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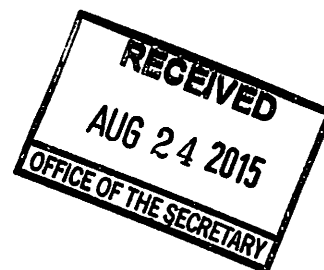
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-16223

In the Matter of

SANDS BROTHERS ASSET MANAGEMENT, LLC, STEVEN SANDS, MARTIN SANDS AND CHRISTOPHER KELLY,

Respondents.

RESPONDENT SANDS BROTHERS ASSET MANAGEMENT, LLC'S ADDITIONAL BRIEF IN RESPONSE TO THE DIVISION OF ENFORCEMENT'S MOTION FOR SUMMARY DISPOSITION

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Dated: August 21, 2015

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In the "Order Following Second Prehearing Conference" dated June 17, 2015, this Court invited respondent Sands Brothers Asset Management, LLC ("SBAM") and all other parties to file additional briefs related to the Enforcement Division's summary disposition motion by today, August 21, 2015. The order stated that "[i]n its filing, SBAM shall identify whether it adopts the opposition filed by former counsel and, to the extent new counsel disagrees with or wishes to retract statements or arguments made by former counsel, new counsel shall specifically identify those statements or arguments." The order also invited SBAM to move for summary disposition if it so chose. SBAM submits this additional brief in compliance with the Order.

I. SBAM's POSITION ON FORMER COUNSEL's OPPOSITION

On February 13, 2015, SBAM, through its former counsel, filed an opposition to the Division's motion for summary disposition. In that opposition, former counsel conceded that "[SBAM's] audited financials for year-end 2010, 2011 and 2012 were not distributed within the 120 days as required by the Custody Rule." (SBAM Opp. at 3.) Prior counsel then argued that the Division's requested sanctions against SBAM—revocation of registration, third-tier penalties, and a cease-and-desist order—must be denied, because it would be inappropriate to award sanctions on summary disposition (SBAM Opp. at 2-4); there are material facts in dispute with regard to whether sanctions against SBAM are justified at all, let alone at the level the Division seeks; and relief cannot be granted to the Division as a matter of law (SBAM Opp. at 4-9).

In compliance with its responsibilities under the Order, SBAM states as follows:

- SBAM **adopts** prior counsel's concession that SBAM's audited financials for year-end 2010, 2011 and 2012 were not distributed within 120 days as required by the Custody Rule.

- SBAM **<u>adopts in part</u>** prior counsel's arguments that the sanctions the Division seeks cannot and should not be awarded at all, let alone on summary disposition.

This Court should note that SBAM's original opposition, and this additional brief, would have been short and non-controversial if the Division had not sought summary disposition on sanctions, rather than just on liability—a position in conflict with the summary disposition rule and in tension with the Division's colloquy with the Court during the December 2014 status conference. Because of the Division's overreach, and because of the risk—however slight—that this Court might accept the Division's invitation to award the sanctions it seeks, SBAM must present additional argument and facts to defeat summary judgment.

II. <u>ARGUMENT</u>

The Division's motion seeks not only a liability determination, but sanctions—extraordinarily severe sanctions—against SBAM, including (i) revocation of SBAM's registration, which is the most draconian penalty available under § 203(e)(5) of Investment Advisers Act (the "Act") and capital punishment for an investment adviser; (ii) a staggering third-tier penalty of $22,250,000.00; and (iii) a cease-and-desist order. As this Court knows, when the Commission seeks extraordinary sanctions, it must satisfy a heightened burden: to show—with particularity—the facts and policies justifying those sanctions, and why lesser remedial measures would not serve the public interest in preventing investor harm. Cases in which extraordinary penalties are awarded contain some of the worst examples of advisers defrauding, manipulating, stealing from, and otherwise causing substantial losses to, their investors. They read like a compendium of methods to cause investors actual harm.

