

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

---

In the Matter of :  
:   
GUALARIO & CO., LLC and : INITIAL DECISION  
RONALD GUALARIO : February 14, 2012

---

APPEARANCES: Jack Kaufman, Alexander J. Janghorbani, and Ibrahim S. Bah for the  
Division of Enforcement, Securities and Exchange Commission

Ronald Gualario pro se and for Respondent Gualario & Co., LLC

BEFORE: Carol Fox Foelak, Administrative Law Judge

### SUMMARY

This Initial Decision (ID) concludes that Ronald Gualario (Gualario) and Gualario & Co., LLC (Gualario & Co.), violated the antifraud provisions of the federal securities laws by making material misrepresentations and omissions in the sale of promissory notes to investors and in the operation of a hedge fund. Additionally, Respondents acted as unregistered brokers. The ID orders Respondents to cease and desist from violations of the antifraud and registration provisions, to disgorge ill-gotten gains of \$492,249.67, and to pay a civil money penalty of \$390,000, and imposes broker-dealer, investment adviser, and investment company bars.

### I. INTRODUCTION

#### A. Procedural Background

The Securities and Exchange Commission (Commission) instituted this proceeding with an Order Instituting Proceedings (OIP) on April 8, 2011, pursuant to Section 8A of the Securities Act of 1933 (Securities Act), Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act), Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (Advisers Act), and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). The undersigned held a four-day hearing on September 12-15, 2011, in New York City.<sup>1</sup>

---

<sup>1</sup> The hearing session on September 14 was abbreviated. Tr. 407-13, 419-20. Respondents did not appear; a conference call that included the undersigned and counsel for the Division of

Seven witnesses testified, including Gualario, and numerous exhibits were admitted into evidence.<sup>2</sup>

The findings and conclusions in this ID are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the parties' Proposed Findings of Fact and Conclusions of Law and Respondents' Reply were considered. All arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected.

## **B. Allegations and Arguments of the Parties**

This proceeding concerns Respondents' dealings with advisory clients during 2006 and 2007. The OIP alleges that they fraudulently sold promissory notes to clients, acted as an unregistered broker-dealer in their sale of limited partnership interests in real estate ventures, and failed to disclose a material change in their hedge fund investment strategy.

The Division of Enforcement (Division) is seeking a cease-and-desist order; disgorgement; a third-tier civil money penalty; and bars. Respondents argue that the charges are unproven and no sanctions should be imposed.

## **II. FINDINGS OF FACT**

As discussed below, during 2006 and 2007, Respondents raised more than \$8 million from the sale of promissory notes and limited partnerships in a hedge fund from their existing customers. By November 2007, the money had been spent or lost in trading, mostly in ways that were at variance to the representations made to the investors.

### **A. Respondents and Other Relevant Individuals**

#### **1. Respondents**

Gualario graduated from Columbia College in 1990 and worked in the financial industry in various capacities for several years. Tr. 422-26. He founded Gualario & Co., an investment adviser, in February 1998, and has always been its owner, sole principal, president, and CEO.<sup>3</sup> Tr. 423, 426-28; Answer at 7. Gualario & Co. was registered with the Commission as an investment

---

Enforcement was placed to Gualario's telephone number, and a summary of the phone call was placed in the record. Tr. 407-13.

<sup>2</sup> Citations to the transcript will be noted as "Tr. \_\_\_." Citations to exhibits offered by the Division of Enforcement and by Respondents will be noted as "Div. Ex. \_\_\_" and "Resp. Ex. \_\_\_," respectively.

<sup>3</sup> Gualario has never been a registered broker-dealer or associated with one. Tr. 423.

adviser during the time at issue in 2006 and 2007.<sup>4</sup> Tr. 427. Its principal product was a discretionary large cap equity account, which emphasized S&P 500 stocks.<sup>5</sup> Tr. 430-31. During 2006 and 2007, these individually-managed accounts were held at TD Ameritrade. Tr. 433. In 2007, Gualario & Co. had over \$40 million in assets under management. Tr. 438. Following the events at issue, Gualario & Co. shut down in approximately March 2008. Tr. 724.

As discussed below, starting in late 2006, Respondents raised money from existing clients via promissory notes and launched a hedge fund in August 2007.<sup>6</sup> Gualario & Co. was a one-man operation until late 2006. Tr. 428. Thereafter, Gualario hired a few staffers, including, in early 2007, a compliance officer, Sheng Fu Lin. Tr. 428-29. Nonetheless, Gualario remained the sole decision-maker on trades and provider of investment advice to clients. Tr. 138-39, 194, 433.

## **2. Sheng Fu Lin**

As of January 1, 2007, Gualario hired as chief compliance officer Sheng Fu Lin (Lin), a CPA whose background included positions at the Commission, Morgan Stanley, and the Federal Reserve. Tr. 586, 640-41, 643-44; Resp. Exs. 77, 84, 87. Lin's last day at Gualario & Co. was September 14, 2007.<sup>7</sup> Tr. 586, 673; Resp. Ex. 140. Although claiming that Lin encouraged Gualario to trade options and take other risks, Gualario acknowledges that all decisions and representations were his responsibility. Tr. 672-90.

## **3. Thomas Genduso and Mortgage Bankers**

Thomas Genduso (Genduso) is, and was at the time at issue, employed at Mortgage Bankers, a mortgage banking company; the company's two principals, Genduso and Edward Pozzuoli (Pozzuoli), each owned 50%. Tr. 112-14. Genduso and Gualario are cousins and had a close relationship in 2006. Tr. 114, 458. Genduso was also an advisory client of Gualario at that time. Tr. 451, 458. Genduso loaned Gualario substantial sums of money from time to time. Tr. 117, 132, 457, 459. Gualario testified evasively and inconsistently about these transactions – that they were gifts, loans, or not exactly loans, in that Gualario intended to repay the monies at some point, but Genduso never asked for specific repayments. Tr. 442-43, 457-61, 467-72.

---

<sup>4</sup> Gualario believes that Gualario & Co. is no longer registered. Tr. 426-27; Answer at 7. However, according to the Commission's public official records, of which official notice is taken pursuant to 17 C.F.R. § 201.323, it has been, and still is, a registered investment adviser since 2006.

<sup>5</sup> Additionally, Gualario & Co. offered real estate holding accounts. Tr. 430.

<sup>6</sup> Until that time, Gualario & Co.'s clients had only separately-managed accounts. Tr. 429-430.

<sup>7</sup> Gualario testified that he did not realize that Lin had left permanently until a month later, when he noticed that Lin's office was vacant. Tr. 589, 676-77.

## **B. Promissory Notes**

During the first half of 2006, Gualario & Co. earned approximately \$380,000 in advisory fees. Answer at 8. However, the market value of its proprietary trading account dropped from approximately \$262,000 at the end of June 2006 to approximately \$162 at the end of July 2006, and it had to meet a margin call of approximately \$20,000 in its proprietary trading account. Tr. 441-42; Div. Ex. 25 at SEC-NY-7870-006017; Answer at 8. At that time, Gualario borrowed \$25,000 from Genduso. Tr. 442-43. Also around that time, Gualario started recommending to his clients the purchase of promissory notes in Gualario & Co. Tr. 443-46.

### **1. Phyllis Wilson**

Phyllis Wilson (Wilson) became a client of Gualario in 2002. Tr. 444, 611-13; Resp. Exs. 101, 102. Wilson trusted Gualario and considered him a friend. Tr. 32-34, 51, 54, 70-71, 86, 98, 103-04. In February 2007, she even made a health care power of attorney naming Gualario as her agent to make health care decisions for her, gave him a general power of attorney to take effect in the event of her disability, and created a living trust, naming him as successor trustee on her death. Resp. Exs. 1, 2, 3, 4, 5. In an accompanying handwritten note expressing her “Life/Death Wishes,” she wrote, “I trust you and believe in you!” Resp. Ex. 4. As a result of the events at issue, her attitude changed drastically; when cross-examined by Gualario, she testified: “I trusted you. And you lied to me.” Tr. 103.

