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Message: Opinion and Order Imposing Remedial Sanctions in the matter of Montford and Company, Inc. d/b/a Montford Associates and Ernest V. Montford, Sr.; IA-3829; I-3-14536.

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

INVESTMENT ADVISERS ACT OF 1940

Release No. 3829 / May 2, 2014

Admin. Proc. File No. 3-14536

In the Matter of

MONTFORD AND COMPANY, INC.,
d/b/a MONTFORD ASSOCIATES, and
ERNEST V. MONTFORD, SR.

OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Fraud

Misrepresentations on Form ADV

Failure to Update Form ADV

Former registered investment adviser and its president committed securities fraud and reporting violations by failing to disclose a material conflict of interest and making material misrepresentations to clients and in a Form ADV. The firm also failed to amend its Form ADV when information in it became materially inaccurate, a violation that the firm president aided and abetted and caused. *Held*, it is in the public interest to bar the president from associating with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; order respondents to cease and desist from committing or causing any violations or future violations of the provisions violated; order disgorgement, jointly and severally, of \$210,000, plus prejudgment interest; and order civil money penalties of \$500,000 against the firm and \$150,000 against its president.

compensation from the investment managers that they recommended. Respondents concede that, during the same time period they were making these representations, they accepted two payments totaling \$210,000 from Stanley J. Kowalewski ("Kowalewski") of SJK Investment Management LLC ("SJK"), whose firm Respondents were recommending to clients. Respondents admit that at no time before January 2011, when the Commission filed a fraud action against Kowalewski,⁶ did they disclose these payments to their clients.

A. Respondents

Montford has worked in the securities industry for the past forty years and holds multiple securities licenses.⁷ In 1989, Montford formed Montford Associates, which at all relevant times operated as an investment adviser to institutional investors.⁸ According to the firm's business model, Respondents did not execute securities transactions on behalf of their clients; rather, they recommended various investment managers to do so. After their clients selected an investment manager, Respondents continued to advise them by, among other things, monitoring their portfolios and reporting periodically on the portfolios' and investment managers' performance.

During 2009 and 2010, Respondents had approximately thirty clients, most of whom were pension funds, school endowments, hospitals, and non-profit organizations. Generally,

⁶ In January 2011, the Commission obtained a temporary restraining order and emergency asset freeze against Kowalewski and SJK. The underlying complaint alleged that Kowalewski misappropriated at least \$12.5 million from SJK clients by diverting client funds to pay personal and operating expenses. On June 29, 2011, the United States District Court for Northern District of Georgia permanently enjoined Kowalewski from violating the federal securities laws. *SEC v. Kowalewski*, Civ. A. No. 1:11-CV-0056-TCB. The Commission later barred Kowalewski and revoked SJK's registration. *Stanley J. Kowalewski*, Investment Advisers Act Rel. No. 3281, 2011 WL 4359983 (Sept. 19, 2011); *SJK Invest. Mgmt., LLC*, Advisers Act Rel. No. 3463, 2012 WL 3992035 (Sept. 12, 2012).

⁷ Montford has passed the Series 1 (Registered Representative), Series 4 (Registered Options Principal), Series 12 (NYSE Branch Manager), Series 24 (General Securities Principal), Series 63 (Uniform Securities Agent State Law); and Series 65 (Uniform Investment Adviser Law) Examinations and is a certified investment management analyst.

⁸ Respondents do not dispute, and the record establishes, that they each met the general definition of an "investment adviser" under the Advisers Act at the time of the conduct at issue. *See* 15 U.S.C. § 80b-2(a)(11) (defining an "investment adviser" as "[a]ny person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities"); *accord Warwick Capital Mgmt., Inc.*, Advisers Act Rel. No. 2694, 2008 WL 149127, at *9 n.37 (Jan. 16, 2008) (holding advisory firm's president liable as an "investment adviser" "where his activities cause[d] him to meet the broad definition of investment adviser") (internal quotation marks and citation omitted). Montford, the firm's sole owner, president, and CEO, was also a "person associated with an investment adviser" under Advisers Act § 202(a)(17). 15 U.S.C. § 80b-2(a)(17) (defining a "person associated with an investment adviser . . . [as] any partner, officer, or director of such investment adviser").

these entities' investment committees were made up of volunteers, who hired Respondents to independently monitor and advise them on the investments. Respondents charged clients an annual advisory fee ranging from 8 to 20 basis points of each client's assets under management. Respondents managed over \$800 million in investment assets, earning gross revenues of \$600,000 in 2009 and \$830,000 in 2010.

B. Respondents claimed they were independent advisers.

Throughout the period at issue, Respondents attracted clients, in part, by touting their ability to provide disinterested investment advice, making representations to this effect in Forms ADV and in promotional materials.

1. Montford Associates' Forms ADV contained representations about Respondents' independence.

Form ADV is the uniform registration form and disclosure statement used by investment advisers to register with the Commission and state securities authorities. Part 2 of Form ADV contains disclosure requirements for the firm's "brochure," which advisers must provide to prospective clients initially and to existing clients annually.⁹ During the period at issue, Montford Associates filed two annual Forms ADV with the Commission, one on March 4, 2009, and one on March 29, 2010, both of which Montford signed on behalf of the firm as its president.

Montford Associates' 2009 and 2010 Forms ADV contained multiple representations about Respondents' independence. For example, in Item 13 of Part 2, Respondents answered "no" to a question asking whether they received any cash or other economic benefit from a non-client in connection with giving advice to clients.¹⁰ In Schedule F of the Forms ADV, Respondents specifically described Montford Associates as an "independent investment advisor" representing it would "[a]void any material misrepresentation in any . . . investment recommendation" and "[d]isclose to clients . . . all matters that reasonably could be expected to impair [the firm's] ability to make unbiased and objective recommendations."¹¹

Schedule F of the Forms ADV included additional representations about Respondents' advisory services, explaining that:

[Montford Associates] does not have the authority to execute securities trades for clients. We select investment managers to make these decisions. We advise clients on appropriate managers and evaluate the clients [sic] total fund and each manager quarterly. We do not accept any fees from investment managers or mutual funds.¹²

⁹ *Amendments to Form ADV*, Advisers Act Rel. No. 3060, 2010 WL 2957506, at *3 n.5 (Aug. 12, 2010).

¹⁰ Answer ¶ 6; Div. Exs. 28 at 6, 29 at 6.

¹¹ Answer ¶ 6; Div. Exs. 28 at 8, 29 at 8.

¹² Answer ¶ 6; Div. Exs. 28 at 9, 29 at 9.

In his testimony, Montford admitted that the above statement has been part of the firm's annually filed Form ADV for as long as the firm has been operating. Montford also conceded that Respondents provided this information to clients during 2009 and 2010 and that Respondents never amended the Forms ADV to reflect any post-filing changes.

2. Montford Associates' promotional materials contained representations about Respondents' independence.

During 2009 and 2010, Montford Associates maintained a publicly accessible website, www.montfordassociates.com, which marketed the firm as "a source of independent investment advice for institutional investors."¹³ The website contained articles touting the benefits of a "conflict-free" investment adviser.¹⁴ One undated article, titled "Why Use an Independent Investment Advisor," stated that "[t]he best investment advisors are *independent*—without affiliations to banks, insurance firms, brokers and money managers."¹⁵ The article explained that, with an independent adviser, "the client will get impartial, unbiased reporting" because "the fund hires investment expertise with as little politics as possible."¹⁶ The article concluded: "[T]he *benefits* of having an impartial investment evaluator are several, but at the core of the concept is expert, experienced advice to the fiduciary without concern about conflicts of interest which occur with managers, banks, insurance firms, and brokers."¹⁷

A second article on the firm's website, titled "Montford Associates Offers Expert Independent Guidance" and dated February 8, 2010, quoted Montford as stating "I believe an independent view is particularly beneficial to fiduciaries charged with oversight of other people's money."¹⁸ Montford further stated that clients "need a strategy they can trust, because investments . . . should be based on merit, not . . . undisclosed compensation."¹⁹ Montford testified that he made these statements and that he knew that they were publicly available on the firm's website.²⁰

¹³ Answer ¶ 7.

¹⁴ Div. Ex. 11.

¹⁵ Answer ¶ 7; Div. Ex. 10 (emphasis in original).

¹⁶ Div. Ex. 10.

¹⁷ *Id.* (emphasis in original).

¹⁸ Div. Ex. 11.

¹⁹ Answer ¶ 7; Div. Ex. 11.

²⁰ Respondents also admitted that they advertised on their letterhead that the firm was an "Independent Investment Management Consultant to Corporations, Endowments, Foundations, and Charitable Institutions." Answer ¶ 7; Resp. Ex. 11; *see also* Div. Ex. 56.

C. SJK paid Respondents \$210,000.

Montford met Kowalewski in 2002 when Kowalewski owned and operated Phoenix Advisors, Inc., a small advisory firm. Montford testified that he was drawn to Kowalewski's "hedge fund of funds" investment strategy, a strategy that Montford described as a fund that invested in several other funds with contrasting investment objectives that "hedged" against various economic conditions.²¹ Soon after, in 2003, Montford began recommending Kowalewski as an investment manager to his clients. According to Montford, by the end of 2003, "four or five" of his clients had invested with Kowalewski.²² In 2005, Kowalewski joined Columbia Partners, L.L.C. Investment Management ("Columbia"), a Maryland-based investment adviser. Montford advised his clients to transfer their assets from Phoenix Advisors to Columbia.²³ By 2009, ten of Montford's clients were invested with Kowalewski.

In June 2009, Kowalewski told Montford that he was leaving Columbia to start his own firm, SJK, a registered investment adviser based in Greensboro, North Carolina.²⁴ SJK planned to employ a similar investment strategy to the ones Kowalewski used at Phoenix and Columbia. Montford testified that he knew that it would be a challenge to convince his clients to transfer their assets to Kowalewski's new firm because they were generally conservative, risk averse, uncomfortable with change, and had become skeptical about investing in hedge funds. Montford admitted that he counseled Kowalewski on how best to present his new venture to Montford's clients. He also told Kowalewski that he would try to convince his clients to transfer their Columbia investments to SJK and that he would assist in administering the transfers.

From July through mid-August, 2009, Montford and his staff met individually with the ten clients with investments at Columbia to recommend they transfer their assets to SJK. According to Montford, most of these meetings took place over the telephone and lasted from thirty minutes to two hours. Over the ensuing months, nine of Respondents' clients followed Montford's recommendations. Montford admitted that he did not inform any of the clients that he had agreed to help Kowalewski convince them to move their investments to SJK or to assist in administering any transfers.

²¹ Transcript of Hearing ("Tr.") at 138–39, 259. *See generally Fund of Funds Investments*, Investment Company Act Rel. No. 26198 (Oct. 1, 2003), 68 FR 58226, 58226 (Oct. 8, 2003) (explaining that "so-called fund of funds [are] arrangements . . . in which one investment company invests in . . . another," rather than investing directly in securities, such as stocks and bonds).

²² Tr. at 35.

²³ On appeal, Respondents claim, without citation to record support, that Montford assisted Kowalewski at the time in transferring his clients' funds to Columbia "at no charge to either Montford's clients or to [Kowalewski]." Respondents' Opening Br. at 6–7. But Montford testified that his clients would have considered such services to be covered by their annual advisory fee, which ranged from \$25,000 to \$146,000. *See infra* note 25.

²⁴ Shortly after his conversation with Kowalewski, Columbia informed Montford that it would no longer offer the fund-of-funds investment strategy for Respondents' clients.

Montford testified that by August 2009 he and his staff had provided substantial assistance to SJK, so he decided that he would approach Kowalewski and demand payment for their work.²⁵ In an August 30, 2009, telephone call, Montford told Kowalewski, "I need to be paid for all this work . . . [W]hatever amount you think is fair is acceptable, I don't care."²⁶ During the call, Kowalewski agreed to pay Montford but did not specify an amount. In about October 2009, Kowalewski agreed to pay Respondents \$130,000 initially and to pay an additional unspecified amount after SJK's first year in business, sometime in 2010. Montford testified that he accepted the amount Kowalewski proposed without negotiation. He conceded that he did not know how Kowalewski calculated the amount, that Respondents had kept no records of their work for SJK, and that Respondents had not given any figure to Kowalewski.²⁷ The parties kept no records of their agreement.²⁸

On November 2, 2009, Montford Associates sent SJK an invoice for \$130,000. The invoice stated it was for "Consulting Services for the SJK Investment Management LLC Launch July 15th–October 30, 2009."²⁹ The invoice contained no other explanation of the services provided. In a subsequent e-mail concerning details about making the \$130,000 payment, Montford told Kowalewski, "By the way[,] we are advising [a client] to give you another \$800,000," to which Kowalewski replied, "Nice job and we appreciate the additional capital."³⁰

On November 30, 2009, Montford Associates sent SJK a second invoice for \$130,000, in place of the November 2 invoice. At Kowalewski's request, Montford changed the description of the services provided to "Marketing and Syndication Fee for SJK Investment Management LLC Launch July 15th–November 30, 2009."³¹ Montford claimed during his testimony that he did not believe this description was accurate but sent it to SJK anyway. The invoice gave no further detail of the services provided. On January 4, 2010, SJK paid Respondents \$130,000.³²

²⁵ Montford admitted that he did not seek to charge his clients for this work because they would have rejected him. He testified that they would have "sa[id], are you crazy? I'm not going to do that" because they would have believed that such work was part of the services they already paid Respondents to provide. Tr. at 72.

²⁶ Tr. at 60.

²⁷ One of Montford's employees testified that the firm kept no records of the firm's work for SJK.

²⁸ According to Montford, no document was drafted because he "had never charged a [fund] manager before for anything." Tr. at 73.

²⁹ Div. Ex. 8.

³⁰ Div. Ex. 66.

³¹ Div. Ex. 4.

³² The invoices billed "Stan Kowalewski, CEO, SJK Investment Management, LLC." *Id.* We make no distinction, nor did Montford in his testimony, between SJK and Kowalewski. As SJK's sole owner, Kowalewski necessarily acted on behalf of his firm.

