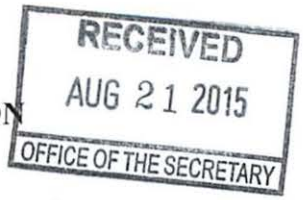
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-16223

In the Matter of

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

Respondents.

RESPONDENTS STEVEN SANDS AND MARTIN SANDS' SUPPLEMENTAL BRIEF IN OPPOSITION TO THE DIVISION OF ENFORCEMENT'S MOTION FOR SUMMARY DISPOSITION

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STATUTES, RULES AND REGULATIONS

Respondents Steven Sands ("S. Sands") and Martin Sands ("M. Sands") (collectively the "the Sands"), respectfully submit this Supplemental Brief in Opposition to the Division of Enforcement's (the "Division") Motion for Summary Disposition (the "Motion").

INTRODUCTION

The Division's Motion should be denied because the Division lacks sufficient evidence to carry its burden of proof on summary disposition, cannot refute the overwhelming evidence of the Sands' reasonable care, and seeks draconian penalties of $4.6 million and permanent industry bars for each of the Sands—all in a case it which it does not allege fraud or harm to a single investor. To establish aiding and abetting liability, the Division must prove that the Sands acted recklessly and substantially assisted SBAM's alleged violation. The Division's causing claim requires proof of negligence and an act or omission that was a cause of SBAM's purported violation. The Division offers *no* evidence to establish any of these elements. To the contrary, the evidence establishes that the Sands exercised reasonable care by appointing a highly qualified chief compliance officer and chief operating officer and vesting him with full authority and responsibility for compliance at SBAM—including compliance with the Custody Rule. The Sands also retained an independent compliance consultant who annually reviewed SBAM's compliance program and concluded in written reports issued to SBAM, the Commission, and the Connecticut Department of Banking that SBAM's compliance program was working well. Notwithstanding, this unrebutted evidence of reasonable care and the Division's inability to carry its burden of proof on summary disposition, the Division nonetheless seeks extreme sanctions that include almost $5 million in penalties and permanent industry bars in case where there is no evidence fraud, investor losses, or even the risk of such loss. For all of these reasons, the Division's Motion should be denied. The Sands also incorporate SBAM's supplemental Brief.

FACTUAL STATEMENT

The evidence submitted by the Sands in their Opposition shows that they took significant, affirmative steps to create a robust compliance system at SBAM and that they reasonably delegated responsibility and authority to Kelly to design and implement that system to ensure compliance.

A. The Sands Took Significant Steps To Create A Robust Compliance System.

Between 2008 and 2010, the Sands completely overhauled the compliance structure at SBAM. The evidence reflects that they took the following actions:

- **The Sands hired a new, fully-qualified Chief Compliance Officer and Chief Operating Officer.** In April of 2008, the Sands hired Kelly to be SBAM's new Chief Compliance Officer (CCO) and Chief Operating Officer (COO). Kelly was highly qualified to fulfill these roles: he had over twenty years of experience practicing law as a regulatory and securities lawyer (*see* FINRA Central Registration Depository Report for Kelly, Ex. 7 to Division's Motion for Summary Disposition, at 4 ("Division's Motion")), he had spent additional time working as general counsel and chief compliance officer for two investment advisers and a broker-dealer (*id.*; Slavin Tr. at 37), and he had passed the FINRA Series 7 General Securities Examination (FINRA Central Registration Depository Report for Kelly, at 5).
- **The Sands reasonably delegated responsibility and authority to Kelly to design and implement a new compliance system.** The Sands delegated to Kelly, as SBAM's new CCO and COO, full responsibility and authority for creating new compliance policies and procedures ***so as to ensure the firm was meeting its regulatory obligations.*** In this role, Kelly drafted a new Compliance Policies and

Procedures Manual ("compliance manual") and assumed responsibility for ensuring SBAM's compliance with all rules and regulatons (Sands Brothers Asset Mgmt. LLC Compliance Policies & Procedures Manual, Nov. 15, 2009, Ex. 39 to Division's Mot. at 1 ("2009 Compliance Manual")). Kelly was also required to annually review SBAM's compliance policies and procedures, including those relating to compliance with the Custody Rule (*id.* at 13).

- **SBAM retained qualified independent auditors for annual audits of funds.** Through Kelly, SBAM retained fully-qualified independent auditors to conduct annual audits of SBAM's various funds (Division's Mot. at 15; Auditor Engagement Letters, Ex. 17 to Division's Mot.).
- **The Sands hired a new, fully-qualified independent compliance consultant.** The Sands retained Richard Slavin as an independent compliance consultant in 2009 pursuant to an agreement with the Connecticut Department of Banking (Slavin Tr. at 10:3-7). Slavin's responsibilities included conducting annual independent reviews of SBAM's compliance program and submitting reports reflecting his findings to the Connecticut Department of Banking, the Commission, and SBAM. (*id.* at 26:2-11, 27:21-25, 28:1-6; 2010 OIP at ¶14). Slavin was highly qualified to fulfill this role: he was the former Director of the Securities and Investments Division of the Connecticut Banking Department (Slavin Tr. at 8:23-9:1) and he had served as the chief enforcement attorney for the Ohio Division of Securities and as an SEC staff attorney (*id.* at 8:14-23).
- **The independent compliance consultant represented that the compliance system worked well.** Slavin carefully examined the new compliance system and manual and

