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

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 3081 / August 31, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16223

In the Matter of SANDS BROTHERS ASSET MANAGEMENT, LLC, STEVEN SANDS, MARTIN SANDS, AND CHRISTOPHER KELLY	ORDER ON MOTIONS FOR SUMMARY DISPOSITION

The Securities and Exchange Commission commenced this proceeding on October 29, 2014, with an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) against Respondents, pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940. The OIP alleges that: Sands Brothers Asset Management, LLC (SBAM), a registered investment adviser, willfully violated Advisers Act Section 206(4) and Rule 206(4)-2 because, for fiscal years 2010 to 2012, it failed to undergo surprise audits or timely distribute audited financial statements to investors of pooled investment vehicles managed by SBAM as an alternative means of compliance; and the other Respondents willfully aided, abetted, and caused SBAM's violations. OIP at 1-2, 5-7.

At the initial prehearing conference, I set a briefing schedule for motions for summary disposition. *Sands Bros. Asset Mgmt., LLC*, Admin. Proc. Rulings Release No. 2074, 2014 SEC LEXIS 4574 (Dec. 2, 2014). This schedule was later applied to Christopher Kelly after he did not proceed with an offer of settlement. *Sands Bros. Asset Mgmt., LLC*, Admin. Proc. Rulings Release No. 2166, 2014 SEC LEXIS 5014 (Dec. 24, 2014). The Division of Enforcement and Kelly have each moved for summary disposition. Following the disqualification of SBAM's original counsel, new counsel for SBAM appeared in this proceeding, and I gave the parties the opportunity for additional briefing. Briefing is now complete.[1]

[1] The Division filed its motion against all Respondents, with a declaration (Brown Jan. Decl.) and forty-five exhibits (Div. Exs. 1-45). Kelly filed his motion (Kelly Motion), with nine exhibits (Kelly Exs. 1-9). Thereafter, Kelly filed an opposition to the Division's motion (Kelly Opp.), with an affidavit (Kelly Aff.) and four exhibits (Kelly Opp. Exs. 1-4); Martin and Steven Sands filed a joint opposition to the Division's motion (Sands Opp.), with a single exhibit (Sands, Ex. A); and SBAM filed an opposition (SBAM Opp.), with no supporting exhibits. Also, the Division filed an opposition to Kelly's motion, with a declaration attached to which are

I. Summary Disposition Standard

A motion for summary disposition may be granted if there is no genuine issue with regard to any material fact and the party making the motion is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(b). The facts on summary disposition must be viewed in the light most favorable to the non-moving party. *See Jay T. Comeaux*, Securities Act of 1933 (Securities Act) Release No. 9633, 2014 SEC LEXIS 3001, at *8 (Aug. 21, 2014). However, once the moving party has carried its burden of establishing that it is entitled to summary disposition on the factual record, the opposing party may not rely on bare allegations or denials, but instead must present specific facts showing a genuine issue of material fact for resolution at a hearing. *See id.*; *accord Jeffrey L. Gibson*, Securities Exchange Act of 1934 (Exchange Act) Release No. 57266, 2008 SEC LEXIS 236, at *22 (Feb. 4, 2008), *pet. denied*, 561 F.3d 548 (6th Cir. 2009). Thus, summary disposition may be appropriate in non-follow-on proceedings. *E.g.*, *S.W. Hatfield, CPA*, Exchange Act Release No. 73763, 2014 WL 6850921, at *9 (Dec. 5, 2014); *Gordon Brent Pierce*, Exchange Act Release No. 71664, 2014 WL 896757, at *7-8 (Mar. 7, 2014), *pet. denied*, 786 F.3d 1027 (D.C. Cir. 2015); *China-Biotics, Inc.*, Exchange Act Release No. 70800, 2013 WL 5883342, at *16 (Nov. 4, 2013).

In considering the Division's motion for summary disposition, Respondents' Answers have been taken as true, except as modified by stipulations or admissions made by them, by uncontested affidavits, and by facts officially noticed pursuant to Rule of Practice 323, which includes any matter in the Commission's public official records. *See* 17 C.F.R. §§ 201.250(a), .323. Conversely, in considering Kelly's motion, the OIP has been taken as true, except as modified by stipulations or admissions made by the Division, by uncontested affidavits, and by facts officially noticed. *See id.*

Thus, the OIP's allegations that were not denied by Respondents' Answers have been deemed true. *See* 17 C.F.R. § 201.220(c). Sworn statements, such as declarations, certifications, and attestations, are equivalent to affidavits. *E.g.*, Div. Exs. 2, 19; *see Allen v. Potter*, 152 F. App'x 379, 382 (5th Cir. 2005). Official notice has been taken of the various regulatory proceedings involving Respondents. *See, e.g.*, *Gregory Evan Goldstein*, Exchange Act Release No. 71970, 2014 WL 1494527, at *1 n.1, *3 n.12 (Apr. 17, 2014) (official notice may be taken of public records of discipline by FINRA).

A statement by a party, or by a party's agent, or that a party agrees is true, constitutes an admission within the meaning of Rule of Practice 250. *See Wheat, First Sec., Inc.*, Exchange Act Release No. 48378, 2003 WL 21990950, at *12 & n.55 (Aug. 20, 2003) (citing Federal Rule of Evidence 801(d)(2)). Thus, statements by a party or a party's agent in a brochure, on the SBAM

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sixteen exhibits (Berke Feb. Decl., Exs. A-P), and a second declaration attached to which are six exhibits (Brown Feb. Decl., Exs. 1-6). The Division filed a reply in support of its motion, with a declaration and two exhibits (Div. Reply Exs. 1-2); and Kelly filed a reply in support of his motion (Kelly Reply), with two exhibits. Lastly, SBAM filed a supplemental brief (SBAM Supp.), Martin and Steven Sands filed a joint supplemental brief (Sands Supp.), and Kelly filed a supplemental brief (Kelly Supp.), to which were attached four exhibits.

website, in investigative testimony, or in an email or letter, are all admissions and have been considered against that party. *E.g.*, Div. Ex. 1 (SBAM brochure); Div. Ex. 3 (SBAM website); Div. Ex. 6 (Kelly investigative testimony); Div. Exs. 26, 27, 32 (emails from Kelly communicating statements by Martin Sands). By contrast, exhibits that do not contain admissions have not been considered as evidence against Respondents (although they have been considered in opposition to the Division's motion). Such exhibits include letters and emails containing no statements by parties (Div. Exs. 14, 25, 29, 30, 37, 44), auditor reports and engagement letters (except to the extent they contain admissions, as indicated by signatures) (Div. Exs. 17, 18, 21, 23), and invoices (Div. Exs. 22, 24, 34, 35). The investigative testimony and report of Richard Slavin (Div. Exs. 9, 10; Sands, Ex. A) has been considered, but only those portions that constitute admissions, such as testimony recounting conversations between Slavin and Kelly.

The parties' motion papers and all documents and exhibits of record have been fully reviewed and carefully considered. All arguments and proposed findings and conclusions that are inconsistent with this decision were considered and rejected.

II. Background

A. Respondents

SBAM is a New York limited liability company, has been a registered investment adviser since 1998, and provides advisory services to pooled investment vehicles, i.e., a series of funds. OIP ¶¶ 3, 11; SBAM & Sands Answer ¶¶ 3, 11. It has approximately $64 million in assets under management. Div. Ex. 2 at 32.[2] At issue is SBAM's late distribution of the audited financial statements of ten funds under SBAM's management.[3] OIP ¶ 20; SBAM & Sands Answer ¶ 20; Div. Ex. 1 at 3-5. Cornick, Garber & Sandler, LLP, served as the auditing firm for these financials. *See* Div. Ex. 6 at 30-31.