So what does the Division argue justifies the gravest penalties that may be ordered in *this* case? Three missed deadlines. That's it. There is no allegation that any investor lost a dime; no

suggestion that SBAM lined its pockets; no fraud; no misrepresentation; no deception. Just three missed deadlines. Unlike every other case that the Division cites in its briefs, in which the missed deadline came with investor loss, or fraud, or deception, here the missed deadline was accompanied by—nothing.

In its struggle to justify putting SBAM out of existence, the Division argues—even in the admitted absence of actual harm—that some unquantified, non-specific *risk* of harm to investors, plus a cease-and-desist order entered against SBAM in 2010, should turn SBAM's three missed deadlines into a capital case. They argue that three missed deadlines should be counted as 30 because SBAM managed ten funds and missed the deadline over three years. As demonstrated below, each of these efforts fail, for the following reasons: The offense charged is beyond the scope of the statute, and therefore no liability can be found. Even if it could be, none of these penalties may be awarded on summary disposition. Moreover, they are completely out of line with the law, SEC regulations, and relevant precedent—the very cases the Division itself cites in its briefs—and they are not in the public interest.

A. SBAM's Technical Violation Of Rule 206(4)-2, Without More, Cannot Constitute A Violation Of Section 206(4) Of The Investment Advisers Act, And Therefore No Liability May Be Found Against SBAM

Here, the Division is using an SEC rule to attempt to punish conduct that the Act does not prohibit, because the conduct is not actually fraudulent, deceptive, or manipulative. The Act makes it "unlawful for any investment adviser . . . directly or indirectly . . . (4) to engage in any act, practice, or course of business which *is* fraudulent, deceptive, or manipulative." 15 U.S.C. §80b-6(4) (emphasis added). Unlike § 17(a)(3) of the Securities Act of 1933 (the "Securities Act"), which makes it unlawful "to engage in any transaction, practice, or course of business

which operates *or would operate* as a fraud or deceit," § 206(4) of the Act prohibits only such conduct that *is* actually fraudulent, deceptive, or manipulative. Pursuant to the Act:

> The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business *as are* fraudulent, deceptive, or manipulative.

15 U.S.C. §80b-6(4) (emphasis added). It is axiomatic that the scope of a rule may not exceed the scope of the statute pursuant to which it is promulgated. *See, e.g., Matter of John P. Flannery,* No. 314081, 2014 WL 7145625, at *12 (S.E.C. Dec. 15, 2014) ("liability under Rule 10b-5 cannot extend beyond conduct encompassed by Section 10(b)'s prohibition") (internal quotation omitted); *SEC* v. *Tambone*, 597 F.3d 436, 446 (1st Cir. 2010).

As with § 17(a) of the Securities Act, scienter is not a required element of a violation of § 206(4) of the Act; the focus is on the result of the challenged conduct (*i.e.*, whether it was *in fact* fraudulent, deceptive, or manipulative). As explained by the Supreme Court in *Aaron* v. *SEC*, "§ 17(a)(3)'s language, 'to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit,' plainly focuses upon the *effect of* particular conduct on members of the investing public, rather than upon the culpability of the person responsible." 446 U.S. 680, 681 (1980) (emphasis in original). Thus, the Division errs when it claims that "[b]ecause the Custody Rule provides for strict liability, SBAM's late delivery of the 10 Funds' audited financial statements makes it liable as a matter of law." Mot. at 18. Instead, to decide whether SBAM may be sanctioned, this Court must determine whether SBAM's missed Rule 206(4)-2 deadlines were, in fact, fraudulent, deceptive, or manipulative—*i.e.*, whether any SBAM investor was defrauded, deceived, manipulated, or otherwise injured by SBAM's delay in providing audited financial statements—because that is the only conduct that violates the statute. But according to the Division itself, "there is *no* evidence of investor loss."

Mot. at 32 (emphasis added). The Division's back-up argument is that SBAM's delay in providing investors with audited financial statements "subjected investors to significant risk of substantial loss." *Id.* While this argument might support the Division's overreaching request for third-tier penalties if it were correct, it does not help with the Division's more basic problem: enforcing a regulation in a manner not allowed by the statutory text.