interviewed Kelly. (Slavin Tr. at 27:21-28:25; 29:1-19). As part of his duties, he was required to review the new compliance manual and test Kelly and the compliance system (*id.* at 29:1-19), highlight any compliance deficiencies and make recommendations and if there had been a violation of the 2010 Order it may have been a compliance deficiency (*id.* at 91:6-14). He concluded that by 2010 SBAM's compliance system functioned well, a conclusion he included in a report provided to SBAM, the Commission, and the Connecticut Department of Banking (*id.* at 133:18-134:9; 2012 Analysis of Compliance System of Sands Brothers Asset Management, LLC at 14.).

B. The Sands Reasonably Delegated Responsibility For Compliance To Kelly.

The Sands reasonably delegated to Kelly, SBAM's Chief Compliance Officer and Chief Operating Officer, authority over and responsibility to implement the compliance program. There was never any question that Kelly had responsibility for ensuring SBAM's compliance with Commission rules and regulations. The compliance manual, which Kelly drafted, vested responsibility for compliance in Kelly: "Mr. Kelly will be empowered with full responsibility and authority to develop and enforce appropriate compliance policies and procedures for the Firm." 2009 Compliance Manual, at 1. The compliance manual also provided that, "Where the Firm maintains possession or custody of client funds/securities, the Chief Compliance Officer shall ensure compliance with the restrictions and requirements of *Rule 206(4)-2 adopted under the Advisers Act*."[1] *Id.* at 18.

[1] The compliance manual also separately stated that "[i]t shall be the responsibility of the Chief Compliance Officer to ensure that the Firm complies with Rule 206(4)-2 with respect to those clients (including those Funds), if any, for which the Firm is deemed to have custody of funds or securities pursuant to the [custody] rule." *Id.*

In contrast, the compliance manual charged the Sands with the narrow duty to "ensur[e] that the Firm provides adequate resources to the persons with the responsibilities for implementing an effective compliance program for the Firm," or in other words, to provide adequate resources to the corporate officer to whom they had delegated responsibility for compliance. *Id.* at 1.

ARGUMENT

A. Summary Disposition Is Inappropriate In This Case Under Commission Rules and Policy.

Rule 250(b) of the Commission's Rules of Practice permits the grant of a motion for summary disposition "if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law." The Comment to Rule 250 cautions that, "[t]ypically, enforcement and disciplinary proceedings that reach litigation involve genuine disagreement between the parties as to the material facts" and that, "[w]hile 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 (emphasis added). The Comment recognizes—consistent with federal law on this subject—that determinations of mental state and penalty judgments are uniquely unsuited for summary disposition. This case requires the Administrative Law Judge ("Law Judge") to determine, among other things, *both* mental state and, in the unlikely event liability is found, whether remedial sanctions are necessary. Summary disposition is thus particularly inappropriate in this case.

Historically, the Commission and the Division have followed this policy closely. This is reflected in the Commission's administrative decisions. For example, decisions that summarily dispose of aiding and abetting liability—which requires a scienter determination—ordinarily do

so where the underlying scienter and conduct have been established in a collateral proceeding, such as a criminal case, or are otherwise undisputed. *See, e.g.*, *In the Matter of John J. Bravata, Antonio M. Bravata*, Release No. 737, 2015 WL 220986, at *1 (Jan. 16, 2015) (finding summary disposition appropriate in follow-on proceeding where "[a]ll material facts that concern the activities for which Respondents were convicted were decided against them in the criminal and civil cases on which this proceeding is based."); *In the Matter of John W. Lawton*, Release No. 419, 2011 WL 1621014 (Apr. 29, 2011) (same); *In the Matter of Charles Trento*, Release No. 8391, 2004 WL 1765489, File No. 3-9933, 2004 WL 329040 (Feb. 23, 2004) (same); *In Re Winkler*, Release No. 8348, 2003 WL 23701768, File No. 3-9933, 2003 WL 22971038 (Dec. 17, 2003) (same); *see also In the Matter of Total Wealth Mgmt., Inc., Jacob Keith Cooper, Nathan Mcnamee, & Douglas David Shoemaker Respondents*, File No. 3-15842, 2014 WL 1438614, at *2 (Apr. 15, 2014) (respondents "knew about the revenue sharing arrangements and the related misrepresentations, [and] likewise failed to fully disclose those arrangements to clients"); *In the Matter of Vfinance Investments, Inc., Nicholas Thompson & Richard Campanella*, 94 S.E.C. Docket 1689, 2008 WL 4826017 (Nov. 7, 2008) (respondent CCO and COO knew of violations but failed to address violations).

The Division all but concedes this fact in its Reply Brief. While it argues that summary disposition is not reserved for cases where the respondent's scienter and related conduct are undisputed, it fails to point to a *single* case that supports its argument. Indeed, in the one case it cites, it admits that "sufficient *undisputed* evidence existed to grant the Division's motion." Reply at 3 (citing *In re Matter of S. W Hatfield, CPA*, Release No. 3602, 2014 WL 6850921 (S.E.C. Dec. 5, 2014)) (emphasis added). The undisputed evidence in *Hatfield* included the respondents' scienter and conduct. *See Hatfield*, at *7 (finding respondents *knew* they had not

received the proper certifications and therefore were making false statements when they represented that they were certified).