In October 2010, Kowalewski instructed Montford to provide an \$80,000 invoice for the second payment. As with the previous payment, Montford did not negotiate the amount, kept no records justifying this amount, and did not know how Kowalewski had calculated it. On November 1, 2010, Montford Associates sent SJK an \$80,000 invoice for "Marketing and Syndication Fee for the SJK Investment Management LLC Launch," with no further explanation.³³

In late November 2010, SJK wired Respondents \$80,000. Respondents conceded in their Answer that the two payments totaling \$210,000 from SJK constituted over twenty-five percent of the firm's total 2010 revenue.

D. Respondents did not disclose SJK's payments to their clients.

Respondents advised ten of their clients to invest in SJK during the period at issue, nine of which followed the advice.³⁴ These clients collectively invested about \$80 million in SJK, which comprised fifteen percent of Respondents' assets under management. Representatives of six of these clients testified at the hearing. All agreed that information about Respondents' arrangement with Kowalewski would have been important to their investment decisions, particularly because they had hired Respondents for their disinterested investment advice. During the relevant period, each received periodic reports from Respondents evaluating SJK's management of their investments. The evidence also establishes several specific instances when Montford failed to disclose the payments from SJK, even though he gave clients advice about SJK, and in at least one instance, when he specifically told a client that Respondents did not receive any compensation from investment managers, such as SJK. Most of the SJK clients who testified terminated their business with Respondents in 2011 after learning of the undisclosed payments from sources other than Respondents.³⁵

1. Sea Island Company and Resort Hotel Association

James Barrow testified on behalf of Sea Island Company and Resort Hotel Association, both clients of Respondents since the 1990s.³⁶ Barrow testified that Montford's independence was crucial to Sea Island and to Resort Hotel Association and that both clients followed

³³ Div. Ex. 17.

³⁴ Piedmont College, the one exception, declined to transfer its investments to SJK after its investment committee met in October 2009. Montford admitted he attended the meeting and advised Piedmont to invest in SJK without disclosing his pay arrangement with SJK.

³⁵ Only Northeast Georgia Foundation, a non-profit organization that paid Respondents \$15,000 to \$18,000 annually, remained a client of Respondents until the time of the hearing in this matter. An NGF representative, however, testified that he learned of the undisclosed payments only just before the hearing.

³⁶ Sea Island, a resort and real estate development company, was a member of Resort Hotel Association, although at all relevant times both maintained separate accounts with Respondents.

Respondents' advice to invest with Kowalewski.³⁷ For example, on November 17, 2009, Montford participated in a Resort Hotel Association board of directors' meeting at which he advised the board against replacing SJK and investing in a more traditional fund. Despite recommending SJK, Montford did not disclose that he had arranged for SJK to pay him in August 2009 and that Montford had billed SJK \$130,000 on November 2, 2009.

On March 23, 2010, Montford participated in another Resort Hotel Association board meeting, this time with Kowalewski, to discuss SJK's investment performance. Neither Montford nor Kowalewski disclosed their financial arrangement at the meeting. As Barrow testified, this information would have been important to the board "[b]ecause we wanted to know if [Montford] was impartial or if he was taking any kind of fees from . . . any of our managers," adding "I really wouldn't care why he got [the money] so much," only that "he got it."³⁸

2. St. Joseph's Hospital

John Albert testified on behalf of St. Joseph's Hospital, Respondents' largest client in 2009 and 2010, with a total of \$185 million in assets under management. St. Joseph's paid \$146,000 in annual advisory fees to Respondents in 2009 and 2010. In November 2009, St. Joseph's made an initial investment with SJK based on Montford's recommendation but Montford did not disclose his financial arrangement with Kowalewski. In September 2010, St. Joseph's invested an additional \$7.4 million with SJK based on Montford's advice. In his "buy recommendation" to St. Joseph, Montford wrote, "We have worked with SJK Partners for many years and we are impressed with their experience, knowledge and expertise."³⁹ But he did not disclose in the recommendation his financial arrangement with SJK. In Albert's view, this information would have been "a significant factor in questioning Mr. Montford's objectivity in recommending an investment."⁴⁰

3. Savannah Country Day School Foundation

Will Monroe testified on behalf of Savannah Country Day School Foundation ("SCDS"), a client of Respondents since 2004. SCDS paid \$35,000 in advisory fees in 2009 and 2010. On September 24, 2009, Monroe sent an e-mail to Montford raising "concerns" about SJK and citing several news reports that Kowalewski had improperly purchased personal items with \$5,000 from a fund set up to support a youth basketball team.⁴¹ Montford responded by e-mail denying the reports' accusations. But Montford failed to disclose in that e-mail or otherwise that a month

³⁷ Barrow estimated that Sea Island paid Respondents \$25,000 to \$30,000 in annual advisory fees but did not indicate an amount for Resort Hotel Association.

³⁸ Tr. at 264.

³⁹ Div. Ex. 31.

⁴⁰ Tr. at 225. Albert's and Montford's testimony indicated that St. Joseph's later sued Respondents in a civil action and that Respondents paid the hospital group \$40,000 to settle the case, but the details of that action are not in the record.

⁴¹ Div. Ex. 34.

earlier he had demanded payment from Kowalewski for, among other things, convincing clients to invest in SJK. Three days after Montford's e-mail, SCDS invested in SJK. According to Monroe, the endowment committee would have wanted to know about Montford's financial arrangement with SJK because SCDS was "paying for independent advice" and "didn't want [Montford's] judgment to be clouded in any way."⁴²

In April 2010, SCDS's endowment committee voted to withdraw its investment from SJK. At the meeting, committee members voiced concerns that SJK's investments "were difficult to understand," lacked liquidity, and "were subject to heavy expenses," particularly because "there were managers managing managers being directed by consultants (all of which were compensated)."⁴³ When Montford was informed of the committee's decision, he sent an e-mail to the committee in which he wrote, "Since we have a fiduciary responsibility, we must express our disagreement with the change."⁴⁴ Montford listed several "reasons SJK . . . matters to SCDS."⁴⁵ He stated that, although he could "identify another hedge manager who may produce higher returns, . . . there will also be higher volatility."⁴⁶ But Montford did not disclose in the e-mail that he had recently received a \$130,000 payment from Kowalewski in January 2010 or that he expected another payment later in the year. Montford forwarded a copy of the e-mail to Kowalewski.

After receiving Montford's e-mail, SCDS's endowment committee delayed reaching a final decision on termination of SJK. In September 2010, Montford requested an in-person meeting with the endowment committee to present his position, again citing his advisory role: "While the committee has the final decision[,] we participate and advise in the investments for SCDS."⁴⁷ At a subsequent endowment committee meeting, Monroe specifically asked Montford whether he received compensation from the investment managers that he recommended. Monroe testified, consistent with the minutes from that meeting, that Montford denied receiving any "other income except for pay [from] his consulting clients like us."⁴⁸ At the conclusion of the meeting, the committee followed Montford's recommendation to remain invested with SJK.

⁴² Tr. at 194.

⁴³ Div. Ex. 57 (SCDS Endowment Committee Meeting Minutes, Apr. 8, 2010).

⁴⁴ Div. Ex. 24.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ Div. Ex. 25 (Montford e-mail, Sept. 4, 2010).

⁴⁸ Tr. at 188. SCDS's minutes from this meeting noted that Montford responded that "the only revenue he receives is from clients like [SCDS] and no managers pay him anything." Div. Ex. 57.

In January 2011, after learning of SJK's undisclosed payment of \$130,000, SDCS terminated their business with Respondents. In a subsequent e-mail to SCDS, Montford attempted to justify the \$130,000 payment as a "negotiated fee" for administrative services.⁴⁹

4. Georgia Port Authority

Marie Roberts testified on behalf of Georgia Port Authority ("GPA"), a client of Respondents since 1992 that paid approximately \$109,000 in annual advisory fees. Roberts testified that, during 2009 and 2010, GPA did not know of Respondents' pay arrangement with SJK but learned of it from newspaper reports in January 2011. That month, Roberts and GPA's finance committee specifically asked Montford about the reports. Montford replied that Kowalewski had paid him \$130,000 for helping set up SJK. But Montford did not disclose the additional \$80,000 payment. Roberts testified that GPA later terminated Respondents' services primarily because of their lack of independence and failure to disclose the payments from SJK.

E. Montford testified to additional nondisclosures.

At the hearing, Montford testified that he regretted failing to disclose the \$210,000 in payments from SJK and that many of his clients left because of that nondisclosure. When asked by his counsel whether he would ever again accept compensation from an investment manager without disclosing it to his clients, Montford responded, "Of course not . . . it was a one-off, something I'll live to regret all my life."⁵⁰

Montford also testified that he received other undisclosed compensation from Kowalewski. During 2009, Montford and Kowalewski went on a three-day fishing trip in Bozeman, Montana. Kowalewski paid for Montford's transportation, food, and lodging. Montford conceded that he did not disclose these facts to his clients.

Montford further admitted that in 2009 and 2010 he invested a \$235,000 personal IRA rollover with SJK. In an e-mail on July 30, 2010, SJK personnel told Montford that SJK had waived its standard management fee on this investment. Montford admitted that at no point did he disclose, either directly to his clients or by updating his firm's Forms ADV, that he had invested in SJK and that he received more favorable terms than his clients.⁵¹

⁴⁹ Div. Ex. 41.

⁵⁰ Tr. at 176.

⁵¹ Montford also admitted that he did not initially disclose to the Division of Enforcement during its 2010–2011 investigation of SJK that Kowalewski had paid him \$80,000 in November 2010. The Division's December 9, 2010, subpoena to Montford specifically requested he produce "[a]ll documents regarding any payment or other benefit (travel, entertainment, *etc.*) provided to [him] by Kowalewski, SJK or any investment fund advised by Kowalewski or SJK." Div. Ex. 1. He also gave investigative testimony on December 17, 2010, during which he did not volunteer disclosure of the \$80,000 payment, only doing so in February 2011.

F. The law judge found multiple violations of the Advisers Act and rule thereunder.

On April 20, 2012, the law judge found that Respondents willfully violated Sections 206(1) and (2) of the Investment Advisers Act of 1940⁵² by failing to disclose the \$210,000 in payments from SJK. The law judge further found that Respondents violated Advisers Act Section 207⁵³ by making materially false and misleading statements in their 2010 Form ADV. The law judge also found that Montford Associates violated Advisers Act Section 204 and Rule 204-1(a)(2)⁵⁴ by failing to amend its 2009 and 2010 Forms ADV when statements about Respondents' independence became materially inaccurate as a result of SJK's \$210,000 payment to Respondents and that Montford willfully aided and abetted and was a cause of these violations.

In assessing an appropriate sanction, the law judge determined that Respondents' misconduct was particularly egregious because they "violated a basic premise of an investment adviser's role" as a fiduciary, acted with a high degree of scienter, and failed to acknowledge any wrongdoing.⁵⁵ The law judge ordered Respondents to cease and desist from committing or causing any violations or future violations of the provisions violated; barred Montford from associating with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and ordered disgorgement of \$210,000 plus prejudgment interest. The law judge also determined that the egregiousness of Respondents' misconduct warranted third-tier civil penalties of \$500,000 against the firm and \$150,000 against Montford.⁵⁶ The law judge further ordered the creation of a fair fund from which to compensate clients harmed by Respondents' violations.

⁵² 15 U.S.C. § 80b-6(1) and (2) (prohibiting investment advisers from "defraud[ing] any client or prospective client" or "engag[ing] in any . . . practice . . . which operates as a fraud or deceit").

⁵³ 15 U.S.C. § 80b-7 (prohibiting "any persons" from making untrue statements of a material fact or omitting to state a material fact in reports or applications required to be filed by Advisers Act §§ 203 or 204).

⁵⁴ 15 U.S.C. § 80b-4, 17 C.F.R. § 275.204-1(a)(2) (together requiring investment advisers to amend Form ADV, "promptly whenever any information in [Part 2] becomes materially inaccurate").

⁵⁵ *Montford*, 2012 WL 1377372, at *16. The initial decision also identified Montford's failure to volunteer disclosure of the \$80,000 payment to the Division during its investigation of SJK among the several instances that "raise[d] questions about Montford's credibility." *Id.* at *17.

⁵⁶ The law judge noted that these civil penalty amounts were "considerably more" than the \$25,000 civil penalty that the Division had recommended she impose against each Respondent. *Id.* at *21; Division's Post-Hr'g Br. at 35.

III.**This administrative proceeding is not time-barred by Exchange Act Section 4E(a).**

Before reaching the merits of the fraud and reporting charges, we first address Respondents' jurisdictional claim, originally made before the law judge, that the proceeding must be dismissed because it is time-barred under Section 4E(a) of the Exchange Act.⁵⁷ That provision, codified by Section 929U of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,⁵⁸ sets forth a "deadline for completing enforcement investigations," stating in pertinent part:

- (1) **IN GENERAL**—Not later than 180 days after the date on which Commission staff provide[s] a written Wells notification to any person, the Commission staff shall either file an action against such person or provide notice to the Director of the Division of Enforcement of its intent to not file an action.
- (2) **EXCEPTIONS FOR CERTAIN COMPLEX ACTIONS**—Notwithstanding paragraph (1), if the Director of the Division of Enforcement of the Commission or the Director's designee determines that a particular enforcement investigation is sufficiently complex such that a determination regarding the filing of an action against a person cannot be completed within the deadline specified in paragraph (1), the Director of the Division of Enforcement of the Commission or the Director's designee may, after providing notice to the Chairman of the Commission, extend such deadline as needed for one additional 180-day period. . . .⁵⁹

As explained below, Respondents' argument for dismissal based on Section 4E(a) fails because Section 4E does not impose a limit on the Commission's jurisdiction to bring these administrative proceedings.

A. Background

The Commission issued the order instituting proceedings (OIP) in this matter 187 days after staff provided Respondents with a written Wells notification⁶⁰—i.e., seven days after the 180-day deadline. Before the law judge, Respondents asserted, as an affirmative defense in their Answer and in a separate motion to dismiss, that the proceeding must be dismissed because it

⁵⁷ 15 U.S.C. § 78d-5.