Martin and Steven Sands (collectively, the Sands) founded SBAM, are the firm's principals and two of its control persons, and act as senior portfolio managers. OIP ¶¶ 4-5; SBAM & Sands Answer ¶¶ 4-5; Div. Ex. 5 at 125-26.[4] They have ultimate responsibility for SBAM's management of funds. Div. Ex. 10 at 61 (discussing Div. Ex. 9 at 3). Their families

[2] Cited page numbers are the written numbers located in the upper left corner of the document.

[3] The ten funds at issue consist of: 1) seven venture capital funds, namely Sands Brothers Venture Capital LLC (SBVC I), Sands Brothers Venture Capital II LLC (SBVC II), Sands Brothers Venture Capital III LLC (SBVC III), Sands Brothers Venture Capital IV LLC (SBVC IV), 280 Ventures LLC (280 Ventures), Granite Associates LLC (Granite), and Katie and Adam Bridge Partners LLC (K&A); 2) two asset-based lending funds, namely Genesis Merchant Partners, LP (Genesis I), and Genesis Merchant Partners II, LP (Genesis II); and 3) a distressed debt fund, Vantage Point Partners, LP (Vantage). OIP ¶ 20; Div. Ex. 1 at 3-5.

[4] Cited page numbers are the written numbers located in the upper left corner of the document.

are beneficiaries of two trusts that are SBAM's sole members. OIP ¶ 3; SBAM & Sands Answer ¶ 3; Div. Ex. 1 at 3; Div. Ex. 5 at 125-26. The Sands have been the subject of disciplinary proceedings and sanctions by state authorities and self-regulatory organizations, as well as customer complaints concerning misappropriation of assets, one of which resulted in an arbitration award of over $2 million. OIP ¶¶ 4-5; SBAM & Sands Answer ¶¶ 4-5; Div. Ex. 4 (Steven Sands CRD Report at 15-48, Martin Sands CRD Report at 17-84).[5]

Kelly was SBAM's chief compliance and chief operating officer from 2008 until May 2014. OIP ¶ 6; Kelly Answer at 2; Div. Ex. 6 (Kelly Tr. 8). SBAM's 2012 Form ADV, which Kelly prepared and signed, identifies him as a control person of SBAM, along with the Sands. Div. Ex. 5 at 125-28, 146; Div. Ex. 6 (Kelly Tr. 45-46). Kelly was responsible for SBAM's compliance and for operations that did not involve investment decision-making. Div. Ex. 10 (Slavin Tr. 61-62); *see* Div. Ex. 6 (Kelly Tr. 10). Before joining SBAM, Kelly worked as a corporate and regulatory attorney in private practice from 1983 to 2003, and then served as general counsel and/or chief compliance officer for broker-dealer and investment adviser entities. Div. Ex. 7 (Kelly CRD at 4)[6]; Div. Ex. 8 at 1, 4. Kelly previously held a series 7 license. Div. Ex. 6 (Kelly Tr. 7); Div. Ex. 7 at 5.

B. Custody Rule

Under Advisers Act Section 206(4), it is unlawful for an investment adviser, by use of the mail or any means or instrumentality of interstate commerce, to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. 15 U.S.C. § 80b-6(4).

Advisers Act Rule 206(4)-2 – the custody rule – specifies that it is an illegal practice or course of business within the meaning of Section 206(4) for an investment adviser to have custody of client funds or securities unless, in relevant part, the adviser: 1) notifies clients of the account information and location of the qualified custodian maintaining the client assets (notice requirement); 2) has a reasonable basis for believing that the qualified custodian sends quarterly account statements to each of the adviser's clients for which the custodian maintains assets (account requirement); and 3) undergoes an annual surprise examination by an independent public accountant to verify the client assets in custody (surprise audit requirement). 17 C.F.R. § 275.206(4)-2(a)(2), (3), (4). Alternatively, an adviser to a pooled investment vehicle is not required to comply with the notice and account statement requirements, and deemed to have complied with the surprise audit requirement, if the adviser distributes audited financial statements to all limited partners of the fund within 120 days of the fund's fiscal year end (distribution exception).[7] 17 C.F.R. § 275.206(4)-2(b)(4).

C. Prior Deficiencies and the Commission's 2010 Cease-and-Desist Order

[5] Cited page numbers are the written numbers located in the upper right corner of the document.

[6] Cited page numbers are the written numbers located in the upper right corner of the document.

[7] It is undisputed that each fund's limited partners are the fund investors in this context.

In 1999, the Commission's Office of Compliance Inspections and Examinations (OCIE) issued a deficiency letter to SBAM. Div. Ex. 12. The letter noted, among other things, that based on an OCIE examination, SBAM appeared to have custody and possession of client assets, which was contrary to the representation in the firm's 1998 Form ADV. *Id.* at 1-2. The letter further laid out custody rule requirements that were then in effect. *Id.* at 3-4.

In 2009, OCIE sent a request, directed to Kelly, for information relating to SBAM's distribution to investors of the 2007 audited financial statements of private funds managed by SBAM. Div. Ex. 13. SBAM's responsive documents showed that its distribution of audited financials to investors were past the 120-day deadline. *Id.*

In 2010, pursuant to an offer of settlement, SBAM and the Sands consented to the entry of a cease-and-desist order and imposition of sanctions against them, without admitting or denying the findings therein. Div. Ex. 15. Kelly signed the offer of settlement on behalf of SBAM. Div. Ex. 16 at 8. The Commission found that:

- SBAM willfully violated the custody rule because, as the staff's exam revealed, the year-end 2007 financial statements for eight funds and four funds-of-funds managed by SBAM were not distributed to investors in accordance with the custody rule. Div. Ex. 15 ¶¶ 4, 9, 13(c). Specifically, because SBAM did not satisfy the distribution exception, it was obliged to comply with the account statement or surprise audit requirement under the custody rule provisions in effect at the time, which it failed to do.[8] *Id.* ¶¶ 7-9.

- The Sands were SBAM's lead principals, and they willfully aided, abetted, and caused SBAM's violations. *Id.* ¶¶ 4, 13(e).

As a result, the Commission censured SBAM and the Sands, and further ordered them to "cease and desist from committing or causing any violations and any future violations of," among other provisions, the custody rule. *Id.* at 6. The Commission also ordered SBAM to pay a $60,000 civil penalty. *Id.*

Meanwhile, in 2009, SBAM retained Richard Slavin as an independent compliance consultant, pursuant to a stipulated order of the Connecticut Department of Banking, which resulted from allegations that Martin Sands failed to disclose to state regulators securities-related complaints, actions, or proceedings against him in violation of a prior state directive. Div. Ex. 11; Sands, Ex. A (Slavin Tr. 10, 26). In connection with his consulting role, Slavin interviewed

[8] At the time of the 2007 financials, the distribution exception was under Rule 206(4)-2(b)(3), as cited in the 2010 order. That exception is now under Rule 206(4)-2(b)(4), pursuant to 2010 amendments. *See* 17 C.F.R. § 275.206(4)-2(b)(4); Custody of Funds or Securities of Clients by Investment Advisers, 75 Fed. Reg. 1456, at 1466, 1484-85 (Jan. 11, 2010) (codified at 17 C.F.R. pts. 275 & 279). Those amendments also made the surprise audit requirement applicable to all registered investment advisers with custody of client assets, whereas previously it was an alternative to the account statement requirement. 75 Fed. Reg. 1456, at 1457-60, 1484.

Kelly and other SBAM employees, sought to overhaul SBAM's compliance program, and tested Kelly on SBAM's obligations. Sands, Ex. A (Slavin Tr. 28-29, 41); Div. Ex. 10 (Slavin Tr. 130-31). The issues described in the Commission's 2010 Order, however, were beyond the scope of Slavin's engagement, and although he recalled reviewing the custody rule with Kelly, he was not hired to specifically address custody rule compliance. Sands, Ex. A (Slavin Tr. 89-90); Div. Ex. 10 (Slavin Tr. 130-31).