In contrast, where respondents dispute scienter and related conduct—as the Comment to Rule 250 states—summary disposition is ordinarily denied. As one Law Judge explained in denying summary disposition in a case where the respondents "dispute[d] the predicate acts for almost all the alleged violations, and any intent to commit" those violations: "based on past experience, the circumstances when summary disposition prior to hearing could be appropriately sought or granted will be *comparatively rare*." *In the Matter of Flagship Sec., Inc., Dennis G. Milewitz & Noreen M. Barrington*, Release No. 511, 1996 WL 325248, at *2 (June 3, 1996) (emphasis added).

Against this backdrop, it is unsurprising that almost all of the cases relied on by the Division to support its arguments are decided not on motions for summary disposition but after full-fledged hearings. *See* Opp. at 8-9 n.36 (collecting cases); *see also* Reply (citing *In re Midas Sees., LLC*, No. 3-14308, 2012 WL 169138, at *13 (S.E.C. Jan. 20, 2012) (appeal from FINRA hearing); *In re Marc N. Geman*, 54 S.E.C. 1226, 2001 WL 124847 (2001) (decision on full hearing)).

This case represents a radical departure from that precedent and policy. Here, the Sands dispute mental state, related conduct, and any penalty in their case. The Sands have submitted a 19-page Opposition and file this Supplemental Brief, which identify evidence that demonstrates—at a minimum—a genuine dispute as to whether their conduct was reasonable, whether they were reckless and negligent, and whether penalties are warranted. For this reason alone, the administrative law judge should reject the Division's attempt to dispose of these issues through summary disposition in this case.

B. Summary Disposition Should Be Denied Because The Division Has Not Met Its Burden Of Proof, And Even If It Has, The Sands Have Submitted Evidence That Creates A Genuine Dispute Of Material Fact.

To prove "causing" liability, the Division must establish three elements: "(1) a primary violation was committed; (2) an act or omission by the respondent was a cause of the primary violation; and (3) the respondent knew, or should have known, that [his or] her conduct would contribute to the violation." *Robert M. Fuller*, 56 S.E.C. 976, 984 (2003). This third element requires proof of a "failure to exercise reasonable care or competence." *In the Matter of Zpr Inv. Mgmt., Inc., & Max E. Zavanelli*, Release No. 602, 2014 WL 2191006, at *45 (May 27, 2014).

The standard of proof for aiding and abetting liability is even higher. The Division must prove: (1) a primary or independent securities law violation committed by another party; (2) awareness or knowledge by the aider and abettor that his or her role was part of an overall activity that was improper; and (3) that the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation. *SEC v. Apuzzo*, 689 F.3d 204, 206 (2d Cir. 2012). Where there is a fiduciary duty, recklessness satisfies the scienter requirement, and inaction may constitute substantial assistance. *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990). Federal courts have held that the three elements of the aiding and abetting test "cannot be considered in isolation from one another." *Apuzzo*, 689 F.3d at 214-15. For example, "a high degree of knowledge may lessen the SEC's burden in proving substantial assistance, just as a high degree of substantial assistance may lessen the SEC's burden in proving scienter." *Id.* The cases the Division relies upon are consistent with this standard: they involve either "a high degree of knowledge," or a "high degree of substantial assistance"—or both.[2] In contrast, in this case, the

[2] For example, as the Sands explained in their Opposition, in *Hatfield*, the respondents *knew* that they made misleading statements (2014 WL 6850921, at *7), and in *In re Executive Registrar & Transfer, Inc.*, Release No. 366, 2008 WL 5262371 (Dec. 18, 2008), the Respondent was himself *personally responsible* for the filings and record-keeping tasks at issue, *id.* at *5, *26.

Division seeks to push through a summary disposition for aiding and abetting liability based on the *slightest* possible degree of scienter—recklessness—and the *lowest* possible level of assistance—inaction. The Division's burden of proof in this case is correspondingly high under federal law—and the Division has failed to meet it.

Although at times in its briefing, the Division seems to treat these burdens of proof as simple strict liability (*see, e.g.*, Division's Mot. at 19 ("Where the respondent controls the primary violator and is engaged in the conduct that results in the violation, or fails to ensure the violator's compliance with the law, he is an aider and abettor."))—more is required. To prove causing liability, the Division must prove negligence which is a complete "failure to exercise reasonable care or competence." *In the Matter of Zpr Inv. Mgmt., Inc., & Max E. Zavanelli*, 2014 WL 2191006, at *45.