B. The Sanctions Sought Are Not Available On Summary Disposition

Even if the Division's case were authorized by the statute, its call for sanctions against SBAM should be denied out of hand, because such severe sanctions cannot be awarded on summary disposition. In assessing whether sanctions are warranted, the Court considers, among other things, whether the conduct "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement" (§ 203(i)(3)(A))—all of which require analysis of respondents' state of mind. The Court also considers the so-called *Steadman* factors, including respondents' "scienter." *Steadman* v. *SEC*, 603 F .2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). These matters, implicating respondents' state of mind to determine whether remedial sanctions are warranted, are uniquely suited for determination in an evidentiary hearing—not on summary disposition. The Commission's own rules contemplate this. As stated in the comment to Rule 250:

> Motions for disposition prior to hearing may provide particular benefits in regulatory proceedings. Enforcement or disciplinary proceedings in which a motion for disposition prior to hearing would be appropriate are likely to be less common.
>
> * * *
>
> Where partial disposition may be appropriate in some cases, a hearing will still often be necessary in order to determine a respondent's state of mind and the need for remedial sanctions if liability is found.

17 C.F.R. § 201.250 (2009); *accord Matter of Orlando Joseph Jett*, No. 3-8919,1996 WL

281717, at *2 (S.E.C. May 17, 1996). While the Division argues that summary disposition is appropriate as to SBAM's liability because "scienter is not at issue" with respect to "the Division's Custody Rule Claims against SBAM" (Mot. at 17), it musters no caselaw support for the proposition that a sanctions determination is appropriate at this stage; it instead acknowledges that "the degree of scienter involved" must be considered to determine if the sanction it seeks—revocation—serves the public interest. Mot. at 27. For this reason alone, the Division's request for sanctions on summary disposition must be denied.

C. The Division Has Not, And Cannot, Meet Its Burden To Justify Extraordinary Sanctions, Including Permanent Revocation And Third-Tier Financial Penalties

According to the Fifth Circuit's *Steadman* decision, "when the Commission chooses to order the most drastic remedies at its disposal, it has:

- *a greater burden*
- to show *with particularity*
- the *facts and policies* that support those sanctions
- and *why less severe action would not serve to protect investors.*

Steadman, 603 F.2d at 1137 (emphases added). The Division's papers utterly fail in this regard. Instead of satisfying its "greater burden," showing "with particularity" the need for the sought-after sanctions, and addressing why "less severe action" would not suffice, the Division makes the bare minimum showing on each sanctions request. For example, with regard to its demand that SBAM's registration be permanently revoked, it suggests that the violation was "willful" (a low bar to clear) and that a penalty would be in the "public interest." Reply at 13. While SBAM disputes that any penalty requested satisfies the public interest test (*see infra*), even assuming that it did, the Division's bare-bones showing gets it, at best, to § 203(e)'s *minimum* penalty: censure. It has failed to meet its heightened burden to support the permanent revocation of

SBAM's registration, especially as opposed to less severe penalties. Likewise, the Division attempts to justify third-tier penalties on only two of § 203(i)(C)'s seven possible statutory grounds. As demonstrated *infra*, it fails even on those two, but the Division cannot have met its heightened burden with *no* showing of "fraud," "deceit," "manipulation," "substantial losses" (let alone *any* losses), or "substantial pecuniary gain to" SBAM (let alone *any* pecuniary gains)—and an ineffectual showing on "reckless disregard of a regulatory requirement" and "significant risk of substantial losses" to investors. 15 U.S.C. § 80b-3(i)(1)(C).

D. The Division Has Failed To Prove Any "Significant Risk Of Substantial Losses" To Investors

Although the Division has attempted to remove all sense of context and materiality from this proceeding, with its soundbites and selective quotations aside, *there was no harm to investors*. In every other proceeding we have found alleging Custody Rule violations by an investment adviser, the Division alleged more than simply a delay in providing audited financials—material misrepresentations in financial statements, diversion of investor funds to offshore bank accounts, commingling of investor funds, and the like. No such misconduct is alleged here.

Because it cannot show actual investor harm, the Division alleges that SBAM subjected its investors to "significant risk of substantial loss" based solely on the delays in delivering audited financial statements. Mot. at 31. But the Division fails in demonstrating risk. First, the best indicator of a substantial risk—the actual occurrence of harm—is wholly absent. "Actual investor losses have a bearing on whether Defendants' conduct presented a risk of substantial investor losses." *SEC* v. *Reserve Mgmt. Co., Inc.*, 2013 U.S. Dist. LEXIS 141018, at *61 (S.D.N.Y. Sept. 30, 2013). Second. the Division has not cited a case in which an adviser's delays in providing audited financial statements *alone*, as here, was the cause of "substantial risk

of significant harm." Third, following the issuance of the OIP in this very case, securities experts cast doubt on the usefulness of audited financials to fund investors at all—calling into question the Division's conclusory explanation that missing the 120-day deadline risks any harm, let alone causes a "*significant* risk of *substantial* losses." For example, the Day Pitney firm's November 4, 2014 client alert, *"Custody Rule" Information Delays Lead to Enforcement against Investment Adviser*, states that as a result of this case, "enforcement actions have moved out of the realm of punishing wrongdoers for harm caused and into preemptive measures apparently designed to enhance full compliance with . . . the 'Custody Rule.'" Alert at 1. The alert further noted that the administrative proceedings against SBAM were instituted "regardless of the impact of such breaches [of the Custody Rule] on the client." *Id.* at 2. According to the Alert:

> most fund investors *may not see much value* in receiving annually the GAAP-compliant audited financial statements of the fund. Reporting to investors on a fund's performance typically occurs quarterly, *so information in the annual audits, sent 120 days after the end of the fiscal year, may be seen as unnecessary for an investor's evaluation of the fund and its performance.*

Id. (emphases added) Finally, and most importantly, the Division's attempt to argue how late delivery of audited financials can cause a "significant risk of substantial losses"—especially given its heightened burden to show, with particularity, facts that justify such sanctions (*Steadman*, 603 F.2d 1137)—utterly fails. The Division argues in sweeping generalities about possible risks, not in particularized facts about specific risks to SBAM's investors. It suggests, in general, that late audited financials might result, in some cases, in the discovery by an investor of some untoward activity, slightly later than the investor would otherwise have discovered it. At most, this describes a *general* risk of *possible* losses. But that is all. This argument does not meet the Division's burden, and, in addition to allowing this Court to reject the top-tier sanctions

the Division seeks, this weak showing by the Division allows the Court to limit sanctions against SBAM to the lowest possible tier.[1]

E. None of the Division's Requested Penalties Is In The Public Interest

Monetary penalties and registration revocation require a finding, "on the record after notice and opportunity for hearing" (*id.*), that "the public interest" would be served by the requested sanction. *See* §§ 203(e) (for registration status); 203(i)(1)(A) (for monetary penalties). Here, the Division's requested sanctions are obviously not in the public interest.

Section 203(i)(3)(B) lays out the public interest factors, including (1) whether the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the resulting harm to other persons; (3) any unjust enrichment; (4) the respondent's regulatory record; (5) the need for deterrence; and (6) "such other matters as justice may require." It is immediately apparent that, out of the five substantive public interest factors, the Division has not and cannot make any showing as to two of them: investor loss and unjust enrichment. The Division does not claim that anyone suffered any loss here; in fact, it admits the opposite: that "there is no evidence of investor loss." (Mot. at 32.)[2] And there is no allegation that SBAM or any of the respondents was unjustly enriched. With no investor loss and no unjust enrichment, the Division has a tough road making a public interest showing—especially on

[1] The Division cites *In re China-Biotics, Inc.*, No. 3-14581, 2013 WL 5883342, at *13 (S.E.C. Nov. 4, 2013), for the proposition that "the 'timeliness of information [in periodic reports] has considerable value to investors and the markets' and 'a lengthy delay before that information becomes available makes the information less valuable to investors.'" Notwithstanding that China-Biotics was a NASDAQ-traded company alleged to have delayed filing of 10-Ks and 10-Qs containing material, negative information, the case does nothing to reduce the Division's burden to provide particularized facts showing a "significant risk of substantial losses" to SBAM's investors—which it has not done.

[2] The Division cites *In re Flannery*, No. 3-14081, 2014 WL 7145625, at *41 (SEC Dec. 15, 2014) to suggest that *risk* of investor harm, rather than investor harm itself, is part of the public interest calculus. *Flannery* stands for no such proposition, and the Division's argument conflates the statutory factors for public interest (in which "harm to other persons"—not potential harm—is considered) with the separate issue of whether third-tier penalties are warranted (in which "significant risk of substantial losses" may be considered).

summary disposition. Given this, the Division focuses on other factors: it attempts to argue that SBAM (1) deliberately or recklessly disregarded a regulatory requirement; that its regulatory record justifies penalties; and that there is a need for deterrence. None of these arguments succeeds.[3]

1. The Division Does Not and Cannot Show That SBAM's Actions Were In "Deliberate Or Reckless Disregard Of A Regulatory Requirement"

It is undisputed that SBAM did not commit an "act or omission [that] involved fraud, deceit, [or] manipulation."[4] Therefore, the Division attempts to show that SBAM "*deliberately* or *recklessly disregarded* a regulatory requirement"—specifically, the 120-day rule—because (i) the 2010 Order supposedly gave SBAM "*actual notice* . . . that it was required to deliver its audited financial statements within the 120-day timeframe" and, in the 2010 Order, SBAM supposedly was required to cease and desist "*from that precise conduct*" (Reply at 14 (emphases added)), and (ii) "none of the Respondents did anything to ensure that it did not [continue to violate the Rule]" (Mot. at 6).[5]

SBAM urges this Court to focus on the Division's representations about the 2010 Order, and compare them to what the 2010 Order *actually says*. If the Court depended solely on the Division's briefs, it might conclude that in the 2010 Order SBAM:

- was found to have "willfully violated the Custody Rule by not timely distributing audited financials to investors" (Mot. at 5);
- "consented to . . . cease and desist from *that precise conduct*" (Reply at 14);

[3] The Division also points to the *Steadman* factors to attempt to prove public interest: (1) the egregiousness of the defendant's actions, (2) the isolated or recurrent nature of the infraction, (3) the degree of scienter involved, (4) the sincerity of the defendant's assurances against future violations, (5) the defendant's recognition of the wrongful nature of his conduct, and (6) the likelihood that the defendant's occupation will present opportunities for future violations. We address the *Steadman* factors herein as well.

[4] As discussed elsewhere in this brief, this inexorably leads to the conclusion that there was no violation of Sec. 206(4) of the Advisers Act, notwithstanding the language of the rule. *See supra* Part II.A.

[5] The Division also attempts to show "egregiousness" under *Steadman* in this fashion. Missing the Custody Rule deadline in the absence of loss or harm cannot be considered "egregious."

- "had *actual notice* . . . that it was required to deliver its audited financial statements within the 120-day timeframe" (*id.*); and

- was "sanctioned for previous failures" "to deliver [financial statements] *within 120 days* of the end of its fiscal year" (Reply at 16).

