personal bank account. (Trial Tr. (Mausner) 1313:4-1314:21; Div. Exhs. 309, 310.) Mausner received from the JO Samantha account over $200,000 in inappropriate distributions of money obtained through clients' soft dollar credits. (Div. Exhs. 417, 452, 453, 454, 455.)

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[8] JO Samantha's general ledger shows that it received from Instinet $10,000 monthly from January through June 2009, $15,000 monthly from July 2009 through July 2010, $10,000 monthly again from August through October 2010, and $7,500 monthly in November and December 2010, for a total of $300,000 in 2009 and 2010. (Div. Exhs, 311, 312.)

c) Soft dollars to pay maintenance fees on Mausner's personal timeshare at a luxury hotel in New York City

Mausner also used client soft dollar credits to pay maintenance fees on his personal timeshare. In late 2008, Mausner's family trust purchased a timeshare that granted Mausner the use of a two-bedroom condominium unit at the luxury St. Regis Hotel in New York City each year for a fixed week and for 21 additional days. (Trial Tr. (Mausner) 1320:24-1321:16; Div. Ex. 414.) As part of his contract, Mausner was obligated to pay real estate taxes, maintenance fees, an annual membership fee, and other fees on the timeshare. (Div. Ex. 414.)

In 2009, J.S. Oliver submitted two invoices to Instinet for payment of Mausner's timeshare expenses, characterizing the purpose of the expenses as evaluating "potential investment opportunities, including travel." (Div. Exhs. 186, 219.) The timeshare expenses were for "maintenance fees" and "back-up reserves" totaling $40,094.54. (Trial Tr. (Mausner) 1321:22-1322:1; 1322:10-22; Div. Exhs. 186, 219.)

The disclosures in J.S. Oliver's Form ADV, Part II and J.S. Partner Funds' offering memoranda provided that soft dollars may be used to reimburse travel expenses related to conferences only. (Div. Ex. 86 at JSO 000384-385; Div. Ex. 89 at JSO 000366-368; Div. Ex. 160 at JSO 001375-76 (Fund 1 Offering Memorandum); Div. Ex. 411 at JSO 001163 (Fund 2 Offering Memorandum); Div. Ex. 412 at JSO 00114 (Offshore Fund Offering Memorandum).) Mausner did not introduce any evidence that he attended any conferences in connection with his use of the timeshare. Similarly, the CGF offering memorandum allowed soft dollar payments for "travel, meals and lodging" if it was connected to any "potential investment opportunity," but there is no evidence that Mausner used the timeshare to evaluate potential investment opportunities. (Div. Ex. 135.) But even if the facts were different and Mausner did use the timeshare for conferences or evaluating investment opportunities, the timeshare's maintenance

and other fees cannot legitimately be considered travel or lodging expenses, and they were not disclosed to J.S. Oliver clients as possible soft dollar uses. Moreover, Mausner regularly used the timeshare for personal use, including trips with girlfriends or family visits, or for uses that did not benefit J.S. Oliver's clients, such as meeting with prospective clients, but he made no effort to apportion the personal versus purported business use of the timeshare. (Trial Tr. (Mausner) 1323:7-18.) Mausner and J.S. Oliver did not disclose to clients or fund investors that they would use client soft dollars to pay the entire maintenance bill, totaling over $40,000, on Mausner's personal timeshare.

d) Soft dollar credits to pay Drennan more than $480,000 in salary and bonuses under the Section 28(e) safe harbor

Drennan had previously worked for J.S. Oliver from its inception in 2004 through May 2008, after which he worked at a different firm for six months. Upon his return to J.S. Oliver, the respondents represented to Instinet and to BTIG that Powerhouse Capital, Inc., a purported outside research firm Drennan formed in January 2009, provided independent research analysis to J.S. Oliver, and the respondents sought payment for Powerhouse's purported research services. Drennan drafted the Powerhouse Capital invoices for submission to Instinet for payments using soft dollars. (Trial Tr. (Drennan) 957:2-17.) In 2009 and 2010, J.S. Oliver used client soft dollar credits to pay Drennan $482,381 for purported research pursuant to the Section 28(e) safe harbor, including a $100,000 one-time bonus.[9] (Trial Tr. (Drennan) 892:10-15; 896:2-897:3; Div. Exhs. 83, 140, 181, 708.)

[9] Drennan received $312,381 in soft dollar payments in 2009. (Div. Ex. 83; Trial Tr. (Drennan) 895:7-896:7.) In 2010, Drennan received monthly soft dollar payments of $12,500 in January and February, and monthly payments of $14,500 for the remainder of the year, for a total of $170,000 in 2010. (Div. Ex. 140 at INST-4th 015574-584; Div. Ex. 708 at WFB 0000105-113.) Drennan thus received a total of $482,381 in soft dollar payments in 2009 and 2010.

Drennan, however, was not an outside research analyst but in reality was a full-time J.S. Oliver employee who performed many duties in addition to research upon his return. Drennan served as one of the primary contacts for J.S. Oliver in its soft dollar relationship with Instinet, including initiating the soft dollar account and approving, on J.S. Oliver's behalf, Instinet's initial payments to Powerhouse Capital and the reimbursement to J.S. Oliver for the payment to Ms. Kloes. (Trial Tr. (Driscoll) 247:5-6; 256:18-21; 277:21-278:3; 279:6-9; 280:7-11; Div. Ex. 52.) Drennan explained to Ms. Kartes the process for submitting expenses to have them paid with soft dollars. (Trial Tr. (Kartes) 596:19-597:18.) Drennan also facilitated the payment of at least three of Mausner's inflated "rent" payments with soft dollars. (Trial Tr. (Driscoll) 283:7-284:8; Div. Ex. 55.) As of February 2009, Drennan and Mausner were the only J.S. Oliver employees who could approve the payment of soft dollar invoices on Instinet's online system. (Trial Tr. (Drennan) 950:21-25.) Drennan admitted to Ms. Kartes that he received a $100,000 bonus for his work in establishing J.S. Oliver's soft dollar arrangements. (Trial Tr. (Kartes) 649:20-651:5.)

In fact, when Drennan returned to J.S. Oliver, he simply resumed his prior duties at the firm in addition to his duties overseeing the soft dollar program. Indeed, Mausner, when referring to Drennan's return to J.S. Oliver after six months at another firm, and the ability to pay his compensation with soft dollars, stated that anyone would "jump at [the] opportunity" to "get a great employee back for free." (Trial Tr. (Mausner) 1329:25-1331:9.) Mausner further testified that he did not consider there to be much of a difference between what Drennan did before he left J.S. Oliver and when he returned in 2009. (Trial Tr. (Mausner) 1329:1-16.) For example, Drennan began entering trades at J.S. Oliver in January 2009. (Trial Tr. (Mausner) 1326:9-25.) Upon his return, Drennan worked in J.S. Oliver's offices every day, used a key to enter the premises, had complete access to J.S. Oliver's computers and client files, and used an

@jsoliver.com email address and J.S. Oliver's telephone number for his communications. (Trial Tr. (Drennan) 850:8-852:5.) Drennan also supervised J.S. Oliver's accounting and financial reporting (Trial Tr. (Kartes) 647:5-648:1; *see* Div. Exhs. 205, 421, 426, 427, 549, 550, 553, 556, 565, 566, 567, 568, 575, 578.)

The evidence established clearly that Mausner and the other J.S. Oliver employees considered Drennan to be not only a J.S. Oliver employee, but one who occupied a leadership role with the firm. Upon Drennan's return to J.S. Oliver, Mausner introduced him as the "team leader." (Trial Tr. (Kartes) 581:24-582:17; 583:12-17; Trial Tr. (Mausner) 1327:5-1328:8; 1328:19-24.) Ms. Kartes testified that when Drennan returned, "we had a team leader to manage." (Trial Tr. (Kartes) 579:15-25.) As team leader, Drennan was responsible for, among other things, delegating work and following up to make sure that the work was completed, and resolving conflicts among J.S. Oliver employees. (Trial Tr. (Kartes) 582:11-583:7; 592:1-8.) Drennan often acted as J.S. Oliver's team leader even when Mausner was present. (Trial Tr. (Kartes) 583:15-584:6.) Drennan sent other employees weekly emails with tasks to perform. (Trial Tr. (Kartes) 585:3-15; 587:16-590:14; 592:15-20; Div. Ex. 356.)

When conducting business on J.S. Oliver's behalf, Drennan did not identify himself as working for Powerhouse Capital or otherwise as an independent contractor for J.S. Oliver. In fact, Drennan represented himself as a "trader" and J.S. Oliver's primary contact in J.S. Oliver's account opening documents with Instinet and J.S. Oliver's backup contact with BTIG. (Div. Ex. 306 at INST-5th 396224 and 396258; Trial Tr. (Endres) 530:8-24; Div. Ex. 706.) Drennan also signed documents as a "trader" for J.S. Oliver with BTIG in February 2009, giving him trading authorization on the J.S. Oliver account, and he performed a variety of functions in troubleshooting issues with trades and commissions. (Trial Tr. (Mausner) 1325:15-23; Div. Ex.

418; *see also* Div. Exhs. 357, 358, 359, 360, 435, 438, 440, 441, 442, 445, 446, 447, 448, 449, 450, 451, 459, 460, 470, 494, 494, 496, 497, 502, 503, 508, 510, 514, 515, 554, 555.)

Importantly, the soft dollar payments Drennan received would have been improper even if made to him as an employee. The use of soft dollars for salary was never disclosed to J.S. Oliver's individual clients or investors in the J.S. Partners Funds. Only the CGF offering memorandum disclosed salary as a potential use of soft dollars; the Forms ADV, Part II and the J.S. Partners Funds' offering memoranda did not. (Div. Ex. 86 at JSO 000384-385; Div. Ex. 89 at JSO 000366-368; Div. Ex. 160 at JSO 001375-76 (Fund 1 Offering Memorandum); Div. Ex. 411 at JSO 001163 (Fund 2 Offering Memorandum); Div. Ex. 412 at JSO 00114 (Offshore Fund Offering Memorandum).) Even if Drennan spent some time on research, there is no evidence to support how much time Drennan spent conducting research because he did not provide written reports to Mausner and he did not keep track of how much time he spent on research matters compared to all of the other work he conducted for J.S. Oliver.

D. J.S. Oliver and Mausner Failed to Keep Required Records

Mausner and J.S. Oliver failed to maintain certain records. First, J.S. Oliver failed to maintain records of trade blotters. (Trial Tr. (Mausner) 1342:10-1344:11.) Second, J.S. Oliver failed to maintain originals of Mausner's email messages, and in particular, the persons to whom Mausner sent the email by blind (bcc) copy, in which he touted the performance of CGF and encouraged investments in that fund. (Trial Tr. (Mausner) 1252:22-1253:8; 1256:1-6; 1257:17-24; 1259:25-1260:3; 1261:12-14.)

III. LEGAL ARGUMENT

A. Mausner and J.S. Oliver Violated, and Drennan Aided, Abetted and Caused Their Violations of, the Antifraud and Investment Adviser Fraud Provisions of the Federal Securities Laws

The evidence clearly established that Mausner and J.S. Oliver, by engaging in the conduct described above, violated the investment adviser antifraud provisions of Sections 206(1), (2), and (4) of the Advisers Act and Rule 206(4)-8 thereunder, and the antifraud provisions of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The evidence also showed that Drennan aided and abetted and caused J.S. Oliver's violations of the investment adviser fraud and antifraud provisions relating to soft dollar practices. The evidence further showed that J.S. Oliver violated, and Mausner aided and abetted and caused J.S. Oliver's violations of, the books and records provisions of Section 204 of the Advisers Act and Rules 2(a)(3) and (7) thereunder and the written policies and procedures provisions of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and that Mausner and J.S. Oliver violated the false Form ADV provisions of Section 207 of the Advisers Act and Rule 204-1(a)(2) thereunder.

Although the specific provisions of the antifraud and investment adviser fraud provisions differ slightly, the factual underpinning of the violations of each of these provisions is the same – Mausner's and J.S. Oliver's cherry-picking of profitable trades for favored accounts, to the detriment of the disfavored accounts, and their misuse of client soft dollars, aided and abetted by Drennan.

1. Mausner and J.S. Oliver Violated Section 206(1) and (2) of the Advisers Act

a) The legal standard for violations of Section 206(1) and 206(2)

Section 206 of the Investment Advisers Act states in relevant part:

> It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly –
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to 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.

In general, to establish violations under Section 206(1) and 206(2), the Division must prove that respondent is an investment adviser, that it engaged in fraudulent activities by jurisdictional means, and that it negligently breached its fiduciary duty by making false or misleading statements or omissions of material fact. *See SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 191-92 (1963); *SEC v. Merrill Scott & Assoc., Ltd.*, 505 F. Supp. 2d 1193 (D. Utah 2007); *SEC v. Bolla*, 401 F. Supp. 2d 43, 67 (D.D.C. 2005); *SEC v. Wall Street Publishing, Inc.*, 591 F. Supp. 1070, 1083 (D.D.C. 1984). Section 206(1) requires a showing of scienter; Section 206(2) does not. *Steadman v. SEC*, 603 F.2d 1126, 1134-35 (5th Cir. 1979). Scienter may be established by showing extreme recklessness. *See SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990) (*en banc*).

The Supreme Court has held that Section 206 establishes a statutory fiduciary duty for investment advisers to act for the benefit of their clients. *Transamerica Mortgage Adviser, Inc.*

v. Lewis, 444 U.S. 11, 17 (1979) ("Indeed, the Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations.") *See also Fundamental Portfolio Advisors, Inc.*, Securities Act Release No. 8251 (July 15, 2003), 56 S.E.C. 651, 684; *see SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. at 191-92, 194, 201. Those fiduciary duties require advisers to exercise "an affirmative duty of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading his clients." *Id. at* 194. The focus of the Advisers Act is on the investment adviser and his actions, and clients and prospective clients are mentioned only in relation to advisers. *SEC v. Gruss*, 859 F. Supp. 2d 653, 662-63 (S.D.N.Y. 2012). As fiduciaries, advisers are required "to act for the benefit of their clients, ... to exercise the utmost good faith in dealing with clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients." *SEC v. DiBella*, No. 3:04-cv-1342 (EBB), 2007 WL 2904211, at *12 (D. Conn. Oct. 3, 2007) (*quoting SEC v. Moran*, 922 F. Supp. 867, 895-96 (S.D.N.Y. 1996)), *aff'd*, 587 F.3d 553 (2d Cir. 2009). "[W]hat is required is '... not simply truth in the statements volunteered but disclosure' [of material facts]." *Capital Gains Research Bureau, Inc.*, 375 U.S. at 201.

As discussed below, J.S. Oliver and Mausner violated Sections 206(1) and (2) in two distinct ways: by cherry-picking profitable trades for favored accounts and by misusing client soft dollar credits.

b) Mausner and J.S. Oliver were investment advisers who used instrumentalities of interstate commerce

J.S. Oliver is registered as an investment adviser with the Commission. It provides investment advice to its clients – individuals and hedge funds – by selecting investments for them. J.S. Oliver executed trades for its clients on national exchanges and using means and

instrumentalities of interstate commerce, including telephones and email. J.S. Oliver receives compensation from its clients in the form of management and performance fees.