To prove aiding and abetting liability, the Division must show recklessness, defined as an "extreme departure from the standards of ordinary care to the extent that the danger . . . was either known to the defendant or so obvious that the defendant must have been aware of it." *Rothman v. Gregor*, 220 F.3d 81, 90 (2d Cir. 2000) (citation omitted).[3] This is "a mental state . . . akin to conscious disregard." *In re Comshare Inc. Securities Litig.*, 183 F. 3d 542, 550 (6th Cir. 1999); *In re The Robare Group, Ltd., Mark L. Robare, and Jack L. Jones, Jr.*, Release No. 806, 2015 WL 3507108, *38 (June 4, 2015) ("Although this definition [of recklessness] 'might not be

[3] *See also In re Larry C. Grossman & Gregory J. Adams*, Release No. 727, 2014 WL 7330327 (Dec. 23, 2014) ("Recklessness is an 'extreme departure from the standards of ordinary care, ... which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'") (quoting *SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992)); *In Re Woessner*, Release No. 225 (Mar. 19, 2003) ("Reckless conduct is conduct which is 'highly unreasonable' and which represents 'an extreme departure from the standards of ordinary care ... to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'") (quoting *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1978)).

the conceptual equivalent of intent as a matter of general philosophy,' as a practical legal matter, it amounts to the same thing.") (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)), *review granted* Aug. 12, 2015. For example, the Third Circuit has held that to prove "reckless" issuance of false audit reports, it must be shown that the auditor "lacked a genuine belief that the information disclosed was accurate and complete in all material respects." *McLean v. Alexander*, 599 F.2d 1190, 1198 (3d Cir. 1979). Likewise, to show substantial assistance, the Division must prove that the Sands' conduct "was designed intentionally to aid" the violation or "was in conscious and reckless violation of a duty to act." *SEC v. Mudd*, 885 F. Supp. 2d 654, 670-71 (S.D.N.Y. 2012) (quoting *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983)); *see e.g.*, *In the Matter of Vfinance Investments*, 2008 WL 4826017, at *15-16 (finding aiding and abetting liability where respondent CCO and COO of firm knew of employee's repeated violations but failed to act to reprimand employee and comply with rules).

Under these standards, the Division must do *more* than merely point simultaneously at a Firm's principals and a Firm's alleged rule violation. But the Division's evidence does nothing more than that. The Division fails even to carry its burden on summary disposition to prove causing or aiding and abetting liability. The Division does not point to any evidence in the record that shows the Sands failed to exercise reasonable care, much less that the Sands knew, should have known, or were *reckless* in not knowing about the alleged Custody Rule violation.

1. The Division does not show that the Sands failed to exercise reasonable care—much less that they were reckless.

The Division can point to no evidence that the Sands knew, should have known, or were negligent in not knowing about or complying with the 120-day rule. Instead, the Division relies on constructive knowledge and strict liability concepts such as the Sands' status as firm principals and the Sands' certifications of general compliance with the law. For example, the

Division states that the Sands "are the principals, co-chairmen and controlling persons of SBAM, who "make material decisions on behalf of SBAM." Div. Mot. at 20. It then points to "yearly Acknowledgements," in which "S. Sands and M. Sands each acknowledged that he was 'aware of all laws, rules and regulations applicable to [him], and undertakes to continue to remain informed about all relevant compliance requirements.'" *Id.* But such certifications to abide by "all laws" are not enough to show that the Sands should have known or were negligent in not knowing about a specific part of a specific rule—particularly where they had expressly *delegated responsibility* for compliance with that rule to another corporate officer.

Similarly, the Division argues that the "Custody Rule's 120-day requirement was set out in the Compliance Manual." Div. Mot. at 20 (citing Ex. 39, at Section IX. D. 5). The 120-day requirement is ***not*** set out in the portion of the compliance manual cited by the Division—or anywhere else in that document. The portion of the compliance manual cited by the Division restates the old custody rule, which requires issuance of quarterly reports to investors, or as an alternative to quarterly statements, distribution of financial statements within 120 days of the close of the fiscal year. *See* Div. Mot. Ex. 39, at Section IX. D. 5. Thus, the Division cannot possibly rely on the compliance manual it cites to prove its case as the Sands.

The Division also argues that "the Sands understood their obligations to ensure SBAM's compliance with the Custody Rule because each consented to entry of the 2010 Order against him personally for aiding and abetting SBAM's Custody Rule violations." Div. Mot. at 20. But, again, the Division overstates the evidence. The 2010 Order says ***nothing*** about the 120-day deadline. Instead it finds that for the fiscal year 2003, SBAM violated the Custody Rule by distributing financial statements with an auditor disclaimer. It also contains a single sentence stating more generally that financial statements for fiscal year 2007, were not distributed in

accordance with "the Rule." Div. Mot Ex. 15, Commission's Oct. 22, 2010 Order Instituting Administrative and Cease-and-Desist Proceedings, *In re Sands Brothers Asset Management LLC, Steven Sands, and Martin Sands*, File No. 3-14097. Thus, the Division cannot rely on the 2010 Order either.

In addition, the Commission's cease and desist order against the Sands does not specifically refer to a 120-day deadline either. That order directs the Sands to cease and desist from committing or causing any violations and future violations of certain sections of the Advisers Act and related rules. *Id.* at ¶ IVA. Similar orders have been viewed with disfavor by federal courts because such orders do not "describe in reasonable detail . . . the act or acts restrained or required." *SEC v. Goble*, 682 F. 3d 934 (11th Cir. 2012) ("[O]ne of the primary problems with obey-the-law injunctions is that they often lack the specificity required by [Fed. R. Civ. P.] 65(d). As the Supreme Court has explained, [those requirements] are 'designed to prevent uncertainty and confusion on the part of those faced with injunctive orders, and to avoid the possible founding of a contempt citation on a decree too vague to be understood.'" (quoting *Schmidt v. Lessard*, 414 U.S. 473, 476 (1974)).