In 2006, Wilson, then aged 63, retired as a teacher. Tr. 30-31, 445-46. Almost all of her money was invested with Gualario. Tr. 33-34. Gualario was aware of the extent of her assets and knew that she was not a sophisticated investor and that she relied on his advice. Tr. 445-48. Invested in stocks before her retirement, Wilson became concerned with the fluctuation of the stock market and desired, instead, a fixed monthly income. Tr. 32-35, 44-45, 68, 447-50. Gualario suggested a promissory note. Tr. 34-35, 68-70. Wilson expected the note to be issued by Gualario or Gualario & Co. but, when she received the documentation, found Mortgage Bankers to be the issuer. Tr. 35-44, 72-73, 77; Div. Exs. 12, 13. Gualario, however, told her he would assume the note.<sup>8</sup> Tr. 39, 110, 474. Gualario’s reason for substituting Mortgage Bankers was that he was not in a position to pay the interest on the note. Tr. 471, 613-14. The record does not show that Wilson understood the significance of this. Tr. 39, 65, 72-73, 471. Wilson signed the Mortgage Bankers promissory note and Gualario & Co.’s form titled “Self-Directed Investment Authorization Non-Publicly Traded Investments”<sup>9</sup> on July 27, 2006. Tr. 37, 454, 457-59, 461; Div. Ex. 12, Div. Ex. 13 at SEC-NY-7870-004750. In early August, Gualario arranged for the transfer of \$100,000 from

---

<sup>8</sup> He never did so. Tr. 479, 619.

<sup>9</sup> This form represented, falsely, that Gualario & Co. had no business relationship with Mortgage Bankers. Tr. 457-58. Div. Ex. 12. Gualario testified that the document essentially was boilerplate; he did not review its accuracy before it was sent to a customer. Tr. 454-57. Wilson did not read this or any other document Gualario provided for the notes in which she invested because she trusted him and because, in her words, “[she] was stupid.” Tr. 51, 53-55, 76.

Wilson's Gualario & Co. account to Mortgage Bankers. Tr. 114, 453-57; Div. Exs. 12, 13, 143. Gualario did not tell Wilson that he was going to use her money to pay a debt he owed Genduso. Tr. 42, 110. Wilson did not realize until too late, when she was not receiving interest payments, that Gualario was in financial trouble. Tr. 65, 78-79.

When Mortgage Bankers received Wilson's \$100,000 on August 7, 2006, Genduso understood the payment was intended to satisfy a debt of about \$50,000 that Gualario owed Genduso. Tr. 116-17. Genduso retained \$50,000 and gave the remaining \$50,000 to Gualario.<sup>10</sup> Tr. 117. Genduso received Wilson's Mortgage Bankers note on August 9, 2006, a few days after receiving the \$100,000. Tr. 119; Div. Exs. 18, 144. Mortgage Bankers had never previously issued a promissory note.<sup>11</sup> Tr. 121-22. Genduso instructed Gualario "to take care of" the note; Gualario responded that he, not Mortgage Bankers, was responsible for the note and that he would "take care of it." Tr. 122-23. Genduso never considered the document to be a genuine, authorized promissory note issued by Mortgage Bankers. Tr. 124, 129. Genduso made at least two payments, totaling \$2,000, to Wilson at Gualario's request. Tr. 128-29, 618-19; Div. Ex. 14. Genduso placed the note, which had a line for his signature, in his cabinet; he signed it sometime later, at the request of Gualario, who said that the signature was a necessary technicality.<sup>12</sup> Tr. 125, 473-74; Div. Exs. 17, 18. Genduso never told his partner, Pozzuoli, about the matter. Tr. 117, 123, 133-36.

Wilson invested an additional \$340,000 in promissory notes of Gualario & Co. between September 2006 and January 2007. Tr. 44-55, 622-23; Div. Exs. 50, 56, 57, 58, 59, 60. She had no idea of the purposes for which the funds were to be used. Tr. 101-02.

---

<sup>10</sup> Gualario denies that Genduso personally retained \$50,000 of the \$100,000 but admits that Genduso returned \$50,000. Tr. 467-68. Gualario's alternative explanation concerning the \$50,000 that was not returned is convoluted, contradictory, and hard to follow, for example that his intended future assumption of the \$100,000 note "would have been repayment of the [\$50,000] gift." Tr. 467-72. Since Genduso had knowledge of his own actions, and Pozzuoli, Genduso's sole partner in Mortgage Bankers, knew nothing of the matter, Mortgage Bankers cannot have received the benefit of the \$50,000 that was retained. Tr. 134-36. Since any other explanation makes no sense, it is found that Genduso retained \$50,000.

<sup>11</sup> Genduso testified that, prior to receiving the note, he knew nothing about it. Tr. 121-22. Gualario testified that Genduso authorized him to issue the note in the name of Mortgage Bankers. Tr. 467, 471, 613-14. This conflict in the evidence, however, is not material to any issue in this proceeding.

<sup>12</sup> Genduso's signature line is blank on the copy provided to Wilson. Tr. 40-41; Div. Ex. 13. Genduso testified that he signed years later, while Gualario testified that Genduso signed at an unspecified earlier time. Tr. 125, 473-74. Genduso provided to Commission staff a copy of the note without a signature page on November 19, 2010; after a further request, he provided a signed version. Tr. 126-28; Div. Exs. 17, 18. The date when Genduso signed the note, however, is not material to any issue in this proceeding.

Wilson received some interest payments but lost the entire principal, \$440,000, that she had invested with Gualario. Tr. 55-56, 63, 65-66, 74, 76-77, 105-06, 480; Div. Ex. 137. At one point in 2008, Wilson travelled to New York City to meet with Gualario in the hope that he would pay her money that she was owed; he gave her some post-dated checks, but they bounced. Tr. 57-59, 81, 106; Div. Exs. 136, 138. As a result of the loss of her capital, Wilson had to sell her house, move to a rundown apartment, and ask her cousins for money to help support her mother, who lives with her. Tr. 66. She also returned to teaching; she substitute teaches almost every day that school is in session. Tr. 66.

## **2. Gualario & Co. Promissory Notes**

In early September 2006, Gualario & Co. had approximately \$7,000 in its business account and had issued several checks that bounced. Tr. 503-04. Starting around that time, Gualario solicited and obtained investments, from existing clients, in Gualario & Co. promissory notes to raise funds that he represented would be used to launch a hedge fund. Div. Exs. 31-42, 44-78. Letters from Gualario to these clients enclosing offering documents and paperwork stated, “As we discussed, this offering will allow me to put in place the proper infrastructure needed to successful [sic] transition part of our business to a hedge fund model.” Div. Exs. 31-39. The subscription agreements executed by the investors stated:

[Gualario & Co.] is in the process of transitioning a portion of its . . . business to a hedge fund model . . . . [This] will require [Gualario & Co.] to, incur significant legal and accounting fees, increase staffing (including Chief Compliance Officer and Chief Financial Officer, both of which positions are presently held by Ronald Gualario), retain an outside hedge fund administrator and relocate to a larger office space. [Gualario & Co.] will use the proceeds of the Offering to meet the expenses related to the above requirements and to provide it with additional working capital.

Div. Exs. 66-78. Gualario stated in the initial solicitation, “I anticipate the official launch of the [hedge fund] on December 29, 2006.” Div. Exs. 31-38.

