UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3927 / September 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16139

In the Matter of **LINCOLNSHIRE MANAGEMENT, INC.,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Lincolnshire Management, Inc. ("LMI" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent 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, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

SUMMARY

1. These proceedings arise from a breach of fiduciary duty by private equity fund adviser Lincolnshire Management, Inc. ("LMI"). Beginning in 2001, LMI integrated two portfolio companies owned by different LMI-advised funds and managed them as one company. The two companies – Peripheral Computer Support, Inc. ("PCS") and Computer Technology Solutions Corp. ("CTS") – were owned by separately advised LMI private equity funds with distinct sets of investors and LMI owed a fiduciary duty to each LMI fund. As part of this integration, the companies utilized a joint management team and developed an expense allocation policy that required each portfolio company to pay a certain percentage of various operating and administrative expenses. The expense allocation policy was not followed in certain instances, however, which resulted in one portfolio company paying more than its share of certain expenses that benefitted both companies. This constituted a breach of LMI's fiduciary duty to the funds and violated Section 206(2) of the Advisers Act.

2. LMI separately violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act arising from integrating two portfolio companies owned by separately advised LMI private equity funds.

RESPONDENT

3. **Lincolnshire Management, Inc. ("LMI")** is a privately held Delaware corporation that was formed in 1986 and has been registered with the Commission as an investment adviser since March 28, 2012. During the relevant time period, LMI served as the investment adviser for Lincolnshire Equity Fund, L.P. and Lincolnshire Equity Fund II, L.P. LMI's principal place of business is in New York, New York.

OTHER RELEVANT ENTITIES

4. **Lincolnshire Equity Fund, L.P. ("LEF")** is a Delaware limited partnership and private investment fund formed in 1993 to make private equity investments in middle market companies.

5. **Lincolnshire Equity Fund II, L.P. ("LEF II")** is a Delaware limited partnership and private investment fund formed in 1999 to make private equity investments in middle market companies.

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[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.

FACTS

A. Background

6. LMI is a New York-based private equity fund adviser with approximately $1.7 billion in assets under management. LMI was formed to make private equity investments in leveraged buyouts and recapitalizations.

7. During the relevant time period, LMI advised multiple private equity funds, including LEF and LEF II. LEF and LEF II had separate Limited Partnership Agreements ("LPA") and distinct sets of limited partner investors. The LPA for each fund governs the rights and obligations of its limited partners, including their obligations to pay advisory and other fees and expenses to LMI pursuant to a separate management agreement between each fund and LMI.

8. In April 1997, LMI caused LEF to acquire PCS through a $5 million equity investment. PCS was a California-based company that primarily serviced and repaired computer hard disk drives.

9. In September 2001, LMI caused LEF II to acquire CTS through an $8.5 million equity investment. CTS was a Texas-based company that primarily serviced and repaired laptop computers and handheld devices.

10. The investment opportunity in CTS was brought to LMI's attention by PCS management. The LMI investment committee believed PCS and CTS would have valuable synergies and that each company would complement the other. However, by 2001, LEF's commitment period was closed and it could not call capital to make a new acquisition. Therefore, LMI caused LEF II to acquire CTS with the intention of integrating PCS and CTS where possible and ultimately marketing the two companies for a combined sale. In connection with the 2001 acquisition of CTS, LMI disclosed to LEF's and LEF II's limited partners its intention to integrate and jointly sell the two portfolio companies. In quarterly fund disclosures thereafter, LMI provided regular updates to LEF's and LEF II's limited partners on the operations of the respective portfolio companies, together with additional information regarding the progress toward integration and plans to sell the two companies together.

11. From at least July 2009 to January 2013, PCS was the only portfolio company held by LEF.

12. LMI entered into consulting agreements with each portfolio company that was owned by an LMI-advised fund. Pursuant to the terms of the consulting agreements, LMI charged each portfolio company an annual fee in exchange for rendering consulting and advisory services concerning the portfolio company's financial and business affairs, its relationships with lenders, and the operation and expansion of its business. With regard to LEF II, a percentage of any consulting fees paid to LMI, as well as certain other fees charged by LMI, were used to offset the limited partners' share of the management fees owed to LMI under the LPA.

13. LMI entered into consulting agreements with PCS and CTS in April 1997 and September 2001, respectively. CTS paid LMI $250,000 annually under its consulting agreement; $125,000 of the $250,000 was used to offset management fees owed to LMI. PCS also paid LMI $250,000 annually during the relevant period, but was unable to pay its consulting fee from 2001 through 2004 based on its financial condition. No portion of PCS's $250,000 annual consulting fee was used to offset management fees.

B. <u>The Integration of PCS and CTS</u>

14. Although LEF could not purchase CTS because its commitment period had closed, LMI believed that owning both PCS and CTS together would create value for each set of limited partners in LEF and LEF II. Accordingly, in September 2001, LMI caused LEF II to purchase CTS.

15. At the time LEF II purchased CTS, in 2001, LMI disclosed to the limited partners of both LEF and LEF II that it believed there were synergies between PCS and CTS that would provide customers with a single venue to support their personal computing and mobile device support needs. LMI believed that these synergies would allow the companies to compete more effectively in the industry and would add value to both companies. LMI further disclosed its intention to exit the PCS and CTS investments by combining both companies and selling them together. As contemplated, the management of PCS and CTS – at LMI's direction – took various steps to integrate certain operations of the two companies.

16. By 2005, PCS and CTS had integrated their financial accounting systems, and a number of business and operational functions, including all payroll and 401(k) administration, and substantial portions of their respective human resources, marketing, and technology.

17. PCS and CTS also integrated their financing needs. For example, the two companies entered into a line of credit on a joint and several basis.