Finally, the Division seeks to rely on Kelly's self-interested testimony that he "repeatedly reminded everyone in the working group- including the Sands –of the Custody Rule deadlines." Div. Mot. at 20. But when questioned specifically on the subject, Kelly said that he "mentioned [the Rule] within a couple of weeks of arriving at Sands Brothers in 2008." Div. Mot. Ex. 6 at 20:23-21. Of course, this would have been *before* the new 120-deadline was implemented so, again, the Division cannot base its case on this evidence. And regardless, Kelly's self-interested statements would be insufficient—*on summary disposition*—to show that the Sands knew, should have known or were negligent in not knowing about the rule violation.

The Division's evidence that the Sands caused or substantially assisted the rule violation suffers from similar failings. As an initial matter, the Division has a hard time identifying any specific failure to act at all. First, it argues the Sands "did not allocate additional resources to the task, as the Compliance Manual required." Div. Mot. at 21. However, the Division does not identify any specific resources that the Sands should have allocated, but did not, nor does it explain how allegedly missing resources ever prevented SBAM's compliance with the Custody Rule. The record in the case does not show that SBAM's purported rule violation was caused or aided and abetted by a "lack of resources." Indeed, in his repeated contemporaneous interviews with SBAM's independent compliance consultant, Slavin, Kelly never once complained about inadequate resources to implement an effective compliance program. Slavin Tr. at 57:2-6.

The Division also argues the Sands "did not ensure that the audits were completed on time" and "failed to make information available to the auditors necessary to the completion of the audit work." Div. Mot. at 21. But supervision and the provision of information to the auditors was Kelly's responsibility as CCO and COO. Although the Division points to a letter from the auditors to the Sands that highlights delays in receipt of information, Div. Mot. Ex. 44, Letter from CGS to M. Sands and S. Sands, at 3 (Sept. 3, 2013), the Letter is dated September 3, 2013. Thus, subsequent to this letter, SBAM corrected its conduct and the audits were completed on time in the following year, 2014.

The Division next argues that the refusal to timely pay the auditors led to the rule violation. Div. Mot. at 22. The Division infers this from emails that indicate payments were made late on two funds, but nowhere in these emails is there any connection made between late payments and the rule violation. And, regardless, as SBAM's CCO and COO, it was Kelly's obligation to ensure proper payment of the auditors.

Finally, the Division argues that Martin Sands "produced SBAM's violation in at least one year" by "refus[ing] to sign the Management Representation letters that the auditors required because he wanted to review the 10 Funds' financial statements 'all at once.'" Div. Mot. at 21. In fact, Mr. Sands received the email requesting his signature on the funds on April 29, 2011, *the day before* the financial statements were due. At the eleventh hour, it was impossible for him to complete *his* review of the statements and perform *his* duties in time to send out the statements by April 30, 2011.

Moreover, the Division points to *no* evidence whatsoever that shows that Steven Sands was the cause of any rule violation or failed to exercise reasonable care. *See* Div. Mot. at 21-22.

The Division's tenuous evidence is plainly inadequate to prove that summary disposition against the Sands is warranted.

2. The evidence shows that the Sands exercised reasonable care or—at a minimum—that there is a genuine dispute over whether they exercised reasonable care.

Even if the Division has carried its burden on summary disposition, the Sands have submitted evidence that shows they exercised reasonable care under the circumstances. The Sands' evidence shows: (1) that they took affirmative steps to create a robust compliance system at SBAM and (2) that they reasonably delegated responsibility and authority for implementing that system and ensuring compliance to Kelly. At a minimum, the evidence creates a genuine dispute of material fact for trial.

First, as set forth in their Opposition and above, *supra* at 2-4, between 2008 and 2010, the Sands completely overhauled the compliance structure at SBAM and hired Kelly, a new, fully-qualified CCO and COO, as well as a new, fully-qualified independent compliance consultant. The Sands delegated responsibility to the new CCO and COO to design and implement a new

compliance system, including creating new compliance policies and drafting a new compliance manual. 2009 Compliance Manual, at 1. The CCO and COO also retained qualified independent auditors for annual audits of funds. Div. Mot. at 15. Ultimately, SBAM's independent compliance consultant represented that the compliance system worked well. Slavin Tr. at 133:18-134:9.

This evidence reveals that the Sands took significant steps to create effective comprehensive, sophisticated compliance structure at SBAM. Consistent with Commission guidance on this subject, they "implemented comprehensive, written policies and procedures" and hired independent compliance expert Richard Slavin to "conduct periodic reviews of their compliance programs." Compliance Programs of Investment Companies and Investment Advisers, 68 Fed. Reg. 74,714, 74,724 (Dec. 24, 2003).