Gualario also made oral representations concerning the notes to clients. Tr. 445. For example, he approached Zachary Goldman (Goldman)<sup>13</sup> in August 2006 about investing in the notes. Tr. 138-40. Gualario told Goldman that he had \$45 million under management, that he wanted to establish a hedge fund, for which clients had already committed \$7 million, that he needed to move his office and hire staff to launch the fund, and that he needed \$500,000 to do this.<sup>14</sup> Tr. 141. Gualario represented to Goldman and other investors that the proceeds from the

---

<sup>13</sup> Goldman was a client of Gualario & Co. from 2004 to 2008. Tr. 138-39. Aged 78 during the time at issue, Goldman had previously retired as a chief financial officer of a corporation. Tr. 137-38. He resumed employment in February 2009; from January through April 15, he does tax returns for H&R Block, and from September through December, he substitute teaches in Palm Beach County, Florida, high schools. Tr. 137-38.

<sup>14</sup> Gualario explained that the hedge fund would be conservatively managed; he would continue his long equity position strategy hedged with a short position of about 20%. Tr. 144.

notes were to be used for these purposes only. Tr. 142, 199-202, 510-518; Div. Exs. 31-39, 66-78. The proceeds were not to be used for trading. Tr. 170-71. Gualario did not tell Goldman that he would use the proceeds from the notes to trade options for Gualario & Co.'s own account. Tr. 142, 171. Goldman was concerned that Gualario did not have \$500,000 on hand, but Gualario reassured him on this point. Tr. 141. Gualario did not disclose anything about the financial condition of Gualario & Co. or about his own financial condition, although he emphasized that the notes would have his personal guarantee, which influenced Goldman's decision to invest.<sup>15</sup> Tr. 142-46. Gualario explained that the notes would be for a two-year term, but that he expected to launch the hedge fund within a short time. Tr. 141-42. Goldman decided to invest \$50,000 in a note. Tr. 144; Div. Exs. 32, 41, 51, 67. Although Goldman scanned the subscription agreement, he did not read it carefully because he trusted Gualario. Tr. 147-48, 172. Goldman received interest payments due through 2007, although the payments due for the last several months of 2007 were paid in early 2008; then the payments stopped, and the principal was not repaid. Tr. 150-51.

Ronald Rapuano (Rapuano)<sup>16</sup> also invested \$100,000 in a promissory note. Tr. 197; Div. Ex. 54. Gualario told him the proceeds were to be used as start-up money to develop the Fund. Tr. 199-202; Div. Exs. 31, 47. Rapuano never received any repayment of principal on the note.<sup>17</sup> Tr. 202.

The proceeds from the first group of promissory notes were \$490,000. Tr. 499. Much of that sum was exhausted by the end of November 2006.<sup>18</sup> Div. Exs. 23, 25. About \$300,000, rather

---

<sup>15</sup> Gualario's explanation for the reason for the personal guarantee was that he would be taking distributions from the accounts. Tr. 511, 653.

<sup>16</sup> Rapuano, an oral surgeon, retired in 2006. Tr. 190-91. He was a client of Gualario & Co. from early 2005 until relatively recently. Tr. 194. He also was on a friendly basis with Gualario. Tr. 194-95, 227. After observing Gualario's handling of a small portion of his assets, he placed a larger account under Gualario's control. Tr. 196.

<sup>17</sup> Rapuano testified that he never received any interest payments on the note. Tr. 202. Gualario argues that interest payments were made, and the record contains several Gualario & Co. checks payable to National Investor Services Corp. f/b/o Ronald Rapuano (No. 1178, \$1,227.40, paid December 15, 2006; No. 1199, \$1,358.90, paid January 23, 2007; No. 1230, \$1,358.90, paid March 30, 2007; No. 1269, \$1,227.40, paid April 11, 2007; No. 1004, \$1,358.90, paid May 10, 2007). Div. Ex. 23 at SEC-NY-7870-007966, -007997, -008009, -008029, -008091, -008105, -008131, -008169, Div. Ex. 24 at SEC-NY-7870-008193, -008225. There is no evidence in the record tying the payments to the note (or illuminating their purpose in any way), and the sums paid are not congruent with the amounts due Rapuano. The \$100,000 note had an interest rate of 16%, payable monthly. Div. Ex. 54. Thus, monthly payments of the \$16,000 in interest due annually would have been \$1,333.33. Nonetheless, to the extent there is any conflict in the record concerning interest payments to Rapuano, it is not material to any issue in this proceeding.

<sup>18</sup> Division Exhibit 133e, a summary exhibit, erroneously reports the balance in Gualario & Co.'s Chase Business accounts on November 20, 2006, as \$9,282.69. Review of the account

than being spent on launching the hedge fund, was transferred into Gualario & Co.'s TD Ameritrade proprietary trading account and lost in trading options. Tr. 521-22, 527-28, 539, 635; Div. Exs. 20, 23, 25. Gualario was "in a jam." Tr. 530. Accordingly, a second set of notes was sold from November 28, 2006, to March 22, 2007, which yielded proceeds of \$390,000.<sup>19</sup> Div. Exs. 23, 56-61, 148. A portion of that sum was transferred to Gualario & Co.'s trading account. Div. Exs. 23, 25. This was also used for options trading. Tr. 635. Additional notes were sold between April 5 and July 27, 2007, yielding \$240,000. Div. Exs. 20, 23, 24, 25, 62, 64, 65. Of the total raised up to that point, \$1.12 million, Gualario has repaid \$130,000.<sup>20</sup> Tr. 539, 669; Resp. Ex. 120. Thus, disregarding unpaid interest, his clients lost \$990,000 invested in the notes.<sup>21</sup>

### 3. Gualario's Use of the Proceeds from the Notes

There is no doubt that Gualario spent some of the proceeds on expenses related to launching the fund, such as professional services, computers, increased rent, and staff. Resp. Exs. 70, 71, 74, 75, 76, 82. Gualario's own list of one-time expenses amounted to \$539,000, and that sum is accepted as the amount spent to launch the fund. Resp. Ex. 89. A detailed list shows that \$1.04 million was spent from September 2006 until the end of 2007 on various specified categories, but half of the list, including such items as charitable giving, auto expenses, liquor, and restaurants, was irrelevant to starting the hedge fund, and the time frame was too long, far beyond the December 2006 launch date specified in the offering materials and the actual launch date in August 2007. Tr. 174-78; Resp. Ex. 95. Such expenditures were at variance with what Goldman understood from Gualario's representations on how the proceeds would be used. Tr. 174-78.

Gualario gave Lin access to all of the firm's data, including the notes, and told him to review everything the firm had done. Tr. 588, 680. However, he did not tell Lin how he had spent the proceeds of the notes. Tr. 588.

---

statements for the period November 1-30, 2006, shows the correct figure to be \$92,782.69. Div. Ex. 23 at SEC-NY-7870-007954 - 007963. The incorrect figure is also referenced in another summary exhibit, Division Exhibit 133g. The undersigned has not relied on Division Exhibits 132 or 133a through 133h.

<sup>19</sup> Inconsistently and illogically, Gualario denied that he sold additional notes to make up for the approximately \$300,000 of the first offering that he lost in trading. Tr. 533. (His alternative explanation was that he realized that launching the fund would cost \$1 million rather than \$500,000. Tr. 529-30.)

<sup>20</sup> Subsequently, note-holder Thomas G. Colacino (Colacino) invested an additional \$50,000 in a promissory note on November 2, 2007. Tr. 669; Resp. Ex. 120 at 1 and Ex. C. On February 13, 2008, Gualario paid Colacino \$200,000, which included \$130,000 in principal of his original notes, \$50,000 in principal of the November 2, 2007, note, and \$20,000 in interest. Tr. 669; Resp. Ex. 120 at 1.