III. Discussion

A. SBAM Violated Advisers Act Section 206(4) and Rule 206(4)-2

For fiscal years 2010 to 2012, SBAM had custody of client assets, but did not undergo surprise audits. OIP ¶ 19; SBAM & Sands Answer ¶ 19. Thus, to comply with the custody rule, SBAM had to fulfill the requirements of the distribution exception. *See* 17 C.F.R. § 275.206(4)-2(a)(4), (b)(4).

Respondents either concede or do not dispute that for fiscal years 2010 to 2012, SBAM failed to distribute audited financial statements of the ten funds within 120 days after the end of each fund's fiscal year, pursuant to the distribution exception. SBAM Opp. Br. at 3; Kelly Opp. at 12; *compare* OIP ¶¶ 19-20, *with* SBAM and Sands Answer ¶¶ 19-20, *and* Kelly Answer at 2; *see generally* Sands Opp. Br. Specifically, audited financial statements for the fiscal year 2010 were distributed at least forty days late, audited financial statements for the fiscal year 2011 were distributed at least 191 days late, and audited financial statements for the fiscal year 2012 were distributed at least eighty-four days late. *See* OIP ¶ 20; SBAM and Sands Answer ¶ 20; Kelly Answer at 2.

Scienter is not required to establish a violation of Section 206(4) and rules thereunder. *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992). Accordingly, SBAM violated Advisers Act Section 206(4) and Rule 206(4)-2. And as a result of its violations, SBAM violated the Commission's 2010 Order. *See* Div. Ex. 15 at 6.

B. Aiding, Abetting, and Causing Liability of the Sands and Kelly

Aiding and abetting liability is proven where: 1) there was a primary violation; 2) the alleged aider and abettor provided substantial assistance to the primary violator; and 3) the alleged aider and abettor provided such assistance with the necessary state of mind. *See Graham v. SEC*, 222 F.3d 994, 1000 (D.C. Cir. 2000); *Phlo Corp.*, Exchange Act Release No. 55562, 2007 SEC LEXIS 604, at *35 (Mar. 30, 2007). The substantial assistance prong is satisfied by a respondent's failure to act where he "has a clear duty to act and the failure to act itself constitutes the underlying primary violation." *vFinance Invs., Inc.*, Exchange Act Release No. 62448, 2010 SEC LEXIS 2216, at *44-45 (July 2, 2010); *see Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983) (recognizing that inaction may be treated as substantial assistance when "it was in conscious and reckless violation of a duty to act"). Where the respondents are fiduciaries or active participants, the state of mind requirement for aiding-and-abetting liability is satisfied by recklessness. *See Geman v. SEC*, 334 F.3d 1183, 1195-96 (10th Cir. 2003); *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990). It is undisputed that the Sands and Kelly were fiduciaries to the

funds managed by SBAM. *See Fundamental Portfolio Advisors, Inc.*, 56 S.E.C. 651, 684 (2003) (investment advisers and associated persons are fiduciaries), *pet. dismissed*, 167 F. App'x 836 (2d Cir. 2006); *see also* 15 U.S.C. § 80b-2(a)(17) (definition of associated persons).

Causing liability requires proof that: 1) there was a primary violation; 2) an act or omission by the respondent was a cause of the violation; and 3) the respondent knew, or should have known, that his conduct would contribute to the violation. *Robert M. Fuller*, 56 S.E.C. 976, 984 (2003), *pet. denied*, 95 F. App'x 361 (D.C. Cir. 2004); *see* 15 U.S.C. § 80b-3(k)(1). Negligence is sufficient to establish liability for causing a primary violation that does not require proof of scienter. *See KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1175 & n.100 (2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002). "One who aids and abets a primary violation is necessarily a 'cause' of the violation." *Ronald S. Bloomfield*, Exchange Act Release No. 71632, 2014 SEC LEXIS 698, at *63 (Feb. 27, 2014).

As already established, SBAM committed primary violations of Advisers Act Section 206(4) and Rule 206(4)-2.

1. The Sands and Kelly Had Clear Duties to Act

SBAM's compliance manual designated the Sands as the firm's managers and provided that they "shall be responsible for ensuring that the Firm provides adequate resources to the persons with the responsibilities for implementing an effective compliance program for the Firm." Div. Ex. 39 at 1. The compliance manual tasked Kelly, as chief compliance officer, with the responsibility to "ensure compliance with the restrictions and requirements of" the custody rule. *Id.* at 1, 18-19. He also was responsible for reviewing SBAM's compliance policies and procedures, and for making changes to such policies and procedures when necessary. *Id.* at 1. Notably, Kelly revised the manual after his arrival at SBAM. Div. Ex. 8 at 6. Kelly knew that he was responsible for SBAM's operations that did not involve investment-decision making. Div. Ex. 10 (Slavin Tr. 61-62). Thus, the undisputed evidence establishes that the Sands had a clear duty to provide adequate resources for the compliance program, and Kelly had a clear duty to ensure custody rule compliance and make appropriate changes if the firm was noncompliant.

In the wake of Commission's 2010 Order, there can be no reasonable dispute that the Sands and Kelly were on notice about the custody rule and the importance of complying with it. Moreover, the compliance manual set forth the custody rule's 120-day distribution deadline. Div. Ex. 39 at 18-19. Generally speaking, the manual specified that employees are to annually certify an acknowledgement and agreement to abide by the firm's compliance policies and procedures; and that employees are required to maintain, among other standards, compliance with the federal securities laws. *Id.* at 2, 4, Ex. A-1-A-2. In early April 2011, the Sands and Kelly all acknowledged that they had read and understood the information contained in the compliance manual, were "aware of all laws, rules and regulations applicable to [them], and undert[ook] to continue to remain informed about all relevant compliance requirements." Div. Ex. 40 (signed acknowledgements of the Sands and Kelly ¶ 2). They also certified that they would abide by "all rules, restrictions, policies and procedures described in the [m]anual," and that they attended annual compliance training. *Id.* (signed acknowledgements of the Sands and Kelly ¶¶ 3, 9).

It is undisputed that the Sands and Kelly were engaged in the audit process each year. At the outset of the audits for fiscal years 2010 to 2012, Kelly signed engagement letters on behalf of SBAM, to retain Cornick Garber. *See* Div. Ex. 17. Those letters made clear that company management was responsible for establishing and maintaining a sound system of internal controls to prevent or detect legal violations, and for ensuring compliance with applicable laws. *See id.* During the course of the audits, the Sands and Kelly were in regular contact with the auditors and involved in the process; participated in conference calls with them; and, either directly or through other firm employees, answered the auditors' questions and provided the auditors with requested financial information and appraisals. *See* Div. Exs. 41-42; *see also* Div. Ex. 6 (Kelly Tr. 15-16, 42, 54-55). Kelly also signed and submitted information about certain portfolio companies in which funds were invested. Div. Ex. 43.

Importantly, at the close of the audits, the Sands and Kelly signed management representation letters, acknowledging their "responsibility for the preparation and fair presentation of the financial statements . . . ." Div. Ex. 31 (Letters ¶ 6). The auditors would not finalize and release the audit reports until those management representation letters were signed. Div. Exs. 26, 27. Thus, by virtue of their positions and given the undisputed evidence, the Sands and Kelly had a clear duty to sign these management representation letters. Failure to do so would prevent timely release of the audit reports.

That Sands delegated compliance responsibility to Kelly does not create a genuine issue for hearing. For purposes of summary disposition, I accept that the Sands could have reasonably delegated the compliance function to Kelly, and, in doing so, they would not be responsible insofar as they neither knew nor had reason to know of compliance deficiencies. *See Consol. Inv. Servs., Inc.*, 52 S.E.C. 582, 590 & n.30 (1996) (setting forth this delegation principle in the broker-dealer context); Div. Reply Ex. 1 at 5-7 (the Sands' acknowledgment of the application of this delegation principle to them).[9] The Sands were not only fiduciaries to the funds, but SBAM's principals and co-managers. OIP ¶¶ 4-5; SBAM & Sands Answer ¶¶ 4-5; Div. Ex. 5 at 125-26; *supra* section III.B.