The Sands' efforts here contrast starkly with the conduct at issue in the cases relied upon by the Division. For example, in *Matter of Marc N. Geman*, No. 3-9032, 2001 WL 124847, at *17 (S.E.C. Feb. 14, 2001), *aff'd*, 334 F.3d 1183 (10th Cir. 2003), the principal of a firm was held liable for the firm's record-keeping violations even though he argued he had delegated responsibility for record-keeping to another corporate officer. But as the Division concedes, the Commission held in *Geman*, that the principal "*took no steps* to ensure that—or inquire whether—[the firm] was making . . . arrangements to satisfy recordkeeping obligations." *Id.*

Second, the Sands reasonably delegated responsibility for ensuring compliance to Kelly. The Commission has held in an analogous context that a firm's principal or manager "is responsible for the firm's compliance with all applicable requirements unless and until he or she reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such a person is not properly performing his or her duties." *In re John B.*

Busacca III, Exchange Act Release No. 63312 (Nov. 12, 2010), 99 SEC Docket 34481, 34496, 2010 WL 5092726, at *10 (quoting *In re Richard F. Kresge*, Release No. 55988 90 SEC Docket 3072, 3084, 2007 WL 502250 (June 29, 2007)); *see also In re Donald T. Sheldon*, 51 S.E.C. 59, 79 (1992), *aff'd* 45 F.3d 1515, 1517 (11th Cir. 1995).

There was never any question that Kelly had responsibility for ensuring SBAM's compliance with Commission rules and regulations. The compliance manual, which Kelly himself drafted, vested responsibility for compliance in Kelly: "Mr. Kelly will be empowered with full responsibility and authority to develop and enforce appropriate compliance policies and procedures for the Firm." 2009 Compliance Manual, at 1. The manual also provided that that "Where the Firm maintains possession or custody of client funds/securities, the Chief Compliance Officer shall ensure compliance with the restrictions and requirements of *Rule 206(4)-2 adopted under the Advisers Act*." *Id.* at 18. In contrast, it charged the Sands with the narrow duty to "ensur[e] that the Firm provides adequate resources to the persons with the responsibilities for implementing an effective compliance program for the Firm," or in other words, the corporate officer to whom they had delegated responsibility for compliance. *Id.* at 1.

"The Commission has recognized with approval the use of compliance experts to assist firms in meeting their disclosure obligations." *In re The Robare Group*, Release No. 806, 2015 WL 3507108 (citing Compliance Programs of Investment Companies and Investment Advisers, 68 Fed. Reg. 74,714, 74,724-25 & nn.105, 107, 74728 n.130 (Dec. 24, 2003)). In fact, one Administrative Law Judge recently rejected, after a hearing, the Division's claims that firm principals were reckless and negligent in failing to comply with portions of the Custody Rule where they hired fully-qualified experts to ensure compliance. The Law Judge found that, "[a]bsent evidence from the Division on this matter, I find that the relevant standard of care

entails employing a compliance professional and following his or her advice." *Id.* at *39. Where the firm and its principals had "relied on several compliance professionals and followed the advice it received[,] [t]o say that it departed in an extreme fashion from the standards of ordinary care is to unhinge the word extreme from its ordinary definition." *Id.* The Law Judge similarly rejected the Division's negligence arguments, holding that neither firm principal "have expertise with respect to [the relevant portions of the Custody Rule]; thus, they "relied on experts," and no one told them "there was a problem." *Id.* at *40.

In this case, the Sands relied on Kelly's expertise—and Slavin's independent, regular evaluations—to ensure compliance with the Custody Rule. The Sands also relied on Kelly for their understanding of the Custody Rule. As explained above, the Compliance Manual did not set forth the *new* requirements of the 2010 Custody Rule's 120-day deadline, *supra* at 11, and nowhere has Kelly stated or testified that he specifically told *the Sands* about the 120-day rule or its import. In fact, as the Division reveals in its Motion, the 120-day rule is not an unyielding deadline—the SEC may make alternative arrangements with firms who cannot or do not meet the 120-deadline. The Division specifically states that Kelly should have sought guidance from the Commission on Custody Rule compliance under the circumstances, but failed to do so.[4] Indeed, we have not found a single other case in which the Division has sought third tier penalties for an isolated violation of the 120-day rule. Under these facts, the Sands would have no "reason to know that [Kelly] [was] not properly performing [his] duties." *In re John B. Busacca III*, 2010 WL 5092726, at *10. For these reasons too, the Division has failed to show that the Sands knew, should have known, were willfully blind or otherwise were negligent in not knowing about the alleged violation of the Custody Rule.

[4] *Id.* at 25.

This evidence of the Sands' significant steps to create and ensure an adequate compliance system as well as their delegation of compliance responsibility to Kelly creates a "genuine issue with regard to . . . material facts" at issue in this case. Commission Rules of Practice Rule 250(b). The Law Judge accordingly should deny the Division's motion for summary disposition.

C. A Hearing Is Necessary To Determine Whether Sanctions Are Warranted In This Case.

Regardless of whether the Law Judge finds liability suited to determination on summary disposition, Commission policy makes clear that summary disposition is not an appropriate way to dispose of remedial sanctions. The Comment to Rule 250 explains that, "[w]hile 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 (emphasis added). This is particularly true here because imposition of third tier sanctions *requires* a finding of intent or recklessness.