Given these representations, one would be forgiven for thinking that the main thrust of the 2010 Order was a 120-day violation. After all, the Division leaves that impression at every turn. But it is not. Instead, SBAM "improperly relied on the custody rule exception that was, at the time, set forth in Rule 206(4)-2(b)(3)" because in 2003 "financial statements for nine funds managed by SBAM came with the auditor's disclaimer of opinion." *See* 2010 Order at 4. While the 2010 Order also says that, in 2007, financial statements "were not distributed to investors in accordance with the Rule" (*id.*), nowhere does the 2010 Order mention that any violation was a result of missing the 120-day clock—in fact, the 120-day timeframe is not found anywhere in the 2010 Order. Courts have cast grave doubt on similar "obey the law" injunctions when—in light of Fed. R. Civ. P. 65(d)(1)—they do not "describe in reasonable detail . . . the act or acts restrained or required." *See, e.g., SEC* v. *Goble*, 682 F.3d 934 (11th Cir. 2012). The act described in reasonable detail in the 2010 Order has to do with whether the 2003 financial statement audit contained a disclaimer, not whether the 120-day rule was violated. In these circumstances—where the 120-day clock was not even mentioned—one cannot conclude that the existence of the 2010 Order made SBAM's subsequent delay "reckless."

That leaves the Division's assertion—loosely based upon testimony from Kelly—that, because no compliance changes were made as a result of the 2010 Order, SBAM was reckless. Leaving aside that a fair reading of the 2010 Order might suggest that the required compliance change would be to refrain from issuing financials with a disclaimer of auditor's opinion, SBAM's prior counsel demonstrated the Division's slight-of-hand on this point as well: no

compliance changes were made after the 2010 Order *because Kelly had made them in 2008.* SBAM Opp. at 5. More importantly, the Division's argument on recklessness cannot be squared with undisputed facts that rebut any inference of recklessness, including:

- SBAM's hiring of an experienced Chief Compliance Officer in April 2008 to serve as the gatekeeper of SBAM's compliance with SEC rules;
- SBAM's retention of an independent compliance consultant, who made regular reports to regulators and the Commission to the effect that SBAM was in compliance with the Act, in 2009;
- safeguards such as the review of SBAM's financial condition, valuation of assets, and reports to investors by lawyers, accountants, auditors, and custodians.

In addition to these safeguards, there is substantial indicia that the Custody Rule—by the SEC's and other's actions and statements—is difficult to comply with, and the missing of deadline, without more, cannot be considered reckless. For example, Slavin, the third-party independent compliance consultant whose reports the Commission required be delivered to it, was the former Director of the Securities and Business Investments Division of the Connecticut Banking Department and a former staff attorney at the SEC. Slavin was inarguably aware of the 2010 Order and the allegations regarding SBAM's violations of the Custody Rule. Slavin was provided with the "late" audits, but did not bring them to the attention of SBAM or the Commission as violations of the Custody Rule. In fact, as admitted by the Division in a footnote to the Motion, "Slavin's reports do not cite SBAM's Custody Rule Violations." Mot. at 3, n.6. The Division says that "Slavin testified, however, that he would have noted them had he known about those violations" (*id*)—admitting that, even for a former SEC official, hired to independently audit an adviser's compliance with the Act—detecting Custody Rule errors is hard.

Moreover, the staff's own statements and guidance provide exceptions to the Rule because of the difficulty of compliance, and the staff acknowledges that there are circumstances under which it would it would not recommend an enforcement action, even in the case of technical violations of the 120-day Rule. *See* Staff Responses to Questions About the Custody Rule (Dec. 13, 2011) ("The Division would not recommend enforcement action for a violation of rule 206(4)-2 against an adviser that is relying on rule 206(4)-2(b)(4) and that 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.") Evėn in this very case, it seems as though—had SBAM asked the Commission in the right way—SBAM's supposedly egregious violations would not have led to an enforcement action: the Division criticizes Kelly for not "reach[ing] out to the Commission's staff for guidance when it became clear that the deadline could not be met." Mot. at 25 (emphasis added). It is also worth noting the tension between, and the difficulty of simultaneous compliance with, two mandatory rules: Rules 206(4)-2 and 206(4)-8, which requires advisers' statements to be not misleading.

Given all of this, not only can no finding of recklessness be reached as to SBAM, but the Division's attempt, by revocation and penalty, to put SBAM out of business for its innocent violation should not be countenanced by this Court.