As such, there can no reasonable dispute that at the point they knew or had reason to know of repeated compliance deficiencies, they had a duty to act. Rule 206(4)-7 specifically requires that investment advisers adopt written compliance policies and procedures, annually review the adequacy of those policies and procedures and their effectiveness, and designate a chief compliance officer who is a supervised person. 17 C.F.R. § 275.206(4)-7. The Sands are not charged with a violation of this rule. However, their fiduciary obligations and these compliance requirements demonstrate that the Sands had a clear duty to act if they knew or had reason to know of compliance deficiencies, and to follow-up on the delegation of compliance responsibility to Kelly. Also, in delegating such responsibility, "[i]mplicit is the additional duty to follow-up and review that delegated authority to ensure that it is being properly exercised." *Rita H. Malm*, 52 S.E.C. 64, 73 (1994) (citation omitted). The Sands could not "simply wash [their] hands of the matter until a problem [was] brought to [their] attention." *Id.*; *see Johnny*

[9] Cited page numbers are the written numbers located in the upper left corner of the document.

Clifton, Securities Act Release No. 9417, 2013 SEC LEXIS 2022, at *49 (July 12, 2013) (respondent "retained a duty to follow-up on that delegation, which he failed to do").

2. Martin Sands' Responsibility for the Late 2010 Financials of Five Funds

The 2010 audited financial statements of five funds—namely Vantage, SBVC I, K&A, Granite, and 280 Ventures—were completed before the April 30, 2011, distribution deadline, but were not released until June 9, 2011. Div. Exs. 26-27, 31 at tab FY 2010; OIP ¶ 20(a); SBAM and Sands Answer ¶ 20; Kelly Answer at 2. This is because Martin Sands did not sign management representation letters for those funds' audits until June 9, 2011, when he signed the letters for all ten funds; the audits were not released until that day. Div. Exs. 18, 31.

Email correspondence establishes that Martin Sands was responsible for the untimely distribution. On April 29, 2011, Kelly emailed the Sands and told them: "We would like to get the five completed audits out the door this morning. (If not done already) Please execute [the] attached and provide to David LaRocca," a CPA at Cornick Garber. Div. Ex. 26. Steven Sands signed that day, and the letters were again sent to Martin Sands for his signature. *Id.* at 1. By mid-afternoon, LaRocca asked Kelly to "please send over the signature pages for Marty [Sands] and Yourself so we can finalize these five reports." *Id.* Kelly responded: "Here they are with my signature. Only Marty is left. He said he would do it later today." Div. Ex. 27. At 4:55 p.m., Martin Sands' executive assistant wrote to LaRocca, in a message marked high importance, that Martin Sands needed him and Sal Vicari, another Cornick Garber auditor, to call his cell. Div. Ex. 28; *see* Div. Ex. 36 (Martin Sands Tr. 78). There were no further email communications that day about the five completed audit reports.

While waiting for Martin Sands' signature, Cornick Garber made no substantive changes to the reports. Div. Ex. 33. On May 31, 2011, LaRocca again asked Kelly to "please have Marty sign" the letters and "wrap up the only open point for SBVC I," that is, the loan receivable confirmation. *Id.* That same day, in response to an email from Vicari about finalizing audit reports that were ready and getting them out before finalizing others, Kelly stated: "Marty has advised he wants all at once." Div. Ex. 32.

The undisputed evidence shows that as a result of Martin Sands' withholding his signature on the management representation letters until he could review the audited financials "all at once," he prevented the timely release of the five completed audited financial statements. Even viewing this evidence in the light most favorable to Martin Sands, i.e., taking as true his assertion that he had only one day to review the five completed audited financial statements, he waited to sign their associated representation letters until June 2011. Sands Supp. at 14; Ex. 31. As such, Martin Sands provided substantial assistance to the untimely distribution of the 2010 financials of five funds. Indeed, he was the "proximate cause" of SBAM's violations, which were undeniably "a direct and foreseeable result" of his decision not to sign the management representation letters. *Russo Secs. Inc.*, 53 S.E.C. 271, 279 (1997).

3. The Sands and Kelly's Failures: the Late 2011 and 2012 Financials

a. Kelly

In his investigative testimony, Kelly stated that he did not recall making any changes to SBAM's compliance protocols relating to the Commission's 2010 Order. Div. Ex. 6 (Kelly Tr. 15). That was arguably reasonable in late 2010 and early 2011 because Kelly had previously made compliance changes after being hired in 2008. However, at the point that SBAM failed to comply with the custody rule yet again by mid-2011, with the untimely distribution of the 2010 financials, Kelly failed to take any meaningful action. Kelly was fully aware that the audit process took time and the auditors required complete and accurate information, and yet he opined that there was "very little" anyone at SBAM could do. Div. Ex 6 (Kelly Tr. 37-38).

Even when viewed in the light most favorable to Kelly, the record shows that Kelly did very little: he reminded everyone of the distribution deadline, and engaged in the usual processes with the auditors, such as looking over draft valuations and answering questions. Div. Ex. 6 (Kelly Tr. 15-16, 20). Kelly sought to avoid the surprise audit requirement and have SBAM rely on the distribution exception. Div. Ex. 10 (Slavin Tr. 98). But if audited financials could not be distributed to investors on time, which was evident by mid-2011 after SBAM's failure to timely distribute the 2010 financials, the clear alternative would have been to implement the surprise audit requirement going forward. *See* 17 C.F.R. § 275.206(4)-2(a)(4), (b)(4); Div. Ex. 10 (Slavin Tr. 130-31).

Kelly argues, among other things, that he lacked the authority to hire "another accounting firm." Kelly Supp. at 9-10. However, Kelly offers no evidence of his lack of authority. Moreover, he offers no evidence that he lacked the authority or resources to: implement the surprise audit requirement to bring SBAM into custody rule compliance; create a robust timetable with checkpoints to ensure timely completion of the audits and, in turn, timely distribution of the financials; or begin the audit process earlier. As such, his arguments are only bare denials and do not raise a genuine issue of material fact. *See Jay T. Comeaux*, Exchange Act Release No. 72896, 2014 WL 4160054, at *2 (Aug. 21, 2014).

Under these circumstances and given the obvious red flags, Kelly's failures to act amounted to substantial assistance that resulted in SBAM's repeated violations. *See vFinance Invs., Inc.*, 2010 SEC LEXIS 2216, at *43-45.

b. The Sands

In the wake of the Commission's 2010 Order and on the heels of SBAM's failure to timely distribute the 2010 financials by mid-2011, the Sands either knew or were reckless in not knowing that SBAM's custody rule compliance had serious deficiencies. Yet, they do not dispute that they took no corrective action to establish an effective compliance system, to follow-up on the delegation of compliance responsibility to Kelly, or even to replace Kelly to the extent they believed Kelly was responsible for SBAM's repeated violations. In such circumstances and given their duties as described *supra*, the Sands' failures amounted to substantial assistance and

were a moving force behind SBAM's violations in untimely distributing its 2011 and 2012 financials.

During his May 2012 investigative testimony, Martin Sands was asked whether the financials for fiscal year 2011 had been prepared. Div. Ex. 36 (Martin Sands Tr. 76). He testified:

> I don't know if they're finished yet. I think they're in – or they're getting close. They may have already been done. I don't know. I have to check.
>
> But, they're very close. They're – they're in the process of being worked on. They're in the – they're either close to being done or they're finished. I have to check.