⁵⁸ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁵⁹ *Id.*

⁶⁰ A "Wells notification" is a letter in which Division staff, in its discretion, may advise a prospective defendant or respondent of the general nature of the investigation and violations contemplated by staff. The letter permits the proposed defendant or respondent to submit a response to the allegations within a time frame determined by staff. *See Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations*, Securities Act Rel. No. 5310, 1972 WL 128568, at *1 (Sept. 27, 1972); 17 C.F.R. § 202.5(c).

does not comply with Exchange Act Section 4E(a)(1). Respondents further claimed that the Division did not take the necessary steps under Section 4E(a)(2) to obtain an extension of the deadline.

The Division disagreed. It asserted that the Division Director, after providing notice to the Chairman, extended the initial 180-day deadline and that the OIP was instituted within the extended period. In support, the Division submitted a declaration from a Division staff attorney assigned to the underlying investigation (the "Division's Declaration"). According to the Division's Declaration, before the 180-day deadline expired:

- On August 19, 2011, the Division's investigative staff submitted a request to the Division Director to extend the 180-day deadline to institute enforcement proceedings against Respondents;
- On August 19, 2011, the Division Director's staff notified the Commission's Chairman of the Division's intent to extend the 180-day deadline;
- On August 22, 2011, the Division Director authorized a designee to approve on his behalf the staff's request for an extension of the 180-day deadline; and
- On August 23, 2011, the Division Director's staff notified investigative staff that the Director had approved the extension request, extending the deadline from August 30, 2011, until September 9, 2011.⁶¹

During a prehearing conference on October 3, 2011, the law judge denied Respondents' motion to dismiss. On October 5, 2011, the law judge issued a subsequent order explaining that the Division's Declaration sufficiently established that it met the requirements for an extension of the 180-day deadline.

Respondents sought interlocutory review from the Commission. On November 9, 2011, we denied interlocutory review, finding that the controlling issue—whether the Division complied with the requirements of Exchange Act Section 4E—constituted a mixed question of law and fact inappropriate for interlocutory review.⁶² In so doing, we rejected Respondents' claim that there was no dispute that the Division Director had failed to make the necessary complexity determination as to the investigation.⁶³ We further noted our general rule disfavoring

⁶¹ Decl. of Michael J. Cates in Support of the Division's Mem. of Law in Opp'n to Respondents' Mot. to Dismiss Out-of-Time OIP, Ex. A.

⁶² *Montford & Co.*, Order Denying Suggestion for Interlocutory Review, Advisers Act Rel. No. 3311, 2011 WL 5434023, at *2 (Nov. 9, 2011) (collecting cases).

⁶³ *Id.* (stating, "[t]o the contrary, the law judge implicitly found that the Division Director had made the required complexity determination" when she noted the Division's position that "the Division Director is not required to articulate or memorialize the reason for deciding that an investigation is sufficiently complex" (internal quotation marks omitted)).

interlocutory review because, as we have held, once we exercise our "prosecutorial discretion to institute proceedings, 'the appropriate remedy . . . is to litigate the proceeding to a final decision.'"⁶⁴

In her initial decision, the law judge again rejected Respondents' argument that the proceeding must be dismissed, stating that Section 4E does not "(1) require that the Director . . . make public his/her determination that the complex nature of the investigation precludes initiating an action within 180 days of the Wells submission; or (2) provide for challenging that judgment."⁶⁵ The law judge added that, because "the Director extended the deadline, . . . one can deduce that he/she made the [necessary complexity] determination."⁶⁶ Respondents reassert their jurisdictional claim on appeal.

B. Exchange Act Section 4E provides no defense in an administrative action.

This is the first instance in which we construe the recently enacted Section 4E. Respondents essentially claim that Section 4E operates as a statute of limitations precluding the Commission from instituting an administrative proceeding more than 180 days after staff provided a written Wells notification. We find no merit in this claim. Section 4E was enacted as part of the Dodd-Frank Act, a statute that significantly expanded the Commission's authority to police fraud in the securities industry.⁶⁷ This particular provision was included under the section of the Dodd-Frank Act titled "Increasing Regulatory Enforcement and Remedies,"⁶⁸ which Congress explained at the time "strengthens the SEC's authority to conduct investigations."⁶⁹ Nowhere in Section 4E, or elsewhere in the Act, did Congress identify a consequence if Commission staff fails to comply with these deadlines. Section 4E states in pertinent part only that, 180 days after providing a Wells notification, Division "staff shall either file . . . or provide notice to the Director of the Division . . . of its intent to not file an action."⁷⁰ Section 4E says

⁶⁴ *Id.* at *3 (quoting *Kevin Hall*, Exchange Act Rel. No. 55987, 2007 WL 1892136, at *2 (June 29, 2007)).

⁶⁵ *Montford & Co.*, 2012 WL 1377372, at *11 (Initial Decision).

⁶⁶ *Id.*

⁶⁷ See, e.g., Thomas Lee Hazen, 6 Law Sec. Reg. §§ 1.2, 16.2 (Jan. 2012) (noting that the Dodd-Frank Act, among other things, "expanded the SEC's administrative authority beyond securities professionals," "increase[d] the penalty amounts that the SEC can seek in administrative proceedings," and "significantly expanded the whistleblower provisions applicable to the securities laws"); Marc I. Steinberg & Ralph C. Ferrara, 25 Sec. Prac. Fed. & State Enforcement § 2:1 (Sept. 2012) (stating that "the enactment of the Dodd-Frank [Act] . . . enhances the SEC's enforcement powers and authority").

⁶⁸ Dodd-Frank Act § 929U, Pub. L. No. 111-203, 154 Stat. 1376.

⁶⁹ H.R. Rep. No. 111-517, Joint Explanatory Statement of the Committee of Conference, Title IX, Subtitle B, "Increasing Regulatory Enforcement and Remedies," at 870-71 (June 29, 2010).

⁷⁰ 15 U.S.C. § 78d-5(a)(1).

nothing about dismissal or preclusion of action if the deadline is missed; nor does it expressly afford the recipients of a Wells notification any rights.

The only statute of limitations generally applicable to our proceedings is set forth in 28 U.S.C. § 2462.⁷¹ This provision states that "any proceeding for enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued."⁷² There is no dispute that all the conduct underlying the charges for this proceeding—and thus all of the conduct for which the Division sought the civil penalties subject to § 2462—took place between 2009 and 2011, well within this five-year period. In enacting Section 4E, Congress said nothing about creating a new abbreviated statute of limitations, either as a replacement for or a supplement to 28 U.S.C. § 2462. Moreover, it would be inconsistent with Congress's intent to increase our authority to curb securities fraud under the Dodd-Frank Act section enacting Section 4E to read the provision as limiting our ability to act in a proceeding that otherwise meets the requirements of 28 U.S.C. § 2462.⁷³ This is particularly true where, as here, dismissal of the action would harm the investing public by foreclosing the Commission from taking appropriate remedial measures.⁷⁴ Because this proceeding was instituted within the time prescribed by 28 U.S.C. § 2462, we find that it is not time-barred.⁷⁵

⁷¹ *Gabelli v. SEC*, 568 U.S. ___, 133 S. Ct. 1216, 1219 (2013); *SEC v. Mohn*, 465 F.3d 647, 653–54 (6th Cir. 2006); *Johnson v. SEC*, 87 F.3d 484, 486–88 (D.C. Cir. 1996).

⁷² 28 U.S.C. § 2462.

⁷³ See, e.g., *United States v. James Daniel Good Real Prop.*, 510 U.S. 43, 65 (1993) ("It would make little sense to interpret directives designed to ensure the expeditious collection of revenues in a way that renders the Government unable, in certain circumstances, to obtain its revenues at all."); *United States v. Montalvo-Murillo*, 495 U.S. 711, 720 (1990) ("[T]here is no reason to bestow upon the defendant a windfall and to visit upon the Government and the citizens a severe penalty by mandating release of possibly dangerous defendants every time some deviation from the strictures of § 3142(f) occurs."); *Brock v. Pierce Cnty.*, 476 U.S. 253, 265 (1986) ("It would be very odd if Congress had implemented that intent by cutting off the Secretary's authority to correct abuses just 120 days after learning of them.").

⁷⁴ See, e.g., *Brock*, 476 U.S. at 260 (citing "the great principle of public policy, applicable to all governments alike, which forbids that the public interests should be prejudiced by the negligence of the officers or agents to whose care they are confided").

⁷⁵ At least three federal courts have rejected similar arguments, holding that § 4E does not create any right to dismissal. *SEC v. Scammell*, CV 11-6597, ECF No. 13 (C.D. Cal. Nov. 15, 2011) (order denying motion to dismiss) ("It is well-established that a violation of statutory deadlines for internal agency action does not bar a claim by the agency if it is otherwise brought within the statute of limitation" period. (citing *Good*, 510 U.S. at 62–65)); *SEC v. Levin*, No. 12-21917-CIV, 2013 WL 594736, at *13 (S.D. Fla. Feb. 14, 2013) (order on motions to dismiss) ("The Supreme Court has held on several occasions that an internal agency deadline of the type found in Section 4E does not create a statute of limitations."); *SEC v. NIR Grp., LLC*, No. CV 11-4723, 2013 WL 5288962, at *5 (E.D.N.Y. Mar. 24, 2013) ("Every relevant authority supports (continued...)

Our interpretation of Section 4E is consistent with United States Supreme Court precedent interpreting similar statutes. The Court has repeatedly held that congressional enactments that prescribe internal time periods for federal agency action without specifying any consequences for noncompliance do not necessitate dismissal of the action if the agency does not act within the time prescribed.⁷⁶ In *Brock v. Pierce County*, the Court addressed a deadline set forth in Section 106(d) of the Comprehensive Employment and Training Act ("CETA"). That section provided that the Secretary of Labor "shall" issue a final determination as to the misuse of CETA funds by a grant recipient within 120 days after receiving a complaint alleging such misuse.⁷⁷ But it did not identify a consequence for missing the deadline. The Court rejected a claim that the Secretary's failure to act within the 120-day deadline foreclosed any subsequent action and held that the statute's use of "shall" together with an express deadline "does not, standing alone, divest the [agency] of jurisdiction to act after [the deadline]."⁷⁸

Similarly, in *United States v. James Daniel Good Real Property*, the Court reversed a United States Court of Appeals' decision dismissing a government forfeiture action for failure to meet various "internal timing requirements" despite being filed within the applicable five-year statute of limitation.⁷⁹ The Court held that, when "a statute does not specify a consequence for noncompliance with statutory timing provisions, the federal courts will not in the ordinary course impose their own coercive sanction."⁸⁰ The Court reasoned that, because the action at issue was subject to an existing "statute of limitations—the usual legal protection against stale claims—we doubt Congress intended to require dismissal of . . . [the] action for noncompliance with the internal timing requirement"⁸¹ The Court concluded that "[t]he Government filed the action in this case within the 5-year statute of limitations, and that sufficed to make it timely."⁸²

(...continued)

the conclusion that expiration of the 180-day deadline imposed by section [4E] does not create a jurisdictional bar to SEC enforcement actions.").

⁷⁶ *E.g., Good*, 510 U.S. at 63 (timing of forfeitures under customs laws); *Montalvo-Murillo*, 495 U.S. at 714 (timing of hearing under Bail Reform Act); *Brock*, 476 U.S. at 253 (timing of Secretary of Labor's investigation of misuse of Comprehensive Employment and Training Act funds).

⁷⁷ *Brock*, 476 U.S. at 259.

⁷⁸ *Id.* at 266; *see also Barnhart v. Peabody Coal Co.*, 537 U.S. 149, 158 (2003) ("Nor, since *Brock*, have we ever construed a provision that the Government 'shall' act within a specified time, without more, as a jurisdictional limit precluding action later.").

⁷⁹ *Good*, 510 U.S. at 65; *id.* at 73 (O'Connor, J, concurring in judgment) (explaining that "[t]he Ninth Circuit [in that case] improperly converted a set of housekeeping rules for the government into statutory protection for the property of malefactors" (internal quotation marks and citation omitted)).

⁸⁰ *Id.* at 63–64 (citing *Montalvo-Murillo*, 495 U.S. at 721).

⁸¹ *Id.* at 65.

⁸² *Id.*

The discretionary nature of the Wells notification process is further indication that dismissal of an action is not the appropriate remedy when the time periods set forth in Section 4E are exceeded. Division staff "may, in its discretion," issue a Wells notification to a person who is the subject of an investigation to allow that person an opportunity to respond before the staff recommends an enforcement action to the Commission.⁸³ It would make little sense to conclude that the remedy for missing the 180-day deadline is dismissal when the Division could avoid this outcome by not issuing a Wells notification in the first place.⁸⁴

Based on the text and legislative history of Section 4E and Supreme Court precedent interpreting similar statutes, we find that this provision is intended to operate as an internal-timing directive, designed to compel our staff to complete investigations, examinations, and inspections in a timely manner⁸⁵ and not as a statute of limitations.⁸⁶

⁸³ 17 C.F.R. § 202.5(c).

⁸⁴ Courts addressing challenges to our Wells process have long held that it confers no substantive rights to respondents in subsequent enforcement actions. *SEC v. Nat'l Student Mktg. Corp.*, 538 F.2d 404, 406–07 (D.C. Cir. 1976) (rejecting claim that staff's failure to comply with predecessor notification practice to Wells process created an affirmative defense to charges because "[h]ad the Commission intended to establish a procedural rule which, if breached, would require dismissal of a complaint, we think it would have said so"), *cert denied sub nom., White & Case v. SEC*, 429 U.S. 1073 (1977); *Wellman v. Dickinson*, 79 F.R.D. 341, 352 (S.D.N.Y. 1978) ("While the procedure of affording prospective defendants an opportunity to present their views to the Commission [in the Wells process] may well be a salutary one, . . . it is not a procedure which is constitutionally compelled"); *see also Trautman Wasserman & Co., Order Denying Pet. for Interlocutory Review, Advisers Act Rel. No. 2613, 2007 WL 1892138*, at *5 (June 29, 2007) (noting the Wells process "give[s] rise to [no] right or remedy").