2. SBAM's Regulatory Record Does Not Justify Penalties, and Repeat Conduct Has Already Been Deterred

As already discussed, the 120-day requirement was nowhere mentioned in the 2010 Order. Therefore, even though SBAM has recognized it missed the 120-day deadline (a *Steadman* factor weighing in favor of SBAM), such conduct should not be considered "recurrent" under *Steadman*—because, while it occurred over three years, it was a single

mistake, and it was different from the conduct that was specifically detailed in the 2010 Order. Since the OIP in this case was issued on October 29, 2014, *none of SBAM's funds has run afoul of the 120-day rule;* SBAM complied with the Rule's 120-day timeline for distribution of audited financial statements for 2013 and 2014. Moreover, SBAM not only assures against future violations (which is another *Steadman* factor weighing in SBAM's favor), but that assurance is highly credible given SBAM's 2013 and 2014 compliance. Additionally, SBAM has overhauled SBAM's compliance procedures and staff, and Kelly is no longer employed by SBAM.

Also relevant to whether penalties are required is whether there were any actual losses suffered by SBAM's investors, or whether SBAM was unjustly enriched. As already shown, neither of these happened. As this Court held in *Matter of Peak Wealth Opportunities, LLC*, a matter in which there had "been no demonstrated resulting harm to other persons and Respondents were not unjustly enriched," a civil penalty is not "needed to deter anyone." No. 3-14979, 2013 WL 812635, at *11. ("In simple terms, Respondents failed to comply with reporting and recordkeeping requirements, nothing more."). In this context—where SBAM has acknowledged its fault, taken significant steps to ensure future compliance, and actually complied in each annual cycle after the OIP was issued, it is not in the public interest to levy strict penalties, because the conduct has already been deterred, and future violations are not likely.

F. There is No Basis for the Imposition of Second- or Third-Tier Monetary Penalties

Section 209(e) of the Act provides three tiers of monetary penalties, in increasing severity, for statutory violations. A first-tier penalty may be imposed for any violation so long as it is in the public interest; a second-tier penalty may be imposed if the violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;" and a

third-tier penalty may be imposed when, in addition to meeting the second-tier requirements, the "violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission."

Here the Division requests that this Court award ***$22,250,000.00*** in penalties. (Mot. at 32-33.) That is the maximum allowable statutory third-tier penalty ($750,000.00), multiplied by 30, since, by the Division's reckoning, there were 30 violations—10 funds' audited financial statements, over three years.

This sanctions demand is, in a word, indefensible. Setting aside the Division's finding of 30 violations when there is only one, SBAM has already shown that:

- Since there was no "significant risk of substantial loss" to SBAM's investors, let alone any *actual* "substantial losses or . . . pecuniary gain" to SBAM (*supra* Part II.D.), third-tier penalties are not warranted, and should be ordered off the table for the hearing in this matter;
- Since there was no "deliberate or reckless disregard of a regulatory requirement" (*supra* Part II.E.1.), not even second-tier penalties are warranted, and should be ordered off the table for the hearing in this matter;
- Since there was no actual losses to SBAM's investors and no significant risk of substantial loss, among many other reasons, the public interest does not require *any* monetary penalties at all in this matter.

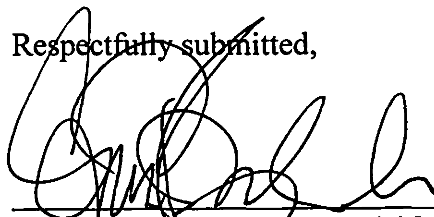
Now to the Division's math. SBAM made one mistake—not 30. And, as amply shown, this one mistake did not result in investor losses or ill-gotten gains to SBAM or any individual respondent. The penalty, if any, should be based on SBAM's single mistake. *See, e.g., Matter of*

