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In the Matter of Weiss Research: Financial Newsletter Publisher Sanctioned as an Unregistered Investment Adviser

On June 22, 2006, in *In the Matter of Weiss Research, Inc.*,[1] the Securities Exchange Commission ("SEC" or the "Commission") issued a Cease-and-Desist Order (the "Order") against Weiss Research, Inc., a financial newsletter publisher, its owner, Martin Weiss ("Weiss"), and one of its principal editors, Lawrence Edelson ("Edelson"). The Commission found that Weiss Research failed to meet the "publishers' exemption" under Section 202(a)(11)(D) of the Investment Advisers Act of 1940 (the "Advisers Act"). Instead, because the company was engaged in the business of advising others concerning the buying and selling of securities in response to market activities, it met the definition of "investment adviser" as defined under Section 202(a)(11) of the Advisers Act. Accordingly, the Order found that Weiss Research violated: Section 203(a) of the Advisers Act, which requires investment advisers to register with the Commission and Section 206 of the Advisers Act, which requires investment advisers to exercise the utmost good faith in dealings with clients or prospective clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients or prospective clients.

I. BACKGROUND

The Investment Advisers Act of 1940 was adopted to correct the "problems and abuses" in investment counseling services.[2] The Act is meant to protect the public and investors against malpractice by individuals or organizations paid to advise others about securities.[3] If a person falls within the definition of "investment adviser," as set out in Section 202(a)(11) of the Advisers Act, and does not fit within any of the definition's exemptions or exclusions then that person is required to register with the SEC.[4]

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1 *In the Matter of Weiss Research, Inc.* ("*In re Weiss*"), Investment Advisers Act of 1940 Release No. 2525 (June 22, 2006), available at http://www.sec.gov/litigation/admin/2006/ia-2525.pdf.

2 S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940).

3 *See* Advisers Act § 203.

4 *See* Advisers Act § 203(a).

The Advisers Act makes it unlawful for any unregistered investment adviser, except those expressly excluded from the operation of the statute, to make use of the mails or any means or instrumentality of interstate commerce in connection with the investment adviser's business.[5] In addition to regulating adviser registration, the Act also prohibits fraudulent or deceptive practices by persons falling within the definition of "investment adviser."[6] The Act authorizes the SEC to initiate a judicial proceeding to impose a civil penalty for any violation of the Act or any rules or regulations under it.[7]

The statutory definition of investment adviser specifically excludes from its scope of coverage "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation."[8]

The U.S. Supreme Court addressed the scope of this exclusion in *Lowe v. SEC*.[9] That case involved Christopher Lowe ("Lowe") who was the president and principal shareholder of a corporation registered as an investment adviser under the Advisers Act. As a result of certain convictions against Lowe for various offenses involving investments, the SEC, after a hearing, ordered that his company's registration be revoked and that Lowe not associate with any investment adviser. The SEC later brought an action in federal court alleging that Lowe and the corporation were violating the Advisers Act and that Lowe was violating the SEC's order, by publishing, newsletters containing investment advice for paid subscribers. The Court concluded that Lowe's publication fell within the publishers' exclusion. In interpreting the exclusion, the Supreme Court first read the term "bona fide" to mean a "genuine" publication "in the sense that it would contain disinterested commentary and analysis as opposed to promotional material disseminated by a "'tout.'"[10] The Court then found that "[t]he Act was designed to apply to those persons engaged in the investment-advisory profession—those who provide personalized advice attuned to a client's concerns, whether by written or verbal communication."[11] Accordingly the Court held that Lowe was not an investment adviser as defined by the Act since the newsletters did "not offer individualized advice attuned to any specific portfolio or to any client's particular needs."[12]

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5 *See Id.*

6 *See* Advisers Act § 206.

7 *See* Advisers Act § 203(i).

8 *See* Advisers Act § 202(a)(11)(D).

9 472 U.S. 181 (1985).

10 *Id.* at 206.

11 *Id.* at 207-08.

12 *Id.* at 208.