Mausner has been the president and head portfolio manager of J.S. Oliver since 2004, when he founded the advisory firm with his now ex-wife. From at least mid-2008 through 2011, Mausner was the control person of J.S. Oliver and he made all of the investment decisions for J.S. Oliver's clients. Mausner received a salary and distributions from J.S. Oliver's profits, and thus received compensation in connection with giving investment advice. Therefore, Mausner is an investment adviser under Section 202(a)(11). *See In the Matter of John J. Kenny, et al.*, SEC Rel. No. IA-2128, n. 54 (May 14, 2003) (an individual associated with investment adviser entity "may be charged as a primary violator under Section 206 where the activities of the associated person cause him or her to meet the broad definition of 'investment adviser.'").

c) Mausner and J.S. Oliver violated Sections 206(1) and 206(2) by cherry-picking profitable trades to benefit favored accounts, to the detriment of disfavored accounts

The evidence showed convincingly that Mausner and J.S. Oliver breached their fiduciary duties to their clients by misallocating trades to the detriment of the three disfavored clients. *See, e.g., In the Matter of Ark Asset Management Co., Inc.*, Advisers Act Rel. No. 3091 (Sept. 29, 2010) (settled administrative proceeding in which adviser knowingly or recklessly allocated profitable trades to the proprietary accounts at the expense of certain client accounts and did not disclose the scheme to its clients). The harm to the disfavored clients was substantial: more than $10.9 million over eighteen months.

The evidence plainly established that Mausner and J.S. Oliver engaged in fraudulent activities by engaging in a cherry-picking scheme, in breach of their fiduciary duty. (Div. Ex. 695A.) There can be little dispute that Mausner and J.S. Oliver cherry-picked favorable or profitable trades for the favored accounts, while dumping unprofitable trades into the disfavored

accounts and causing them substantial losses. Such a fraudulent trade allocation scheme, directly benefiting themselves to the detriment of their clients, is one of the most extreme examples of placing the adviser's interests ahead of those of their clients, and unquestionably constitutes violations of the investment adviser fraud provisions. *See, e.g., SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1303-04, 1308-09 (S.D. Fla. 2007) (defendants' cherry-picking scheme operated as a device, scheme, or artifice to defraud, and as a fraud or deceit upon investors, "[i]n nearly every conceivable way").

The evidence was clear that Mausner acted with scienter in perpetrating his cherry-picking scheme. Mausner personally apportioned trades among J.S. Oliver client accounts, or directed others to do so. Mausner knew or was reckless in not knowing that he allocated trades long after execution, and sometimes after the close of the market, in a calculated manner designed to benefit the favored accounts at the expense of the disfavored accounts. Indeed, Mausner's high level of scienter is shown by his disingenuous explanations to Mr. Anderson that the differences in performances between J.S. Oliver's funds and the Sapling account were due to options trading, when in fact options trading had little, if any, actual impact. Moreover, Mausner was cynically touting the performance of one of the favored accounts, the new CGF fund, in an effort to obtain new investors, which also demonstrates his high level of scienter. The statistical evidence showed that the cherry-picking was not happenstance, but was a deliberate scheme to defraud investors for Mausner's and J.S. Oliver's benefit.

Mausner's scienter is imputed to J.S. Oliver. *See SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1089 n.3, 1096-97 n. 16-18 (2d Cir. 1972) (company's scienter imputed from individuals who control it).

Thus, the evidence established that Mausner and J.S. Oliver violated sections 206(1) and 206(2) with their cherry-picking scheme.

d) Mausner and J.S. Oliver violated Sections 206(1) and 206(2) of the Advisers Act by misusing client soft dollar credits

The evidence showed convincingly that, from 2009 through November 2011, J.S. Oliver and Mausner breached their fiduciary duty to their clients, both individuals and the hedge fund investors, by using client soft dollar credits for several purposes that were not in their clients' best interests, were not disclosed to individual clients or J.S. Oliver's hedge funds and, even if they had been disclosed, were excessive in amount. These soft dollars uses were outside the Section 28(e) safe harbor and thus not only needed to be disclosed, but should have been disclosed with enough specificity so that J.S. Oliver's clients could understand exactly what their soft dollars were being used for. Respondents never made such disclosures.

It is well established that investment advisers have a duty "to eliminate, or at least expose, all conflicts of interest which might incline [them] - consciously or unconsciously - to render advice which was not disinterested." *Capital Gains*, 375 U.S. at 194; *see also In the Matter of Renaissance Cap. Advisors, Inc.*, Advisers Act Rel. No. 1688 (Dec. 22, 1997) (settled administrative proceeding involving an adviser that failed to disclose its soft dollar arrangement, thereby violating Sections 206(1) and (2)). "The fundamental obligation of the adviser to act in the best interest of his client also generally precludes the adviser from using client assets for the adviser's own benefit or the benefit of other clients, at least without client consent." *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934* ("*Commission Guidance*"), 2006 SEC Lexis 1625, *4, n.3 (July 18, 2006) (citation omitted). Investment advisers "must disclose client commission arrangements as material information," *id.* at *45, or they may be held liable for violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections

206(1) and (2) of the Advisers Act. *See, e.g., In the Matter of Sage Advisory Services LLC, et al.*, Advisers Act Rel. No. 1954, 2001 SEC Lexis 1482 (July 27, 2001) (settled administrative proceeding).

Section 28(e) of the Exchange Act "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* at *3. The Section 28(e) safe harbor "does not excuse a money manager from [its] disclosure obligations[,]" but only from "obtaining the lowest available commission rate where the amount of commission is reasonable in relation to the value of brokerage and research services provided." *Sage Advisory Services LLC*, 2001 SEC Lexis 1482, *10, n.7 (citation omitted).

Importantly, the Commission has noted that "[m]ore detailed disclosure is required when the adviser receives products or services that fall outside the scope of Section 28(e)." *Id.* at *10; see also *Commission Guidance* at *45. Indeed, soft dollar payments must be disclosed to clients "with enough specificity so that clients can understand what is being obtained." Securities and Exchange Commission 17 C.F.R. Part 241, Release No. 34-23170, Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, April 28, 1986. Specific items that fall outside the scope of Section 28(e) include "salaries (including research staff)" and rent. *Commission Guidance* at *61-62.

Payment to Gina Kloes. First, the evidence showed that Mausner and J.S. Oliver did not disclose to their clients that they would use client soft dollar credits to pay Mausner's ex-wife pursuant to a divorce agreement funds "in lieu of spousal support," and such payments were not in the best interest of J.S. Oliver's clients. None of J.S. Oliver's disclosures addressed such use. The payment to Ms. Kloes was neither salary nor a consulting fee, because Ms. Kloes was not

obligated to do any work for the firm in exchange for the payment and, the evidence showed, Ms. Kloes did not perform any work after 2007. Moreover, even if the facts were different and the divorce payment to Ms. Kloes could be considered "salary," the payment would be considered excessive given the lack of work she performed. In addition, the Forms ADV, Part II, which were received by J.S. Oliver's individual clients, and the J.S. Partners' offering memoranda, which were received by investors in the J.S. Partners Funds, did not disclose that client soft dollar credits could be used for any salaries. Only the CGF offering memorandum disclosed salary as a potential use of soft dollars, and that disclosure nowhere indicated that such "salary" could be paid in an excessive amount pursuant to a divorce agreement to an individual performing no work for the firm.

Excessive rent payments. Second, Mausner and J.S. Oliver did not disclose to their clients that they would use client soft dollar credits to pay excessive rent to an entity owned by Mausner, or that Mausner would enrich himself with the excess "rent." Additionally, such payments clearly were not in the best interest of J.S. Oliver's clients. While the Form ADV, Part II and JS Partner Funds' offering memoranda disclosed that certain narrow "overhead" expenses could be paid with soft dollars, the disclosures did not mention rent. Rather, they identified "telephone charges, legal and accounting expenses, . . . office services, equipment and supplies." This is far from sufficient disclosure to address the use of soft dollars to pay rent, and it unquestionably is inadequate disclosure of the fact that Mausner was funneling hundreds of thousands of dollars in excess "rent" payments to himself. *See SEC v. Syron*, 2013 U.S. Dist. Lexis 48183, *50 (S.D.N.Y March 28, 2013) (citations omitted) (a party "ha[s] a duty to be both accurate and complete" with respect to disclosures of material issues so as to avoid rendering statements misleading").

