

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4276 / November 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16968

In the Matter of

JH PARTNERS, LLC,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTIONS 203(e) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against JH Partners, LLC (“Respondent” or “JHP”).

II.

In anticipation of the institution of these proceedings, JHP has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, JHP consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that

Summary

These proceedings arise from negligent breaches of fiduciary duty by JHP, an investment adviser to several private equity funds (the "Funds"). From at least 2006 to 2012, JHP and certain of its principals loaned approximately \$62 million to the Funds' portfolio companies to provide interim financing for working capital or other urgent cash needs. By doing so, JHP and its principals in certain cases obtained interests in portfolio companies that were senior to the equity interests held by the Funds. JHP also caused more than one Fund to invest in the same portfolio company at differing priority levels and/or valuations, potentially favoring one Fund client over another. JHP did not adequately disclose to the advisory boards of the affected Funds the potential conflicts of interest created by the undisclosed loans and cross-over investments. Finally, JHP failed to adequately disclose to, or obtain written consent from, its client Funds' advisory boards when certain of their investments exceeded concentration limits in the Funds' organizational documents. Accordingly, JHP violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

Respondent

1. **JH Partners, LLC** ("JHP") is a Delaware limited liability company based in San Francisco, CA and has been registered with the Commission as an investment adviser since March 2012. JHP provides investment advice to three private equity funds, **JH Investment Partners, L.P.**, **JH Investment Partners II, L.P.**, and **JH Evergreen Fund, L.P.** As of March 31, 2015, JHP's total assets under management were \$465.4 million.

Other Relevant Entities

2. **JH Investment Partners, L.P.** ("Fund I"), **JH Investment Partners II, L.P.** ("Fund II"), and **JH Evergreen Fund, L.P.** ("Fund III" or "Evergreen Fund") (collectively, the "Funds") are Delaware limited partnerships formed in 2004, 2006, and 2008, respectively, with JHP as their investment adviser. The Funds' limited partners consisted of university endowments, other institutions, and high-net-worth individuals. The Funds primarily invested in lower to middle-market luxury consumer goods brands. A Delaware limited liability company that is under common control of JHP was named as each Fund's general partner in the Funds' organizational documents.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Background

3. Formed in 2004, JHP advises and sources potential investments for its Funds that invest in lower and middle-market consumer products companies.

4. JHP's Funds pursue investment strategies that are focused on investing in buyouts, spinouts, recapitalizations and other opportunities in the U.S. and abroad. The Funds were given broad authority to carry out their investment activity and could acquire or trade securities of every kind, including stocks, notes, bonds, debentures, and other evidences of indebtedness.

5. The limited partners in JHP's private equity funds include university endowments and other large institutional investors and high-net-worth individuals. The limited partners commit and subsequently contribute a specified amount of capital to the Funds for their use to make qualifying investments during the investment period.

6. JHP charges its Funds a management fee, which was 2.5% of committed capital during the Funds' investment period. JHP's affiliated general partners also receive a carried interest of up to 20-25% of the net profits realized by the limited partners in the Funds.

7. An advisory board, consisting of the representatives from the endowment limited partners, was formed for each Fund to consult on new investments, resolve potential conflicts of interest, approve valuations, and provide oversight over JHP.

8. The Funds' Limited Partnership Agreements ("LPAs") require consent of the advisory board for any investments in portfolio companies by the general partner or its principals. According to the LPAs, consent of the advisory board is also required when the general partner, its principals, or their affiliates transfer securities or assets to the Funds.

Undisclosed Direct Loans to the Portfolio Companies

9. From 2006 to 2012, JHP and certain of its principals provided nearly \$62 million in direct loans to the Funds' portfolio companies. By making these loans, JHP and its principals in certain cases obtained interests in portfolio companies that were senior to the equity interests held by the Funds. With few exceptions, JHP did not disclose to the Funds' advisory boards the existence of the direct loans or the potential conflicts of interest they created, nor did JHP obtain consent from the advisory boards.

10. For example, in one series of loans, JHP required a portfolio company to execute security agreements that pledged the assets of the company to JHP as collateral. The loans, which totaled \$2.9 million over a two-year period, funded the company's litigation against the founder and former CEO for allegedly violating his non-compete agreement.

Undisclosed Cross-Over Investments

11. From 2007 to 2012, JHP also failed to adequately disclose that it caused more than

one fund to invest in the same portfolio company at differing seniority or priority levels and/or valuations, potentially favoring one Fund client over another.

12. For example, Fund II and the Evergreen Fund both invested in the equity of one portfolio company but the Evergreen Fund's equity interests were senior to those of Fund II and had a liquidation preference. In addition, the Evergreen Fund extended tens of millions of dollars in loans to the same portfolio company, further elevating the seniority of that Fund's security interests over the interests held by Fund II. JHP did not adequately disclose to, or seek consent from, Fund II's advisory board that the Evergreen Fund would be investing in the same portfolio company.

Undisclosed Overconcentration in Certain Portfolio Companies

13. The Funds' LPAs provide that investments in any single company may not exceed 20% of each fund's committed capital without advisory board consent and that "in no event" may a single company investment exceed 30%. The LPAs also limit aggregate investments in foreign companies to 30% of Funds I and II and 50% of the Evergreen Fund. The LPAs further require that consents be documented by way of a written instrument with signatures from each advisory board member.

14. JHP, however, repeatedly exceeded the concentration limits without adequate disclosure or obtaining written consent. In one instance, Fund II invested over 30% of the committed capital in a foreign company, simultaneously violating two concentration limits, one for single company investments and another for foreign investments. Under the LPAs, exceeding the 30% limit for a single company investment could not be cured by advisory board consent but instead required a waiver by all limited partners. JHP did not seek the required waiver.

15. In addition, JHP caused the Funds to make a significant number of loans to the same portfolio companies that had already exceeded the concentration limits, without appropriate disclosure. Even though the loans increased the Funds' exposure to already overly-concentrated positions, JHP did not advise the advisory boards of this fact.

SEC Compliance Examination

16. In January 2013, following an SEC examination, JHP disclosed the transactions described above to the advisory boards of the affected Funds. In March 2013, JHP agreed to subordinate (or place in equal footing) the direct loans to the Funds' investment interests. It also agreed to forego any rights to pursue repayment under the security agreements on certain loans, and has waived to date \$24 million in management fees and carried interest. As part of the March 2013 agreement, the advisory boards of the affected Funds consented in writing to the direct loans, cross-over investments and investments exceeding both single company and international concentration limits.

Violations

17. Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging “in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.” A violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of *scienter* is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* As a result of the conduct described above, JHP willfully violated Section 206(2) of the Advisers Act.²

18. Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder make it unlawful for any investment adviser to a pooled investment vehicle to “[m]ake any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle” or “engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.” As a result of the conduct described above, JHP willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

JHP’s Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by JHP and cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Respondent JHP’s Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

- A. Respondent JHP cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.
- B. Respondent JHP is censured.

² A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing. It does not mean that, in addition, he must suppose that he is breaking the law.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). Instead, “it has been uniformly held that ‘willfully’ [in the securities law context] means intentionally committing the act which constitutes the violation,” and there is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

C. Respondent shall, within 15 days of the entry of this Order, pay a civil money penalty in the amount of \$225,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying JH Partners, LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Marshall Sprung, Co-Chief Asset Management Unit, Division of Enforcement, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, CA 90071.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based

on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary