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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16353

In the Matter of

SPRING HILL CAPITAL MARKETS, LLC,
SPRING HILL CAPITAL PARTNERS, LLC,
SPRING HILL CAPITAL HOLDINGS, LLC,
and KEVIN D. WHITE,

Respondents.

PREHEARING BRIEF OF THE DIVISION OF ENFORCEMENT

DIVISION OF ENFORCEMENT
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PRELIMINARY STATEMENT

In the wake of the 2008 collapse of Lehman Brothers ("Lehman"), Kevin White, a securities industry veteran and long-time managing director at Lehman, started his own broker-dealer firm, Spring Hill Capital Partners, LLC ("SHCP"). With 20-plus years of experience in fixed income and structured finance, including an executive role as Lehman's Global Head of Securitized Products, White knew that broker-dealers needed to be registered.

However, eager to earn revenue for his start-up company, whose expenses he had been paying out of his own savings, White began offering broker-dealer services to customers through SHCP seven months after the firm's creation, without registering. In July 2009, after SHCP started generating trading revenue through its broker-dealer business, White had an affiliated firm which he controlled – Spring Hill Capital Markets, LLC ("SHCM") – apply for membership with FINRA, which he knew was necessary to operate a broker-dealer lawfully.

Operating an unregistered broker-dealer business through SHCP (to generate a positive cash flow) while applying for a broker-dealer license for SHCM (which he knew was required to achieve long-term success and viability in the industry) left White and Spring Hill (defined below) balancing on a tightrope, which they traversed by telling one group of people (prospective clients and customers) that SHCP had an active broker-dealer business that could service their needs while simultaneously telling the regulatory authorities a different story entirely.

To conceal SHCP's ongoing trading activity, SHCM's broker-dealer application process with FINRA was permeated by deception. For example, SHCM explained to FINRA that it intended to introduce trades to Rafferty Capital Markets, LLC ("Rafferty") and to "piggyback" on Rafferty's arrangement with a clearing firm. However, when asked about the nature of

SHCP's business, White and SHCM failed to disclose to FINRA that, for the ten months prior to SHCM's registration, SHCP was already acting as an introducing broker at White's direction. SHCP's unregistered broker-dealer activity involved introducing trades to Rafferty, soliciting customers, and earning approximately $4 million in transaction-based compensation – in short, the very same business activities that SHCM planned to conduct and that White, in his own words, acknowledged were "hallmarks of broker-dealer activity that require registration with FINRA." Tellingly, when White and SHCM were asked by FINRA about funds that Rafferty had remitted to SHCP (which were then transferred to SHCM to satisfy its initial net capital requirement), they falsely claimed that the payment from Rafferty was for "consulting services" and repeatedly represented that SHCP "[did] not conduct a securities business."

White's deception paid off literally and figuratively. Between 2009 and 2010, White personally received more than $2 million in salary/bonus and equity distributions from his majority-owned Spring Hill entities, a substantial portion of it attributable to SHCP's unregistered broker-dealer revenues. Moreover, uninformed of SHCP's broker-dealer conduct, FINRA approved SHCM's application and cleared SHCM to commence operations on March 4, 2010, at which point SHCP effectively ceased activity.

Around the same time that he learned of FINRA's approval of SHCM's application, White once again chose to disregard regulatory requirements by twice directing a trader at his firm to purchase a security position – a bond issued by a collateral debt obligation ("CDO") – without having an order from a customer. Because Spring Hill traded on an agency basis and did not have sufficient capital to take on proprietary risk, the firm's business model involved matching buyers and sellers. White's decision to buy the bond before he had an agreement in place with a customer resulted in a net capital deficiency. Spring Hill attempted to conceal this

violation, as well as its pre-March 4 trading activity, by preparing falsified entries in its trade blotter, which it subsequently produced to the staff of the Securities & Exchange Commission (the "Commission") and, in pertinent part, reaffirmed when faced with the staff's queries. In addition to committing these violations, White approved his firm's decision to withhold a trade ticket from Rafferty for several days after the bond's purchase because he did not want Rafferty to learn that his firm had executed an unmatched, risky trade. This deliberate deception caused Rafferty's books and records to be inaccurate.

The Division's evidence will include Spring Hill's business records as well as testimony from (1) individuals with firsthand knowledge about SHCP's arrangement to introduce trades through Rafferty and receipt of transaction-based compensation; (2) industry executives to whom White pitched SHCP's (unregistered) broker-dealer services; and (3) FINRA examiners who were misled about SHCP's business activities. In addition, Yui Chan, the Managing Director of Broker-Dealer Operations and Financial Responsibility in FINRA's Risk Oversight & Operational Regulation Division, has testified via expert report that SHCM violated the net capital rule through a bond purchase, and that, as CEO and a Series 24 General Securities Principal, White was expected to understand the improper nature of the transaction. This and other evidence will demonstrate that: 1) SHCP willfully violated Section 15(a) of the Securities and Exchange Act of 1934 (the "Exchange Act"); 2) SHCM willfully violated Sections 15(c)(3) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3(a)(1), and 17a-11(b)(1) thereunder; and 3) White and Spring Hill Capital Holdings, LLC ("SHCH") willfully aided and abetted and caused SHCP's violations of Section 15(a) of the Exchange Act, SHCM's violations of Sections 15(c)(3) and 17(a) of the Exchange Act and Rules 15c3-1 and 17a-11(b)(1) thereunder, and Rafferty's violations of Section 17(a) of the Exchange Act and Rule 17a-3(a)(1) thereunder.

CONTENTIONS OF FACT[1]

A. Respondents

Spring Hill Capital Holdings, LLC ("SHCH"), a Delaware company headquartered in New York, New York, is a holding company that is the sole direct owner of SHCP, SHCM, and Spring Hill Management Company, LLC ("SHMC") (collectively, "Spring Hill" or the "Spring Hill entities"). ¶ 5. SHCH is majority owned by Kevin White. *Id.* Pursuant to Spring Hill's operating agreements, SHCH acts as the "full and exclusive" manager of the business and affairs for each of its subsidiaries. Div. Exs. 180B, 180D, 180E. SHCH has never been registered with the Commission in any capacity. ¶ 5.

Spring Hill Capital Markets, LLC ("SHCM"), is a registered broker-dealer organized under the laws of Delaware and headquartered in New York, New York. ¶ 6. It is majority owned, through SHCH, by Kevin White. *Id.* SHCM's broker-dealer registration became effective on February 26, 2010, and the firm was authorized to commence operations on March 4, 2010. Div. Exs. 187, 219.

Spring Hill Capital Partners, LLC ("SHCP"), a Delaware company headquartered in New York, New York, has never been registered with the Commission in any capacity. ¶ 7. It is majority owned, through SHCH, by Kevin White. Div. Ex. 1C. From May 2009 until SHCM commenced operations in March 2010, SHCP traded securities in SHCP-designated customer accounts held by Rafferty. Div. Ex. 138. SHCP has had virtually no business activity since SHCM commenced operations. Div. Ex. 213A.

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[1] Where undisputed facts are alleged in a given paragraph of the Order Instituting Proceedings and admitted in the corresponding paragraph of Respondents' Answer, this brief uses the notation "¶ __" to refer to the paragraph number in both documents.

Kevin D. White, age 52, founded the Spring Hill entities and is their CEO. He holds Series 3, 7, 9, 10, 24, and 63 licenses. ¶ 8. He previously was associated with three registered broker-dealers in a variety of capacities over the periods 1986 to 1988 and 1991-2008. *Id.*

B. Other Relevant Entities

Rafferty Capital Markets, LLC ("Rafferty"), a New York company headquartered in Garden City, New York, is a broker-dealer registered with the Commission. During the relevant period, Rafferty provided trade clearing and processing services for trades introduced by SHCM and SHCP. Div. Exs. 121, 204.[2]

C. SHCP's Arrangement with Rafferty

In early 2009, White approached Michael Rafferty ("M. Rafferty"), a close acquaintance and the president of Rafferty Holdings, LLC, to discuss his business plans for SHCP. Subsequent to their discussions, SHCP entered into a business relationship with Rafferty to allow it to start trading fixed income securities. As M. Rafferty described the arrangement in an email to White, "We can act as B/D of record for your registered reps . . . . We would keep a fair percentage of the commissions, I'd cover my own clearing personnel, you would be responsible for the associated clearing costs, and retain the remain[ing] commissions to pay the salesman and cover your overhead. Fails and/or mistakes (hooks) would be on your end. . . . we'd need to be comfortable with your personnel and you'd manage the business yourselves." Div. Ex. 127.

White and M. Rafferty also negotiated an 85%-15% split of trading revenues for their respective firms, which was memorialized in an agreement entered into with White's approval on April 28, 2009. Pursuant to this agreement, SHCP was entitled to 85 percent of gross revenues

[2] On May 15, 2014, the Commission accepted Rafferty's offer to settle charges that it willfully violated Section 17(a) of the Exchange Act and Rules 17a-3(a)(1) and 17a-4(b)(4) thereunder and willfully aided and abetted and caused a violation of Section 15(a) of the Exchange Act.

for trades it introduced to Rafferty, while Rafferty was to receive the remaining 15 percent of the transaction-based compensation for providing SHCP with "clearing and trade processing" services. Div. Exs. 192-194, 204, 274-276. In addition, certain SHCP employees were to be registered as "independent" representatives of Rafferty. Div. Ex. 204. Consistent with the framework envisioned by White and M. Rafferty, SHCP operated independently of Rafferty. *See, e.g.*, Div. Ex. 114 (distinguishing SHCP traders from Rafferty's "actual" registered representatives). Under White's management, SHCP made its own trading decisions and maintained its own blotter. *See, e.g.*, Div. Exs. 138, 205. All SHCP-affiliated persons worked out of SHCP's office, and they used SHCP's email and Bloomberg messaging addresses that were not reviewed by Rafferty. *See* White Inv. Test. Tr. 19:20-20:9, 24:1-24:12 (7/9/13); Martens Inv. Testimony Tr. 15:22-16:22, 22:22-25, 59:3-5, 61:18-25, 62:5-7. SHCP also exercised control over its traders, including through compensation decisions, all of which it made.[3] *See, e.g.*, Martens Inv. Test. Tr. 87:5-1, 122:22-123:1.

D. Generation of Transaction-Based Compensation Through Regular Trading

From May 2009 through February 2010, SHCP conducted approximately 100 trades in asset-backed securities in SHCP-designated customer accounts at Rafferty – that is, approximately 100 purchases and 100 contemporaneous sales – generating about $4.4 million.[4] Div. Exs. 138, 169, 185, 186A, 206A-206J, 213A, 214, 226-235, 237-249. At the same time that SCHP was taking in millions of dollars in transaction-based compensation, Spring Hill (with White's knowledge) was telling FINRA that SHCP performed only "non-transaction related

[3] Certain payments to registered representatives were made by Rafferty, out of SHCP's transaction-based compensation and at SHCP's direction. At other times, payments to registered representatives were made directly by Spring Hill.

[4] This amount excludes approximately $200,000 in transaction-based compensation earned by SHCP for trades entered into on February 26, 2010, which was the effective date of SHCM's registration but which pre-dated authorization by FINRA for SHCM to commence business.

services," earned exclusively "advisory fees," and simply did "not conduct a securities business." Div. Exs. 1X, 8. In an attempt to conceal SHCP's trading activity along with the transaction-based nature of SHCP's compensation, monthly invoices that SHCP prepared for Rafferty characterized the payments to SHCP as "consulting" fees. Div. Exs. 130, 226-235, 237-249.

When, in 2011, the Commission's Office of Compliance Inspections and Examinations ("OCIE") asked Spring Hill to explain the "consulting" payments, Spring Hill continued the cover-up, replying that the payments were for "consultation and advice to Rafferty." Div. Ex. 178. In fact, however, as eventually acknowledged by Spring Hill, the payments from Rafferty to SHCP were simply deducted from an SHCP account balance at Rafferty, which equaled 85% of revenues for the trades SHCP introduced to Rafferty. *See, e.g.*, Div. Exs. 130, 137-138, 198, 203; White Invest. Test. Tr. 25:6-18 (7/9/13). On a monthly basis, SHCP decided how much of its transaction-based compensation to have transferred from its account at Rafferty to its regular bank account and/or to the registered representatives. *See, e.g.*, Div. Exs. 126, 130, 198, 202. Net of Rafferty's share, SHCP earned approximately $3.7 million for trades it introduced to Rafferty prior to the February 26, 2010, representing the overwhelming majority of SHCP's revenues. Div. Exs. 138, 185, 186A, 213A, 226-235, 237-249.

In short, for over four years, Spring Hill, directed by and under the control of White, engaged in multiple attempts to deceive and mislead regulators about SHCP's unregistered trading activity and receipt of trading commissions, a deception facilitated by the firm's failure to preserve electronic communications for the 16-month period preceding February 2010. While Spring Hill engaged in this chicanery, it apparently maintained two sets of records, one for itself and one for regulators. With respect to the financial records that were provided to Spring Hill's own accountants, Spring Hill accurately described SHCP's trading revenue as "commission

income" and identified SHCPs "payments to registered reps" as expenses. Div. Ex. 185. However, as late as 2014, Spring Hill was still providing virtually identical records to the Division that replaced "commission income" with "consulting income" and relabeled the "payments to registered reps" as "direct consulting expense" payments. Div. Exs. 283A, 283B.

E. Marketing of SHCP's Broker-Dealer Services

White and the Spring Hill entities also presented two different stories concerning SHCP's business activities depending on whether they were communicating with regulators or market participants who White wanted to do business with. When dealing with regulators like FINRA, Spring Hill repeatedly claimed that SHCP "did not conduct a securities business." *See, e.g.*, Exs. 1A, 1B, 1C, 1D, 1F, 4. However, when dealing with hedge funds and large financial institutions, White repeatedly boasted about SHCP's securities business and routinely reached out to prospective customers to describe his firm's "Broker/Dealer." *See, e.g.*, Ex. 49 at SH-AP-00000016; SH-AP-00000028.

In particular, with the establishment of SHCP's arrangement to introduce trades to Rafferty in 2009, SHCP began aggressively touting its broker-dealer services to the market. SHCP prepared numerous marketing decks between approximately June 2009 and February 2010 highlighting its "Broker/Dealer" services designed to satisfy "a full range of client needs" relating to ABS, CMBS, RMBS, and CDOs, among other products. Div. Exs. 20 – 37; 39-52b; 57 – 58b; 63; 66-67B. As White acknowledged, "we were trying to communicate to potential clients . . . telling them who we are and what we do . . . , why they should find us interesting . . . Marketing 101." White Inv. Test. Tr. 15:5-15 (7/9/13).

White circulated these marketing materials to industry contacts to showcase SHCP's recent "Broker/Dealer" activity "across the spectrum of structured finance asset classes." *See, e.g.*, Div. Exs. 33, 33A. These materials told prospective investors: "The Broker/Dealer trades

securities on an agency basis, focusing on highly structured consumer and non-consumer ABS, CMBS, and RMBS . . . . We trade with a wide range of institutions and asset managers across a broad geographic footprint." *Id.* Another piece circulated by White advertised SHCP as a "broker/dealer [that] matches buyers and sellers for structured products." Div. Ex. 49-49A. SHCP's pitch books were often customized for potential customers who, in multiple instances, subsequently engaged in trades with SHCP. *See* Div. Ex. 138. In addition to the general dissemination of marketing materials, White solicited his personal contacts in connection with specific potential transactions. Div. Exs. 64, 74, 175, 301.[5]

Beyond its agency trading activity, SHCP actively sought other broker-dealer engagements. For example, SHCP restructured and distributed a bond known as "Legal Fee Funding 2006-1," which was a securitization of legal fees owed by certain tobacco companies. According to a marketing piece that White distributed, "[SHCP] sourced and placed the entire current outstanding face amount, achieving efficient execution for both buyers and seller . . . [illustrating its ability to] leverage its vast network of capital markets partners to develop liquidity for illiquid securities." Div. Ex. 60.

F. SHCH's Authorization of SHCP's Unregistered Broker-Dealer Activity

Upon the establishment of SHCH on June 3, 2009 as the sole direct owner of the Spring Hill entities, operating agreements were executed vesting in SHCH the "full and exclusive right, power and authority to manage" SHCP, including the "sole" power to conduct its "business and affairs" and to manage, deal with and dispose of its "capital, assets and funds." Div. Ex. 180B.

[5] In reality, the Division has likely seen only a small slice of White's marketing efforts because the Spring Hill entities did not archive emails prior to February 2010. Div. Exs. 1BB, 12, 270.

Accordingly, most of the unregistered broker-dealer activity by SHCP took place under the management and direction of SHCH, including about 90 of SHCP's approximately 100 matched trades in asset-backed securities. Div. Ex. 138. Furthermore, while the original agreement between SHCP and Rafferty predated the establishment of SHCH, an updated agreement entered into by SHCP in July 2009, under SHCH's management, affirmed SHCP's entitlement to 85 percent of the transaction-based compensation generated through the arrangement. Div. Ex. 204.

In addition to SHCH's management of SHCP, the holding company directed SHCP to side-stream approximately $2.6 million of SHCP revenues (primarily attributable to transaction-based compensation) to cost-bearing affiliate SHMC, which spent most of the funds in connection with the business activities of other SHCH subsidiaries after SHCP's operations ended. Div. Exs. 186B; 213B, 217A, 218, 221A-D, 282A. Significantly, SHCH also directed SHCP to transfer more than $200,000 to SHCM in order to capitalize SHCM during its application for a broker-dealer registration. Div. Ex. 1B at F000209. Accordingly, SHCH approved, directed, aided, and benefitted from SHCP's unregistered broker-dealer activity.

G. SHCM's Application for FINRA Membership

While SHCP was conducting a broker-dealer business at the direction of White and SHCH, White at the same time arranged for affiliate SHCM to apply for broker-dealer registration, filing its initial Form BD with the Commission in June 2009 and Form NMA with FINRA in July 2009. Div. Ex. 1. Throughout the membership application process, FINRA examiners asked questions about SHCP's business activities and revenues, which were of particular interest because SHCP's revenues were being used to provide initial funding for SHCM. Div. Ex. 3. From the onset, Spring Hill repeatedly described SHCP to FINRA as a "consulting firm" that provided "consulting services to its clients in return for a consulting fee" and purportedly did "not conduct a securities business." *See, e.g.*, Exs. 1A, 1B, 1C, 1D, 1F, 4.

SHCP's business activities were specifically discussed during a membership interview attended by White in November 2009. In White's presence, it was represented to FINRA that SHCP earned "consulting/advisory fees." Div. Exs. 2, 5-7. Omitted was the fact that transaction-based compensation formed the lion's share of SHCP's revenues. *Id.* In follow-up correspondence copying White, Spring Hill again expressly denied that SHCP engaged in a securities business, instead representing that the firm offered "management consulting services, including analytics and non-transaction related services." Div. Ex. 8 (emphasis added). Moreover, Spring Hill specifically represented that $108,000 received by SHCP from Rafferty on July 13, 2009 and transferred to SHCM were for "consulting services rendered" to Rafferty as a client. Div. Exs. 1A, 1B, 4. In fact, the $108,000 payment came out of SHCP's 85% share of the transaction-based compensation it generated for trades introduced to Rafferty in May and June 2009. Div. Exs. 138, 220, 224-226. As of August 21, 2009, Spring Hill claimed to FINRA that it had earned $527,197.69 in year-to-date "advisory fees," when in reality most of the revenues were "commission income." *Compare* Div. Ex. 1X *with* Div. Ex. 185.

As a result of Spring Hill's deception, FINRA was misled to believe that SHCP was "only providing consulting services by evaluating businesses and providing advisory services as to what options are available to clients interested in restructuring their debt." Div. Ex. 2.

H. Commencement of SHCM's Operations

After receiving clearance from FINRA to commence operations on March 4, 2010, trades were sent to Rafferty on behalf of SHCM rather than SHCP, but no new agreement between the firms was immediately signed. Div. Ex. 199. SHCM ultimately entered into a "Commission Sharing Agreement" with Rafferty, dated as of July 19, 2010, to govern trades conducted by a dually registered representative of both SHCM and Rafferty. Div. Ex. 121. Like the earlier agreement between SHCP and Rafferty, under this agreement SHCM was entitled to 85 percent

of profits generated by its trades processed through Rafferty. *Id.* Additionally, as with SHCP, SHCM's activity took place under the auspices of SHCH, which exercised "full and exclusive" management rights to control and direct SHCM's business activities. Div. Ex. 212.

I. The Gramercy CDO Bond Transactions

On March 1, 2010, after the effective date of SHCM's registration but before it received permission to commence business, White instructed trader Paul Tedeschi to buy $15 million face amount of a bond issued by a collateralized debt obligation known as Gramercy Real Estate CDO 2005-1 (the "Gramercy CDO"). Div. Ex. 78. White had discussed the bond in late February 2010 with Roger Cozzi, a social acquaintance and the CEO of GCC, whose subsidiary managed the Gramercy CDO. Cozzi initially expressed interest in the bond at a price up to $75, but on February 25 told White that following discussions with counsel GCC would not seek to purchase the bond until after an upcoming earnings release on March 4. Div. Exs. 89. As Cozzi explained, "[i]f the bonds trade away in the interim, so be it." Div. Ex. 89. Given the prospect that the "bonds were going [to] trade away" to another buyer, on March 1, White, who hoped to buy the bond at a price in the low 70s then sell it to GKK at a price up to 75, directed Tedeschi, on behalf of Spring Hill, to purchase the bond despite not having a customer for it. Div. Exs. 78-79, 89. Tedeschi followed White's instruction and arranged an extended settlement schedule with Citigroup (the seller) so that delivery of the bond could take place after GCC's earnings release when GCC, it was hoped, would be in a position to make the contemplated purchase. Div. Exs. 78, 97, 211. With White's approval, Tedeschi also withheld the ticket for the March 1 trade from Rafferty for ten days. Div. Exs. 80, 106, 140, 145.[6]

[6] In an apparent attempt to conceal this misconduct from the Commission, Spring Hill later claimed in response to questions from OCIE staff that "the terms of all of Spring Hill trades with no exception are forwarded to Rafferty by the Spring Hill traders" "when the trade is agreed upon" such that there is "never a timely delay between Spring Hill's trades and Rafferty's entry of the trades." Div. Ex. 179 (emphasis added).

White's high hopes for the Gramercy CDO bond initially fell through when GCC postponed its earnings call until March 15 (after the scheduled delivery date from Citigroup). White and others at Spring Hill then approached numerous possible counterparties in an effort to park the bond somewhere, because White did not want to sell the bond in the open market. Div. Exs. 92-93, 107, 131, 141. Most of the parties declined, with one explaining, "We can't do it. It is ostensibly 'parking', which would put me in a very precarious place that ethically [I] won't go to." Div. Ex. 77. Another possible buyer told White flatly that "legal shot it down." Div. Ex. 81. As of the March 10 expected delivery of the bond, Spring Hill had still not secured a counterparty, but it got a reprieve when "back office inefficiency" at Citigroup further delayed the settlement, prompting White to exclaim, "Sometimes it's better to be lucky than good!" *Id.*

Desperate to avoid a situation where Rafferty declined to honor the Gramercy CDO trade when Citi reached out to settle the transaction, on March 11, 2010, Spring Hill sold the bond at $70.25 to Barclays with the expectation of being able to repurchase it after the March 15 GCC earnings call. Div. Exs. 91, 102, 143-144. On the same date, Rafferty learned for the first time that Spring Hill had purchased the Gramercy CDO from Citi. Div. Ex. 106. The arrangement with Barclays was negotiated between Tedeschi and Thomas Gonnella, a trader at Barclays who, in Tedeschi's words, had agreed to "stop [Spring Hill] out on the settlement mismatch." Div. Ex. 90. In connection with these transactions, SHCM's trade blotter was doctored to indicate that the bond purchase from Citi and the bond sale to Barclays both took place March 12, instead of on the actual dates of the trades, March 1 and March 11, respectively. Div. Ex. 138.

Just one day after selling the bond to Barclays – and with White's express go-ahead – Tedeschi offered to repurchase the bond, on behalf of SHCM, at $70.75, providing a gain to Barclays of $87,000 in exchange for its temporary ownership of the bond. Div. Ex. 152. This

was three days before GCC's earnings release, and there was still no agreement from GCC to buy the bond. In other words, for the second time in less than two weeks, Spring Hill sought to conduct a trade without an order from a customer. SHCM and Barclays reached an agreement in principle on the terms of the repurchase at approximately 1 p.m. on March 15. Div. Ex. 103. With White's approval, the trade was executed no later than the morning of March 16, 2010, when a trade ticket was also issued. Div. Exs. 146-147, 151.

Hours after trade tickets had been exchanged between SHCM and Barclays, at approximately 6:00 pm on March 16, 2010, White emailed Tedeschi, "Done @ $74," appearing to indicate that GCC would be willing to buy the bond from SHCM at a price of $74. Div. Ex. 104. At 6:31 pm, SHCM informed Rafferty that it would "likely have a trade with [GCC] tomorrow[.]" Div. Ex. 154. The following day, March 17, 2010, the sale of the bond to GCC was finally executed at profit to SHCM of $414,375 (the firm's most profitable trade of the year), and a trade ticket was issued. Div. Exs. 148-149. Also on March 17, SHCM confirmed to Rafferty that GCC would know March 17 as the trade date. Div. Exs. 153, 156. Irrespective, though, of whether the sale to GCC took place on the evening of March 16 or the next day, SHCM held the bond for a period of time following its purchase from Barclays, resulting in a net capital deficiency that was concealed by SHCM falsifying its trade blotter to reflect March 17 rather than March 16 as the trade date for its purchase of the bond from Barclays. Div. Ex. 138. Further, SHCM failed to notify the Commission of its net capital deficiency.

CONTENTIONS OF LAW

A. SHCP Violated Section 15(a) of the Exchange Act

Section 15(a)(1) of the Exchange Act prohibits a broker or dealer from effecting any transaction in, or inducing or attempting to induce the purchase or sale of, any security by

making use of the mails or any means or instrumentality of interstate commerce, unless such broker-dealer: (1) is registered with the Commission in accordance with Section 15(b) of the Exchange Act; (2) in the case of a natural person, is associated with a registered broker-dealer; or (3) satisfies the conditions of an exemption or safe harbor. Section 3(a)(4)(A) of the Exchange Act defines a broker as any person "engaged in the business of effecting transactions in securities for the account of others." In determining whether a defendant falls within the Exchange Act definition of a broker, courts consider whether the defendant's conduct "may be characterized by a 'certain regularity of participation in securities transactions at key points in the chain of distribution.'" *SEC v. Benger*, 697 F. Supp. 2d 932, 944-45 (N.D. Ill. 2010) (citing *SEC v. Martino*, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003)); *see also Mass. Fin. Servs., Inc. v. SIPC*, 411 F. Supp. 411, 415 (D. Mass.), *aff'd*, 545 F.2d 754 (1st Cir. 1976), cert. denied, 431 U.S. 904 (1977); *SEC v. Hansen*, 1984 WL 2413, at *10 (S.D.N.Y. Apr. 6, 1984). Factors indicating a person is acting as a broker include whether that person: (1) receives commissions as opposed to salary; (2) is involved in negotiations between the issuer and the investor; (3) makes valuations as to the merits of the investment or gives advice; and (4) is an active rather than passive finder of investors. *Benger*, 697 F. Supp. 2d at 944-45 (citing *Hansen*, 1984 WL 2413, at *10). Scienter is not required to prove a violation of Section 15(a). *SEC v. Nat'l. Exec. Planners, Ltd.*, 503 F. Supp. 1066, 1073 (M.D.N.C. 1980).

For nearly one year, SHCP held itself out and acted as a broker-dealer. *See SEC v. Schmidt*, No. 71 Civ. 2008, 1971 WL 293 (S.D.N.Y. Aug. 26, 1971) (finding a "clear indication that defendant has violated Section 15(a)" because he "is in the business of buying and selling securities and is holding himself out as being engaged in the business of being a broker-dealer in securities."); *cf. also* No Action Letter to e-Media, 2000 SEC No-Act. LEXIS 1006, at *1-2

(Dec. 14, 2000) (stating that no action will be taken, provided, among other conditions, recipient of letter does not "hold itself out as providing any securities-related services"); No Action Letter to David A. Cifrino, P.C., 2000 SEC No-Act. LEXIS 1034, at *7 (Dec. 1, 2000).

There can be little doubt that SHCP marketed itself as a broker-dealer. White explicitly told prospective clients that SHCP was "a structured finance-focused investment advisor and broker-dealer." *See, e.g.,* Div. Ex. 49. These representations that his firm had a broker-dealer business were reinforced by his firm's actual conduct: SHCP conducted in its customer accounts approximately 100 trades in asset-backed securities that generated nearly $4.4 million in transaction-based compensation. In addition to regularly effecting securities transactions between buyers and sellers, SHCP also actively solicited prospective customers by distributing scores of marketing materials to industry participants touting the company's accomplishments and services. *See SEC v. Margolin*, No. 92 Civ. 6307, 1992 WL 279735, at *5 (S.D.N.Y. Sept. 30, 1992) ("brokerage" conduct may include receiving transaction-based income, advertising for clients, and possessing client funds and securities).

As its numerous marketing materials demonstrate, SHCP both was involved in negotiations between the issuer and the investor and made valuations as to the merits of the investment. For example, with respect to its restructuring and distribution of the "Legal Fee Funding 2006-1" bond, SHCP and White distributed a "trade highlight" describing how SHCP "sourced and placed the entire current outstanding face amount, achieving efficient execution for both buyers and seller . . . [illustrating its ability to] leverage its vast network of capital markets partners to develop liquidity for illiquid securities." *See SEC v. Ridenour*, 913 F.2d 515, 517 (8th Cir. 1990) (defendant who "attempted to obtain and keep a regular clientele for his 'private' bond deals" was a broker); *SEC v. Gagnon*, No. 10 Civ. 11981, 2012 WL 994892, at *11 (E.D.

Mich. Mar. 22, 2012) (defendant who "act[ed] as the link between the issuer and the investor" was a broker). Also in connection with this bond, SHCP stated that it "supported investor analysis" through "walk-throughs of structural features and risk factors of the transaction," and "[a]dvised [a] seller on the unwind of various derivative hedges." *See SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005) (defendant was a broker because he "was regularly involved in communications with and recruitment of investors for the purchase of securities").

SHCP does not qualify for any exemptions or safe harbors from the broker-dealer registration requirements. Its sales were not exclusively intrastate or restricted to "exempted securities" as defined in Section 3(a)(12)(A) of the Exchange Act. Also, the safe harbor provided by Rule 3a4-1 for associated persons of an issuer is available only to natural persons.

The fact that Tedeschi and other SHCP employees were designated as "independent representatives" of Rafferty does not cure SHCP's primary violation of Section 15(a). These persons acted on behalf of SHCP (which held itself out as the broker-dealer responsible for the trades), worked out of SHCP's offices, and effected transactions in SHCP-designated accounts at Rafferty. In addition, SHCP, not Rafferty, primarily supervised and managed these registered representatives as well as their trading decisions, and SHCP, through White, decided how much compensation these individuals received for their broker-dealer activities on behalf of his firm.

B. White and SHCH Aided and Abetted and Caused SHCP's Section 15(a) Violation

To establish aiding and abetting liability, the Commission 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." *John Thomas Capital Mgmt. Grp. LLC*, Initial Decision Release No. 693, 2014 SEC

LEXIS 4162, at *77 (Oct. 17, 2014). "The knowledge or awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a[n] . . . active participant." *Id.*; *see also SEC v. Apuzzo*, 689 F.3d 204, 215 (2d Cir. 2012) ("[A] high degree of substantial assistance may lessen the SEC's burden in proving scienter.").

"Causing liability" requires that: (1) a primary violation occurred; (2) an act or omission by the respondent contributed to the violation; and (3) the respondent knew or should have known that his or her conduct would contribute to the violation. *See* Exchange Act Section 21C. The "fact that others also may have caused" a violation "does not insulate [respondent] from liability for [one's] own acts and omissions." *In re Eric W. Chan*, Sec. Act. Rel. No. 8078, 2002 SEC LEXIS 1059, at *31 (Commission opinion) (Apr. 4, 2002). Where, as in this case, the primary violations do not require a finding of scienter, the standard of liability for being "a cause of" such violations is negligence. *KPMG, LLP v. SEC*, 289 F.3d 109, 120 (D.C. Cir. 2002). Negligence is the failure to exercise reasonable care or competence. *In re Byron G. Borgardt*, Sec. Act Rel. No. 8274, 2003 WL 22016313, at *10 (Commission opinion) (Aug. 25, 2003).

White both willfully aided and abetted and caused SHCP's violation of Section 15(a) of the Exchange Act. At the time of SHCP's conduct, White knew enough to seek to register SHCM as a broker-dealer to conduct an identical business to the one he was running through SHCP. *See* Div. Ex. 1A (business plan reflecting SHCM's intention to conduct fixed income securities trading on behalf of institutional customers and clear its trades through Rafferty). White also signed a letter to FINRA reflecting his awareness in 2010 that "[s]oliciting business for a broker-dealer, effecting transactions in securities, and the receipt of commission-based compensation are all hallmarks of broker-dealer activity that require registration." Div. Ex. 189. And significantly, White had extensive experience in the securities industry, including 17 years

in senior roles at Lehman. SHCM's application to FINRA boasted that White had "extensive experience (both related and direct) with the products which the Firm will be trading and distributing and with supervising activities related to such products." Div. Ex. 1K. At Lehman, White had even been tasked with "regular monitoring of . . . industry compliance requirements" and with specific duties relating to registration. *Id.*

Despite his knowledge that firms that engaged in broker-dealer activity had to be registered, White was an active participant in SHCP's unregistered broker-dealer activity, personally soliciting broker-dealer business on SHCP's behalf and negotiating SHCP's arrangement to conduct trades through Rafferty and receive transaction-based compensation. White continued to hold out SHCP as a broker-dealer after passing the Series 24 license exam in November 2009, the content outline for which specifically covered the prohibitions against unregistered broker-dealer activity under Section 15(a) of the Exchange Act. Div. Ex. 197. Tellingly, White also participated in a pattern of deception in which, between 2009 and 2014, representatives of SHCM made multiple misrepresentations to both FINRA and the Commission to conceal the true nature of SHCP's business activities. Throughout this entire period, SHCM repeatedly claimed to regulators that SHCP did not conduct a securities business and that its revenue came from "consulting" and "advisory" services. Div. Exs. 8, 178.

SHCH – whose state of mind can be imputed from White as its CEO – willfully aided and abetted and caused SHCP's primary violation by exercising its "full and exclusive right, power and authority" to manage SHCP and to conduct SHCP's business and affairs in a manner that permitted the unregistered broker-dealer activity to take place. Div. Ex. 180B. Under SHCH's management, SHCP marketed itself as a broker-dealer and affirmed SHCP's entitlement to 85 percent of the transaction-based compensation it generated. Div. Exs. 20-67, 204. SHCH never

attempted to register SHCP as a broker-dealer or to end SHCP's broker-dealer activity prior to the registration of SHCM. *See, e.g., In re Centreinvest, Inc.*, Sec. Act. Rel. No. 60413, 2009 SEC LEXIS 2611 (July 31, 2009) (finding that affiliate of unregistered broker-dealer caused the latter's Section 15(a) violation). Instead, it approved and authorized this prohibited conduct and directly benefitted in the form of *de facto* equity distributions of SHCP's unregistered broker-dealer revenues which SHCH used to capitalize SHCM and pay SHCM's operating expenses.

C. SHCM Violated the Net Capital Rule

Section 15(c)(3) of the Exchange Act provides, among other things, that no broker-dealer shall effect securities transactions in contravention of Commission rules proscribed to provide safeguards concerning the financial responsibility and related practices of brokers and dealers. The Commission adopted Rule 15c3-1 of the Exchange Act, the net capital rule, under Section 15(c)(3). This rule requires a broker-dealer to maintain a minimum level of net capital (meaning highly liquid capital) at all times.[7] *See In re Weis Securities, Inc.*, 605 F.2d 590, 593 (2d Cir. 1978), *cert. denied sub. nom., Grossman v. Reddington*, 439 U.S. 1128 (1978). It is unlawful for a broker or dealer to engage in any securities business while not in compliance with Rule 15c3-1. Given the requirement to maintain sufficient net capital at all times, a broker or dealer must be able to demonstrate "moment to moment compliance" with the rule. *See Interpretations of Financial and Operational Rules (GTRI)*, SEA Rule 15c3-1, available at http://www.finra.org/Industry/Regulation/Guidance/FOR/. Moreover, under Section 17(a) of the Exchange Act and Rule 17a-11(b)(1) thereunder, a broker or dealer whose net capital declines below the required minimum must notify the Commission of the deficiency that same day.

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[7] *See* 17 CFR 240.15c3-1.