⁸⁵ *See* Conference Report on H.R. 4173, Dodd-Frank Wall Street Reform and Consumer Protection, 116 Cong. Rec. H5237 (June 30, 2010) (Statement of Rep. Kanjorski) (noting the 180-day deadlines among the provisions implemented to modify the Commission's operations); *accord Levin*, 2013 WL 594736, at *13 ("This Court agrees that Section 4E imposes only an internal deadline on the SEC, not a private right to be free from agency action occurring beyond the internal deadline.").

⁸⁶ *See Peabody Coal Co.*, 537 U.S. at 172 ("The way to reach the congressional objective, however, is to read the statutory date as a spur to prompt action, not as a bar to tardy completion of the [action]"); *Good*, 510 U.S. at 65 ("Statutes requiring customs officials to proceed with dispatch have existed at least since 1799 It would make little sense to interpret directives designed to ensure the expeditious collection of revenues in a way that renders the Government unable, in certain circumstances, to obtain its revenues at all.").

Respondents assert that *Brock* supports their position because "[i]n this case . . . the statute is explicit" by giving "the Commission two options: file the complaint within 180 days or dismiss the action."⁸⁷ But the provision says nothing about dismissal.⁸⁸ Respondents assert further that dismissal is compulsory because, without it, "Commission staff's failure to follow the law has no consequence."⁸⁹ The Supreme Court, however, has held that "the failure of Congress to specify a consequence for noncompliance with [an internal] timing requirement . . . implies that Congress intended the responsible officials administering the Act to have discretion to determine what disciplinary measures are appropriate when their subordinates fail to discharge their statutory duties."⁹⁰

Respondents also challenge the law judge's finding that the Division met the requirements for an extension of the 180-day deadline. We find no error in the law judge's acceptance of the Division's Declaration to find that the Division Director extended the deadline in compliance with Section 4E(a)(2).⁹¹ Respondents argue that the Declaration was deficient because it failed to explicitly state that the Director had found the case sufficiently complex, or otherwise discuss the reasons for the extension. But Section 4E(a)(2) commits the decision to extend the deadline to the sole discretion of the Division Director.⁹² There is no statutory requirement that the Director articulate the reasoning or basis for granting the extension, let

⁸⁷ Respondents' Opening Br. at 25 (citing *Brock*, 476 U.S. at 261); Respondents' Reply Br. at 7.

⁸⁸ At oral argument, Respondents asserted that § 4E(a) means that the Division has essentially "180 days to fish or cut bait." Oral Arg. Tr. at 8. But Congress has designed statutes that specifically require dismissal of an untimely commenced action when that is its intent. For example, in contrast to § 4E, Congress clearly set forth in the Speedy Trial Act of 1974—requiring the filing of a criminal indictment "within thirty days" of an arrest—that the government's failure to meet the 30-day deadline "shall" result in the action being "dismissed or otherwise dropped." 18 U.S.C. §§ 3161(b), 3162(a)(1); *accord Dolan v. United States*, 560 U.S. 605, 611 (2010) (noting that, under 18 U.S.C. §§ 3161(c)(1) and 3162(a)(2), failure to begin the criminal trial within the 70-day deadline "requires dismissal of [the] indictment").

⁸⁹ Respondents' Opening Br. at 21.

⁹⁰ *Good*, 510 U.S. at 64–65; *see also NIR Grp.*, 2013 WL 5288962, at *4–5 (discussing *Brock* and *Peabody Coal*).

⁹¹ *See SEC v. Yorkville Advisors, LLC*, 12-Civ.-7728, 2013 WL 3989054, at *1 n.1 (S.D.N.Y Aug. 2, 2013) (order denying motion to dismiss) (rejecting claim that the complaint should be dismissed for non-compliance with § 4E because "the SEC requested, and was granted, an extension to file an enforcement action" and "the complaint was filed well in advance of the extended deadline"); *NIR Grp.*, 2013 WL 5288962, at *5 (discussing similar declaration adduced by the Division in a federal district court action).

⁹² The plain language of § 4E(a) leaves the complexity determination to the sole discretion of the Division's Director (or designee) for extending the deadline for an additional 180-day period, subject to notifying the Chairman before doing so. For extensions beyond "the additional 180-day period," the Director (or designee) must notify *and* "receiv[e] approval" from the Commission before granting an extension. 15 U.S.C. § 78d-5(a)(2).

alone, on the record before the law judge in the subsequent administrative action.⁹³ Given our holding above that Section 4E does not create a limit on the Commission's jurisdiction to institute an administrative proceeding, the basis for Director's determination is irrelevant to any claim or defense that Respondents can make here.⁹⁴

Accordingly, we reject Respondents' claim that Exchange Act Section 4E requires dismissal of this proceeding.

IV.

Advisers Act Violations

A. Respondents violated Advisers Act Sections 206(1) and (2) by failing to disclose and making misrepresentations and misleading omissions about a material conflict of interest.

Advisers Act Sections 206(1) and (2) make it unlawful for an investment adviser: "(1) to employ any device, scheme, or artifice to defraud any client or prospective client; [or] (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client[.]"⁹⁵ These provisions impose "federal fiduciary standards" on investment advisers,⁹⁶ reflecting Congress's judgment that advisers owe their clients "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts, as well as

⁹³ See *Heckler v. Chaney*, 470 U.S. 821, 828 (1985) (holding that a matter committed to agency discretion is not subject to judicial review); *Webster v. Doe*, 486 U.S. 592, 599–600 (1988) (holding that National Security Act § 102(c), which affords the CIA Director authority to terminate employee when Director "shall deem [it] necessary or advisable," precludes judicial review). Nor do we find error in the law judge's inference that, by granting an extension, the Division Director necessarily "made the [requisite complexity] determination." *Moniford & Co.*, 2012 WL 1377372, at *11. Accord *Braniff Airways, Inc. v. Civil Aeronautics Bd.*, 379 F.2d 453, 460 (D.C. Cir. 1967) ("A strong presumption of regularity supports the inference that when administrative officials purport to decide weighty issues within their domain they have conscientiously considered the issues").

⁹⁴ *NIR Grp.*, 2013 WL 5288962, at *5 (holding that, because Exchange Act § 4E "does not create a jurisdictional bar to SEC enforcement actions[.] . . . evidence concerning compliance with the statutory deadline is not relevant to a claim or defense in this action"); cf. *Nat'l Student Mktg.*, 538 F.2d at 407 ("Mandating such a procedure [i.e., requiring notice of an investigation when no substantive right exists] would seriously burden the Commission's enforcement procedure, already characterized by adequate due process safeguards."); *Wellman*, 79 F.R.D. at 352 ("It must be remembered that all that is in issue here is the institution of suit by the government against the Defendants, not the substantive adjudication of their rights. Thus, before any sanction is imposed, the Defendants will be afforded the protections of a full trial.").

⁹⁵ 15 U.S.C. § 80b-6(1) and (2).

⁹⁶ *Transamerica Mortg. Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979) (internal quotation marks and citation omitted).

an affirmative obligation to employ reasonable care to avoid misleading [their] clients."⁹⁷ The provisions are designed "to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."⁹⁸ To this end, Section 206 prohibits "failures to disclose material information, not just affirmative frauds."⁹⁹

Respondents violated their fiduciary duty to their clients when they failed to disclose the payments they received from SJK. We have long stated that advisers owe their clients "a duty to render disinterested advice . . . and to disclose information that would expose any conflicts of interest," including "even . . . a potential conflict."¹⁰⁰ The "fundamental purpose of [the Advisers Act is] to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus . . . achieve a high standard of business ethics in the securities industry."¹⁰¹ Respondents failed to meet this most basic standard. As the record establishes, Respondents' clients came to them for disinterested investment advice. While Respondents repeatedly recommended SJK to their clients, at no point did they disclose that they had a conflict of interest after arranging for and later receiving substantial payments from SJK.¹⁰²

Respondents' conflict of interest was material because a reasonable investor would have viewed their pay arrangement as "significantly alter[ing] the 'total mix' of information made available" about their investment.¹⁰³ SJK's payments were substantial, comprising over 25% of Respondents' revenue for 2010 and increasing their earnings that year by 35%. Such payments could cause a reasonable investor to question the objectivity of Respondents' advice. Client testimony supports our conclusion. Each of the clients who testified at the hearing stated it

⁹⁷ *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963).

⁹⁸ *Id.* at 191–92.

⁹⁹ *SEC v. Wash. Inv. Network*, 475 F.3d 392, 395 (D.C. Cir. 2007).

¹⁰⁰ *Kingsley, Jennison, McNulty & Morse, Inc.*, Advisers Act Rel. No. 1396, 51 SEC 904, 1993 WL 538935, at *3 (Dec. 23, 1993); *see also Capital Gains*, 375 U.S. at 201 ("The statute in recognition of the adviser's fiduciary relationship requires that his advice be disinterested.").

¹⁰¹ *Capital Gains*, 375 U.S. at 186; *see also SEC v. Mut. Benefits Corp.*, 323 F. Supp. 2d 1337, 1340 (S.D. Fla. 2004) (stating that one of the principal purposes of the federal securities laws is full disclosure of material information reflecting the philosophy that "[s]unlight . . . the best of disinfectants").

¹⁰² *Capital Gains*, 375 U.S. at 201 (noting that an investment adviser must "fully and fairly reveal[] his personal interests in [his] recommendations to his clients").

¹⁰³ *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)); *see also Vernazza v. SEC*, 327 F.3d 851, 859 (9th Cir. 2003) (stating that even "potential conflicts of interest are 'material' facts with respect to clients and the Commission"); *cf. Guy P. Riordan*, Exchange Act Rel. No. 61153, 2009 WL 4731397, at *8 n.46 (Dec. 11, 2009) (secret kickback payments are necessarily material) (citing *SEC v. Savino*, 2006 WL 375074, at *13 (S.D.N.Y. 2006) (unpublished)), *petition denied*, 627 F.3d 1230 (D.C. Cir. 2010).

would have wanted to know about these payments because it specifically hired Respondents to provide disinterested investment advice.¹⁰⁴ In 2011, when the clients had an opportunity to evaluate the conflict created by the pay arrangement, most decided to terminate their advisory relationship with Respondents.¹⁰⁵

In addition to these violations, Respondents made several affirmative misrepresentations. In materials on their website, in Forms ADV, and in client communications, Respondents repeatedly held themselves out as independent investment advisers. Articles on their website stressed to potential and existing clients the need for a "conflict-free" investment adviser, stating that "investments . . . should be based on merit, not . . . undisclosed compensation."¹⁰⁶ In their Forms ADV, Respondents specifically represented that they were "independent"; "received no economic benefit from a non-client in connection with giving advice to clients"; "would disclose to clients . . . all matters that reasonably could be expected to impair [the firm's] ability to make unbiased and objective recommendations"; and "do not accept *any fees* from investment managers."¹⁰⁷ In September 2010, Montford also answered "no" when a client asked him directly whether he or his firm received any compensation from investment managers. These were misrepresentations because, contemporaneous with these statements, Respondents arranged and accepted payments totaling \$210,000 from SJK, an investment manager Respondents recommended to their clients.

Scienter—*i.e.*, an intent to deceive—"is required for a Section 206(1) violation but need not be found for a violation of Section 206(2)," which may be demonstrated by negligence.¹⁰⁸ Montford acted with scienter, which is imputed to his firm.¹⁰⁹ Montford has extensive

¹⁰⁴ For instance, one client representative testified that the existence of the payments would be "a significant factor in questioning Mr. Montford's objectivity in recommending an investment." Tr. at 225. Another testified that he would want to know if Montford "was taking any kind of fees from . . . any of our [investment] managers." Tr. at 264.

¹⁰⁵ *Feeley & Willcox Asset Mgmt. Corp.*, Advisers Act Rel. No. 2143, 56 SEC 616, 2003 WL 22680907, at *13 (July 10, 2003) ("Of course, if the adviser does not disclose the conflict, the client has no opportunity to evaluate . . . the conflict.").

¹⁰⁶ Answer ¶ 7; Div. Ex. 11.

¹⁰⁷ Answer ¶ 6; Div. Exs. 28 at 6–9, 29 at 6–9 (emphasis added).

¹⁰⁸ *David Henry Disraeli*, Advisers Act Rel. No. 2686, 2007 WL 4481515, at *8 (Dec. 21, 2007) (citing *Capital Gains*, 375 U.S. at 195, and *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992)), *petition denied*, 334 F. App'x 334 (D.C. Cir. 2009). "Scienter may be established by recklessness, defined as . . . an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it." *Id.* at *5 (quoting *SEC v. Rubera*, 350 F.3d 1084, 1094 (9th Cir. 2003)). Negligence is a "failure to exercise reasonable care or competence." *Byron G. Borgardt*, Investment Co. Act Rel. No. 26169, 56 SEC 999, 2003 WL 22016313, at *10 & n.35 (Aug. 25, 2003) (citation omitted).

¹⁰⁹ *Disraeli*, 2007 WL 4481515, at *5 n.25 ("The scienter of a corporation's officers and directors establishes the scienter of the corporation for purposes of the antifraud provisions." (continued...))

experience advising clients. He has multiple securities licenses and practiced in the securities industry for forty years, the last twenty-three as the head of a registered investment adviser. Montford therefore knew that he had a fiduciary duty to disclose a conflict to his advisory clients. Statements on his firm's website attributed to him and in his firm's Forms ADV which he signed further demonstrate his knowledge of his fiduciary obligations at the time.¹¹⁰ Such evidence also establishes that he knew, in arranging for and accepting payments from SJK, an investment manager he recommended to clients, that any representation by him or his firm that they did not accept fees from investment managers was false. He nonetheless made this representation repeatedly on the firm's website, in its Form ADV, and personally to at least one client, despite soliciting and later accepting two payments from SJK in 2010 in amounts totaling 25% of the firm's revenue.