Id. At the time, the audit reports were already overdue. *See id*. Even if viewed in the light most favorable to him, Martin Sands' response establishes a lack of awareness of the audit process and that, despite prior violations, he had taken no meaningful steps to check or ensure that the 2011 financials would be timely distributed.

4. State of Mind

The Sands and Kelly were aware of the custody rule deadlines, and Kelly reminded the Sands of such deadlines. Div. Ex. 6 (Kelly Tr. 15, 20-21); Div. Ex. 8 at 7. The Sands and Kelly were responsible for signing the management representation letters required for the audit reports to be finalized, and thus they either knew or were reckless in not knowing that the distribution deadline was missed year after year. *See* Div. Exs. 26, 27. In these circumstances, Martin Sands' decision not to sign management representation letters as to the 2010 financials of five funds, the audit reports of which were ready to be finalized, was deliberate, which satisfies the state of mind requirement for both aiding and abetting and causing liability.

Kelly indisputably knew that the audited financials were not being distributed on time, and his failure to take corrective action was at least reckless. Given the Commission's 2010 Order and SBAM's repeated violations, the Sands' failures – resulting in the late financials for fiscal years 2011 and 2012 – were so unreasonable, and such an extreme departure from the standard of care imposed on investment advisers, that they acted at least in reckless disregard of SBAM's custody rule obligations, which constitutes scienter. *See Ronald S. Bloomfield*, 2014 SEC LEXIS 698, at *62-63. At minimum, it was extremely reckless for the Sands to close their eyes to whether the distribution deadline was being met and simply delegate away the compliance duty without any follow-up.

Kelly's and the Sands' recklessness is underscored by the fact that by mid-2012 and continuing into 2013, they knew that SBAM was subject to another Commission investigation. *See* Div. Ex. 36 (Martin Sands' May 2012 investigative testimony); Div. Ex. 38 (Division subpoena); Div. Ex. 6 (Kelly's April 2013 investigative testimony). Yet they do not argue or offer any evidence that during this period they took any corrective measures to bring SBAM into

compliance. *Cf*. Sands Supp. at 13 (noting that the required audits were completed on time in 2014).

Nonetheless, the Division has not established on summary disposition that Martin Sands aided and abetted or caused the late financials of the remaining five funds for fiscal year 2010 – namely SBVC II, SBVC III, SBVC IV, Genesis I, and Genesis II; or that Kelly and Steven Sands aided and abetted or caused the ten funds' late financials for fiscal year 2010. After coming on board in 2008, Kelly implemented compliance changes, and there was some indication that the compliance program functioned well. Div. Ex. 8 at 6-7; Div. Ex. 39; Sands, Ex. A (Slavin Tr. 133-34). As such, it was arguably reasonable for the Sands and Kelly to be hopeful that such procedures would be effective for fiscal year 2010. Drawing all inferences in their favor, I cannot find that the Sands and Kelly acted negligently, let alone with scienter, in this regard at this juncture. The Division's motion is thus denied on these claims of secondary liability as to fiscal year 2010.

C. Respondents' Oppositions Generally Fail to Overcome the Division's Motion

1. SBAM

SBAM concedes that it violated the custody rule, but contests the Division's assertion that it acted recklessly.[10] SBAM Opp. at 3. The firm also argues that it acted in good faith to comply with the custody rule deadlines and that any failures were not willful. *Id.* at 4-5. I address these issues here to the extent they are relevant in determining sanctions.

SBAM makes unsupported assertions that its "failure was the result of relying on [Kelly's] misinterpretation of the Custody Rule that compliance with the 120[-day] requirement was excused due to the need for completeness of valuations." *See, e.g.*, SBAM Opp. at 4; *id.* at 7 ("SBAM employees relied in good faith on Kelly's misinterpretation of the valuation and completeness requirement for the distribution of audited financials under the Custody Rule."). SBAM offers no evidence to support these bare assertions, which alone is fatal to its argument. *See Robert L. Burns*, Advisers Act Release No. 3260, 2011 SEC LEXIS 2722, at *17-18 (Aug. 5, 2011) (respondent failed to defeat summary disposition where he "neither presented the evidence to which he refers nor made a showing why he could not do so"). The most that can be gleaned from the record is that Kelly, in discussing why the audit reports were late, testified that auditors would not send out incomplete or inaccurate audit statements, but he did not say that incompleteness excused the deadline. Div. Ex. 6 (Kelly Tr. 34).

Moreover, ignorance or confusion about custody rule obligations cannot insulate SBAM from liability. *See Robert L. Burns*, 2011 SEC LEXIS 2722, at *41 n.60 ("[W]e have repeatedly held that ignorance of the securities laws is not a defense to liability thereunder."). Further, SBAM fails to rebut the Division's evidence that everyone at SBAM (and especially Kelly) knew of the custody rule deadlines, and that the firm's custody rule obligations were clear. Nothing in evidence or the text of the custody rule supports the notion that it would have been

[10] To the extent SBAM suggests that the custody rule exceeds the scope of Advisers Act Section 206(4), *see* SBAM Supp. at 3-5, I lack the authority to declare the Commission rule invalid.

reasonable for anyone to think that the 120-day deadline could be "excused," absent compliance with the surprise audit requirement.[11] *See* 17 C.F.R. § 275.206(4)-2(a)(4), (b)(4). Thus, because SBAM had a clear duty to act, knew of that duty, and failed to carry it out, it acted willfully. *See Ivan D. Jones, Jr.*, 52 S.E.C. 430, 440 (1995) (citing *Frank W. Humpherys*, 48 S.E.C. 161, 164 (1985)), *aff'd*, 115 F.3d 1173 (4th Cir. 1997); *Oppenheimer & Co.*, 47 S.E.C. 286, 287-88 (1980); *see also Marc N. Geman*, 54 S.E.C. 1226, 1260-61 (2001) (a finding of willfulness does not require intent to violate the law, but merely intent to commit the act which constitutes the violation), *aff'd*, 334 F.3d 1183 (10th Cir. 2003).

SBAM's attempt to shift blame to Kelly does not create a genuine issue as to the firm's state of mind, which is necessarily determined by reference to that of its senior officers responsible for its violations. *See A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir. 1977); *Clarke T. Blizzard*, 57 S.E.C. 696, 708 & n.16 (2004). SBAM contends that Kelly "was unequivocally responsible" for the firm's custody rule compliance, and concedes that he "fail[ed] to comport SBAM's conduct with the Custody Rule." SBAM Opp. at 6-8. SBAM does not expressly contend that Kelly's failures are unattributable to the firm, nor could it; he functioned within the scope of his employment as an SBAM control person and its chief compliance officer, and nothing suggests that he acted entirely for his own interests. *See vFinance Invs., Inc.*, 2010 SEC LEXIS 2216, at *38; *cf. Wight v. Bankamerica Corp.*, 219 F.3d 79, 87 (2d Cir. 2000) (explaining the adverse interest exception to imputing misconduct by senior officers to a corporation). In these circumstances and given that the Sands delegated compliance responsibility to Kelly, Kelly's failures and scienter are imputable to SBAM.

SBAM does not dispute that Kelly did not implement changes to SBAM's compliance program after the Commission's 2010 Order; instead, SBAM says such changes were not made after the 2010 Order because Kelly had previously overhauled SBAM's compliance program upon being hired in 2008, which addressed the conduct at issue in the 2010 Order. SBAM Opp. at 5. Although that may have been reasonable for purposes of distribution of the 2010 financials, as discussed *supra*, Kelly's custody rule failures with respect to the 2011 and 2012 financials are undisputed and were reckless. SBAM also does not dispute that Martin Sands did not sign the management representation letters for five funds until all audits were completed, preventing the timely distribution of the 2010 financials for those five funds. Its conclusory footnote – that the Division "has failed to establish sufficient proof of" the Sands' mental state – fails to create a genuine issue for hearing. Sands Opp. at 4 n.13.