Both the Law Judge and the Division itself have already acknowledged this fact in this proceeding. At the December 2, 2014 Conference, the Law Judge noted, consistent with Commission policy, summary disposition would be inappropriate for determining potential sanctions if liability were found on other claims: "I would expect anyway that if I were to resolve anything it might resolve the question of liability, [] but I would not necessarily expect that it would resolve the question of sanction if I were to get to the point of sanctions."[5] Counsel for the Division agreed, stating, "That's totally in line with our views, Your Honor."[6]

Thus, Commission policy, the Law Judge, and both parties *agreed* that summary disposition is not an appropriate forum for determining whether and what sanctions are

[5] Tr. of December 2, 2014 Prehearing Conf. in *In re Sands Brothers Asset Mgmt. LLC et al.* ("Conf. Trans.") at 5:12 – 22.

[6] Conf. Trans. at 5:24-6:4.

warranted in this case. Accordingly, the Division's Motion for Summary Disposition against the Sands on the issue of sanctions should be denied.

D. Sanctions Are Not Warranted In This Case.

The Division may bar an advisor from practice if the sanction is in the public interest and the adviser or associated person has "willfully violated any provision of the Advisers Act," or "willfully aided and abetted another person's violation of the Advisers Act, or its rules or regulations," and the bar "is in the public interest." 15 U.S.C. § 80b-3(e). To determine whether a bar is in the public interest, the Law Judge may consider, "[1] the egregiousness of the respondent's actions, [2] the isolated or recurrent nature of the infraction, [3] the degree of scienter involved, [4] the sincerity of the respondent's assurances against future violations, [5] the respondent's recognition of the wrongful nature of his or her conduct, and [6] the likelihood that the respondent's occupation will present opportunities for future violations,"[7] (7) the age of the violation,[8] (8) the degree of harm to investors and the marketplace resulting from the violation,[9] (9) the extent to which the sanction will have a deterrent effect,[10] and the combination of sanctions against the respondent.[11] The Law Judge should weigh these factors in light of the entire record and no one factor is dispositive.[12]

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[7] *Matter of Vladimir Boris Bugarski*, No. 3-14496, 2012 WL 1377357, at *4 (S.E.C. April 20, 2012) (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)).

[8] *Marshall Melton*, 56 S.E.C. 695, 698 (2003).

[9] *Id.*

[10] *Schield Mgmt. Co.*, Exchange Act Release No 53201 (Jan 31, 2006), 87 SEC Docket 848, 862.

[11] *KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1192 (2001), *pet'n denied*, 289 F.3d 109 (D.C. Cir. 2002).

[12] *Id.* at 1185.

The Division argues that the Sands willfully violated the Custody Rule or aided and abetted SBAM's violation and that a bar is in the public interest. It submits that a bar is in the public interest here even though the majority of factors considered are absent. First, it argues that "the violations were recurrent—occurring three years in a row, in addition to the prior violations that were the subject of the 2010 Order." Div. Mot. at 27. But even assuming that the evidence in this case shows that Sands knew, should have known, or were negligent in not knowing about the rule violation—which it does not—because the Division did not notify the Sands of any violation until all three violations had occurred, the Division can hardly rely on this factor to make its case. And despite the division's suggestive language, there is no question that the conduct at issue in this case, an alleged failure to comply with the Custody Rule, reflects a *single* alleged violation, not multiple violations. Thus, the Sands' case stands in stark contrast to the cases cited by the Division (Mot. at 28-29) to support severe penalties here. *Compare In re Executive Registrar & Transfer, Inc.*, 2008 WL 5262371, at *20 (Dec. 18, 2008) ("During the five examinations performed by the staff from 2002 through 2006, numerous deficiencies were found .... Year-after-year, [respondent], as the control person for each company, seemed incapable or unwilling to comply with Commission rules, as judged by the repeated deficiencies found at agencies under his control."), *and Matter of Phlo Corp.*, No. 3-11909, 2007 WL 966943, at *12-13, 16 (S.E.C. Mar. 30, 2007) (respondent engaged in numerous and varied violations).

The Division also argues that the Sands "delivered the audited financials to investors not just days, but months, after they were due."[13] The Sands, nonetheless, did deliver the financial statements *each* year, and once they were informed of a violation, they delivered the statements *on time* in the following year. The one case cited by the Division (Mot. at 28) to support its

[13] Div. Mot. at 28.

argument is—again—nothing like this case. *In re China-Biotics, Inc.*, No. 3-14581, 2013 WL 5883342 (S.E.C. Nov. 4, 2013), involved a NASDAQ-traded company alleged to have numerous deficiencies, including late-filed 10-Ks and 10-Qs containing material, negative information.

In addition, the Division argues that the Law Judge—*on summary disposition*—should "view[] skeptically" "any assurances against future violations."[14] It is rather remarkable that the Division even submits this admonition to the Law Judge, much less attempts to insert it into this case to show a bar is in the public interest. On the contrary, the Sands' efforts to completely overhaul SBAM's compliance structure starting in 2008 reflect a sincere desire on their part to prevent future violations. Finally, the Division argues that "SBAM will have every opportunity to flout its regulatory obligations again."[15] Again, this is not a reason that a bar would be in the public interest, but an unsupported opinion of counsel that the Law Judge should not credit, and particularly not in a summary disposition proceeding.