Respondents assert that they had no obligation to disclose the payments because SJK compensated them only for administrative work. But even assuming that SJK's payments were only for administrative services, this compensation presented a conflict of interest for Respondents.¹¹¹ Acceptance of substantial payments from SJK at a time when Respondents recommended the firm to clients created a risk that they would not provide impartial advice by placing their financial interest in SJK ahead of their clients' interests. This conflict arose as early as August 30, 2009, when Montford admittedly asked and Kowalewski agreed to pay Respondents for services related to SJK. Respondents were required to disclose this conflict so that their clients could "make an informed decision as to whether to enter into or continue [the] advisory relationship with the adviser or whether to take some action to protect [themselves] against the specific conflict of interest."¹¹² Disclosure of any payments from investment

(...continued)

(internal quotation marks and citation omitted)); *see also A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir. 1977) (holding that a firm "can act only through its agents, and is accountable for the actions of its responsible officers").

¹¹⁰ For example, in recognition of his fiduciary duty, he was quoted on the firm's website as stating that he "believe[s] an independent view is particularly beneficial to fiduciaries charged with oversight of other people's money" and that "investments . . . should be based on merit, not . . . undisclosed compensation." Answer ¶ 7; Div. Ex. 11. The Forms ADV explicitly stated that Respondents did not accept "any fees" from investment managers and would "[d]isclose to clients . . . all matters that reasonably could be expected to impair their ability to make unbiased and objective recommendations." Answer ¶ 6; Div. Exs. 28 at 8, 29 at 8.

¹¹¹ *Capital Gains*, 375 U.S. at 187–88.

¹¹² *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*, Advisers Act Rel. No. 1092, 1987 WL 112702, at *8 (Oct. 8, 1987), quoted in *O'Brien Partners, Inc.*, Advisers Act Rel. No. 1772, 1998 WL 744085, at *8 (Oct. 27, 1998) (settled proceeding); *see also Kingsley*, 1993 WL 538935, at *2–3.

managers was particularly important here, given Respondents' repeated representations to clients that they did not take "any" fees from investment managers.¹¹³

The weight of the evidence also does not support Respondents' assertion that their services were only administrative. Respondents kept no records describing their work for SJK, had no written agreement with SJK, did not negotiate the payment amount, and did not know how Kowalewski determined the amount. Moreover, although Montford testified at one point at the hearing that Respondents performed only administrative work, he also testified at another point that he solicited payment from Kowalewski in August 2009 for work that included meeting with clients to convince them to invest in SJK. And in his December 17, 2010, sworn investigative testimony, Montford twice admitted that SJK paid him, at least in part, to convince clients to stay with SJK.¹¹⁴ Montford's admissions, which occurred closer in time to the events at issue than his hearing testimony, are consistent with other record evidence, including the two invoices Montford sent SJK for "[m]arketing" services, not administrative services,¹¹⁵ and Montford's e-mails updating Kowalewski on his promotion of SJK.¹¹⁶ In none of these or other communications with Kowalewski did Montford reference the firm's progress on the administrative work it was purportedly conducting for SJK.¹¹⁷

¹¹³ Div. Exs. 28 at 9, 29 at 9, 57; Tr. at 26, 30, 188.

¹¹⁴ Montford's sworn investigative testimony was as follows:

Division attorney: Let me ask a question to make sure I understand the universe of services you provide. In connection with this \$130,000, you met - is it fair to say that you met with [your] clients on behalf of SJK to recommend continuing to do business with SJK?

Montford: It is fair, yes.

Division attorney: Is that accurate?

Montford: Yes.

¹¹⁵ See, e.g., *Donner Corp. Int'l*, Exchange Act Rel. No. 55313, 2007 WL 516282, at *3 n.11 (Feb. 20, 2007) (according "greater weight" to investigative testimony "given closer in time to the events at issue" than contradictory hearing testimony (collecting cases)).

¹¹⁶ For example, Montford forwarded Kowalewski an e-mail to a client in which Montford strongly advocated against SJK's termination. Div. Ex. 24. In another e-mail, Montford told Kowalewski that "we are advising [a client] to give you another \$800,000," while instructing him where to wire him SJK's payments. Div. Ex. 66; see also Div. 68 (e-mail from Montford Associates personnel to SJK noting that Montford will be advising a client about its SJK investment "tomorrow" and that "[Kowalewski] can expect the wire Friday").

¹¹⁷ Respondents claim for the first time in their reply brief that the law judge improperly rejected their attempt to adduce evidence regarding the administrative services they provided SJK. They assert that "the [law judge] stated she did not believe any of the additional evidence

(continued...)

Respondents assert that the Division did not show that "the payment to Montford was contingent upon Montford referring clients to SJK,"¹¹⁸ citing the Supreme Court's decision in *SEC v. Capital Gains Research*, which they claim holds that a conflict of interest arises only when the advice given to the client results directly in a financial benefit to the adviser. Contrary to Respondents' claim, the Court in *Capital Gains* repeatedly emphasized an adviser's fiduciary duty to disclose "all conflicts of interest," not just those created by an illicit *quid pro quo* agreement.¹¹⁹ As the Court observed, "[a]n investment adviser should continuously occupy an impartial and disinterested position, as free as . . . possible from the subtle influence of prejudice conscious or unconscious," and "scrupulously avoid any affiliation, or any act, which subjects his position to challenge in this respect."¹²⁰ Appropriately disclosing such conflicts, the Court reasoned, allows clients to evaluate "overlapping motivations . . . in deciding whether an adviser is serving 'two masters' or only one," the client.¹²¹ Moreover, although a showing of an actual conflict is not required for advisers to violate their fiduciary obligations, the weight of evidence establishes that such a conflict existed here: Montford admitted in his investigative testimony that he was paid to convince his clients to invest in SJK; and his invoices billing SJK for "[m]arketing" and e-mails reflecting his promotional efforts of SJK are further evidence that he was paid, at least in part, to encourage clients to invest or stay invested in SJK. These are precisely the overlapping motivations that the disclosure requirement is meant to address.¹²²

(...continued)

was necessary because the difficulty of Montford's work for SJK was not in dispute."
Respondents' Reply Br. at 15–16. Contrary to their claim, the law judge permitted Respondents to enter the evidence they sought to adduce—consisting of three letters relating to the transfer of client assets from Columbia to SJK. These letters, in any event, say nothing about Respondents' conducting administrative services on behalf of SJK but relate to actions taken by Respondents' clients. Montford, moreover, testified that his clients considered his efforts to transfer their assets part of the services that they paid him to provide. *See supra* note 25.

¹¹⁸ Respondents' Opening Br. at 11.

¹¹⁹ *Capital Gains*, 375 U.S. at 187, 191–92. The Court, in analyzing an adviser's duties, cited to a Commission report that led to the enactment of the Advisers Act, which concluded that investment advisers cannot "completely perform their basic function—furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments—unless all conflicts of interest between the investment counsel and the client [are] removed." *Id.* at 187 (quoting *Investment Trusts and Investment Companies Report of the Securities and Exchange Commission*, H.R. Doc. No. 477, 76th Cong., 2d Sess. (1939)).

¹²⁰ *Id.* at 188.

¹²¹ *Id.* at 196 (quoting *United States v. Miss. Valley Generating Co.*, 364 U.S. 520, 549 (1961)).

¹²² E.g., *Monetta Fin. Servs., Inc. v. SEC*, 390 F.3d 952, 955–56 (7th Cir. 2004) ("That [the adviser] did not, in fact favor director-clients [who were receiving IPO share allocations] over the [fund clients] is of no consequence because the potential for abuse nonetheless existed." (citing *Capital Gains*, 375 U.S. at 191–92, 200)). To the extent that Respondents suggest that they had no duty to disclose SJK's payments because Montford demanded payment only after he had met with many clients to convince them to invest in SJK, they are mistaken. Montford had

Respondents claim that they cannot be held liable because the Division failed to establish their investment advice was unsound or that they were "motivated by anything other than reasonable and good-faith investment advice."¹²³ The soundness of their investment advice is irrelevant to their obligation to be truthful with clients and to disclose a conflict of interest.¹²⁴ Whether they consciously believed they could give objective, unbiased advice, despite soliciting and later receiving substantial payments from SJK, that determination was not their choice to make. As we have held, "it is the client, not the adviser, who is entitled to make the determination whether to waive the adviser's conflict."¹²⁵

Respondents contend that they knew nothing about Kowalewski's fraud, citing Montford's SJK investment as proof he was a "victim, not a perpetrator, of the fraud."¹²⁶ They also argue that the law judge erred in excluding evidence of Kowalewski's fraud from the record, asserting that it would show that the Division knew about this fraud in April 2010 but failed to stop it.¹²⁷ Respondents' arguments are misplaced. This case concerns Respondents' misconduct in violating their fiduciary duties and providing false and misleading statements and omissions to clients, not Kowalewski's fraudulent scheme, which was the subject of a separate enforcement action.¹²⁸ Respondents' asserted lack of knowledge of Kowalewski's fraud and the Division's

(...continued)

an ongoing duty to inform his clients, as he continued to advise them on SJK well after he asked for the payments, during which time his clients made additional SJK investments without the benefit of full disclosure of all material facts. *Id.*; *cf. Robert L. Burns*, Advisers Act Rel. No. 3260, 2011 WL 3407859, at *5 (Aug. 5, 2011) (stating that under Investment Company Act § 17(e)(1), a statute "aimed specifically at insuring the independence of" investment companies, the Division need only show that payment of undisclosed gifts created a conflict, not that they were actually intended to influence the company's investment decisions (citing *United States v. Deutsch*, 451 F.2d 98, 108 (2d Cir. 1971) ("The paying of compensation is evil in itself, . . . for it tends to bring about preferential treatment in favor of the payor"))).

¹²³ Respondents' Opening Br. at 12.

¹²⁴ See *Capital Gains*, 375 U.S. at 200–01 (holding the Advisers Act requires disclosure of a potential conflict of interest even if firm's "advice was 'honest' in the sense that they believed it was sound and did not offer it for the purpose of furthering personal pecuniary objectives" because the statute targets "not only . . . dishonor" but also "conduct that tempts dishonor" (internal quotation marks and citation omitted)); *Monetta Fin. Servs., Inc.*, Advisers Act Rel. No. 2136, 56 SEC 538, 2003 WL 21310330, at *5–6 (June 9, 2003), *aff'd in relevant part*, 390 F.3d 952 (7th Cir. 2004).

¹²⁵ *Feeley & Willcox*, 2003 WL 22680907, at *13.

¹²⁶ Respondents' Opening Br. at 13.

¹²⁷ *Id.* at 14–15.

¹²⁸ See *supra* note 6 (discussing separate enforcement actions against SJK and Kowalewski).

progress in investigating it are irrelevant to Respondents' violations.¹²⁹ We therefore find that the law judge was within her discretion to exclude such evidence from the record.¹³⁰

Accordingly, we conclude that Respondents willfully failed to disclose a conflict of interest and made material misstatements and omissions to existing and prospective clients in violation of Advisers Act Sections 206(1) and (2).¹³¹

B. Respondents violated Advisers Act Section 207 by filing an inaccurate Form ADV and Montford Associates also violated Advisers Act Section 204 and Rule 204-1(a)(2) by failing to amend its Form ADV, violations that Montford aided and abetted and caused.

Advisers Act Section 207 prohibits investment advisers from "willfully making false statements of material fact, or material omissions, in . . . a Form ADV."¹³² Advisers Act Section 204 and Rule 204-1(a)(2) require investment advisers to amend their Form ADV "at least annually, within 90 days of the end of [its] fiscal year . . . or more frequently as required by the instructions to Form ADV."¹³³ The General Instructions for Part 2 of Form ADV require investment advisers to promptly amend Form ADV whenever information in Part 2 becomes materially inaccurate. Scienter is not required to find a violation of these provisions.¹³⁴ We have stated that Form ADV and its amendments embody "a basic and vital part in our administration of the [Advisers] Act, and it is essential in the public interest that the information required by the application form be supplied completely and accurately."¹³⁵

Montford Associates' 2009 and 2010 Forms ADV, signed by Montford, made four representations regarding Respondents' independence. In Item 13 of Part 2, the Forms ADV represented that Respondents received no economic benefit from a non-client in connection with

¹²⁹ Cf. *William H. Gerhauser, Sr.*, Exchange Act Rel. No. 40639, 53 SEC 933, 1998 WL 767091, at *4 (Nov. 4, 1998) (noting "[a] regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation").

¹³⁰ See Rule of Practice 320, 17 C.F.R. § 201.320 ("[T]he hearing officer may receive relevant evidence and shall exclude all evidence that is irrelevant, immaterial or unduly repetitious.").

¹³¹ Willfulness means "intentionally committing the act which constitutes the violation" and does not require that the actor "also be aware that he is violating one of the Rules or Acts." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks and citation omitted).

¹³² *Vernazza v. SEC*, 327 F.3d 851, 858 (9th Cir. 2003) (citing 15 U.S.C. § 80b-7); *Kingsley*, 1993 WL 538935, at *4.

¹³³ 15 U.S.C. § 80b-4; 17 C.F.R. § 275.204-1(a)(2).

¹³⁴ *Disraeli*, 2007 WL 4481515, at *13 (citing *Vernazza*, 327 F.3d at 860).

¹³⁵ *Justin Federman Stone*, Advisers Act Rel. No. 153, 41 SEC 717, 1963 WL 63687, at *5 (Nov. 26, 1963), quoted in *SEC v. Moran*, 922 F. Supp. 867, 899 (S.D.N.Y. 1996); see also *Jesse Rosenblum*, Investment Co. Act Rel. No. 913, 1984 WL 470615, at *2 (May 17, 1984).

giving advice to clients. In Schedule F, the Forms ADV represented that Respondents were "independent" advisers and that they "would disclose to clients . . . all matters that reasonably could be expected to impair [the firm's] ability to make unbiased and objective recommendations."¹³⁶ In Schedule F, the Forms ADV further stated that Respondents "do not accept any fees from investment managers."¹³⁷

Montford Associates violated Section 204 and Rule 204-1(a)(2) by failing to update its 2009 Form ADV to reflect SJK's payment to Montford in January 2010.¹³⁸ Montford is charged with willfully aiding and abetting and causing the firm's violations. To establish aiding and abetting liability, we must find securities laws violations by his firm, knowledge or a general awareness by Montford of his firm's wrongdoing, and that Montford knowingly or recklessly rendered substantial assistance to Montford Associates' primary violations.¹³⁹ These elements are met here: Montford executed the 2009 Form ADV on the firm's behalf in March 2009 and thus knew of its contents. It was also Montford's misconduct in arranging and accepting the undisclosed payments in late 2009 and early 2010 that made the Form ADV's representations materially inaccurate. As a result of this knowing conduct, Montford substantially assisted the firm's Section 204 and Rule 204-1(a)(2) violations.¹⁴⁰ Because we find that Montford aided and abetted these violations, "he necessarily was a cause of the violations."¹⁴¹

Montford Associates' 2010 Form ADV included the same disclosures as the 2009 Form ADV. As a result, Montford Associates violated Advisers Act Section 207 by filing a materially false and misleading Form ADV in March 2010, two months after SJK's first payment. Montford also violated Section 207 by executing and filing this form with the Commission.¹⁴² Because the 2010 Form ADV was inaccurate when Respondents filed it, we decline to find

¹³⁶ Answer ¶ 6; Div. Exs. 28 at 8, 29 at 8.