<sup>21</sup> Gualario acknowledged that this value is correct. Tr. 669.



#### **4. What Did Gualario Tell Clients?**

As found above, Gualario told clients that the proceeds of the notes would be used only to launch the hedge fund. When soliciting clients for the first set of notes, Gualario did not disclose Gualario & Co.'s parlous financial condition. Tr. 142-46, 504-05. When soliciting clients for subsequent rounds of notes, he did not tell them that he had lost a portion of the funds raised from preceding rounds of notes through proprietary trading in options. Tr. 539. He has no specific memory of discussing the losses with anyone who invested in any of the notes. Tr. 539.

Gualario testified that it was his intent to use the proceeds of the notes to launch the hedge fund, not to trade options. Tr. 649. While this may have been his state of mind before he issued the first set of notes, his claimed intent is less believable as to the second set, which was issued after much of the proceeds of the first set were lost in options trading.

#### **C. Gualario SPX Select Fund, LP**

Gualario & Co. launched the hedge fund, Gualario SPX Select Fund, LP (the Fund), in August 2007. Tr. 438-39; Answer at 7, 8. Gualario Capital Partners, LLC (Gualario Capital Partners), of which Gualario was the Managing Member and sole owner, was the general partner; the limited partners were five pre-existing advisory clients of Gualario & Co. Tr. 439-40, 545, 568; Answer at 7, 8. Respondents raised \$7.1 million for the Fund from the five clients. Answer at 7. Gualario made all investment decisions for the Fund. Tr. 439. Gualario told the clients that he would use a strategy similar to that of his existing large cap equity accounts, with the addition of some short selling, referred to as a long/short U.S. equity large cap strategy. Tr. 545-63. A PowerPoint presentation that was provided to clients stated:

The Fund will take both long and short equity positions of select companies in the S&P 500 Index. . . . The investment strategies implemented for the Fund by Gualario & Co. will be an expansion of the investment strategies it uses for its Large-Cap Equity Composite. . . . Some of its risk management guidelines include: employment of adequate portfolio diversification to eliminate excess volatility; taking short positions as the preferred method for hedging a portfolio's systematic risk; and employment of stop loss measures. . . . The Fund is expected to generate better and more consistent returns than Gualario & Co.'s Large-Cap Equity Composite through the combination of its existing large-cap equity strategy and taking short positions, which essentially provide a natural hedge to the inherent market risk. This hedged profit is expected to generate greater Alpha with lower volatility.

Tr. 212-13; Div. Ex. 89 at 3, 7, 8. Gualario & Co.'s August 9, 2007, press release announcing the Fund's launch quoted Gualario: "As our primary focus remains asset protection, the Fund will provide a vehicle for our clients to earn consistent returns regardless of market direction and volatility as they benefit from our proven expertise in large-cap equity while being hedged against systemic risk." Div. Ex. 96.

Rapuano invested in the Fund. Tr. 196, 203; Div. Ex. 90. In reading the private placement memorandum, Rapuano noted that the discussion of risk factors, derivatives, leverage, and options trading suggested that the Fund was intended to be speculative; Gualario reassured him that this was boilerplate, that the Fund was not going to be highly speculative, and that the real risk was negligible.<sup>22</sup> Tr. 205-11, 218, 238-39; Div. Ex. 90. Gualario said his intention was to have the same strategy he used previously in the individually-managed accounts, with the addition of selling short. Tr. 210-11. Rapuano would not have invested his money in a highly risky venture. Tr. 211. Rapuano had discussed his assets with Gualario. Tr. 212, 216-17. He was concerned about the safety of his money in retirement. Tr. 218. Subsequently, Rapuano met in person with Gualario, who showed him the PowerPoint presentation. Tr. 212-13; Div. Ex. 89. Rapuano invested approximately \$740,000 in the Fund in late July or early August 2007. Tr. 215; Div. Ex. 99. That sum was about 20% of his assets and at least 40% of his liquid assets. Tr. 216. At that point, Gualario was in control of about two-thirds of Rapuano's liquid assets. Tr. 216.

In August 2007, as promised, the Fund traded exclusively long and short positions in common stock of large cap U.S. companies; it made a profit of approximately 9%. Tr. 323-24, 572. During September 2007, the Fund's risk profile increased as its position sizes became larger. Tr. 300-01, 321. In September, it incurred a loss of approximately 20%. Tr. 575. The Fund was profitable until a \$1.7 million loss on September 18. Tr. 305; Div. Ex. 127 at 6-7. Starting on September 24, 2007, the Fund changed from investing entirely in equities to investing almost exclusively in highly-speculative and extremely risky short-dated equity options.<sup>23</sup> Tr. 310-11, 326-27. Gualario did this, not as part of a hedging strategy, but because the Fund had little capital left following a massive losing day trade. Tr. 581-82. Gualario considered the option trading risky, with the Fund taking million dollar swings every few days. Tr. 582-83. He also abandoned any risk management measures, took overweighted positions in the Fund, and borrowed excessively on margin.<sup>24</sup> Tr. 584-85. This was not the strategy that Gualario had told investors that he was going

---

<sup>22</sup> In his Reply pleading and elsewhere, Gualario points to the boilerplate language as disclosure that the Fund could engage in trading in "a broad range of financial instruments, securities and transactions, including, without limitation, options, fixed income, derivatives, swaps, convertible securities of U.S. and non-U.S. issuers and other instruments" and "utilize a variety of investment techniques including, but not limited to, short selling, purchase and sale writing of options on securities (both covered and naked options), and the use of borrowed funds for investment purposes (i.e., leverage)." Div. Ex. 90 at SEC-NY-7870-005492.

<sup>23</sup> Short-dated options – options that will expire shortly – have a higher risk/return profile when their strike price is close to the price of the underlying common stock. The risk is that they will expire worthless, with the loss of the premium, in a short time. Because of the short time, very small changes in the stock price will determine whether they are valuable or worthless. Tr. 324-25. Div. Ex. 127 at 5-6.

<sup>24</sup> As the Division's expert witness, Brian Fitzpatrick, noted and Gualario acknowledged, the Fund's positions were overweighted and insufficiently diversified, which increased the risk that losses on short-dated equity options trading would prove catastrophic. The large position sizes magnified the overall risk of the equity options trades. Div. Exs. 113, 127, 128, 130, 131.

to use for the Fund. Tr. 583-84. By the end of October, the Fund had lost 98% of its value.<sup>25</sup> Tr. 583-85. For October, the Fund received about \$10,250 in management fees. Tr. 585; Answer at 13. The Fund collapsed in October 2007 and ceased operations in 2008. Answer at 8.

When Rapuano noted a 20% drop in the value of the Fund on reviewing his account statement for September 2007, he telephoned Gualario who assured him that it was a minor problem that would be resolved in the following month; Gualario said nothing about trading options, changing his trading strategy, or engaging in a more risky trading strategy. Tr. 218-21. On October 31, 2007, Rapuano learned that the account had lost 98% of its value. Tr. 221-24; Div. Ex. 113. In sum, he lost most of the money he invested in the Fund and the \$100,000 he invested in the note. Tr. 224. As of the time of the hearing, Rapuano had not received any restitution for his losses. Tr. 286-87. If Gualario refunded his losses, Rapuano probably would be willing to invest with him again. Tr. 253.

#### **D. Gualario Regrets Causing His Customers' Losses**

When Gualario established the Fund, he intended a long/short equity strategy and did not intend to trade options. Tr. 546-47, 685. Gualario did not personally profit from the events at issue; rather, he perceives the destruction of his business as a grievous loss. Tr. 663-65. Gualario repeatedly recognized the financial harm to customers that his actions have caused and his responsibility for their losses. Tr. 700, 703, 726; Div. Ex. 113. He hopes to pay the customers the money they lost. Tr. 667, 725. He has made this hope concrete in a written instrument that has been conveyed to the Fund investors. Tr. 246, 286-87; Resp. Ex. 112. However, he has not repaid any money as yet. Tr. 287.