As such, SBAM has failed to refute the Division's evidence that through the acts, failures, and scienter of its senior officers, it committed the violations alleged, sometimes with scienter.

[11] No evidence supports the suggestion that Kelly was acting in an attorney capacity or that custody rule advice was sought from Kelly, and thus any purported reliance-on-counsel defense would fail. *See David Henry Disraeli*, Securities Act Release No. 8880, 2007 SEC LEXIS 3015, at *29 n.39 (Dec. 21, 2007), *aff'd*, 334 F. App'x 334 (D.C. Cir. 2009); Kelly Aff. ¶ 16. It is entirely unclear why SBAM would purportedly rely on Kelly, and not its counsel, in interpreting the custody rule.

2. The Sands

The Sands principally contend that they are not responsible for SBAM's custody rule violations and had "no duty to ensure compliance" because such responsibility was delegated to Kelly, and it was Kelly's failures that form the basis of SBAM's violations. *See, e.g.*, Sands Opp. at 3, 12, 14. The Sands made a similar (and similarly unsuccessful) delegation argument in their 2009 Wells submission, in response to the allegation of violations that formed the basis of the Commission's 2010 Order. Div. Reply Ex. 1 at 4-7.

Tellingly, the Sands fail to address that they did nothing in the face of Kelly's failure and the firm's repeated noncompliance. The Sands' contention that they had no duty – washing their hands entirely of the matter – only serves to underscore their reckless disregard of SBAM's custody rule obligations. Contrary to their argument, the Division does not merely "impl[y]" that the Sands must have known that the audited financials would not be timely distributed. Sands Opp. at 14; Sands Supp. at 10-14. As discussed *supra*, the Sands were responsible for signing the management representation letters to permit the release of the audit reports and engaged in regular communications with the auditors. Thus, the Division has submitted undisputed evidence that the Sands were at least reckless in not knowing whether the financials would be timely distributed.

The Sands further contend that the "the Division does not identify any action by [t]he Sands proving that they participated in SBAM's purported violation as something they wished to bring about," and that "the Division does not allege any affirmative action by S[teven] Sands at all." Sands Opp. at 15. For support that an alleged aider and abettor must undertake some affirmative act to be held liable, the Sands cite the standard for substantial assistance in securities fraud cases. *Id.* n.55; *see SEC v. Apuzzo*, 689 F.3d 204, 212 (2d Cir. 2012) ("Judge Learned Hand famously stated that . . . to be liable as an aider and abettor, the Government — in addition to proving that the primary violation occurred and that the defendant had knowledge of it . . . — must also prove 'that he in some sort associate[d] himself with the venture, that [the defendant] participate[d] in it as in something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed.' . . . Judge Hand's standard has thus survived the test of time, is clear, concise, and workable, and governs the determination of aider and abettor liability in securities fraud cases." (internal citations omitted; bracketed alterations in original)). Although such standard makes sense in the securities fraud context, it would be bizarre to hold that aiding and abetting liability for failing to take action as required by the custody rule requires an affirmative act. In this context, the primary violator – SBAM, a corporate entity – necessarily acts or fails to act only through its principals and senior officers, and the violations here directly resulted from the failures of its senior officers. *See vFinance Invs., Inc.*, 2010 SEC LEXIS 2216, at *44-45 (aiding and abetting liability can be established where there is clear duty to act and the respondent's failures constitute the primary violation).

The Sands do not controvert the fact that Martin Sands did not sign the management representation letters for five funds in April 2011, when the audits were ready to be finalized, but waited until all audits were completed. Rather, their retort is:

> [T]he Division does not explain how this prevented Kelly from ensuring SBAM's compliance with the Custody Rule through other means. In addition, the Division offers no evidence that waiting to sign management representation letters for some funds until audits were completed for all of the funds was reckless or even negligent.

Sands Opp. at 15 n.56.

The Division's burden was met by establishing Martin Sands' duties and conduct; it was not required to discount hypothetical "other means" by which Kelly could have brought SBAM into compliance. With the April 30, 2011, distribution deadline looming, Martin Sands knew that the management representation letters were ready for his signature no later than April 29. Div. Exs. 26-27; *see* Div. Ex. 6 (Kelly Tr. 15, 20-21). By that time, it was too late to implement the surprise audit requirement for the 2010 fiscal year, *see* 17 C.F.R. § 275.206(4)-2(a)(4) (surprise audit must occur at least once during each calendar year), and thus the only reasonable conclusion is that Martin Sands' conduct directly prevented SBAM's custody rule compliance and was the moving force behind the violations. Martin Sands' conduct and knowledge are more than sufficient to establish that he at least recklessly disregarded the custody rule.

Lastly, the Sands emphasize that they took steps to institute "a robust compliance structure at SBAM." *See, e.g.*, Sands Opp. at 9. In support, they offer Slavin's investigative testimony. Slavin did not, however, seek to specifically rectify the issues raised by the Commission's 2010 Order. Sands, Ex. A (Slavin Tr. 89-90). In any event, the existence of SBAM's "robust" compliance structure fails to create a genuine issue where, as is undisputed here, SBAM repeatedly failed to effectively implement its compliance procedures, and the Sands knew or were reckless in not knowing of such repeated violations and did nothing. *Cf. Rita H. Malm*, 52 S.E.C. at 69 n.17 ("The presence of procedures alone is not enough. Without sufficient implementation, guidelines and strictures do not assure compliance.").

3. Kelly

I construe the points raised by Kelly's motion for summary disposition as part of both his own motion and his opposition to the Division's motion, a procedure which is more favorable to him as the non-moving party. *See Jay T. Comeaux*, 2014 SEC LEXIS 3001, at *8.

a. Staff Response Regarding the Custody Rule: "Q&A Exemption"

Kelly incorrectly attempts to read a scienter requirement into the custody rule. He argues that there is no violation of the custody rule, "in any respect," if the adviser "reasonably believed that the pool's audited financial statements would be distributed within the 120-day deadline, but failed to have them distributed in time under certain unforeseeable circumstances." Kelly Opp. at 3; *accord* Kelly Motion at 13 ("Audits can be delivered after the 120-day deadline with the advisor still in compliance with the Custody Rule." (formatting altered)). In support, he relies on commentary by the staff of the Division of Investment Management, dubbed by Kelly as the "Q&A Exemption." *See* Kelly Motion at 11-12.

The staff's commentary, on its face, belies Kelly's argument. It confirms that a late distribution is "a violation," and merely advises that, in certain circumstances, the staff would not recommend an enforcement action; the commentary further advises that staff responses to inquiries "are not a rule, regulation, or statement of" the Commission. Berke Feb. Decl., Ex. J at 1, 12-13. Thus, Kelly fails to defeat the conclusion that SBAM committed primary violations.

Further, no evidence supports the contention that Kelly formed a reasonable belief that the deadline could be legally excused, nor could he in light of the Commission's 2010 Order. The undisputed facts show that he understood the distribution deadline and its regulatory importance. Div. Ex. 6 (Kelly Tr. 20-21, 37); Div. Ex. 8 at 1; Div. Ex. 10 (Slavin Tr. 130-31); Div. Ex. 39 at 18-19; Div. Ex. 40 at SB 21-22.