In *In re Weiss*, the SEC similarly addressed the publishers' exclusion. Using *Lowe* as its guide, the Commission ruled that the exclusion only applies where the communications between the newsletters and its subscribers remain "'entirely impersonal and do not develop into the kind of fiduciary, person-to-person relationships that . . . are characteristic of investment advisers-client relationships.'"[13] The Commission also noted that the exemption will not apply if the publications are nothing more than "'personal communications masquerading in the clothing of newspapers, news magazines, or financial publications.'"[14]

II. FACTS AND PROCEDURAL HISTORY

Weiss Research is a newsletter publisher that published several different "premium services" newsletters providing subscribers with specific advice on the purchase of sale of securities. The company charged its subscribers between $1,000 and $5,000 for annual subscriptions to its "premium services" and it had approximately 10,000 subscribers to its newsletters from 2000 to 2004. Between 2001 and 2004 Weiss Research also helped potential subscribers choose the premium services that would best suit them. Weiss Research, however, never registered as an investment adviser with either the SEC or any state securities regulator.

Between 2001 and 2005, Weiss Research allowed its premium services subscribers to engage in "auto-trading." Subscribers who participated in auto-trading opened accounts at and executed auto-trading agreements with a broker-dealer from a list provided by Weiss Research. Under the agreements, subscribers directed the broker-dealers to automatically execute all transactions recommended by the Weiss Research premiums service newsletters without the need for pre-approval by the subscriber. As of December 31, 2003, Weiss Research's auto-trading subscribers had more than $30 million in assets in their auto-trading brokerage accounts.[15]

Weiss Research disseminated advertisements prepared by Weiss, Edelson and others, that were designed to attract new subscribers to its premium services and to convince existing subscribers to subscribe to additional premium services. The solicitations, however, selectively highlighted profitable trades, omitted specific references to unprofitable trades, and presented an unrealistic picture of the company's investment success. Additionally, the advertisements represented to subscribers and potential subscribers that they would be receiving expert trading advice from Edelson when in reality Edelson had nothing to do with selecting the recommendations. The false information provided in these advertisements were significant factors in subscribers' decisions to purchase the publications.

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13 *In re Weiss* at 5 (quoting *Lowe*, 472 U.S. at 210).

14 *Id.* (quoting *Lowe*, 472 U.S. at 209).

15 Having assets under management of at least $30 million is one of the criteria which triggers SEC registration for investment advisers. Investment advisers having less than $30 million in assets under management are not required to register with the SEC although they must register in the State in which they maintain their principal office and place of business. Advisers Act Rule 203A-1(a)(1).

The SEC brought cease-and-desist proceedings against Weiss Research pursuant to Sections 203(e) and (k) of the Advisers Act and against Weiss and Edelson pursuant to 203(f) and (k) of the Act. Anticipating the proceedings the Respondents submitted individual Offers of Settlement, which the SEC accepted, and they consented to the entry of the Order.

III. RATIONALE OF THE COMMISSION

First, the SEC found that Weiss Research met the definition of investment adviser under Section 202(a)(11) of the Advisers Act. The Commission found that Weiss Research was clearly an investment adviser since it was engaged in the business of advising others in the buying and selling of securities in response to market activity and charged a fee of up to $5,000 per year for this service.

Second, the SEC found that Weiss Research was precluded from relying on the publishers' exclusion as set out in section 202(a)(11)(D) of the Advisers Act. In deciding whether a newsletter may rely on the exclusion, the Commission found that certain factors are relevant such as "the existence of authority over the funds of subscribers; decision-making authority to handle subscribers' portfolios or accounts; or individualized, investment-related interactions with subscribers."[16] What distinguished Weiss Research from other newsletter publishers was its practice of engaging in personalized communications with its subscribers regarding its investment advice.[17] Additionally, the company, effectively, had investment discretion to purchase and sell securities on behalf of its auto-trading subscribers since broker-dealers would simply follow its recommendation as received.