In an e-mail sent to Fund investors on October 31, 2007, informing them that the Fund had lost 98% of its value, Gualario stated "I understand full well my fiduciary responsibilities to you and recognize that I failed you . . . ." Div. Ex. 113. He admitted:

[t]he fund was intended to be conservative in nature, utilizing a disciplined and well thought out long/short investment strategy. . . . During [October] our risk management measures went by the wayside, with particular positions overweighted, utilization of excessive margin, derivatives left uncovered, and a portfolio that resembled nothing like our investment model.

Id.

Gualario verbalizes that the conduct at issue was his responsibility. Tr. 433, 682, 689, 702. However, he also insinuates that Lin and Merlin Securities, LLC (Merlin Securities), Gualario & Co.'s introducing prime broker, share responsibility. Tr. 433, 516, 633-36, 642, 673, 680, 689, 702.

---

<sup>25</sup> The largest contributor to the Fund's losses in October was the purchase from October 17 to 19 of a series of put options of Google common stock, many of which expired worthless on October 19. Tr. 325, 327; Div. Ex. 127 at 9-10. The Fund lost over \$6 million on these trades, reducing its available capital to nearly zero. Tr. 326.

While Gualario insinuates that Lin was at least partly responsible for any violations, Lin was not employed at Gualario & Co. during 2006, when most of the notes were sold to customers. Further, while Gualario claims that Lin did not object to Gualario's use of the proceeds from the notes, there is no evidence in the record that Lin knew how Gualario was using the proceeds. Concerning the Fund, Lin had left Respondents' employment on September 14, 2007, before Gualario's final risky option trading. Also concerning the Fund, Gualario blamed Merlin Securities for encouraging him to overspend on new offices and to keep trading risky options.

### **E. Real Estate**

In addition to the discretionary large cap accounts, Gualario & Co. had non-discretionary (investment decisions made by the investor, not by Gualario) accounts that held non-publicly traded real estate holdings.<sup>26</sup> Tr. 430, 590. Respondents facilitated transactions in these accounts by effecting the sale of securities of several issuers to clients. Tr. 593-95; Div. Ex. 119. Gualario & Co. did not receive performance-based fees for these investments.<sup>27</sup> Div. Exs. 119, 123. Rather, it received one-time transaction-based fees equal to the lesser of 1% of the amount invested or \$1,000. Tr. 151-55, 590-91; Div. Ex. 123. Gualario provided investment advice to clients, when asked, concerning real estate investments. Tr. 596-97. Goldman is grateful for Gualario's advice, which helped him to avoid losses. Tr. 152, 159-61; Resp. Ex. 22.

Gualario maintains that he was told by a regulatory official that he could assist clients in the manner at issue here without registering with the Commission as a broker-dealer: he testified that he telephoned officials at the Commission and the NASD concerning this. Tr. 710-17; Resp. Exs. 50, 51, 52. Further, he testified that he does not remember details, but came away from a conversation with somebody, perhaps Afshin Atabaki (Atabaki) of the NASD's general counsel's office, with the feeling that he could facilitate real estate transactions in the manner at issue without registering as a broker-dealer. Tr. 710-17; Resp. Ex. 52. However, Atabaki does not remember this, and, further, the NASD's policy, now published on the website of its successor organization, FINRA, was to provide interpretive guidance relating to its own rules only (that is, not relating to statutes or Commission rules). Tr. 331-39; Div. Ex. 150. The Commission's records reflect calls from Gualario on November 22, 1999, and January 10, 2001, but neither of the calls concerned the type of conduct at issue.<sup>28</sup> Tr. 420-21; Div. Exs. 145, 146, 151. In sum, the record does not support

---

<sup>26</sup> Both Goldman and Rapuano had real estate investments through Gualario. Tr. 152, 159-61, 225-26; Div. Ex. 123.

<sup>27</sup> Gualario & Co. received performance-based fees for its discretionary large cap accounts. Tr. 433-38.

<sup>28</sup> The 1999 call concerned his connecting, for a percentage fee, investors with an Italian bank that was issuing bonds; Gualario was told he would probably be required to register. Div. Ex. 145, 151. Gualario withdrew from involvement in the transaction. Tr. 712. The 2001 call concerned his bringing two broker-dealer parties together, for a fee, with reference to some kind of securities issued by Deutsche Bank; he was told he would probably be required to register. Div. Exs. 146, 151. Gualario believes that the Commission's record of this call does not include

Gualario's contention, and it is found that he was not advised by anyone at the NASD or the Commission that he could assist clients in the manner at issue here without registering as a broker-dealer.

The OIP alleges that, from at least January 2006 through October 2007, Respondents received at least \$89,000 in transaction-based fees for facilitating real estate investments. The Division contends that, between January 2006 and July 2008, Respondents received \$145,624.17 in such fees, describing them as "single day fees," consisting of \$33,000 in fees equal to \$1,000, \$37,153.18 in fees under \$1,000, and \$75,470.99 in fees over \$1,000. Div. Ex. 134.<sup>29</sup> In his Reply, Gualario argues that approximately \$25,000 to \$45,000 is attributable to real estate transaction fees, but he does not point to any evidence of record to support this argument. Gualario & Co.'s TD Waterhouse and TD Ameritrade account statements show \$31,000 in single day fees equal to \$1,000 received from January 2006 through October 2007, the period alleged in the OIP. Tr. 590-93; Div. Ex. 25. It is found that fees of exactly \$1,000 are more likely than not to be real estate transaction fees. Single day fees that individually exceed \$1,000 cannot be real estate transaction fees, which were capped at \$1,000. Of the remaining category – single day fees under \$1,000 – while all could theoretically be real estate transaction fees, many are values, such as \$16.59 or \$73.59, that are unlikely to be such fees, and there is no additional evidence of record that shows the purpose of each credit to Gualario & Co.'s account. Accordingly, it is found that Gualario & Co. received \$31,000 in transaction-based fees for real estate investments from January 2006 through October 2007.

#### **F. Ability to Pay**

In testimony concerning his desire to repay investors, Gualario stated, "I am broke, basically, right now." Tr. 725. However, he has not otherwise asserted an inability to pay disgorgement, interest, or penalties. Nor has he introduced evidence to support such an assertion. Accordingly, Gualario has not demonstrated an inability to pay any disgorgement, interest, or penalties that may be ordered in this proceeding.

### **III. CONCLUSIONS OF LAW**

The OIP charges that Respondents willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act. Additionally, it charges that Gualario & Co. willfully violated and Gualario caused and willfully aided and abetted Gualario & Co.'s violation of Section 206(4) of the Advisers Act and Rule 206(4)-4(a)(1) thereunder. Finally, it charges that Respondents violated the broker-dealer registration provision, Section 15(a)(1) of the Exchange Act. As discussed below, it is concluded that they willfully violated those provisions.

---

an additional topic that was not resolved – his role in the real estate transactions – and that eventually it was resolved by his conversation with Atabaki. Tr. 714-16.

<sup>29</sup> Division Exhibit 134, a summary exhibit, has not been relied on except as a guide to the Division's contentions.

## **A. Antifraud Provisions**

Respondents are charged with willfully violating the antifraud provisions of the Securities, Exchange, and Advisers Acts – Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act – which prohibit essentially the same type of conduct. United States v. Naftalin, 441 U.S. 768, 773 n.4 & 778 (1979); SEC v. Pimco Advisors Fund Mgmt. LLC, 341 F. Supp. 2d 454, 469 (S.D.N.Y. 2004).