Further, although CGF's offering memo allowed payment of rent, the narrow disclosure again was far from sufficient to disclose what was being done with client soft dollar credits. The CGF offering memorandum did not disclose that J.S. Oliver would use soft dollars to pay inflated rent on a property that Mausner also used for personal purposes. Mausner had no justification for increasing the amount of rent from $6,000 to $15,000 over a six-month period, and there was never any disclosure that Mausner could unilaterally raise the rent, pay the rent with client soft dollars, and then divert the excess amount to himself. When Mausner set the rent that J.S. Oliver paid for the office space at an amount far over the actual mortgage paid, instructed Instinet to pay JO Samantha the rent amount, and then transferred the amount in excess of the mortgage to Mausner's personal bank account at Mausner's direction, it constituted a misappropriation of clients' assets that was not disclosed. Additionally, while the disclosure in the CGF offering memorandum allowed the use of soft dollar credits to pay rent, any rent legitimately payable by the firm should have been an amount representing the pro rata portion of the house dedicated and used for the advisory business and not the entire residence. Based on the disclosures, investors would not reasonably expect that payments using soft dollars for rent would fully cover and then far exceed Mausner's obligations on his personal residence.

Timeshare payments. Third, Mausner and J.S. Oliver did not disclose to their clients that they would use client soft dollar credits to pay Mausner's personal timeshare maintenance fees, and such payments were not in the best interest of J.S. Oliver's clients. The disclosure in J.S. Oliver's Form ADV, Part II and J.S. Partner Funds' offering memoranda provided that soft dollars may be used to reimburse travel expenses related to conferences only, and the CGF offering memorandum allowed soft dollar payments for "travel, meals and lodging" only if it was connected to a "potential investment opportunity." There is no evidence that Mausner used his personal timeshare for such purposes and, in fact, Mausner used the timeshare for personal

purposes such as visiting family members and trips with girlfriends. Such uses were never disclosed to J.S. Oliver's clients.

Payments to Powerhouse/Drennan. Fourth, the evidence is clear that Mausner and J.S. Oliver did not disclose to their clients that they would use client soft dollar credits to pay Drennan's salary and bonus, and such payments were not in the best interest of J.S. Oliver's clients. Drennan was not a research analyst, but rather a full-time J.S. Oliver employee who performed many duties in addition to research. Importantly, the soft dollar payments Drennan received would have been improper even if made to him as an employee. Although the CGF offering memorandum disclosed that J.S. Oliver could use soft dollars to pay employee salaries, the Forms ADV, Part II and the J.S. Partners Funds' offering memoranda did not contain such disclosures.

Moreover, Mausner and J.S. Oliver purported to make payments to Powerhouse under Section 28(e), and indeed BTIG did not permit payments outside of Section 28(e). But Section 28(e) does not provide a safe harbor for payments to employees, or for persons who for all and intents and purposes serve as employees. It was a fraudulent activity for Mausner and J.S. Oliver to use soft dollars to pay Drennan for independent research under the 28(e) safe harbor, when in fact Mausner employed Drennan as an all-purpose employee and "team leader" of J.S. Oliver.

Mausner's and J.S. Oliver's Scienter. The evidence showed conclusively that Mausner acted with scienter with regard to each of these fraudulent activities. The evidence showed that Mausner paid Drennan to set up the soft dollar program in early 2009, at a time when J.S. Oliver's assets under management had been declining. (Div. Ex. 696, ¶¶ 29-33.) Indeed, Mausner refused to hire Drennan back unless Drennan could be paid using soft dollars. Mausner also directed Drennan to set up the account at Instinet for the express purpose of aggressively using soft dollars. At a time when J.S. Oliver was only paying $6,000 in monthly rent, the new

soft dollar program allowed Mausner to seek reimbursement for $10,000 in monthly rent for his company, quickly raised to $15,000, with all the excess flowing into Mausner's pocket. Such self-enrichment shows a very high level of scienter. Indeed, Mausner began to refer to the transfer of excess rent payments as his "usual" transfer. Similarly, Mausner knew that his St. Regis luxury timeshare was his personal property, yet directed the use of client assets to pay this personal expense.

The use of soft dollars for the payment to Ms. Kloes showed a high level of scienter. Mausner was informed that Instinet needed evidence that the payment was for salary or a consulting fee. Mausner directed Drennan to fabricate a so-called "excerpt" from a non-existent contract between J.S. Oliver and Ms. Kloes, edited and approved the final version, and then personally sent the false document to Instinet to procure the soft dollar reimbursement. While Mausner and Drennan claimed they did so with advice of counsel, the evidence is clear that no attorney advised them to fabricate a fake excerpt from a non-existent contract, or to send such a false document to Instinet.

Finally, Mausner admitted that using soft dollars to pay Drennan allowed him to get a good "employee" back for free. Mausner knew he was not buying independent research, but rather was using client assets to pay an employee, thus saving him from paying that expense out of his own dwindling resources. Mausner made no secret of the fact that J.S. Oliver was less profitable than it had been – that was the reason he gave Ms. Kloes in 2008 why he could not afford to pay his obligations under the 2005 MSA. Thus, Mausner and Drennan hatched and executed the plan to have Drennan masquerade as "Powerhouse" and claim to be providing independent research, while in reality Drennan was Mausner's employee, team leader, and second in command.

2. Mausner and J.S. Oliver Violated Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

a) Legal standard for violations of Section 10(b) and Rule 10b-5

Mausner and J.S. Oliver violated Section 10(b) and Rule 10b-5(b) by making material misrepresentations and omissions. To establish a violation of Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder, the Division must show the respondent: (1) made an untrue statement or omitted to state a material fact; (2) with scienter; (3) in connection with the purchase or sale of securities. *SEC v. Todd*, 642 F.3d 1207, 1215 (9th Cir. 2011); *SEC v. Phan*, 500 F.3d 895, 907-08 (9th Cir. 2007); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1364 (9th Cir. 1993); *SEC v. First Jersey Securities, Inc.*, 101 F.3d 1450 (2d Cir. 1996). A statement or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). "For the purpose of Rule 10b-5, an investment adviser is a fiduciary and therefore has an affirmative duty of utmost good faith to avoid misleading clients. This duty includes disclosure of all material facts and all possible conflicts of interest." *Laird v. Integrated Resources, Inc.*, 897 F.2d 826, 833-34 (5th Cir. 1990) (citing *SEC v. Blavin*, 760 F.2d 706 (6th Cir. 1985) and *Zweig v. Hearst Corp.*, 594 F.2d 1261 (9th Cir. 1979)).

The Commission has long held that if an investment adviser "chooses to assume a role in which she is motivated by conflicting interests" that she must make full disclosure. *In the Matter of Arleen W. Hughes*, Release No. 34-4048, 1948 WL 29537 (Feb. 18, 1948) (Commission opinion affirming the finding of willful violations of, among other provisions, Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder) (cited with approval in *In the Matter of Marc N. Geman*, Release No. 34-43963, 2001 WL 124847 (Feb. 14, 2001), *aff'd*, *Geman v. SEC*, 334 F.3d 1183 (10th Cir. 2003)). Moreover, an investment adviser

has a duty to update its clients if circumstances have changed such that previous disclosures, even if true when made, have become misleading. *See In re Beacon Assocs. Litig.*, 745 F. Supp. 2d 386, 414-15 (S.D.N.Y. 2010) (in considering a motion to dismiss a Section 10(b) claim, the court found that the duty to update applies to a statement made misleading by intervening events, even if the statement was true when made); *see also In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410 (3d Cir. 1997) (discussing the duty to update providing a basis for a duty to disclose in a Section 10(b) case where "statements that, although reasonable at the time made, become misleading when viewed in the context of subsequent events."); *United States v. Gordon*, 2013 U.S. App. Lexis 5251 *49 (10th Cir. Mar 15, 2013) ("[W]here a party without a duty elects to disclose material facts, he must speak fully and truthfully, and provide complete and non-misleading information") (quoting *SEC v. Curshen*, 372 Fed. Appx. 872, 880 (10th Cir. 2010) (internal quotation marks omitted)).

b) Mausner and J.S. Oliver violated Section 10(b) and Rule 10b-5(b)

The evidence established that Mausner and J.S. Oliver violated Section 10(b) and Rule 10b-5(b) thereunder by failing to disclose their cherry-picking scheme and soft dollar misuses.

There is no dispute that Mausner and J.S. Oliver never disclosed to investors their cherry-picking of profitable trades for the favored accounts, and the allocation of the unprofitable trades to disfavored accounts. Indeed, when confronted with questions about the disparity in performance of the Sapling account, Mausner claimed that lack of options trading accounted for the dramatic disparity between Sapling's performance and the market. In addition, Mausner and J.S. Oliver each had duties to disclose their conflicts of interest in the Form ADV, Part II; but there is no disclosure in the Form ADV, Part II, at any time or in any way, about the cherry-picking scheme, how it impermissibly benefitted them by allocating the winning trades to certain

favored accounts, or how this cherry-picking enhanced their performance fees from CGF. Moreover, as discussed above, Mausner acted with a high level of scienter in cherry-picking certain clients' accounts for the benefit of the favored accounts.

Further, the cherry-picking scheme was "in connection with" the purchase or sale of securities because it was directly related to how purchased and sold securities were allocated among clients. *See SEC v. Zandford*, 535 U.S. 813, 819-20 (2002) (when securities transactions and breaches of fiduciary duty coincide, those breaches are "in connection with" securities sales); *see also In the Matter of Middlecove Capital, LLC, et al.*, Advisers Act Rel. No. 3534 (Jan. 16, 2013) (settled administrative proceeding for violating among other provisions Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by engaging in cherry-picking scheme which favored adviser's personal or business accounts at the expense of his clients); *In the Matter of James C. Dawson*, Advisers Act Rel. No. 3057 (Dec. 18, 2009) (ALJ initial decision) (same).

Similarly, Mausner and J.S. Oliver did not adequately disclose to clients their misuse of soft dollars and the disclosures in the J.S. Partner Funds' and CGF's offering memoranda and J.S. Oliver's Form ADV, Part II contained material omissions concerning J.S. Oliver's use of soft dollar credits. First, Mausner and J.S. Oliver had a fiduciary duty to their individual clients to disclose their conflicts of interest, but in breach of that duty, the Form ADV, Part II failed to disclose several ways in which J.S. Oliver and Mausner used soft dollars to enrich themselves, for example that soft dollars were used to pay Mausner's personal obligation to his ex-wife, or that Mausner was charging excessive rent and pocketing the excess. Indeed, even though J.S. Oliver filed an amended Form ADV, Part II in March 2009, it failed to amend its soft dollar disclosures from its prior filing in March 2007 to reflect accurately how J.S. Oliver was using client soft dollars. To the contrary, the firm narrowed the disclosure by disclosing soft dollar

uses only as it related to the hedge funds and not separately managed client accounts. Given that J.S. Oliver had just put in place its new, aggressive use of soft dollars, this deliberate failure to make appropriate disclosures shows a high level of scienter.

Second, J.S. Oliver's use of soft dollars in 2009 was much broader than the disclosures in the hedge funds' offering memoranda. Once J.S. Oliver and Mausner started using soft dollars in ways inconsistent with those disclosures, those disclosures became materially misleading and Mausner and J.S. Oliver had a duty to update the information regarding their actual soft dollar practices. *See In re Beacon Assocs. Litig.*, 745 F. Supp. 2d at 410. Additionally, although the CGF offering memorandum disclosed the potential use of soft dollars for employee salaries and rent, it did not state that Mausner could use soft dollars to pay his ex-wife pursuant to their divorce agreement or pay Mausner's timeshare expenses. Nor did it disclose the full extent to which J.S. Oliver used client soft dollars to pay excessive "rent," because there was no disclosure that excessive rent would be paid to funnel the excess into Mausner's pockets. Indeed, by listing some specific uses for soft dollars outside Section 28(e) but not others, including the specific uses to pay personal obligations, these disclosures were deliberately misleading. As discussed above, there is substantial evidence that Mausner and J.S. Oliver acted with a high level of scienter.

The evidence also established that these omissions were material. "To fulfill the materiality requirement there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the total mix of information made available." *Basic Inc.*, 485 U.S. at 232 (internal quotations omitted). Several J.S. Oliver clients testified that they were not told about the soft dollars used for Mr. Mausner's personal benefit, and that they considered the information important. For example, Mr. Mahler testified that no one from J.S. Oliver told him that the firm was generating soft dollar

credits when executing trades on his behalf, that he considered them to be an additional fee he "unwittingly" was charged, and he would not have invested had he known such soft dollar credits were being used to pay Mausner's personal expenses. Similarly, Ms. Hall testified she did not know about the soft dollar uses, and would have thought differently about investing her money with J.S. Oliver had she known about the respondents' soft dollar misuses; Mr. Anderson reacted that failure to disclose the soft dollar use was "horrifying."

Further, the soft-dollar scheme was "in connection with" the purchase or sale of securities because it related to soft-dollar credits generated from the purchase and sale of securities. *See SEC v. Zandford*, 535 U.S. at 819-20; *see also In the Matter of Branston*, Advisers Act Rel. No. 2040 (June 26, 2002) (settled administrative proceeding for violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by, among other things, submitting invoices for services falsely claimed to be for the benefit of advisory clients and obtaining cash from soft dollar credits as a result).

Finally, the evidence established that Mausner is directly liable for these antifraud violations. In *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), the Supreme Court narrowly construed Rule 10b-5(b) and held that "the maker of a statement [for purposes of Rule 10b-5(b)] is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Id.* at 2302. Mausner does not dispute that he controlled J.S. Oliver and the funds, and he reviewed and approved all the offering memoranda before they were sent to clients or prospective investors. Mausner signed the Forms ADV. There is no question that Mausner was the maker of the statements that omitted to disclose material information about cherry-picking and soft dollar misuse. Accordingly, under *Janus*, Mausner may be charged as a primary violator of Rule 10b-5(b).

c) Mausner and J.S. Oliver also engaged in a scheme in violation of Rule 10b-5(a) and (c)

Mausner and J.S. Oliver also violated Section 10(b) and Rule 10b-5(b) by engaging in their cherry-picking scheme and by scheming to mislead investors about their misuse of soft dollars. Rule 10b-5(a) and (c) make it unlawful "to employ any device, scheme, or artifice to defraud" and "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person" in connection with the purchase or sale of any security. "Any person who directly or indirectly engages in a manipulative or deceptive act as part of a scheme to defraud can be a primary violator" of Section 10(b) and Rule 10b-5(a). *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006), vacated on other grounds by *Simpson v. Homestore.com, Inc.*, 519 F.3d 1041 (9th Cir. 2008). "To be liable for a scheme to defraud, a defendant must have 'committed a manipulative or deceptive act in furtherance of the scheme.'" *SEC v. Fraser*, 2010 U.S. Dist. Lexis 7038, at *23 (D. Ariz. Jan. 28, 2010) (quoting *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1997)). The respondent must have "'engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme.'" *SEC v. Brown*, 740 F. Supp. 2d 148, 172 (D.D.C. 2010) (quoting *Simpson*, 452 F.3d at 1048).