vFinance Investments, Inc. No. 3-12918, 2010 WL 2674858, at *18 (S.E.C. July 2, 2010) (penalty for each *rule* violated, not each *instance* of the violation of the rule). Moreover, the Division gets to 30 by counting deviations from the *exception* to the applicable rule (Rule 206(4)-2(b)(4)), not deviations from the rule itself (Rule 206(4)-2(a)(4)). There were, at most, three instances in which SBAM did not submit to Rule 206(4)-2(a)(4)'s surprise audit requirement. Given that the maximum first-tier penalty for an adviser was $75,000.00 (2010 and 2011) and $80,000.00 (2012), SBAM's maximum penalty should not exceed $80,000. If the Court wishes to impose a separate penalty for each year in which SBAM missed a deadline, the maximum such penalty would be $230,000. *See vFinance Investments, Inc. 2010 WL 2674858, at *18.* . The Court should limit the Division in this fashion in any subsequent hearing.

III. CONCLUSION

Wherefore, Respondent SBAM respectfully requests that an order be issued denying the Division's request for summary disposition, and for such other and further relief deemed appropriate by the Administrative Law Judge.

Respectfully submitted,



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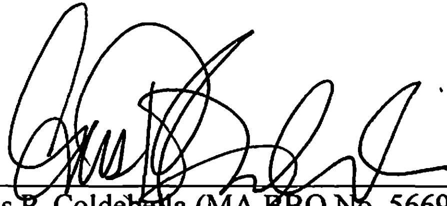
CERTIFICATE OF SERVICE

I hereby certify that on August 21, 2015, I caused all parties to be served with Respondent Sands Brothers Asset Management, LLC's Additional Brief In Response To The Division Of Enforcement's Motion For Summary Disposition.



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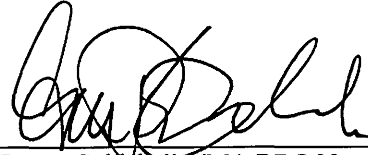
CERTIFICATE OF COMPLIANCE

In accordance with Rule 154(c) of the U.S. Securities and Exchange Commission's Rules of Practice, the undersigned counsel for Respondents Sands Brothers Asset Management, LLC certifies that this Opposition complies with the word-length limitation set forth in Rule 154(c) because it contains 5,141 words.



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Dated: August 21, 2015

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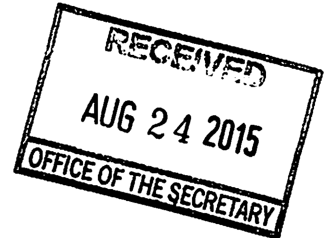

August 21, 2015

<u>VIA EMAIL (alj@sec.gov) AND FEDEX</u>

The Honorable Cameron Elliot
Administrative Law Judge
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: ***In the Matter of Sands Brothers Asset Management, LLC, et al.***
Administrative Proceeding File No. 3-16223

Dear Judge Elliot:

Respondent Sands Brothers Asset Management, LLC ("SBAM") respectfully submits the enclosed Additional Brief in Response to the Division of Enforcement's Motion for Summary Disposition.

By copy of this letter, we have delivered the original and three copies of the Additional Brief for filing, and we have also sent a copy by facsimile.

Thank you.

Very truly yours,

Gus P. Coldebella

Enclosure

ecc: Office of the Secretary (*via facsimile and FedEx*)
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Janna I. Berke, Esq.
Nancy A. Brown, Esq.
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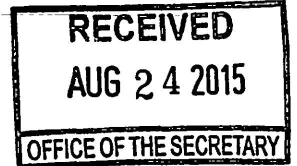

Date August 21, 2015

To Securities and Exchange Commission
Attn: Secretary of the Commission,
Brent J. Fields
100 F Street, N.E.
Suite 1090
Washington, D.C. 20549

Facsimile Fax # 202-772-9324
From Gus P. Coldebella
Re **In the Matter of Sands Brothers Asset Management, LLC, et al.**
Administrative Proceeding File No. 3-16223

Pages including cover 23

Message

NOTE: This facsimile is intended for the addressee only and may contain privileged or confidential information. If you have received this facsimile in error, please notify the sender immediately at the above telephone number.