Section 17(a) of the Securities Act makes it unlawful “in the offer or sale of” securities, by jurisdictional means, to:

- 1) employ any device, scheme, or artifice to defraud;
- 2) obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary to make the statement made not misleading; or
- 3) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Similar proscriptions are contained in Exchange Act Section 10(b) and Rule 10b-5 and in Advisers Act Sections 206(1), 206(2), and 206(4).

Scienter is required to establish violations of Securities Act Section 17(a)(1), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Section 206(1). Aaron v. SEC, 446 U.S. 680, 690-91, 695-97 (1980); SEC v. Steadman, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). It is “a mental state embracing intent to deceive, manipulate, or defraud.” Aaron, 446 U.S. at 686 n.5; Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976); SEC v. Steadman, 967 F.2d at 641. Recklessness can satisfy the scienter requirement. See David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997); SEC v. Steadman, 967 F.2d at 641-42; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is “conduct which is ‘highly unreasonable’ and represents ‘an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.’” Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38, 47 (2d Cir. 1978) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977)).

Scienter is not required to establish a violation of Section 17(a)(2) or 17(a)(3) of the Securities Act or of Section 206(2) or 206(4) of the Advisers Act; a showing of negligence is adequate. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); SEC v. Steadman, 967 F.2d at 643 & n.5; Steadman v. SEC, 603 F.2d 1126, 1132-34 (5th Cir. 1979), aff’d on other grounds, 450 U.S. 91 (1981).

Gualario & Co. is accountable for the actions of its responsible officer, Gualario. See C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988) (citing A.J. White & Co. v.

SEC, 556 F.2d 619, 624 (1st Cir. 1977)). A company's scienter is imputed from that of the individuals controlling it. See SEC v. Blinder, Robinson & Co., Inc., 542 F. Supp. 468, 476 n.3 (D. Colo. 1982) (citing SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972)). As an associated person of Gualario & Co., Gualario's conduct and scienter are also attributed to the firm. See Section 203(e) of the Advisers Act.

Material misrepresentations and omissions violate Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1), 206(2), and 206(4). The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); SEC v. Steadman, 967 F.2d at 643.

Gualario, as owner, sole principal, president, and CEO of Gualario & Co., was an associated person of an investment adviser. See Advisers Act Sections 202(a)(17), 203(f). Investment advisers and their associated persons are fiduciaries. Fundamental Portfolio Advisors, Inc., Securities Act Release No. 8251 (July 15, 2003), 56 S.E.C. 651, 684; see Capital Gains Research Bureau, Inc., 375 U.S. at 191-92, 194, 201; see also Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979). As such, investment advisers and their associated persons are held to a higher standard than broker-dealers and their associated persons.

An associated person may be charged as a primary violator, where, as here, the investment adviser is an alter ego of the associated person. John J. Kenny, Securities Act Release No. 8234 (May 14, 2003), 56 S.E.C. 448, 485 n.54. Accordingly, as discussed below, the undersigned has concluded that Gualario violated Section 206(4) of the Advisers Act and Rule 206(4)-4(a)(1). Thus, it is unnecessary to address his secondary liability for violating those provisions.

In addition to requesting a cease-and-desist order pursuant to Sections 8A of the Securities Act, 21C(a) of the Exchange Act, and 203(k) of the Advisers Act and disgorgement pursuant to Sections 8A(e) of the Securities Act, 21C(e) of the Exchange Act and 203(j) of the Advisers Act, the Division requests sanctions pursuant to Sections 15(b) and 21B of the Exchange Act, 203(e), 203(f), and 203(i) of the Advisers Act, and 9(b) of the Investment Company Act. Willful violations by Respondents must be found in order to impose sanctions on them pursuant to Sections 15(b) and 21B of the Exchange Act, 203(f) and 203(i) of the Advisers Act, and 9(b) of the Investment Company Act. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. See Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Steadman v. SEC, 603 F.2d at 1135; Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

## **B. Antifraud Violations**

The record shows that Respondents violated the antifraud provisions by making material misstatements and omissions in the sale of the "Mortgage Bankers" note to Wilson, the sale of the Gualario & Co. notes, and the radical change in strategy in the Fund that was inconsistent with what clients were told when they invested and not disclosed to them subsequently.

When he sold Wilson the \$100,000 “Mortgage Bankers” note, Gualario knew that she was financially unsophisticated, that she trusted him and relied on his advice, and that she could ill-afford to lose her limited capital. Yet, although he knew that he was unable to pay the interest on the note, when she asked him why Mortgage Bankers was the issuer, he reassured her by saying that he would assume the note. Also, he did not tell her that \$50,000 of the proceeds was used to pay off a debt to Genduso. Further, he provided her with a form that represented falsely that Gualario & Co. had no business relationship with Mortgage Bankers. The fact that she did not read the form does not excuse his action in making the false representation. His actions show at least a reckless degree of scienter – highly unreasonable and an extreme departure from the standards of ordinary care – and a clear violation of the fiduciary duty owed by an investment adviser.

The Gualario & Co. notes were sold to investors with the representation that the proceeds would be used to launch the Fund. That representation was false. Even though a portion of the proceeds was used to launch the Fund, a substantial portion was devoted to other expenditures or lost in risky options trading. Further, Respondents did not tell investors in the second set of notes that a substantial portion of the proceeds of the first set had been lost in trading.<sup>30</sup> These misrepresentations and omissions were clearly material and made with at least a reckless degree of scienter.

While Respondents operated the Fund in accordance with representations made to investors for the first few weeks of its short life, they abandoned risk management completely on September 24, 2007, and changed from investing entirely in equities to investing almost exclusively in highly-speculative, extremely risky, short-dated equity options, took overweighted positions, and borrowed heavily on margin, resulting in losses that reduced the Fund’s value, from about \$6 million to close to zero by the end of October. The materiality of the change from the strategy represented to investors is shown by the fact that the Fund was essentially wiped out in one month. While Gualario points to boilerplate language in the offering materials allowing almost any type of investment, the thrust of the representations to investors is that the Fund would use a strategy similar to that of the existing large cap equity accounts, with the addition of some short selling. His total departure from that strategy in the face of limited losses in September made his previous representations materially misleading. Again, his actions show at least a reckless degree of scienter.

### **C. Registration Provision**

Section 15(a)(1) of the Exchange Act makes it unlawful for any entity to effect transactions in securities, by jurisdictional means, without registering as a broker or dealer, or, if a natural person, without being associated with a registered broker or dealer. “Broker” is defined in Section 3(a)(4) of the Exchange Act as “any person engaged in the business of effecting transactions in securities for the account of others.” 15 U.S.C. § 78c(a)(4). Scienter is not required to establish a violation of this provision. SEC v. Montana, 464 F. Supp. 2d 772, 785 (S.D. Ind. Nov. 22, 2006).

---

<sup>30</sup> Under the circumstances, this failure in itself violated Advisers Act Rule 206(4)-4, which was in effect during the relevant period.



Activities of a broker are characterized by “a certain regularity of participation in securities transactions at key points in the chain of distribution.” Massachusetts Fin. Servs., Inc. v. Sec. Investor Prot. Corp., 411 F. Supp. 411, 415 (D. Mass. Mar. 26, 1976), aff’d 545 F.2d 754 (1st Cir. 1976). Other factors that are relevant in determining whether an individual acted as a broker include whether the individual: “1) is an employee of the issuer; 2) received commissions as opposed to salary; 3) is selling, or previously sold, the securities of other issuers; 4) is involved in negotiations between the issuer and the investor; 5) makes valuations as to the merits of the investment or gives advice; and 6) is an active rather than passive finder of investors.” SEC v. Zubkis, 2000 WL 218393 at \*9 (S.D.N.Y. Feb. 23, 2000) (quoting SEC v. Hansen, 1984 WL 2413 at \*10 (S.D.N.Y. Apr. 6, 1984)). However, “transaction-based compensation” is “one of the hallmarks of being a broker-dealer.” SEC v. Kramer, 778 F. Supp. 2d 1320, 1334 (M.D. Fla. Apr. 1, 2011) (quoting Cornhusker Energy Lexington, LLC v. Prospect Street Ventures, 2006 WL 2620985 at \*6 (D. Neb. Sept. 12, 2006)).