18. The integration of PCS and CTS operations extended to subsidiaries outside the United States. For example, a wholly owned subsidiary of PCS in Singapore supplied various parts and labor to CTS at cost. Likewise, CTS sold parts to various PCS subsidiaries at cost.

19. By March 2009, to further streamline operations and costs, LMI helped recruit a joint management team for PCS and CTS, including a joint chief executive officer and chief financial officer. Additionally, PCS and CTS shared a joint head of sales and controller.

20. From at least March 2009 to January 2013, the two separately owned companies had a joint "PCS CTS" logo that was used in marketing, advertising, and on employees' business cards.

21. From at least 2005 to January 2013, PCS and CTS were integrated and, in certain respects, operating as one company, although they remained two separate legal entities with separate audited financial statements.

22. During the relevant period, LMI made three separate efforts to sell the two companies jointly. In 2003 and later in 2007, LMI retained investment banks who developed marketing materials aimed at selling the two companies as a single entity under the joint "PCS CTS" marketing logo. While these two efforts were unsuccessful, in January 2013, PCS and CTS were sold together to a single buyer.

C. Expense Allocation Policy

23. Although certain operations of PCS and CTS were integrated, they were owned by separately advised LMI funds – LEF and LEF II, respectively – and LMI owed a fiduciary duty to each fund.

24. From at least 2005 until January 2013, PCS and CTS generally allocated expenses that benefitted both companies based on the proportion of each company's revenue to the combined revenue of PCS and CTS. For example, in 2011, the combined revenue of PCS and CTS was approximately $120 million, with approximately $22 million (or 18%) attributable to PCS. Under the expense allocation policy, PCS was required to pay 18% of any relevant shared expense.

25. There was no written guidance or detail that accompanied this expense allocation policy. While the expense allocations were documented in the CTS and PCS financial records and subject to review during the respective annual audits, neither CTS nor PCS had any written agreements relating to sharing or allocating expenses. There were no documents setting forth the parties' respective rights and obligations toward each other.

26. The shared expenses of PCS and CTS related to administrative fees associated with: payroll and 401(k) benefits; information technology; sales and marketing; and corporate management.

D. Misallocated Expenses

27. From at least 2005 to January 2013, PCS and CTS shared numerous annual expenses. While generally the shared expenses were properly allocated and documented in certain instances, a portion of the shared expenses was misallocated and went undocumented, which resulted in one portfolio company paying more than its share of expenses that benefitted both companies.

28. Prior to the integration of PCS and CTS, PCS utilized administrator services to assist with payroll and 401(k) benefits. PCS paid these administrators a fee for the services they provided.

29. After PCS and CTS were integrated, management decided to use PCS's third-party administrators to provide payroll services, and to administer the 401(k) programs for both PCS's and CTS's employees. Notwithstanding the fact that the related administrative expenses covered CTS employees, PCS paid all of the administrative expenses for at least eight years and did not

receive any reimbursement from CTS. During this eight-year period, the estimated administrative expenses paid by PCS averaged approximately $25,000 annually.

30. In addition to these administrative expenses, there were several employees who performed work that benefitted both PCS and CTS, but their salaries were not allocated between the two companies, as required under the policy.

31. PCS's wholly owned Singapore subsidiary performed services for, and sold supplies and parts to, CTS at cost. For example, in 2011 PCS Singapore sold approximately $150,000 in supplies and parts to CTS at cost. However, CTS did not contribute to the general overhead costs of running the Singapore subsidiary. Notably, there were PCS Singapore employees devoted solely to performing work for CTS. CTS reimbursed PCS for the salaries of those specific employees but did not pay any of the costs associated with their office space, their computers, or the local business licenses that PCS had to maintain in order to do business in Singapore.

32. When PCS and CTS were sold in January 2013, PCS's and CTS's then-existing executives were paid transaction bonuses. LEF, which owned PCS, paid 10% of the transaction bonuses of two executives who were solely CTS employees.

E. LMI Failed to Adopt and Implement Policies and Procedures to Prevent Violations Arising from Integrating PCS and CTS

33. On March 28, 2012, LMI registered with the Commission as an investment adviser and became subject to the Advisers Act rules relating to registered advisers, including the requirement to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

34. At the time LMI registered as an investment adviser certain operations of PCS and CTS were integrated. Although PCS and CTS were integrated, they were owned by separately managed LMI funds and LMI owed a fiduciary duty to each fund.

35. Despite LMI's integration of PCS and CTS, LMI did not adopt or implement any written policies or procedures designed to prevent violations of the Advisers Act arising from such integration.

VIOLATIONS

36. 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.*

37. As a result of the conduct described above, LMI violated Section 206(2) of the Advisers Act by breaching its fiduciary duty owed to LEF and LEF II. LMI's breach of fiduciary duty resulted in one portfolio company (and, indirectly, the fund that owned it) paying more than its share of certain expenses that benefitted both companies.

38. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

39. LMI violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act arising from integrating PCS and CTS, which were owned by separately advised LMI private equity funds.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 203(k) of the Advisers Act, it is hereby ORDERED that**:**

A. Respondent Lincolnshire Management, Inc. 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)-7 thereunder.

B. Respondent Lincolnshire Management, Inc. shall pay disgorgement of $1,500,000, prejudgment interest of $358,112, and a civil penalty of $450,000, totaling $2,308,112, to the Securities and Exchange Commission. Payment shall be made in the following installments: (i) $808,112 shall be paid within ten (10) days of the entry of this order; and (ii) $1,500,000 shall be paid within sixty (60) days of the entry of this order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. 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

Payment by check or money order must be accompanied by a cover letter identifying Lincolnshire Management, Inc. 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 Julie M. Riewe, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5010.

By the Commission.

Brent J. Fields
Secretary