¹³⁷ Answer ¶ 6; Div. Exs. 28 at 9, 29 at 9.

¹³⁸ The firm's 2009 Form ADV was not included in the Adviser Act § 207 charges because it was filed before Respondents arranged to be paid by Kowalewski.

¹³⁹ See, e.g., *Zion Capital Mgmt. LLC*, Advisers Act Rel. No. 2200, 2003 WL 22926822, at *7 (Dec. 11, 2003) (finding that firm's president and sole owner aided and abetted and caused firm's violations of Advisers Act § 204 by failing to disclose conflict of interest to advisory clients).

¹⁴⁰ See, e.g., *SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1310 (S.D. Fla. 2007) (finding that firm's officers responsible for Form ADV filings aided and abetted their firm's Advisers Act § 204 and Rules 204-1(a)(2) and (8) violations).

¹⁴¹ E.g., *Zion Capital*, 2003 WL 22926822, at *7; *Abraham & Sons Capital, Inc.*, Advisers Act Rel. No. 1956, 55 SEC 252, 2001 WL 865448, at *7 (July 31, 2001).

¹⁴² See, e.g., *K.W. Brown & Co.*, 555 F. Supp. 2d at 1309–10 (finding firm and its CEO willfully filed false Forms ADV that materially misrepresented the amount of assets under management); *SEC v. Moran*, 922 F. Supp. 867, 900 (S.D.N.Y. 1996) (finding firm's president willfully filed false Forms ADV because "[h]e certainly intended to sign the forms and thus give the underlying [false claims]").

separate Section 204 and Rule 204-1(a)(2) violations for their failure to amend that same filing.¹⁴³

Respondents contend that they did not violate Section 207 because Item 13 of Form ADV Part 2 asked whether they were "paid cash by or receive[d] some economic benefit . . . from a non-client in connection with giving advice to clients,"¹⁴⁴ and Respondents assert they provided only administrative services to SJK for the payments, which were not connected to giving advice to clients. But, other than Montford's self-serving testimony, there is no basis for the claim that the payments were made for only administrative services. Montford also admitted that SJK paid him in part to convince his clients to invest in SJK and the invoices were for "[m]arketing" of SJK.¹⁴⁵ As such, SJK's payments were clearly "in connection with giving advice" to clients.

Respondents further contend that, in stating in Schedule F of their Forms ADV that they "did not accept 'fees' from [investment managers]," they meant that they did not accept any "finder's fee or a commission."¹⁴⁶ But Respondents placed no such limitation on the language they used in Schedule F of their Form ADV,¹⁴⁷ which stated unambiguously that they did not accept "any fees" from investment managers.¹⁴⁸

¹⁴³ See *IMS/CPAs & Assocs.*, Advisers Act Rel. No. 8031, 2001 WL 1359521, at *10 (Nov. 5, 2001) (holding that "[Advisers Act] Rule 204-1(b) simply triggers an update requirement in the event of material changes to the specified information after an accurate filing has been made" and thereby it "is not applicable to Respondents' conduct because their filings were false when filed, in violation of Section 207").

¹⁴⁴ Div. Ex. 29 at 6 (Montford Associates' Form ADV filed Mar. 29, 2010).

¹⁴⁵ We note that the Supreme Court has broadly interpreted the "in connection with" phrase in other contexts. Cf., e.g., *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 (2006) (interpreting "in connection with the purchase and sale" of a security under § 101(b) of the Securities Litigation Uniform Standards Act of 1998); *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (interpreting Exchange Act § 10(b)'s "in connection with" requirement broadly; noting that "the statute should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes" (internal quotation marks omitted) (citing *Capital Gains*, 375 U.S. at 195)).

¹⁴⁶ Respondents' Opening Br. at 37. Respondents do not directly contest that they failed to disclose "all matters," which could "reasonably be expected to impair [the firm's] ability to make unbiased and objective recommendations," as stated in the Forms ADV. Div. Exs. 28 at 8, 29 at 8.

¹⁴⁷ Montford, indeed, made the same unqualified statement to a client in September 2010, when he told SCDS that "no managers pay him anything." Div. Ex. 57.

¹⁴⁸ Respondents suggest that the Form ADV question to which they responded also limited their disclosure to commissions and finders' fees. But the question did not make such a limitation. It concerned "Conditions for Managing Accounts," asking whether the firm "provide[s] investment supervisory services, manage[s] investment advisory accounts, or hold[s] itself out as providing financial planning or some similarly termed services and impose[s] a minimum dollar value of

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Accordingly, we find that Montford Associates willfully violated Section 204 and Rule 204-1(a)(2), that Montford willfully aided and abetted these violations, and that Respondents willfully violated Advisers Act Section 207.

V.

A. Bar from Association

Advisers Act Section 203(f) authorizes the Commission to censure, place limitations on activities of, suspend, or bar an associated person of an investment adviser for any willful violation of the Advisers Act or its rules if we find that such sanction is in the public interest.¹⁴⁹ The law judge barred Montford from associating with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, and nationally recognized statistical rating organization. Respondents argue that these sanctions are unwarranted.

In determining whether a sanction is in the public interest, we consider such factors as: the egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his or her conduct; and the likelihood that the respondent's occupation will present opportunities for future violations.¹⁵⁰ "[T]he Commission's inquiry into the appropriate sanction to protect the public interest is a flexible one, and no one factor is dispositive."¹⁵¹ We find that application of these factors supports barring Montford from associating with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Montford's misrepresentations and misleading omissions were egregious. Investors in the securities industry place a high degree of trust and confidence in the investment advisory relationship. Montford's clients relied on him to independently assess their investments. Instead,

(...continued)

assets or other conditions for starting or maintaining an account?" and, if so, to describe these services in the Schedule F disclosure. Div. Ex. 29 at 5 (Form ADV, Item 10 of Part 2).

¹⁴⁹ 15 U.S.C. § 80b-3(f). Montford was a person associated with an investment adviser at the time of his misconduct, *i.e.*, from August 2009 until January 2011. *See supra* note 8. The OIP also authorized revocation of Montford Associates' registration pursuant to Advisers Act § 203(e) based on an appropriate finding, but Montford Associates' March 2012 deregistration with the Commission renders this sanction moot. *See supra* note 2.

¹⁵⁰ *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

¹⁵¹ *Disraeli*, 2007 WL 4481515, at *15 (quoting *Conrad P. Seghers*, Advisers Act Rel. No. 2656, 2007 WL 2790633, at *4 (Sept. 26, 2007) (collecting cases), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008)).

Montford betrayed their trust when he arranged and accepted substantial payments from an investment manager with which his clients invested and whom he recommended. As a fiduciary, Montford failed to act in the utmost good faith, to provide full and fair disclosure of all material facts, and to affirmatively employ reasonable care to avoid misleading clients.¹⁵² We find particularly egregious the numerous times Montford recommended that clients invest in SJK while failing to disclose the payments from SJK. And when clients raised concerns about SJK and Kowalewski, as they did throughout 2009 and 2010, Montford repeatedly invoked his role as a fiduciary to convince them to remain with SJK. He deliberately misled a client by stating specifically that he did not accept any payments from investment managers. The firm's Form ADV filings and promotional materials further misled clients to believe he took no undisclosed compensation from investment managers or other non-clients.¹⁵³

We have considered as aggravating factors Montford's admitted failure to disclose additional compensation he received from Kowalewski, specifically, the Montana fishing trip and SJK's waiver of its management fees for Montford's IRA. Although these instances were not specifically identified in the OIP, we may consider them in assessing the appropriate sanction.¹⁵⁴ Montford's failure to disclose this additional compensation is further evidence of his fundamental misunderstanding of his fiduciary obligation to put his clients' interests ahead of his own.¹⁵⁵

Montford exhibited a high level of scienter. As discussed, he knowingly made material misstatements and omissions to clients. His failure to disclose a conflict of interest showed a reckless disregard for the well-established fiduciary duty he owed his clients.

Montford's misconduct was recurrent, not isolated, having taken place for over one and a half years, and did not cease until his clients learned of it from sources other than Respondents. During this period, Montford took two substantial payments from Kowalewski and made multiple misstatements and omissions of material fact to every client invested in SJK and publicly in materials available to all investors.

¹⁵² *Capital Gains*, 375 U.S. at 194.

¹⁵³ Montford's reporting violations, alone, warrant significant sanction in the public interest. *Feeley & Willcox*, 2003 WL 22680907, at *13 (finding adviser's failure-to-disclose and reporting violations "serious" misconduct that "call[s] for significant sanction").

¹⁵⁴ See *J. Stephen Stout*, Exchange Act Rel. No. 43410, 54 SEC 888, 2000 WL 1469576, at *16 & n.64 (Oct. 4, 2000) (considering as aggravating conduct respondent's post-OIP misconduct in determining that a bar was appropriate); *Joseph J. Barbato*, Exchange Act Rel. No. 41034, 53 SEC 1259, 1999 WL 58922, at *15 (Feb. 10, 1999) (finding respondent's contact of Division witnesses to be indicative of potential to commit future violations and thus relevant to analysis in assessing sanctions).

¹⁵⁵ *Capital Gains*, 375 U.S. at 196; see also *Scott E. DeSano*, Advisers Act Rel. No. 2815, 2008 WL 5189512, at *4 (Dec. 11, 2008) (settled proceeding) (adviser violated Advisers Act § 206(2) by failing to disclose receipt of travel, entertainment and gifts paid from brokers to whom they directed brokerage).

Before the law judge, Montford vowed he would "never accept money from investment managers," testifying that his receipt of multiple undisclosed payments was a "one-off" that he regrets. The law judge found this testimony not credible.¹⁵⁶ We generally accord considerable weight and deference to the law judge's credibility determination and see no reason to depart from that determination here.¹⁵⁷ The law judge further found that, given Montford's multiple deceptions and inconsistencies in his testimony, any expressions of remorse stemmed from "the results to him personally and professionally," not from any genuine regret for his wrongdoing and that, if allowed continued participation in the securities industry, he would likely commit further violations.¹⁵⁸ We agree with the law judge that Montford's assurances of future compliance must be judged in light of the pattern of dishonesty and noncompliance evident throughout the record.¹⁵⁹

Montford asserts that several mitigating factors are present that justify lesser sanctions. He claims that he cooperated with the Division in its investigation of SJK and has had an otherwise "unblemished" career.¹⁶⁰ But Montford acknowledged that he did not disclose to the Division the \$80,000 payment from SJK for several months despite being subject to a subpoena seeking such information.¹⁶¹ And his lack of previous securities laws violations does not outweigh our concern that he will pose a continued threat to investors if permitted to remain in the industry. For a prolonged period, Montford repeatedly made material misstatements and failed to disclose a material conflict of interest to clients, in violation of his fiduciary duty. This violative conduct, together with the other aggravating factors found in the record, demonstrates a propensity for conduct that would subject the investing public to future harm.¹⁶²

¹⁵⁶ *Montford & Co.*, 2012 WL 1377372, at *17.

¹⁵⁷ *E.g., Robert M. Fuller*, Exchange Act Rel. No. 48406, 56 SEC 976, 2003 WL 22016309, at *7 (Aug. 25, 2003) ("We give considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses' testimony and observing their demeanor. . . . Such determinations can be overcome only where the record contains 'substantial evidence' for doing so.") (internal quotation marks and citation omitted), *petition denied*, 95 F. App'x 361 (D.C. Cir. 2004); *see also Zacharias v. SEC*, 569 F.3d 458, 470 (D.C. Cir. 2009).

¹⁵⁸ *Montford & Co.*, 2012 WL 1377372, at *17; *see also Phillip J. Miligan*, Exchange Act Rel. No. 61790, 2010 WL 1143088, at *5 (Mar. 26, 2010) ("[N]egative credibility findings by [the trier of fact] . . . persuade us to reject [respondent's] minimal assurances of future compliance."); *Disraeli*, 2007 WL 4481515, at *16 (same).

¹⁵⁹ *Gary M. Kornman*, Advisers Act Rel. No. 2840, 2009 WL 367635, at *7 (Feb. 13, 2009), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010); *see also Citizens Capital Corp.*, Exchange Act Rel. No. 67313, 2012 WL 2499350, at *7 (June 29, 2012) (firm's future compliance assurances undermined by record, including evidence of "additional disclosure failures" outside those charged in OIP).

¹⁶⁰ Respondents' Opening Br. at 3.

¹⁶¹ *See supra* note 51.

¹⁶² *Kornman*, 2009 WL 367635, at *7.

Montford further asserts that he had no knowledge of Kowalewski's fraud and did not intend to harm anyone, suggesting he committed only "technical violations."¹⁶³ Whether or not Montford had actual knowledge of Kowalewski's fraudulent scheme is beside the point. Montford knowingly made material misstatements and misleading omissions to clients and failed to disclose a material conflict of interest, misconduct that was neither trivial nor "technical" in nature, but which "undercuts the trust that is the foundation of the investment advisory relationship."¹⁶⁴ Although Montford may not have intended direct harm to his clients, his misconduct caused his clients to pay significant sums in advisory fees for advice they were misled to believe was disinterested, a foreseeable consequence of his acceptance of SJK's undisclosed payments.