#### **D. Registration Violations**

Respondents violated the registration provision in the sale of real estate investments to investors by receiving transaction-based fees for facilitating the investments. During the time at issue, Gualario & Co. was not registered as a broker or dealer, and Gualario was not associated with a registered broker or dealer. As payment for effecting the transactions in the real estate investments for their clients, Respondents received \$31,000 in commissions. Respondents facilitated the sale of securities of several different issuers, and they made valuations and gave investment advice to clients concerning the merits of real estate investments. As such, Respondents engaged in the business of effecting transactions in securities for the account of others in violation of Section 15(a)(1) of the Exchange Act. Their claim that regulators approved their doing this despite not being registered is unfounded and, in any event, is not a defense to the registration violation.

#### **IV. SANCTIONS**

The Division requests a cease-and-desist order,<sup>31</sup> disgorgement of \$1,225,873.84 plus prejudgment interest, a third-tier civil money penalty, and that Gualario be barred from the securities industry. As discussed below, Respondents will be ordered to cease and desist from violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act, to disgorge \$492,249.67 plus prejudgment interest, and to pay a third-tier civil penalty of \$390,000, and broker-dealer, investment adviser, and investment company bars will be imposed on Gualario.

---

<sup>31</sup> The Division is not requesting a cease-and-desist order against future violation of Advisers Act Rule 206(4)-(4) because that rule is no longer in force. The Commission removed it, effective October 12, 2010. Amendments to Form ADV, 75 Fed. Reg. 49234, 49269 (Aug. 12, 2010). The Commission stated that other rule amendments it adopted rendered Rule 206(4)-(4) “largely duplicative.” Id. at 49235.

## **A. Sanction Considerations**

In determining sanctions, the Commission considers such factors as:

the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman, 603 F.2d at 1140 (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. Marshall E. Melton, Advisers Act Release No. 2151 (July 25, 2003), 56 S.E.C. 695, 698. Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. Schild Mgmt. Co., Exchange Act Release No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862 & n.46. As the Commission has often emphasized, the public interest determination extends to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. See Christopher A. Lowry, Advisers Act Release No. 2052 (Aug. 30, 2002), 55 S.E.C. 1133, 1145, aff'd, 340 F.3d 501 (8th Cir. 2003); Arthur Lipper Corp., 46 S.E.C. 78, 100 (1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. See Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); see also Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

## **B. Sanctions**

### **1. Cease and Desist**

Sections 8A of the Securities Act, 21C(a) of the Exchange Act, and 203(k) of the Advisers Act authorize the Commission to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" any provision of those Acts or rules thereunder. Whether there is a reasonable likelihood of such violations in the future must be considered. KPMG Peat Marwick LLP, Exchange Act Release No. 43862 (Jan. 19, 2001), 54 S.E.C. 1135, 1185. Such a showing is "significantly less than that required for an injunction." Id. at 1183-91. In determining whether a cease-and-desist order is appropriate, the Commission considers the Steadman factors quoted above, as well as the recency of the violation, the degree of harm to investors or the marketplace, and the combination of sanctions against the respondent. See id. at 1192; see also WHX Corp. v. SEC, 362 F.3d 854, 859-61 (D.C. Cir. 2004).

Respondents' conduct was egregious and recurrent, continuing for more than one year. The conduct involved at least a reckless degree of scienter. The lack of assurances against future violations and recognition of the wrongful nature of the conduct goes beyond a vigorous defense of the charges. Gualario's attempt to displace blame onto Lin and Merlin Securities is an aggravating factor. His chosen occupation in the financial industry will present opportunities for future violations. The violations were neither recent nor remote in time, having ended about four

years ago. The degree of harm to the marketplace is quantified in the approximately \$8 million in proven losses to investors that resulted from Respondents' misconduct. In light of these considerations, a cease-and-desist order is appropriate.

## 2. Disgorgement

Sections 8A(e) of the Securities Act, 21C(e) of the Exchange Act, and 203(j) of the Advisers Act authorize disgorgement of ill-gotten gains from Respondents. Disgorgement is an equitable remedy that requires a violator to give up wrongfully-obtained profits causally related to the proven wrongdoing. See SEC v. First City Fin. Corp., Ltd., 890 F.2d 1215, 1230-32 (D.C. Cir. 1989); see also Hateley v. SEC, 8 F.3d 653, 655-56 (9th Cir. 1993). It returns the violator to where he would have been absent the violative activity.

The Division requests that Respondents be ordered to disgorge ill-gotten gains, including what the Division calculates as \$1,070,000 received from the sale of notes that has not been repaid, \$10,249.67 in advisory fees earned after Respondents radically changed, but failed to disclose, the Fund's investment strategy, and what the Division calculates as \$145,624.17 in real estate fees.

Respondents will be ordered to disgorge \$492,249.67, which includes: \$31,000 in transaction-based fees for real estate investments from January 2006 through October 2007;<sup>32</sup> \$10,249.67 in management fees for the Fund during October 2007, when Gualario engaged in transactions that were materially different from the strategy disclosed to investors; and \$451,000, representing the \$990,000 in unpaid principal owed on the promissory notes less the \$539,000 actually spent to launch the Fund. To the extent that Gualario adverts to taking distributions in lieu of salary, the Commission has the authority to order disgorgement of salary, and by extension, other forms of compensation. See Rita J. McConville, Exchange Act Release No. 51950 (June 30, 2005), 85 SEC Docket 3127, 3151 n.64, petition for review denied, 465 F.3d 780 (7th Cir. 2006); Gregory O. Trautman, Securities Act Release No. 9088 (Dec. 15, 2009), 97 SEC Docket 23492, 23529-32.

While as of the date of the hearing, Respondents had not repaid customers, Gualario has stated that he intends, or wishes, to repay customers for their losses that Respondents caused. Accordingly, disgorgement amounts will be reduced by any amounts that Respondents have paid the customers with respect to the conduct at issue here. See Laurie Jones Canady, Exchange Act Release No. 41250 (Apr. 5, 1999), 54 S.E.C. 65, 84, recon. denied, 54 S.E.C. 255 (1999), petition for review denied, 230 F.3d 362 (D.C. Cir. 2000). To this end, Respondents may submit an accounting showing any amounts they paid to customers with respect to the conduct at issue.

---

<sup>32</sup> The record evidence includes such fees for additional months beyond those specified in the OIP, January 2006 through October 2007. However, the Commission has not delegated its authority to administrative law judges to expand the scope of matters set down for hearing beyond the framework of the original OIP. See 17 C.F.R. § 201.200(d); J. Stephen Stout, 52 S.E.C. 1162 n.2 (1996). Accordingly, the disgorgement order will not include amounts received in the additional months.

Respondents will be held jointly and severally liable for the disgorgement because Gualario & Co. was Gualario's alter ego in the violative activities. See Daniel R. Lehl, Securities Act Release No. 8102 (May 17, 2002), 55 S.E.C. 843, 874-75 & n.65 (citing SEC v. First Pac. Bancorp, 142 F.3d 1186, 1191 (9th Cir. 1998) (citing SEC v. Hughes Capital Corp., 124 F.3d 449, 455 (3d. Cir. 1997); SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1475 (2d. Cir. 1996); Hateley, 8 F.3d at 656)).