Here, the evidence established that J.S. Oliver and Mausner perpetrated a scheme to defraud and engaged in a course of business that operated as a fraud with respect to the cherry-picking and the misuse of soft dollars. The cherry-picking of more profitable trades for the favored accounts at the expense of the disfavored accounts constituted a fraudulent scheme and a deceptive practice. Mausner and J.S. Oliver disproportionately allocated favorable trades to six clients to the severe detriment of three of its individual clients, causing them $10.9 million in harm.

The cherry-picking scheme was carried out with a high degree of scienter, as discussed above. Indeed, Mausner cherry-picked to pump up the purported performance of his new CGF fund in an effort to lure new investors and new dollars into his funds and under his management.

The evidence also proved that Mausner and J.S. Oliver conducted a fraudulent scheme in repeatedly misusing client soft dollars. Indeed, Mausner and Drennan testified about the inception of the scheme, which not only allowed Mausner to hire back a valued employee for "free," but also provided a means for Mausner to use clients' assets to pay his personal expenses. Mausner engaged in numerous deceptive acts in support of that scheme, including creating a false excerpt from a non-existent contract and then providing that to Instinet to obtain soft dollars for the payment to Ms. Kloes, and grossly inflating the "rent" on his home to generate hundreds of thousands of dollars in excess funds that he diverted to himself, and mischaracterizing to Instinet the purpose of soft dollar payments.

Finally, as discussed above, Mausner and J.S. Oliver acted with a high level of scienter in carrying out the soft dollar scheme. The fact that they created a fake "excerpt" of a non-existent contract to obtain soft dollars shows a very high level of scienter in connection with this soft dollar scheme.

3. Mausner and J.S. Oliver violated Section 17(a) of the Securities Act

Section 17(a) of the Securities Act makes it unlawful for any person in the offer or sale of any securities by the use of interstate commerce (1) to employ any device, scheme, or artifice to defraud, (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. The Supreme Court has expansively interpreted the phrase "in the offer or

sale." *See U.S. v. Naftalin*, 441 U.S. 768, 778 (1979) (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"). Section 17(a)(1) requires scienter, while Sections 17(a)(2) and (3) do not. *See Aaron v. SEC*, 446 U.S. 680 (1980).

The evidence introduced by the Division showed that Mausner's and J.S. Oliver's conduct violated Section 17(a)(2) of the Securities Act. In particular, Mausner and J.S. Oliver violated Section 17(a)(2) by selling securities to obtain soft dollar credits, but failing to disclose to their clients how J.S. Oliver actually used soft dollars. Mausner and J.S. Oliver "obtain[ed] money or property" in the form of soft dollar payments. Mausner and J.S. Oliver also violated Section 17(a)(2) by selling securities that they then misallocated, while failing to disclose to clients that they cherry-picked winning sales for favored accounts and allocated less profitable sales to the disfavored accounts. Mausner and J.S. Oliver "obtain[ed] money or property" as a result because Mausner and his related entities, as investors in CGF, received money from the favored allocations, and J.S. Oliver received performance fees from CGF that the firm would not have received but for the favored allocations.

Mausner and J.S. Oliver also violated Section 17(a)(1) in operating the cherry-picking and soft-dollar schemes discussed above. These violations were "in the offer or sale" of securities in that both the cherry-picking and soft dollar schemes included the sale of securities. *See Naftalin*, 441 U.S. at 778. Further, as discussed above, Mausner and J.S. Oliver acted with a high degree of scienter.

Mausner and J.S. Oliver also violated Sections 17(a)(1) and (3) by offering interests in CGF in emails sent to prospective and actual clients touting the inflated performance numbers without disclosing that CGF's positive performance was attributable, in part, to their fraudulent allocation of favorable trades to CGF.

4. Mausner and J.S. Oliver violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder

Section 206(4) of the Advisers Act prohibits an investment adviser from, directly or indirectly, engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. Rule 206(4)-8(a)(1) prohibits an investment adviser to "pooled investment vehicles," such as hedge funds, from making an untrue statement of material fact or omitting to state a material fact necessary to make the statements made not misleading to investors or prospective investors in those pools. Rule 206(4)-8(a)(2) provides that it is a fraudulent practice for an investment adviser to a pooled investment vehicle to engage in "fraudulent, deceptive, or manipulative" conduct with respect to any investor or prospective investor in the pooled vehicle. *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles,* Advisers Act Rel. No. 2628, 2007 SEC Lexis 1736 (Aug. 3, 2007). Pooled investment vehicles include hedge funds. *Id.* at 13. Scienter is not required; the rule reaches conduct that is negligently deceptive. *Id.* at 23-24. Because Mausner and J.S. Oliver made investment decisions on behalf of the J.S. Partner Funds and CGF – all pooled investment vehicles – for a fee, each can be considered an investment adviser to these vehicles under Section 202(a)(11) of the Advisers Act.

The Division's evidence established that Mausner and J.S. Oliver violated Rule 206(4)-8(a)(1) by providing prospective investors in CGF with performance data that was fraudulently inflated by virtue of the cherry-picking scheme. Mausner did not advise these prospective investors that CGF's positive performance was attributable to fraudulent allocation of favorable trades to CGF and unfavorable trades to the accounts of several individual clients. Mausner and J.S. Oliver also violated Rule 206(4)-8(a)(1) by, as discussed above, making material omissions in the offering memoranda disclosures concerning how J.S. Oliver misused soft dollars.

Mausner and J.S. Oliver and also violated Rule 206(4)-8(a)(2) through their soft-dollar scheme. With respect to the CGF offering, as set forth above, the inflated performance statistics touted by Mausner to induce investments in CGF had been generated as a result of the cherry-picking scheme. With respect to soft dollars, Mausner's and J.S. Oliver's soft dollar scheme included the creation of false documents and mischaracterization of expenses in documents provided to Instinet in order to use soft dollars in manners not disclosed to fund investors.

5. Drennan willfully aided, abetted and caused J.S. Oliver's misuse of soft dollars in violation of the antifraud provisions of the securities laws

To establish aiding and abetting liability, the Commission must show: (1) the existence of an independent primary wrong; (2) actual knowledge or reckless disregard by the alleged aider and abettor of the wrong and of his/her role in furthering it; and (3) the aider and abettor substantially assisted in the accomplishment of the primary violation. *See In the Matter of vFinance Investments, Inc., et al.*, Exchange Act Rel. No. 62448, 2010 SEC Lexis 2216, *41 (July 2, 2010) (Commission Opinion). In administrative proceedings, the Commission applies a "recklessness" standard for aiding and abetting liability. *Id.* at *46; *see also Voss v. SEC*, 222 F.3d 994, 1004-06 (D.C. Cir. 2000). The recklessness standard is satisfied where the respondent fails to use due diligence to investigate a circumstance with unusual factors or ignores red flags and suggestions of irregular conduct. *See Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004) "A defendant provides substantial assistance only if [he] affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed." *SEC v. Espuelas*, 698 F. Supp. 2d 415, 433 (S.D.N.Y. 2010) (internal quotation marks and citations omitted); *see also SEC v. Apuzzo*, 689 F.3d 204, 213 (2d Cir. 2012) (holding that "[t]he SEC is not required to plead or prove that an aider and abettor proximately caused the primary securities fraud violation.").

For "causing" liability, three elements must be established: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his act or omission would contribute to the violation. *In the Matter of Robert M. Fuller*, Exchange Act Rel. No. 48406, 2003 SEC Lexis 2041 (Aug. 25, 2003), *petition for review denied*, 95 F. App'x. 361 (D.C. Cir. 2004). A finding that a respondent willfully aided and abetted violations of the securities laws necessarily makes that respondent a "cause" of those violations. *See In re Clarke T. Blizzard, et al.*, Advisers Act Rel. No. 2253, 2004 SEC Lexis 1298, at *16 n.10 (June 23, 2004) (Commission Opinion).