Montford contends that he has "paid dearly" noting he "lost his retirement funds" as a result of Kowalewski's fraud, paid restitution to one client, paid "over a hundred thousand dollars in legal fees," and "lost his business" because of this proceeding.¹⁶⁵ We have held, however, that the "[f]inancial loss to a wrongdoer as a result of his wrongdoing does not mitigate the gravity of his conduct."¹⁶⁶

Given the nature of Montford's misconduct, we believe it necessary for the protection of investors to impose an industry-wide bar. The securities industry depends heavily on the honesty and competency of its professionals.¹⁶⁷ "We have long held that a history of egregious fraudulent conduct demonstrates unfitness for future participation in the securities industry even if the disqualifying conduct is not related to the professional capacity in which the respondent was acting when he or she engaged in the misconduct underlying the proceeding."¹⁶⁸ Montford's breach of his fiduciary duty, affirmative misstatements to clients, and disregard of his disclosure obligations demonstrate his unfitness to remain in the securities industry in any capacity.¹⁶⁹ His misconduct was neither trivial nor confined to his particular industry or his status as a fiduciary.

¹⁶³ Respondents' Opening Br. at 34–35; Respondents' Reply Br. at 16–17.

¹⁶⁴ *James C. Dawson*, Advisers Act Rel. No. 3057, 2010 WL 2886183, at *3 (July 23, 2010) (barring investment adviser and sole owner for disregarding his fiduciary duty to clients).

¹⁶⁵ Respondents' Opening Br. at 35.

¹⁶⁶ *Kornman*, 2009 WL 367635, at *9 (internal quotation and citation omitted). Although we consider one's financial situation in assessing a claim of an inability to pay disgorgement, interest, or civil penalties, pursuant to a proper motion and entry of supporting materials, Montford has not made such a claim. Cf. 17 C.F.R. § 201.630.

¹⁶⁷ As we have stated, "[t]he securities industry presents continual opportunities for dishonesty and abuse and depends heavily on the integrity of its participants." *Kornman*, 2009 WL 367635, at *7 (internal quotation marks and citation omitted).

¹⁶⁸ *John W. Lawton*, Advisers Act Rel. No. 3513, 2012 WL 6208750, at *11 (Dec. 13, 2012) (citing Pub. L. No. 111-203, 124 Stat. 1376 (2010)). Unlike in *Lawton*, the issue of retroactively applying Dodd-Frank § 925 is not before us, as a portion of Montford's misconduct, including his acceptance of SJK's second payment, occurred after enactment of the Dodd-Frank Act.

¹⁶⁹ *Id.*

His misrepresentations and misleading omissions violated the antifraud provisions, which apply broadly to all areas of the securities industry and show an unfitness to participate in the securities industry that goes beyond the professional capacity in which he was acting when he committed the violations at issue.¹⁷⁰ We find that a bar from associating with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or NRSRO will prevent Montford from putting investors at further risk and serve as a deterrent to others from engaging in similar misconduct.

B. Cease-and-Desist Order

Advisers Act Section 203(k) authorizes the Commission to impose a cease-and-desist order if we find that any person has violated the federal securities laws or rules thereunder.¹⁷¹ To determine whether a cease-and-desist order is in the public interest we look to whether there is some risk of future violations. "The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction; indeed, a single violation can be sufficient to indicate some risk of future violations."¹⁷² Our finding that a violation is egregious "raises an inference that it will be repeated."¹⁷³ We also consider "whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions."¹⁷⁴ This inquiry is flexible and no single factor is dispositive.¹⁷⁵

We believe that the risk of Respondents' committing future violations is high. Respondents failed to disclose a significant conflict of interest to their advisory clients; they compounded this fraud by making false statements about their independence.¹⁷⁶ The

¹⁷⁰ *Id.* (explaining that "[b]rokers, dealers, municipal securities dealers, and transfer agents routinely gain access to sensitive financial and investment information of investors and other market participants, and persons associated with municipal advisors and NRSROs routinely learn confidential and potentially market-moving information about securities, issuers, and potential transactions," which can be used for "lucrative or self-serving . . . ends").

¹⁷¹ 15 U.S.C. § 80b-3(k).

¹⁷² *Burns*, 2011 WL 3407859, at *8, n.34 (citing *KPMG Peat Marwick LLP*, Exchange Act Rel. No. 43862, 54 SEC 1135, 2001 WL 47245, at * 24 (Jan. 19, 2001) (noting Commission's authority to impose a cease-and-desist order on any person who "has violated" the securities laws), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002)).

¹⁷³ *Geiger v. SEC*, 363 F.3d 481, 489 (D.C. Cir. 2004).

¹⁷⁴ *KPMG*, 2001 WL 47245, at *26.

¹⁷⁵ *Id.*

¹⁷⁶ *Disraeli*, 2007 WL 4481515, at *17 ("In view of Respondents' failure to appreciate their obligation to deal honestly with public investors and to understand important regulatory requirements, there is a risk that they will transgress in the future." (quoting *Fundamental Portfolio Advisors, Inc.*, Advisers Act Rel. No. 2146, 56 SEC 651, 2003 WL 21658248, at *18 (July 15, 2003), *petition denied*, 167 F. App'x 836 (2d Cir. 2006))).

wrongdoing is recent, beginning in August 2009 and ending in January 2011, and harmed their clients. Respondents' breach of their fiduciary obligations necessarily threatens the integrity of the marketplace, which relies heavily on the honest dealing of its participants and on investors' confidence. Respondents have made no credible assurances against future violations. Although we have ordered an associational bar against Montford and his firm is not currently registered with the Commission, issuance of a cease-and-desist order will serve the remedial purpose of encouraging Respondents to take their responsibilities more seriously in the future should they ever reenter the securities industry.¹⁷⁷

Respondents argue that ordering them to cease and desist from "committing or causing any violations, and any future violations of Sections 204, 206(1), 206(2), and 207 of the Advisers Act and Advisers Act Rule 204-1(a)(2)" is essentially an "obey the law" injunction and therefore unenforceable.¹⁷⁸ Respondents rely primarily on *SEC v. Smyth*,¹⁷⁹ an Eleventh Circuit decision that questioned a district court's entry of a consent injunction based on what the court found to be a failure to conform to Rule 65(d) of the Federal Rules of Civil Procedure. Rule 65(d) requires that an injunction "describe in reasonable detail . . . the act or acts restrained."¹⁸⁰ While the court in *Smyth* vacated the district court's order on other grounds, it noted its view that the injunction did not satisfy Rule 65(d)'s specificity requirement because it cited only the language of the statute and rules that were violated as the conduct to be enjoined.¹⁸¹

Smyth is inapposite. Rule 65(d) by its terms applies to "injunctions" and "restraining orders" issued by federal courts, not cease-and-desist orders issued in Commission administrative proceedings.¹⁸² The governing statute applicable here, Advisers Act Section 203(k), specifically provides that, if the Commission finds any person has violated a provision of the Act, it may impose a cease-and-desist order to prohibit "any future violation of the [applicable] provision."¹⁸³ Given our findings of violations and that Respondents pose a significant future threat to investors, we believe ordering Respondents to cease and desist from

¹⁷⁷ See 17 C.F.R. § 201.193 (Commission rule governing applications by barred individuals to re-associate); *cf. Rizek v. SEC*, 215 F.3d 157, 161 (1st Cir. 2000) ("We also note that the term 'permanent bar' is more than a bit of a misnomer. It does not literally mean that the sanctioned person may never reenter the securities industry.").

¹⁷⁸ Respondents' Opening Br. at 37–38.

¹⁷⁹ 420 F.3d 1225, 1233 n.14 (11th Cir. 2005).

¹⁸⁰ Fed. R. Civ. P. 65(d) (providing every injunction and restraining order "shall be specific in terms; [and] shall describe in reasonable detail . . . the act or acts sought to be restrained").

¹⁸¹ *Smyth*, 420 F.3d at 1233 n.14. Recently, the Eleventh Circuit, the circuit in which Respondents reside, reaffirmed this view. See *SEC v. Goble*, 682 F.3d 934, 950 (11th Cir. 2012) (vacating district court's injunction order and noting, "[a]s we mentioned in *Smyth*, one of the primary problems with obey-the-law injunctions is that they often lack the specificity required by Rule 65(d)").

¹⁸² Fed. R. Civ. P. 65(d)(1).

¹⁸³ 15 U.S.C. § 80b-3(k).

committing or causing any violations or future violations of Advisers Act Sections 204, 206(1), 206(2), and 207 and Rule 204-1(a)(2) is appropriately tailored to protect the investing public.¹⁸⁴

C. Disgorgement

Advisers Act Section 203(k) authorizes the Commission to require disgorgement, including reasonable interest, in a cease-and-desist proceeding.¹⁸⁵ "Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws."¹⁸⁶ "The paramount purpose of . . . ordering disgorgement is to make sure that wrongdoers will not profit from their wrongdoing."¹⁸⁷ When calculating disgorgement, "separating legal from illegal profits exactly may at times be a near-impossible task."¹⁸⁸ As a result, disgorgement "need only be a reasonable approximation of profits causally connected to the violation."¹⁸⁹ Once the Division shows that the disgorgement is a reasonable approximation, the burden shifts to the respondent to show that the amount of disgorgement is not a reasonable approximation.¹⁹⁰ "The risk of uncertainty in calculating disgorgement should fall on the wrongdoer whose illegal conduct created that uncertainty."¹⁹¹

The law judge ordered, as the Division requested, \$210,000 in disgorgement, representing the amount of undisclosed compensation Respondents received from SJK.¹⁹²

¹⁸⁴ See *KPMG, LLP v. SEC*, 289 F.3d 109, 122–23 (D.C. Cir. 2002) (finding cease-and-desist order was "no 'sweeping order to obey the law' . . . because the terms of the order are limited to the[] provisions [at issue]" and noting, "[i]f the Commission is to attain the objectives Congress envisioned, it cannot be required to confine its road block to the narrow lane the transgressor has traveled; it must be allowed effectively to close all roads to the prohibited goal, so that its order may not be by-passed with impunity") (quoting *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952)); see also *Ponce v. SEC*, 345 F.3d 722, 740-41 (9th Cir. 2003) (upholding cease-and-desist order against further violations of Exchange Act provisions and rules violated); *Valicenti Advisory Servs., Inc. v. SEC*, 198 F.3d 62, 66–67 (2d Cir. 1999) (upholding cease-and-desist order against further violations of Advisers Act provisions and rule violated as "within the SEC's statutory authority and justified under the circumstances"), cert. denied, 530 U.S. 1276 (2000).

¹⁸⁵ 15 U.S.C. § 80b-3(k)(5).

¹⁸⁶ *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989).

¹⁸⁷ *SEC v. Tome*, 833 F.2d 1086, 1096 (2d Cir. 1987).

¹⁸⁸ *First City*, 890 F.2d at 1231.

¹⁸⁹ *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995) (citing *First City*, 890 F.2d at 1231).

¹⁹⁰ *SEC v. Happ*, 392 F.3d 12, 32 (1st Cir. 2004) (citing *First City*, 890 F.2d at 1232).

¹⁹¹ *Id.* at 31.

¹⁹² The law judge ordered \$210,000 in disgorgement but suggested that the disgorgement figure should have been much larger, as high as \$500,000, if it had included the advisory fees that the clients testified they had paid Respondents during the time they were misled. The Division did not seek disgorgement of any advisory fees paid.

Respondents do not offer an alternative disgorgement figure but argue that the \$210,000 paid by SJK were not proceeds from the violation because "receipt of the money itself was [not] wrongful" under the securities laws.¹⁹³ But, as discussed, Respondents had a fiduciary obligation to disclose the payments as a conflict of interest. And they fraudulently misled clients to believe they were independent and did not take any money from investment managers at the same time they were arranging for and receiving substantial payments from such an investment manager. Client testimony demonstrated that, absent Respondents' deception and failure to disclose the conflict, SJK would not have paid Respondents the \$210,000 because the clients would not have retained Respondents as their advisers and would not have invested in SJK.¹⁹⁴

We also reject Respondents' contention that the disgorgement amount "must be equal to the damages" suffered by the victims of the misconduct.¹⁹⁵ This argument improperly conflates disgorgement and restitution. It is well settled that, unlike restitution, "[t]he primary purpose of disgorgement is not to compensate investors" by the amount they lost, but to "force[] a defendant to give up the amount by which he was unjustly enriched."¹⁹⁶ Accordingly, "the measure of disgorgement need not be tied to the losses suffered by defrauded investors."¹⁹⁷

We therefore find \$210,000 a reasonable approximation of Respondents' unjust enrichment. Disgorgement of Respondents' undisclosed compensation serves the remedial purpose of preventing them from reaping substantial financial gain from their violations and

¹⁹³ Respondents' Reply Br. at 13–14.

¹⁹⁴ *IMS/CPAs*, 2001 WL 1359521, at *12 (concluding that "[a]ll enrichment received as a result of this undisclosed conflict was unjust" because "Respondents would not have been paid anything had they not recommended that their clients invest in PPF Funds"); *SEC v. Wash. Co. Utility Dist.*, 676 F.2d 218, 227 (6th Cir. 1982) (reversing and remanding trial court decision that denied disgorgement with instructions that court order defendant "to disgorge a sum of money equal to the total value of all the [undisclosed] payments he received").

¹⁹⁵ Respondents' Reply Br. at 13–15.

¹⁹⁶ E.g., *SEC v. Commonwealth Chem. Sec., Inc.*, 574 F.2d 90, 102 (2d Cir. 1978); *SEC v. Blavin*, 760 F.2d 706, 713 (6th Cir. 1985); *SEC v. Bilzerian*, 29 F.3d 689, 697 (D.C. Cir. 1994); see also Sen. Rep. 101-337, at 5466 (June 29, 1990) ("In contrast to damages granted in private actions, which are designed to compensate the victims of a violation, disgorgement forces a defendant to give up the amount by which he was unjustly enriched."). We note that, "[a]lthough disgorged funds may often go to compensate securities fraud victims for their losses, such compensation is a distinctly secondary goal." *SEC v. Fischbach Corp.*, 133 F.3d 170, 175–76 (2d Cir. 1997) (cited in, *SEC v. Huff*, 758 F. Supp. 2d 1288, 1358 (S.D. Fla. 2010)); see also *First City*, 890 F.2d at 1232 n.24 ("[I]n the context of an SEC enforcement suit . . . deterrence is the key objective.").