### **3. Civil Money Penalty**

Sections 21B of the Exchange Act and 203(i) of the Advisers Act authorize the Commission to impose civil money penalties for willful violations of the Securities, Exchange, Advisers, or Investment Company Acts or rules thereunder. In considering whether a penalty is in the public interest, the Commission may consider six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) previous violations; (5) deterrence; and (6) such other matters as justice may require. See Sections 21B(c) of the Exchange Act and 203(i)(3) of the Advisers Act; New Allied Dev. Corp., Exchange Act Release No. 37990 (Nov. 26, 1996), 52 S.E.C. 1119, 1130 n.33; First Sec. Transfer Sys., Inc., 52 S.E.C. 392, 395-96 (1995); see also Jay Houston Meadows, Exchange Act Release No. 37156 (May 1, 1996), 52 S.E.C. at 787-88, aff'd, 119 F.3d 1219 (5th Cir. 1997); Consol. Inv. Servs., Inc., 52 S.E.C. 582, 590-91 (1996).

As to Respondents, there are no mitigating factors, and there are several aggravating factors. They violated the antifraud provisions, so their violative actions "involved fraud [and] reckless disregard of a regulatory requirement" within the meaning of Sections 21B(c)(1) of the Exchange Act and 203(i)(2) of the Advisers Act. Harm to others is quantified in the approximately \$8 million in losses caused to a handful of clients. One client, Wilson, even had to sell her house, move to a rundown apartment, and ask her relatives for money. Deterrence requires substantial penalties against Respondents because of the abuse of the fiduciary duty owed to advisory clients.

Penalties are in the public interest in this case. Penalties in addition to the other sanctions ordered are necessary for the purpose of deterrence. See Sections 21B(c)(5) of the Exchange Act and 203(i)(3)(E) of the Advisers Act; see also H.R. Rep. No. 101-616 (1990). The Division requests that Respondents be ordered to pay third-tier penalties, without specifying dollar amounts or units of violation. In addition to arguing that there were no violations, Respondents argue that civil penalties are not warranted, much less third-tier penalties. Third-tier penalties, as the Division requests, are appropriate because Respondents' violative acts involved fraud and resulted in substantial losses to other persons. See Sections 21B(b)(3) of the Exchange Act and 203(i)(2)(C) of the Advisers Act. Under those provisions, for each violative act or omission after February 14, 2005, the maximum third-tier penalty is \$130,000 for a natural person and \$600,000 for any other person. 17 C.F.R. §§ 201.1003. The provisions, like most civil penalty statutes, leave the precise unit of violation undefined. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435, 1440-41 (1979).

The events at issue will be considered as three courses of action – the violations arising from the sale of the “Mortgage Bankers” note to Wilson, from the sale of the Gualario & Co. notes, and from the operation of the Fund – resulting in three units of violation. Since Gualario & Co. was essentially a one-man operation and was Gualario’s alter ego in the violative activities, a total third-tier penalty amount of \$390,000 will be ordered against Respondents, jointly and severally.

#### 4. Bar

The Division requests an “industry bar.” Broker-dealer, investment adviser, and investment company bars are authorized pursuant to Sections 15(b) of the Exchange Act, 203(f) of the Advisers Act, and 9(b) of the Investment Company Act<sup>33</sup> and will be ordered.<sup>34</sup> Combined with other sanctions ordered, bars are in the public interest and appropriate deterrents. The violations involved scienter. Respondents’ business provides them with the opportunity to commit violations of the securities laws in the future. The record shows a lack of recognition of the wrongful nature of the violative conduct. Gualario’s attempt to deflect blame for his actions onto Lin and Merlin Securities is an aggravating factor. Respondents’ abuse of the trust placed in them by Wilson is particularly reprehensible.

### V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission’s Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on January 30, 2012, as corrected on February 10 and 13, 2012.<sup>35</sup>

---

<sup>33</sup> The fact that the hedge fund was not a registered investment company is not a barrier to imposing an investment company bar. See Zion Capital Mgmt. LLC, Securities Act Release No. 8345 (Dec. 11, 2003), 57 S.E.C. 99,110 n.27; see also Vladislav Steven Zubkis, Exchange Act Release No. 52876 (Dec. 2, 2005), 86 SEC Docket 2618, 2627, recon. denied, Exchange Act Release No. 53651 (Apr. 13, 2006), 87 SEC Docket 2584 (unregistered associated person of an unregistered broker-dealer barred from association with a broker or dealer).

<sup>34</sup> The Division’s request also includes a collateral bar pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). However, Gualario’s misconduct antedates the July 22, 2010, effective date of the Dodd-Frank Act. Neither the Commission nor the courts have approved such retroactive application of its provisions in any litigated case, and the undersigned declines to impose the new sanction retroactively. See Koch v. SEC, 177 F.3d 784 (9th Cir. 1999); see also Sacks v. SEC, 648 F.3d 945 (9th Cir. 2011).

<sup>35</sup> See Gualario & Co., LLC, Admin. Proc. No. 3-14340 (A.L.J. Feb. 10, 2012) (unpublished) (revising the description of a May 26, 2011, email from Gualario and adding two entries: a May 27, 2011, email to the parties and the Division’s July 25, 2011, Request for Subpoenas); (A.L.J. Feb. 13, 2012) (unpublished) (adding six entries: a May 19, 2011, letter from the Division to Gualario; a May 26, 2011, letter from Gualario to the Division; an August 31, 2011, email and letter from the Division to Gualario; two September 14, 2011, emails from Gualario requesting postponements; and a September 14, 2011, from the Division regarding the requests.

## VI. ORDER

IT IS ORDERED that, pursuant to Sections 8A of the Securities Act, 21C(a) of the Exchange Act, and 203(k) of the Advisers Act, Gualario & Co., LLC, and Ronald Gualario CEASE AND DESIST from committing or causing any violations or future violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act.

IT IS FURTHER ORDERED that, pursuant to Sections 8A(e) of the Securities Act, 21C(e) of the Exchange Act and 203(j) of the Advisers Act, Gualario & Co., LLC, and Ronald Gualario, jointly and severally, DISGORGE \$492,249.67 plus prejudgment interest at the rate established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), compounded quarterly, pursuant to 17 C.F.R. § 201.600(b). Pursuant to 17 C.F.R. § 201.600(a), prejudgment interest is due from November 1, 2007, through the last day of the month preceding which payment is made.

To the extent that Respondents can establish, through an accounting, that they have repaid customers amounts relating to the conduct that is the subject of this proceeding, the disgorgement amount will be reduced by these amounts. If Respondents do not provide an accounting within thirty days of the date of this Initial Decision, the disgorgement amount will remain fixed at that specified above. In the event that Respondents choose to submit an accounting, it shall be filed with the Commission's Secretary, with a copy to the Office of Administrative Law Judges, 100 F St., N.E., Washington, DC 20549-2557.

IT IS FURTHER ORDERED that, pursuant to Sections 21B of the Exchange Act and 203(i) of the Advisers Act, Gualario & Co., LLC, and Ronald Gualario, jointly and severally, PAY A CIVIL MONEY PENALTY of \$390,000.

IT IS FURTHER ORDERED that, pursuant to Sections 15(b) of the Exchange Act, 203(f) of the Advisers Act, and 9(b) of the Investment Company Act, Ronald Gualario is barred from association with any broker, dealer, or investment adviser and is prohibited, permanently, from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

Payment of penalties and disgorgement plus prejudgment interest shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission. The payment, and a cover letter identifying Respondents and Administrative Proceeding No. 3-14340, shall be delivered to: Office of Financial Management, Accounts Receivable, 100 F Street N.E., Washington, DC 20549-6042. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

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

---

Carol Fox Foelak  
Administrative Law Judge