The evidence introduced by the Division showed clearly that Drennan aided, abetted, and caused J.S. Oliver's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 17(a)(1) and (2) of the Securities Act, and Sections 206(1), (2), and (4) of the Advisers Act and Rule 206(4)-8 thereunder. Drennan knowingly, and with extreme recklessness, provided substantial assistance in J.S. Oliver's fraud violations with respect to the misuse of soft dollars. Drennan knew the disclosure documents did not address all the items for which J.S. Oliver sought payment and he also provided substantial assistance with respect to the following soft dollar expenses:

- Payment to Ms. Kloes: Drennan prepared the altered contract excerpt knowing that it was false and that it was to be provided to Instinet in support of the reimbursement for J.S. Oliver's payment to Ms. Kloes. In addition, based upon his involvement in creating the "excerpt" that respondents forwarded to Instinet, Drennan knew or was reckless in not knowing that Ms. Kloes had no obligation to work for J.S. Oliver, and Drennan testified that Ms. Kloes was not a J.S. Oliver employee when he left the firm in 2008 or when he returned in 2009. Drennan also approved this payment in Instinet's soft dollar system on J.S. Oliver's behalf.

- Rent Payments: Drennan worked with Instinet to ensure that it would pay J.S. Oliver's rent payments, including submitting only the CGF offering memorandum to Instinet which had a disclosure for rent, working with Driscoll to get the payments set up, and forwarding the initial invoice to Instinet for payment, and Drennan approved at least three inflated rent invoices in Instinet's soft dollar system. Drennan also knew that Mausner directed J.S. Oliver employees, including Drennan, to distribute the excess "rent" money to Mausner's personal bank account from JO Samantha, Mausner's entity that received the rent payments.
- Powerhouse Capital Payments: Drennan knew that he was receiving payments of soft Drennan knew that he was receiving payments of soft dollars as a purported research analyst under the safe harbor of Section 28(e), when he was in reality functioning as an employee of J.S. Oliver and thus ineligible for soft dollar payments under the safe harbor. Drennan knew that salaries for the adviser's research staff were considered "not eligible research" under the Section 28(e) safe harbor. Nonetheless, Drennan drafted the Powerhouse Capital invoices and submitted them for payment month after month, and he approved at least three of the invoices for payment in Instinet's soft dollar system. Drennan was also reckless in not knowing that using soft dollars to pay employees was not disclosed in the J.S. Partner Funds' offering memoranda and in the Forms ADV, Part II.

B. J.S. Oliver Violated Section 204 of the Advisers Act and Rules 204-2(a)(3) and (7) Thereunder

Section 204 of the Advisers Act requires that investment advisers "make and keep" appropriate records in the course of conducting their business. The Commission does not need to prove that a respondent acted with scienter in order to establish a violation of Section 204. *See*

In the Matter of Lowe Management Corp., Advisers Act Rel. No. 759, 1981 SEC Lexis 1476 (May 11, 1981) (Commission Opinion) ("the failure to make a required report, even though inadvertent, constitutes a willful violation.").

Rule 204-2(a)(3) requires registered investment advisers to make and keep a "memorandum of each order given by the investment adviser for the purchase or sale of any security." J.S. Oliver willfully violated Rule 204-1(a)(3) by failing to maintain trade blotters.

Rule 204-2(a)(7) requires that a registered investment adviser maintain originals of all written communications the investment adviser sends relating to "any recommendation made or proposed to be made and any advice given or proposed to be given." J.S. Oliver failed to maintain originals of Mausner's email messages that reflected the recipients of the emails that promoted CGF's performance and contained his "strong" recommendation that the recipients invest in CGF.

C. J.S. Oliver Violated Section 206(4) and Rule 206(4)-7 Thereunder

Advisers Act Rule 206(4)-7 makes it unlawful within the meaning of Section 206(4) for registered investment advisers to provide investment advice unless they "[a]dopt and implement written policies and procedures reasonably designed to prevent violation" of the Advisers Act and the rules thereunder by the investment adviser and its supervised persons.

J.S. Oliver had policies and procedures in place regarding trade allocation, but failed to implement them. J.S. Oliver's procedures relating to trade allocations required the creation and maintenance of trade memoranda with daily trade details, including allocations. From about June 2008 through mid-2011, however, the firm did not maintain such memoranda. Moreover, the policies required that allocations be done in a fair and equitable manner to all clients. As described above, J.S. Oliver's cherry-picking did not result in fair and equitable allocations to its clients.

D. Mausner Aided, Abetted, and Caused J.S. Oliver's Violations of Sections 204 and 206(4) of the Advisers Act and Rules 204-2(a)(3), 204-2(a)(7), and 206(4)-7 Thereunder

The evidence demonstrates that Mausner knew or was reckless in not knowing that J.S. Oliver (a) failed to keep trade memoranda and original email communications, (b) failed to follow its policies and procedures relating to trading allocations; and (c) advertised misleading performance information concerning CGF in emails that he sent. Thus, Mausner aided, abetted, and caused J.S. Oliver's violations of Sections 204 and 206(4) of the Advisers Act and Rules 204-1(a)(2), 204-2(a)(7), and 206(4)-7 thereunder.

E. Mausner and J.S. Oliver Violated Section 207 of the Advisers Act and Rule 204-1(a)(2)

Section 207 of the Advisers Act makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission … or willfully to omit to state in any such application or report any material fact which is required to be stated therein …." Rule 204-1(a)(2) requires that an adviser must, in addition to the annual amendment, promptly update its Form ADV if information provided in Part II becomes materially inaccurate. Section 207 does not require a finding of scienter; it merely requires that a person act willfully, i.e., intent to do the act that constitutes the violation, regardless of whether he or she knew the act constituted a violation. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000).

Mausner and J.S. Oliver willfully violated Advisers Act Section 207. J.S. Oliver's Form ADV filed on March 3, 2009 made material false statements about how it used soft dollars because the disclosures in Part II, Items 12 and 13: (1) stated that soft dollars would be used for specified expenses, when in fact J.S. Oliver used the client assets to pay for numerous unspecified expenses, and (2) did not disclose that soft dollars generated from individual client

accounts would be used to pay J.S. Oliver's and Mausner's expenses. *See In the Matter of Parnassus Investments, et al.*, 1998 SEC Lexis 1877, *60-61 (Sept. 3, 1998) (Initial Decision) (holding that respondents violated Section 207 because they did not disclose soft dollar arrangements as specifically required by Form ADV; these "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."); 1998 SEC Lexis 2181 (Oct. 8, 1998) (Final Decision). J.S. Oliver and Mausner also willfully failed to amend J.S. Oliver's Form ADVs, Part II, filed March 2007 and March 2009, to update information concerning its soft dollar practices in violation of Rule 204-1(a)(2).

IV. SANCTIONS ARE APPROPRIATE AGAINST RESPONDENTS

A. Respondents' Violations Warrant Industry Bars Against Mausner and Drennan, Revocation of J. S. Oliver's Registration, and Cease-And-Desist Orders Against Each Respondent

Section 203(e) of the Advisers Act authorizes the Commission to sanction any investment adviser if it is in the public interest and the Commission finds that the adviser has willfully violated any provision of the federal securities laws. Section 203(f) of the Advisers Act authorizes the Commission to sanction any person associated with an investment adviser under the same circumstances. Section 9(b) of the Investment Company Act authorizes the Commission to sanction any person under the same circumstances. Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act authorize the Commission to institute cease-and-desist proceedings against any person who has committed or caused a violation of these statutes, respectively. Based on the violations noted above, including a conscious and repeated disregard of their responsibilities under the federal securities laws, orders requiring the respondents to cease and desist from violating and aiding and abetting violations of the above-described provisions of the federal securities laws are warranted.