¹⁹⁷ *Fischbach*, 133 F.3d at 176; see also *SEC v. DiBella*, 587 F.3d 553, 571 (2d Cir. 2009) (disgorging undisclosed payments to state senator for securities business, even though payments emanated from a co-defendant; noting that "the source of the fee is not relevant . . . for purposes of analyzing whether disgorgement was appropriate").

deterring others from misleading clients and violating their fiduciary duties for their own personal gain.¹⁹⁸

Respondents suggest that any disgorgement ordered should be offset by the value of the administrative work they assert they performed for SJK. But, as discussed, even if Respondents' services for SJK were exclusively administrative, they were required to disclose payment for such work to their clients given the size of the payments and Respondents' representations that they did not accept compensation from investment managers or other non-clients. Their failure to do so violated the Advisers Act's antifraud and reporting provisions. As such, amounts received for such work were ill-gotten. In any event, Respondents, who bear the burden of establishing that an offset is warranted,¹⁹⁹ have not introduced sufficient evidence to establish the value of any such services. We thus conclude that all of the undisclosed compensation Respondents received from SJK was unjust and should be disgorged.

Respondents additionally urge an offset of \$40,000 they assert they paid "in restitution" to St. Joseph's Hospital as part of a civil suit against Respondents.²⁰⁰ Respondents failed to provide any documentation to support this claim. The record, consisting of testimony from Montford and a representative of the client, indicates only that Respondents paid \$40,000 to settle the suit. The record contains no information about the basis for this suit or the settlement amount. As a result, we cannot determine the merits of Respondents' offset claim.²⁰¹ For example, if the alleged settlement payment constitutes reimbursement of advisory fees the client paid to Respondents during the time it was misled, such amounts would not warrant an offset because the disgorgement ordered does not include any advisory fees paid.²⁰²

Based on the foregoing, we order Respondents to disgorge \$210,000 plus prejudgment interest, calculated in accordance with Section 6621(a)(2) of the Internal Revenue Code.²⁰³

¹⁹⁸ *Id.*; see also *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1104 (2d Cir. 1972) ("[E]ffective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable.").

¹⁹⁹ See, e.g., *Zacharias*, 569 F.3d at 472; *SEC v. Solow*, 554 F. Supp. 2d 1356, 1365 (S.D. Fla. 2008).

²⁰⁰ Respondents' Opening Br. at 3, 33, 35.

²⁰¹ See, e.g., *Disraeli*, 2007 WL 4481515, at *17 n.106 ("Repayments that Disraeli proves he made could offset his disgorgement.").

²⁰² See *supra* note 192; accord *Solow*, 554 F. Supp. 2d at 1364–65 (denying disgorgement offset because earlier settlement reimbursement for bond transaction included none of the commissions that formed the basis for the disgorgement award in subsequent proceeding); *SEC v. Currency Trading Intern., Inc.*, 175 F. App'x 934, 935–36 (9th Cir. 2006) (denying disgorgement offset absent showing that settlement payments were also "the basis for disgorgement awards" (internal quotation marks omitted)).

²⁰³ 26 U.S.C. § 6621(a)(2).

compounded quarterly until the entire disgorgement amount is paid.²⁰⁴ Because the misconduct committed by Montford and his firm was inextricably entwined, liability of the disgorgement and prejudgment interest shall be joint-and-several.²⁰⁵

D. Civil Monetary Penalty

Advisers Act Section 203(i) authorizes the Commission to impose civil penalties if a respondent has willfully violated or aided and abetted any violation of the federal securities laws and a penalty is in the public interest.²⁰⁶ Section 203(i) establishes a three-tier system for calculating the maximum penalty, each with a larger maximum penalty amount applicable to increasingly serious misconduct. We find third-tier penalties are warranted here because Respondents' misconduct "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement" and "resulted in substantial pecuniary gain."²⁰⁷ Respondents fraudulently misled their clients, misrepresenting that they were independent while at the same time accepting \$210,000 from an investment manager they were recommending. Their failure to disclose this conflict violated a fundamental fiduciary duty of investment advisers. Respondents' pecuniary gain of \$210,000 was substantial, comprising a quarter of their revenue in 2010 and increasing their earnings by 35%.²⁰⁸ Throughout the period of their misconduct, Respondents also received advisory fees from clients that they misled.

²⁰⁴ 17 C.F.R. § 201.600. The law judge ordered prejudgment interest on \$130,000 from February 1, 2010, the first day of the month following Respondents' receipt of that amount from SJK, and on \$80,000 from December 1, 2010, the first day of the month following their receipt of that amount from SJK. Respondents have not challenged the law judge's determination to order prejudgment interest and we adopt it as reasonable. *Id.* ("Prejudgment interest shall be due from the first day of the month following each . . . violation through the last day of the month preceding the month in which payment of disgorgement is made.").

²⁰⁵ "Numerous courts recognize that 'where two or more individuals or entities collaborate or have a close relationship in engaging in the violations of securities laws, they have been held jointly and severally liable for the disgorgement of illegally obtained proceeds.'" *David R. Lehl*, Securities Act Rel. No. 8102, 55 SEC 842, 2002 WL 1315552, at *14 (May 20, 2002) (quoting *SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1191 (9th Cir. 1998)); *see also SEC v. Hughes Capital Corp.*, 124 F.3d 449, 455 (3d Cir. 1997) ("When apportioning [disgorgement] liability among multiple tortfeasors, it is appropriate to hold all tortfeasors jointly and severally liable for the full amount of the damage unless the liability is reasonably apportioned.").

²⁰⁶ 15 U.S.C. § 80b-3(i).

²⁰⁷ *Id.* § 80b-3(i)(2)(C).

²⁰⁸ *See, e.g., Thomas C. Bridge*, Exchange Act Rel. No. 60736, 2009 WL 3100582, at *24 (Sept. 29, 2009); *Disraeli*, 2007 WL 4481515, at *18. Even if we reduced the \$210,000 by the \$40,000 Respondents claim was paid in restitution to St. Joseph's in a settlement—the details of which have not been established, *see supra* notes 200-202 and accompanying text—\$170,000 was still a substantial amount of revenue for Respondents when they accepted it.

We consider the following factors in assessing the appropriate penalty required in the public interest: whether there was fraudulent misconduct; harm to others or unjust enrichment, taking into account any restitution; whether the respondent had previous violations; the need for deterrence of such persons; and such other matters as justice may require.²⁰⁹ The record established that Respondents' fraud harmed clients by causing them to pay significant sums in advisory fees for advice that was not disinterested. Client testimony established that Respondents' perceived independence was paramount and, had the clients known that SJK was paying Respondents to promote SJK, the clients would not have made the investment. Clients who later became aware of the secret payments promptly terminated their business with Respondents. As discussed, Respondents' misconduct resulted in substantial pecuniary gain and they have not adduced credible evidence of any payment of restitution.²¹⁰

Respondents point out that they lack disciplinary histories. But this factor is outweighed by the other public interest factors supporting a significant civil monetary penalty. In addition to failing to affirmatively disclose the conflict to ten clients, Montford directly lied to a client when asked if Respondents accepted any money from investment managers and persuaded that client to reverse its decision to divest from SJK. He participated in client investment committee meetings (in one instance with Kowalewski) without disclosing the pay arrangement. And on multiple occasions he invoked his fiduciary duty with clients to quell their increasing concerns about the SJK investment. We find the need to deter such misconduct great.

Additional aggravating factors warrant imposition of a significant civil monetary penalty. Montford willingly accepted other undisclosed compensation from SJK, including a free vacation and free investment management services for his IRA. Respondents' undisclosed receipt of these additional benefits from SJK demonstrates their propensity to engage in self-dealing at the expense of their clients. Montford also withheld information from the Division during its investigation of SJK and lacked candor before the law judge, who heard Montford's testimony and found it self-serving and not credible.

Respondents' misconduct occurred between August 30, 2009, and January 2011. During that time, for "each act or omission," the maximum third-tier penalty²¹¹ was \$150,000 against a natural person and \$725,000 against any other person.²¹¹ We find it appropriate in the public interest to order a civil penalty of \$75,000 against Montford and \$250,000 against the firm for each of the two undisclosed payments they accepted from SJK, equaling aggregate penalties of \$150,000 and \$500,000, respectively. On two separate occasions, Respondents failed to immediately alert clients, by full and fair disclosure, of information bearing directly on their advisory independence and critical to the clients' investment decisions. In imposing civil penalties consistent with the aggregate amounts imposed by the law judge, we agree that Respondents' misconduct was

²⁰⁹ *Id.* § 80b-3(i)(3).

²¹⁰ See discussion of restitution, *supra* notes 200-202, 208 and accompanying text.

²¹¹ *Id.* at § 80b-3(i)(2)(C).

particularly egregious, antithetical to the fiduciary duties Respondents owed their clients, and warranting strong sanction. We find these penalties serve "the dual goals of punishment of the individual violator[s] and deterrence of future violations" contemplated by the governing statute.²¹²

Respondents contend that the law judge inappropriately imposed third-tier civil penalties when the Division requested only second-tier penalties. The Division contests this characterization of their civil penalty request before the law judge. In any event, in determining the penalty necessary to protect the public interest, we are not bound by the amount the Division requested, and the record amply supports imposition of third-tier penalties.²¹³

Accordingly, we order civil penalties in the amounts of \$150,000 against Montford and \$500,000 against Montford Associates.

E. Fair Fund

The law judge ordered that "the amount of disgorgement and civil money penalties be used to create a Fair Fund for the benefit of Montford Associates' clients who were harmed by the violations" in accordance with Rule of Practice 1100.²¹⁴ "Sarbanes-Oxley's Fair Fund provision provides the [Commission] with flexibility by permitting it to distribute civil penalties

²¹² *Official Comm. of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 81 (2d Cir. 2006) (internal quotation marks and citation omitted) (discussing 1990 amendments to federal securities laws, including Advisers Act, and noting the Commission's "authority to seek or impose substantial money penalties, in addition to disgorgement of profits, is necessary for the deterrence of securities law violations" (quoting H.R. Rep No. 101-616 (1990))).

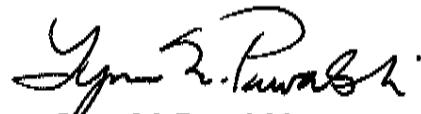
²¹³ While the penalties imposed are less than the third-tier maximum for two "acts or omissions," they are nonetheless significant, reflecting the gravity of Respondents' misconduct. Respondents complain that imposing \$650,000 in civil penalties is unwarranted when compared to the amount imposed in *Sheer Asset Management, Inc.*, Advisers Act Rel. No. 1459, 1995 WL 6234, at *3 (Jan. 3, 1995), a settled action imposing \$10,000 in civil penalties and no disgorgement. But it is well established that "[t]he Commission is not obligated to make its sanctions uniform." *Kornman*, 592 F.3d at 188 (quoting *Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004)). Nor is Respondents' comparison apposite because that action involved only a failure to disclose a brokerage agreement on Form ADV in violation of Advisers Act Section 207 and did not include the multiple failures to disclose a material conflict of interest, affirmative misstatements, and aggravating factors presented in this case. Moreover, we have long stated that "respondents who offer to settle may properly receive lesser sanctions than they otherwise might have received based on pragmatic considerations such as avoidance of time-and-manpower-consuming adversary proceedings." *Kornman*, 2009 WL 367635, at *9 (quoting *Stonegate Sec., Inc.*, Exchange Act Rel. No. 44933, 2001 WL 1222203, at *4 (Oct. 15, 2001)); *see also Orkin v. SEC*, 31 F.3d 1056, 1067 (11th Cir. 1994).

²¹⁴ *Montford & Co.*, 2012 WL 1377372, at *21.

among defrauded investors by adding the civil penalties to the disgorgement fund.²¹⁵ We direct that the civil money penalties and disgorgement ordered be paid into such a fund.

An appropriate order will issue.²¹⁶

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, STEIN and PIWOWAR).



Lynn M. Powalski
Deputy Secretary

²¹⁵ *Riordan*, 2009 WL 4731397, at *22 (internal quotation marks and citation omitted).

²¹⁶ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3829 / May 2, 2014

Admin. Proc. File No. 3-14536

In the Matter of

MONTFORD AND COMPANY, INC.,
d/b/a MONTFORD ASSOCIATES, and
ERNEST V. MONTFORD, SR.

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Ernest V. Montford, Sr. ("Montford"), be, and he hereby is, barred from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and it is further

ORDERED that Montford and Montford and Company, Inc., d/b/a Montford Associates ("Montford Associates"), cease and desist from committing or causing any violations or future violations of Sections 204, 206(1), 206(2), and 207 of the Investment Advisers Act of 1940 and Rule 204-1(a) thereunder; and it is further

ORDERED that Montford and Montford Associates disgorge, jointly and severally, \$130,000, plus prejudgment interest of \$19,202.26, such prejudgment interest calculated beginning from February 1, 2010, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Montford and Montford Associates disgorge, jointly and severally, \$80,000, plus prejudgment interest of \$11,816.77, such prejudgment interest calculated beginning from December 1, 2010, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Montford and Montford Associates pay civil money penalties of \$150,000 and \$500,000, respectively; and it is further

ORDERED that the disgorgement and civil money penalty be used to create a "Fair Fund" for the benefit of Montford and Montford Associates' clients harmed by their violations pursuant to Commission Rules of Practice 1100-1106.

Payment of the amounts to be disgorged and the civil money penalties shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed or delivered by hand to the Office of Financial Management, Securities and Exchange Commission, 100 F Street NE, Mail Stop 6042, Washington, DC 20549; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of the counsel of record.

By the Commission.



Lynn M. Powalski
Deputy Secretary