Weiss Research was, therefore, required to register with the SEC. By failing to register, the company violated section 203(a) of the Advisers Act and Weiss, the president of the company, was found by the SEC to have willfully aided and abetted, and caused, that violation.

Additionally, the Commission noted that "Section 206 of the Advisers Act requires investment advisers to exercise the utmost good faith in dealings with clients or prospective clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients or prospective clients."[18] The Commission found that Weiss Research, in advertisements and other material drafted by Weiss and Edelson: (1) made inconsistent statements about the profitability and past performance of its premium service publication; and (2) made false statements concerning Edelson's involvement in

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16 *In re Weiss* at 5 (citing *Lowe*, 472 U.S. at 210 n. 57).

17 For example, Weiss Research provided a questionnaire on its website which inquired into matters such as a potential subscriber's age, income, cash holding, assets, tax status, investment experience, and objectives. After completing the questionnaire the potential subscriber received an automated evaluation from Weiss Research's website of his or her risk profile as well as a recommendation of whether Weiss Research's premium services would be appropriate for them. Weiss Research also had customer service representatives available to answer questions regarding premium services and it advertised that subscribers would receive private telephone numbers and e-mail addresses to contact Weiss and Edelson directly.

18 *Id.* at 6 (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963)).

choosing the investments. As a result, the SEC found that Weiss Research willfully violated Sections 206(2) and (4) of the Investment Advisers Act and Rule 206(4)-1(a)(5) and Weiss and Edelson willfully aided and abetted and caused the company's violations.

Last, the Commission found that Weiss Research violated, and Weiss and Edelson willfully aided and abetted and caused the company's violation of, Rule 206(4)-1(a)(2) under the Advisers Act, which makes it unlawful for an advertisement by an investment adviser to refer to any past specific recommendations without providing a complete list of all recommendations made within a year.

IV. REMEDIAL MEASURES AND PENALTIES

In determining whether to accept the Settlement Offers made by the Respondents, the Commission took into consideration the cooperation that the Respondents afforded the Commission staff as well as the voluntary remedial efforts made by Weiss Research, including that it: (1) ceased facilitating auto-trading for all subscribers and undertook that it will not resume unless it registered as an investment adviser[19]; (2) made available to current and potential subscribers the performance histories of each premium service; (3) established an internal compliance department to review marketing materials and procedures; and (4) established internal procedures to monitor the accuracy and performance of trading recommendations. The Commission also took into consideration that Weiss Research undertook to continue and maintain all of these remedial efforts.

In light of these remedial efforts, the Commission ordered that: (1) Weiss Research, Weiss and Edelson cease and desist from committing or causing any violations and any future violations of Sections 203(a), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1(a)(2) and (5) under the Act; (2) Weiss Research comply with the remedial efforts it had already undertaken; (3) Weiss Research pay disgorgement and prejudgment interest in the amount of $1,641,141 and a civil money penalty of $350,000; (4) Weiss pay disgorgement in the amount of $1.00 and a civil money penalty of $100,000; and (5) Edelson pay disgorgement in the amount of $1.00 and a civil money penalty of $75,000.

V. SIGNIFICANCE OF DECISION

Although *In re Weiss* does not break any new legal ground insofar as it applies long standing interpretations of the Advisers Act, the facts and circumstances of the case do underscore how the power and scope of internet-based communications can make possible scenarios that lead to regulatory violations under the Act. Up until several years ago, it would have been unthinkable that two individuals could render "personalized investment advice" to thousands of investors and, as part of that service, effectively control their investment decisions. That, however, is exactly what Weiss and Edelson were able to do simply using internet communications technology that is now in wide common use. The case, therefore, provides a useful cautionary example to publishers of investment newsletters of how not to conduct their business so as to cause the "publishers' exemption" from Advisers Act registration to become unavailable.

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19 Registration would either be with the SEC or with the appropriate State securities regulator.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Jonathan I. Mark at (212) 701-3100 or jmark@cahill.com; or John Schuster at (212) 701-3323 or jschuster@cahill.com.