The Division seeks the highest possible penalties in this case, punishment "reserved for conduct involving a 'deliberate or reckless disregard of a regulatory requirement,' and 'creat[ing] a significant risk of substantial losses to the other persons.'"[16] "[W]hen 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 v. S.E.C.*, 603 F.2d 1126, 1137 (5th Cir. 1979) *aff'd*, 450 U.S. 91 (1981). Third-tier penalties are manifestly inappropriate in this case. As demonstrated above, the Division has wholly failed to show that the Sands' conduct in the case

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[14] Div. Mot. at 28.

[15] Div. Mot. at 29.

[16] *See* Division's Mot. at 31 (quoting 15 U.S.C. § 80b-3(i)(1)(B)(2)(C)(i) and (ii)).

was reckless (*supra* at 10-17), or that sanctions are in the public interest (*supra* at 20-21), and as explained below, the Sands' conduct created *no* risk of *any* losses to investors in this case.

"Actual investor losses have a bearing on whether Defendants' conduct presented a risk of substantial investor losses." *SEC v. Reserve Mgmt. Co.*, 2013 U.S. Dist. LEXIS 141018, at *61 (S.D.N.Y. Sept. 30, 2013). As the Division *concedes*, there is no evidence of *any* actual investor loss in this case whatsoever.[17]

In addition, SBAM's investors were highly sophisticated persons and entities that chose to pursue high-risk, illiquid investments that could, in many cases, not readily be redeemed. To the extent any investor was concerned about a lack of information, or about the 120-day rule in particular, it could have contacted SBAM to inquire about the status of the audits or could have sought to redeem any funds that were not locked up due to a fund's liquidation—but of course, none did. Moreover, there is no evidence that the Sands received any pecuniary gain as a result of the allegedly untimely distribution of audited financial statements. On these facts, the Division has wholly failed to show that third tier sanctions are appropriate in this case.[18]

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[17] *See id.* at 32.

[18] In its Order disqualifying Martin H. Kaplan (Kaplan), the Administrative Law Judge mentioned that Kaplan had "colluded with the Sands to formulate a defense that would pin the blame on Kelly." Disqualification Order, AP-2503, at 5. Subsequently, however, the Administrative Law Judge clarified that the Disqualification Order "did not dispose of any 'charges' or impose any sanction against the Sands, nor did it expand their potential liability beyond the scope of the OIP." The Administrative Law Judge also clarified that, "I intend to give the Sands a full and fair opportunity to address this issue once SBAM has retained new counsel (or determined to proceed without retained counsel)." It is plain that if Mr. Kaplan had a conflict of interest in his representation of the Sands, it was incumbent on him to disclose that conflict—as well as its import—to the Sands. Conflicts disclosure is an integral part of effective legal representation, and the Sands, who have no legal training, relied on Kaplan to advise them and make any necessary disclosures. "As a rule, it is the duty of the attorney to disclose conflicts, and not the obligation of his client to ferret them out." *In re Granite Partners, LP*, 219 B.R. 22 (S.D.N.Y. B.R. 1998).

CONCLUSION

Wherefore, Respondents S. Sands and M. Sands respectfully request an order be issued denying the Division's request for summary disposition against them and for such other and further relief deemed appropriate by the Administrative Law Judge.

Dated: August 21, 2015

Respectfully submitted,

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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 Steven Sands and Martin Sands certifies that this Opposition complies with the word-length limitation set forth in Rule 154(c) because it contains 6,555 words, excluding the parts of the Opposition exempted by Rule 154(c).

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Dated: August 21, 2015

CERTIFICATE OF SERVICE

I hereby certify that on August 21, 2015, I caused the following parties to be served with Respondents Steven Sands and Martin Sands' Opposition to the Division of Enforcement's Motion for Summary Disposition and the supporting Declaration of Matthew A. Rossi, by transmitting the same in the manner indicated below:

VIA COURIER Office of the Secretary U.S. Securities and Exchange Commission 100 F Street, N.E. Suite 1090 Washington, DC 20549 *Original and 3 Copies*	***VIA EMAIL TO ALJ@sec.gov AND UPS NEXT BUSINESS DAY*** The Honorable Cameron Elliot Administrative Law Judge U.S. Securities and Exchange Commission 100 F Street, N.E. Washington, D.C. 20054-2557 *Courtesy copy via email to Anthony Bruno* at BrunoA@sec.gov
VIA EMAIL TO BerkeJ@sec.gov AND UPS NEXT BUSINESS DAY Nancy A. Brown Janna I. Berke Securities and Exchange Commission Brookfield Place 200 Vesey Street Suite 400 New York, New York 10281	***VIA EMAIL TO [redacted] AND First Class Mail*** Gus Coldebella Fish & Richardson P.C. 1425 K Street, NW 11th Floor Washington DC, 20005
VIA EMAIL TO [redacted] AND UPS NEXT BUSINESS DAY Christopher Kelly [redacted] Greenwich, CT [redacted]	

The undersigned undertook filing with the Office of the Secretary via courier to ensure filing completion prior to the close of business.

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Dated: August 21, 2015