At bottom, Kelly's argument amounts to a fundamental disagreement with the Commission's decision to institute this proceeding, and he questions the purported decision to pursue this case against him in contrast to others. Kelly Reply at 2-3. However, the decision to institute this proceeding was within the agency's prosecutorial discretion. To the extent Kelly believes that the facts and circumstances show otherwise, he must litigate the proceeding to a final decision. *See Kevin Hall, CPA*, Exchange Act Release No. 61162, 2009 SEC LEXIS 4165, at *68, *81 (Dec. 14, 2009); *Kevin Hall, CPA*, Exchange Act Release No. 55987, 2007 SEC LEXIS 1406, at *4 (June 29, 2007).

b. "Control" of Audit Process

Kelly asserts that he did not "control" the audits, emphasizing that he was a non-financial professional, he participated in the audits "to the extent he could be helpful" but was not responsible for them, the Sands were ultimately in charge, and he did not have a legal position at SBAM. *See, e.g.*, Kelly Opp. at 4-10, 12-14; Kelly Aff. ¶¶ 2, 6; Kelly Motion at 6-8, 11. These points, however, fail to controvert the Division's motion. As discussed *supra*, the Division established that Kelly was an SBAM control person, and he was in charge of ensuring SBAM's compliance with the custody rule and making necessary changes to the compliance program. Kelly does not dispute that he knew about the distribution deadlines and SBAM's failures. Kelly Opp. at 10-11.

It is true, as Kelly points out, that his signing of engagement and management representation letters does not necessarily establish that he had "control" over the entire audit process or that he could necessarily guarantee results. Kelly Opp. at 5; Kelly Motion at 6-7. However, such facts support the conclusion that Kelly had a clear duty to manage SBAM's compliance program, which he does not contest. *See* Kelly's Motion at 5 ("Kelly acknowledges his responsibility to manage the SBAM compliance program."); *cf. Kirk A. Knapp*, 50 S.E.C. 858, 864-65 (1992) (noting that even if a respondent is "more or less a figurehead president," he was still "required to fulfill the obligations attached to his office for as long as he occupied the position, a duty he failed to discharge"). The problem is that Kelly has proffered no evidence rebutting the Division's evidence that he took no meaningful steps to ensure SBAM's custody rule compliance or to make necessary changes when its noncompliance was apparent and ongoing.

c. Reliance Arguments

Kelly claims that he reasonably relied on: 1) Slavin's compliance reports; 2) the Commission's "acceptance" of the compliance reports and SBAM's compliance manual; 3) the Connecticut Department of Banking's "acceptance" of the compliance reports; and 4) the Gusrae Kaplan law firm, with which Kelly "discussed custody matters . . . on multiple occasions," but that never counseled him to change the compliance program or the compliance manual, or advised him that the Commission's claims in this matter had merit. Kelly Motion at 8-11.

Slavin's engagement as an SBAM consultant did not involve overseeing SBAM's custody rule compliance and was not in connection with any Commission proceeding. Instead, it related to SBAM's "compliance policies and procedures safeguard[ing] against violations of the [Connecticut Uniform Securities] Act and Regulations." Div. Ex. 11 at 2; *see* Sands, Ex. A (Slavin Tr. 89-90); Berke Feb. Decl., Ex. A (Slavin Tr. 88). In his first two compliance reports, Slavin did not address the custody rule. *See* Berke Feb. Decl., Exs. B (document production inventory, noting which documents, by Bates-stamp, are the compliance reports); C (2009 analysis), D-E (cover letter and June 2010 analysis). Slavin's third report, issued December 2010, noted only that:

> SBAM takes the position that it has custody of its clients' assets as it has custody of some securities; however, it is not subject to the SEC's surprise audit rule for brokers with custody. It provides monthly reports to its fund investors as well as sending its audits to them. The audits are done by PCAOB accountants.

Berke Feb. Decl., Exs. F, G at 4. Slavin's subsequent reports add nothing further. Berke Feb. Decl., Exs. H-I; Brown Jan. Decl. ¶ 10; Div. Ex. 9 at 4. For example, his 2012 analysis merely noted that the Commission inquired as to the timing of the distribution of the audited financial statements for funds advised by the firm, and made no further inquiry. Div. Ex. 9 at 14.

Slavin's reports and analysis were largely based on information he received from Kelly, who told him that SBAM was not subject to the surprise audit requirement and that the "bad behavior" that resulted in the 2010 Order had stopped; but Slavin did not inquire whether the audited financials complied with the custody rule deadline. Berke Feb. Decl., Ex. A at 85-86, 95-98, 133. In sum, following the Commission's 2010 Order and SBAM's known failure to timely distribute its 2010 audited financials, nothing in Slavin's reports could have reasonably provided Kelly comfort with SBAM's custody rule compliance.

For substantially the same reasons, Kelly establishes no genuine issue insofar as he claims that the Commission "accepted" the compliance reports, as those reports did not address and were not intended to address the firm's custody rule compliance. To the extent Kelly believes that the Commission failed to take earlier action, such purported agency inaction does not obviate his liability or otherwise preclude the present action. *See Graham v. SEC*, 222 F.3d at 1008 & n.26; *G.K. Scott & Co.*, Exchange Act Release No. 33485, 1994 WL 17114, at *3 n.21 (Jan. 14, 1994), *pet. denied*, 56 F.3d 1531 (D.C. Cir. 1995) (table decision); *cf. Hans N. Beerbaum*, Exchange Act Release No. 55731, 2007 WL 1376365, at *5 n.22 (May 9, 2007) (industry participants cannot shift responsibility for compliance to industry regulators).

Kelly's purported reliance on the Connecticut Department of Banking's silence is misplaced, as no evidence indicates that that agency even opined on the issues at stake in this Commission proceeding. Lastly, Kelly's purported reliance on the Gusrae Kaplan law firm fails because he has not established the elements for a reliance-on-counsel defense. *See SEC v. Tourre*, 950 F. Supp. 2d 666, 682-85 (S.D.N.Y. 2013).

d. Alleged Ethical Breaches by the Division

Kelly argues that the Division interfered with his right to counsel of choice and violated applicable rules of professional conduct. Specifically, he alleges that the Division refused to directly communicate with him during the investigation because it erroneously believed that attorney Martin Kaplan was representing him, and then the Division gave Kelly short notice to retain counsel, at which point he formally retained Kaplan in early 2014. Kelly Motion at 2-4. Kelly further alleges that in April 2014, the Division disclosed to Kaplan "confidential" voicemails that Kelly had left with Division counsel, and that the Division knew, at the time, that Kaplan was representing Kelly as well as SBAM and the Sands. *Id.* at 4. The fallout, according to Kelly, is that Kaplan terminated representation of Kelly, and SBAM declined to indemnify him in this matter, stopped paying his salary, and refused to pay him a bonus. *Id.* at 4-5.

The right to counsel of choice in a Commission investigation may be implicated when a respondent is compelled to appear or provide sworn testimony during an investigation. *See Kevin Hall, CPA*, 2009 SEC LEXIS 4165, at *69-70. It does not apply broadly to the entire investigative process, and "[a] Commission investigation does not confer any party with a general right to information about the Division's view of their counsel . . . ." *Id.* at *71-72. Here, Kelly stated during his April 2013 investigative testimony that he was represented by counsel, and Kaplan appeared as his counsel. Div. Ex. 6 (Kelly Tr. 6). There is no indication that the Division interfered with Kelly's choice in this regard or his ability to consult with counsel during his investigative testimony. *See Kevin Hall, CPA*, 2009 SEC LEXIS 4165, at *70-72.

As to the alleged ethical violations, "government action is entitled to a presumption of good faith in the absence of a clear showing of bad faith," which Kelly has failed to establish. *Kevin Hall, CPA*, 2009 SEC LEXIS 4165, at *86 (internal quotation marks and alteration brackets omitted). The voicemails that the Division relayed to Kaplan were not the result of any deliberate government intrusion with Kelly's attorney-client relationship, but the result of Kelly's voluntary decision to contact the Division. *See* Brown Feb. Decl., Exs. 1-3, 5 (Kelly's voicemails). Indeed, if the Division had bypassed Kaplan to contact Kelly directly, the Division would have potentially acted unethically. *See United States v. Stringer*, 521 F.3d 1189, 1200-01 (9th Cir. 2008); N.Y. Rule of Prof'l Conduct 4.2; Brown Feb. Decl. ¶¶ 3-5, 7-10, 15-16.