The Fifth Circuit's decision in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir.1979), is recognized as the leading case that establishes the standard courts should use when evaluating administrative actions involving disciplinary sanctions. *See, e.g., Gibson v. SEC*, 561 F.3d 548, 554-55 (6th Cir. 2009); *Seghers v SEC*, 548 F.3d 129, 134 (D.C. Cir. 2008); *Lowry v. SEC*, 340 F.3d 501, 504 (8th Cir. 2003); *In the Matter of Gregory D. Tindall*, Administrative Proceeding File No. 3-14894, 2012 SEC Lexis 3244 (Oct. 12, 2012). Under *Steadman*, a court must consider a number of factors when imposing disciplinary sanctions: (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infraction, (3) the degree of scienter involved, (4) the sincerity of the respondent's assurances against future violations, (5) the respondent's recognition of the wrongful nature of his conduct, and (6) the likelihood that the respondent's occupation will present opportunities for future violations. *Steadman*, 603 F.2d at 1140.

Respondents' actions in this case warrant the highest sanctions, and every one of the *Steadman* factors supports severe sanctions. Respondents' actions were egregious; they breached their fiduciary duties in multiple ways and on multiple occasions and placed their personal interests ahead of those of their clients and fund investors. Their actions enriched themselves while causing millions of dollars of harm to their clients, which included a charitable foundation and an elderly widow. Indeed, Mausner orchestrated two separate schemes whereby he could fleece his clients and personally benefit greatly from his fraud. Drennan actively facilitated Mausner's use of soft dollars, and he also personally benefited by more than $480,000 from the improper Powerhouse Capital payments. Respondents' violations extended over a lengthy period and evidenced a high level of scienter. Respondents have provided no assurance against future violations and, in fact, they continue to deny that they engaged in any misconduct.

Given Mausner's and Drennan's occupations, there is a strong likelihood that, if permitted, they will engage in such violations again in the future.

Accordingly, the Division requests that J.S. Oliver's registration as an investment adviser be revoked, and that Mausner and Drennan be permanently barred from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

B. Disgorgement with Prejudgment Interest and Third-Tier Civil Penalties Should Be Ordered Against Each Respondent

Sections 203(j) and 203(k)(5) of the Advisers Act, 8A(e) of the Securities Act, 21B(e) and 21C(e) of the Exchange Act, and Section 9(e) of the Investment Company Act of 1940 authorize the Commission to seek disgorgement in administrative or cease-and-desist proceedings, including reasonable interest. "Disgorgement is designed to deprive a wrongdoer of unjust enrichment, and to deter others from violating securities laws by making violations unprofitable." *SEC v. First Pacific Bancorp*, 142 F.3d 1186, 1191 (9th Cir. 1998), cert. denied, 525 U.S. 1121 (1999). Disgorgement need only be a "'reasonable approximation of profits causally connected to the violation.'" *Id.* at 1192 n.6 (quoting *SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997)).

The Division seeks disgorgement, with prejudgment interest, from each of the respondents, in the amounts that they were unjustly enriched through their violations. J.S. Oliver and Mausner should be ordered, jointly and severally, to disgorge the $1,151,840 in soft dollar payments (consisting of the $329,365 reimbursement for the payment to Ms. Kloes, $300,000 in improper "rent," $40,094 in timeshare payments, and $482,381 in payments to Drennan) and the $224,600 in performance fees that CGF would not have earned but for Mausner's cherry-picking scheme, for a total of $1,376,440, plus prejudgment interest of $136,639. (*See* Declaration of

David J. Van Havermaat for prejudgment interest calculations.) Drennan should be ordered to disgorge, jointly and severally with Mausner and J.S. Oliver, $482,381 in soft dollar ill-gotten gains based on the payments Powerhouse Capital received, plus prejudgment interest of $47,886.[10] *SEC v. JT Wallenbrock & Associates*, 440 F.3d 1109 (9th Cir. 2006).

Finally, the Division seeks substantial third-tier civil penalties against each of the respondents. As discussed above, the *Steadman* factors warrant substantial sanctions, and imposition of third-tier civil penalties is appropriate because the conduct involved fraud and deliberate or reckless disregard of a regulatory requirement, directly caused substantial losses, and the respondents obtained substantial pecuniary gain from their conduct. *See* Section 203(i)(B)(2)(C) of the Advisers Act, 15 U.S.C. § 80b-3(i)(B)(2)(C); Section 8A(g)(2)(C) of the Securities Act, 15 U.S.C. § 77h-1(g)(2)(C); Section 21B(b)(3)(C) of the Exchange Act, 15 U.S.C. § 78u-2(b)(3)(C).

The Division requests that a total civil penalty of $3.3 million be imposed against Mausner, and a total civil penalty of $15.95 million be imposed against J.S. Oliver. The Division seeks a total civil penalty of $450,000 against Drennan. These substantial penalties are necessary to deter the respondents' fraudulent conduct, which caused losses to investors of over $11 million. Indeed, respondents showed a callous disregard for their clients and looted their clients' assets for their personal benefit. It is important that persons who engage in such fraudulent conduct suffer the consequences, and that persons who are contemplating fraudulent conduct know that they do so at significant financial peril.

The Division bases its penalty request on the two separate fraudulent activities. The cherry-picking caused substantial losses of $10.9 million to investors. The cherry-picking occurred

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[10] To the extent Drennan satisfies this disgorgement amount, it would reduce the joint and several disgorgement obligation of Mausner and J.S. Oliver.

over a span of 18 months, and every month that conduct continued contributed to the substantial losses to investors. *See, e.g., K.W. Brown and Co.*, 555 F. Supp. 2d at 1314-1315 (it would be reasonable to assess a third-tier penalty for each month a cherry-picking fraud continued). Accordingly, the Division requests that 18 third-tier penalties of $150,000, totaling $2.7 million, be imposed against Mausner for the cherry-picking conduct. The Division requests that 18 third-tier penalties of $725,000, totaling $13,050,000, be imposed against J.S. Oliver for the cherry picking conduct. See also Section 201.1004 and Table IV to Subpart E, Adjustment of civil monetary penalties – 2009, 17 C.F.R. Part 201.1004 and Table IV (setting $150,000 as third-tier penalty for individuals and $725,000 for entities).

The misuse of soft dollars also caused substantial losses to investors, resulting in over $1.1 million of their assets being used to pay Mausner excess cash from rent, his personal obligations to Ms. Kloes, his personal timeshare obligations, and to pay Drennan. These four separate categories of payments each constitute an individual violation and each warrants a separate third-tier penalty. The Division requests that four third-tier penalties of $150,000, totaling $600,000, be imposed against Mausner for the soft dollar violations, and four third-tier penalties of $725,000, totaling $2.9 million, be imposed against J.S. Oliver for this conduct.

Drennan was instrumental in setting up and administering the soft dollar program, and was directly involved in the fraudulent conduct involving the payment to Ms. Kloes, the increased rent payments, and the Powerhouse payments. Accordingly, the Division requests that three third-tier penalties of $150,000, totaling $450,000, be imposed against Drennan.

These are substantial penalties, but they are warranted under *Steadman.* Indeed, there can be little question that these violations are egregious, recurrent, and involved a high level of scienter. On that basis alone, substantial penalties are appropriate. But in addition, respondents have not recognized the wrongful nature of their conduct in any way. Drennan and Mausner are in

the securities industry, so the likelihood that they will have future opportunities to misuse clients' assets is high. And any assurances respondents might provide against future violations cannot be given any credibility, in view of their testimony at trial defending their conduct. Thus, the need for substantial penalties to deter such fraudulent conduct is particularly evident here.

V. CONCLUSION

For all the reasons stated, the Division requests that the Court find that respondents Mausner and J.S. Oliver have violated, and that respondent Drennan has aided and abetted, and caused their violations of, the specified provisions of the federal securities laws and impose the requested sanctions.

Dated: February 21, 2014

Respectfully submitted,

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