Moreover, the Division's disclosure of the voicemails to Kaplan was part of the Division's effort to raise concerns about a potential conflict for Kaplan in jointly representing Kelly and the other Respondents, *see* Brown Feb. Decl., Ex. 6, and such conflict in fact surfaced in this proceeding and resulted in Kaplan's disqualification as SBAM's counsel. *See Sands Bros. Asset Mgmt., LLC*, Admin. Proc. Rulings Release No. 2503, 2015 SEC LEXIS 1250 (Apr. 7,

2015). "In any case, violations of legal or ethical rules governing Commission investigations are not, without more, a defense to the SEC's suit." *Kevin Hall, CPA*, 2009 SEC LEXIS 4165, at *86 n.115 (internal quotation marks and alteration brackets omitted).

e. Alleged Inconsistency

Kelly claims that the charges against him are inconsistent, as he is alleged to have been "very active" – by, for example, engaging the auditors, signing management representation letters, and serving as the principal contact with auditors – and, on the other hand, "insufficiently active." Kelly Motion at 8. The evidence that Kelly was "active" demonstrates that he had clear compliance responsibility at SBAM, a fact Kelly does not deny, and the evidence that Kelly was "insufficiently active" demonstrates his compliance failures. Kelly offers no evidence to create a genuine issue that he acted in any meaningful way to ensure SBAM's compliance. Thus, Kelly's misreading of the allegations fails to establish a genuine issue.

f. Kelly's Evidence

I have considered Kelly's remaining arguments and evidence submitted in support of his motion and opposition, all which fail to establish any genuine issue. For example, in his affidavit, Kelly criticizes the Division for citing his investigative testimony about not making compliance changes after the Commission's 2010 Order, stating that he testified that he could not "recall" making any compliance changes, but that he "could check." Kelly Aff. ¶ 12. However, he fails to bring forward any evidence that he sought to make any compliance changes or undertook any corrective action to ensure compliance as to the distribution of the 2011 and 2012 financials. His exhibits (consisting of a typewritten Greenwich Fund Services' revenue breakout for 2010; a list of SBAM employees, its auditors, and other related personnel; the Sands' biographies from SBAM's website; and a February 2014 engagement letter from his former counsel) do nothing to overcome the Division's motion. Kelly Opp. Exs. 1-4. Similarly, Kelly's assertion that all SBAM employees and especially the Sands had a responsibility to ensure compliance, even if true, fails to absolve Kelly. Kelly Motion at 6 & Kelly Exs. 1-3.

D. Kelly's Motion

The OIP's allegations, taken as true, as they must be in resolving Kelly's motion, would be sufficient to establish Kelly's liability. *See* 17 C.F.R. § 201.250(a); OIP ¶¶ 2, 6, 21, 23. Kelly fails to meet his burden to overcome such allegations with stipulations or admissions made by the Division, by uncontested affidavits, or facts officially noticed. *See* 17 C.F.R. § 201.250(a).

Moreover, as Kelly's arguments fail as points in opposition to the Division's motion, even when construed in the light most favorable to him, they necessarily fail to establish that he is entitled to summary disposition in his favor. Accordingly, Kelly's motion is denied.

IV. Sanctions

The Division seeks significant sanctions: revocation of SBAM's registration as an investment adviser, a permanent associational bar against the Sands, a permanent bar against

Kelly from acting as chief compliance officer for any entity operating in the securities industry, a cease-and-desist order, and third-tier civil penalties against all Respondents. Div. Motion at 26-33.

The Commission is authorized to impose a civil money penalty against SBAM for its violations, and against the Sands and Kelly for causing or for willfully aiding and abetting SBAM's violations. 15 U.S.C. § 80b-3(i)(1)(A)(i)-(ii), (B)(i)-(ii). A three-tier system establishes the maximum civil money penalty that may be imposed for "each act or omission." *Id.* § 80b-3(i)(2). A first-tier penalty is permissible for each act or omission. *Id.* § 80b-3(i)(2)(A). A second-tier penalty is permissible when the respondent's unlawful act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. *Id.* § 80b-3(i)(2)(B). A third-tier penalty is permissible where such state of mind is present, and the misconduct directly or indirectly: 1) resulted in substantial losses, 2) created a significant risk of substantial losses to other persons, or 3) resulted in substantial pecuniary gain to the person who committed the misconduct. *Id.* § 80b-3(i)(2)(C).

To impose a civil penalty, "the Commission must determine how many violations occurred and how many violations are attributable to each person." *Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012). Also, within any particular tier, the Commission has the discretion to set the amount, based on a number of factors. *See Brendan E. Murray*, Advisers Act Release No. 2809, 2008 SEC LEXIS 2924, at *42 (Nov. 21, 2008); *see also* 15 U.S.C. § 80b-3(i)(3) (setting forth public interest factors to be considered); *Jay T. Comeaux*, 2014 SEC LEXIS 3001, at *22 ("the public interest factors in . . . Advisers Act Section 203(i)([3]) . . . are applied when determining whether civil penalties are appropriate").

As discussed *supra*, the Division has established, at minimum, that: SBAM violated the custody rule with respect to its 2010-2012 financials of the ten funds; Martin Sands acted in reckless disregard of the custody rule when he aided, abetted, and caused SBAM's five custody rule violations as to the 2010 financials of five funds; and the Sands and Kelly acted in reckless disregard of the custody rule when they aided, abetted, and caused SBAM's twenty custody rule violations as to all ten funds' 2011 and 2012 financials. As noted, SBAM's state of mind is necessarily derivative of that of its senior officers in these circumstances.

The Division concedes that "there is no evidence of investor loss," but asserts that Respondents' custody rule failures "subjected investors to significant risk of substantial loss" because the custody rule is "intended to prevent such loss." Division Motion at 32. The Division has failed to carry its burden. In support, the Division cites the Commission's opinion in *John P. Flannery*, but there, the Commission referenced specific evidence establishing a significant risk of harm to investors. *See* Advisers Act Release No. 3981, 2014 WL 7145625, at *41 (Dec. 15, 2014). Here, the Division offers no evidence, and it cites no authority for the proposition, that a Commission rule intended to prevent investor loss establishes a significant risk of substantial losses as a matter of law.

Thus, the Division has at most established that: for SBAM and Martin Sands, twenty-five second-tier penalties could be permissibly assessed against each; and for Steven Sands and Kelly, twenty second-tier penalties could be permissibly assessed against each. Regarding

SBAM's remaining five violations as to the 2010 financials, only a first-tier penalty is permissible against SBAM based on the current record.

Moreover, in order to conduct a public interest analysis on the Division's other requested sanctions, additional evidence is necessary; for example, there remain genuine issues over the egregiousness of each Respondent's misconduct and the likelihood of future violations. Accordingly, the Division's requested relief cannot be imposed on summary disposition. If Division continues to seek third-tier penalties, the full range of its other requested sanctions, and liability of the individual respondents for all thirty of SBAM's violations, further proceedings must be held.

V. Ruling

Christopher Kelly's motion for summary disposition is DENIED.

The Division of Enforcement's motion for summary disposition is GRANTED IN PART. There are no genuine issues of material fact, and the Division is entitled to summary disposition, on the following issues:

SBAM willfully violated Advisers Act Section 206(4) and Rule 206(4)-2 as to the late distribution of the ten funds' 2010, 2011, and 2012 audited financial statements;

Martin Sands caused and willfully aided and abetted SBAM's violations as to the late distribution of five funds' 2010 audited financial statements; and

The Sands and Kelly caused and willfully aided and abetted SBAM's violations as to the late distribution of the ten funds' 2011 and 2012 audited financial statements.

SO ORDERED.

_____
Cameron Elliot
Administrative Law Judge