As indicated in the membership agreement with FINRA executed by White on February 22, 2010, SHCM was subject to a $100,000 minimum net capital requirement. Div. Ex. 10. In computing net capital, the broker-dealer must, among other things, take prescribed percentage deductions ("haircuts") from the mark-to-market value of proprietary positions.[8] The haircuts are designed to account for the market risk inherent in these positions and to create a buffer of liquidity to protect against other risks associated with the securities business.[9] On March 12, 2010, SHCM offered to purchase the Gramercy CDO bond from Barclays despite not having a customer for the transaction and knowledge that the earnings call on which intended customer GCC's ability to buy the bond depended was still days away. SHCM reached an "agreement in principle on the terms of the trade" with Barclays no later than March 15 and formally executed the purchase on the morning of March 16. By comparison, SHCM's sale of the bond to GCC did not take place until the evening of March 16 at the earliest, when following a call with GCC CEO Cozzi, White emailed Tedeschi "Done @ $74." Div. Ex. 104.

SHCM used a trade date basis of record keeping. Div. Ex. 155. Accordingly, SHCM's purchase of the Gramercy CDO bond from Barclays on the morning of March 16 increased its assets and liabilities by approximately $10.6 million, the cost of the trade. *See* Expert Report Concerning Impact of Spring Hill Capital Markets, LLC's Purchase of Gramercy CDO Bond on Firm's Net Capital by Yui M. Chan filed April 20, 2015 ("Chan Expert Report") (citing Letter

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[8] *See* 17 CFR 240.15c3-1(c)(2)(vi).

[9] *See, e.g., Uniform Net Capital Rule*, Exch. Act Release No. 13635 (June 16, 1977), 42 FR 31778 (June 23, 1977) ("[Haircuts] are intended to enable net capital computations to reflect the market risk inherent in the positioning of the particular types of securities enumerated in [the rule]"); *Net Capital Rule*, Exch. Act Release No. 22532 (Oct. 15, 1985), 50 FR 42961 (Oct. 23, 1985) ("These percentage deductions, or 'haircuts', take into account elements of market and credit risk that the broker-dealer is exposed to when holding a particular position."); *Net Capital Rule*, Exch. Act Release No. 39455 (Dec. 17, 1997), 62 FR 67996 (Dec. 30, 1997) ("Reducing the value of securities owned by broker-dealers for net capital purposes provides a capital cushion against adverse market movements and other risks faced by the firms, including liquidity and operational risks.") (footnote omitted).

from SEC Division of Market Regulation to AICPA, 1986 No-Act. LEXIS 2375, at *4-5 (Apr. 23, 1986)) ("A broker-dealer must have a consistent policy of reflecting all transactions either on a trade date or a settlement date basis and must compute its net capital on the same basis as it uses in recording its transactions."). However, because of the applicable haircut, the purchase reduced SHCM's capital by approximately $1 million, resulting in a substantial net capital deficiency until SHCM sold the position to GCC between several hours and one day later. *See* Chan Expert Report at 4.[10] SHCM therefore violated the net capital rule because it had not maintained its minimum net capital requirement "at all times." Rule 15c3-1(a). In addition, SHCM violated Section 17(a) of the Exchange Act and Rule 17a-11(b)(1) by failing to give notice to the Commission on March 16 that its net capital declined below the minimum amount required under Rule 15c3-1.

D. White and SHCH Aided and Abetted and Caused SHCM's Net Capital Violation

White and SHCH willfully aided and abetted and caused SHCM's violation of Sections 15(c)(3) and 17(a) of the Exchange Act and Rules 15c3-1 and 17a-11(b)(1) thereunder. SHCH is the sole direct owner of SHCM and possesses the "full and exclusive right, power and authority" to manage SHCM, to conduct SHCM's business and affairs, and to dispose of its "capital [and] assets." Div. Ex. 212. SHCH exercised this authority by permitting SHCM's repurchase of the Gramercy CDO bond from Barclays without an order from a customer. White himself was an active participant in SHCM's violation, personally approving SHCM's offer to repurchase the Gramercy CDO bond from Barclays. Tedeschi Inv. Test. Tr. 110:17 – 111:12; Div. Ex. 146.

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[10] On March 16, 2010, SHCM had net capital of between approximately $200,000 and $395,508 before application of the haircut to the value of the Gramercy CDO bond. Div. Ex. 216; Chan Expert Report at 2.

records as the Commission requires by rule. Implicit in the requirement to keep such records is the requirement that information contained in them be accurate. *In re Ko Secs., Inc.*, Exch. Act Rel. No. 48550, 2003 WL 22233255, at *3 (Commission opinion) (Sept. 26, 2003). The Commission has promulgated Rule 17a-3(a)(1) which requires each registered broker-dealer to make and keep current "[b]lotters (or other records of original entry), containing," among other things, "an itemized daily record of all purchases and sales of securities" relating to "its business." A violation of this rule does not require a showing of scienter. *See SEC v. Drexel Burnham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993).

SHCM violated Section 17(a) of the Exchange Act and Rule 17a-3(a)(1) thereunder because it failed to make and keep current books and records as required by those provisions. SHCM's books included inaccurate trade dates for the purchase of the Gramercy CDO bond from Citigroup and the sale of the bond to Barclays. While these transactions actually took place on March 1, 2010 and March 11, 2010, respectively, SHCM's books indicated that the "buy-side" and "sell-side" trades both took place on March 12, 2010, thereby concealing that Spring Hill was engaged in broker-dealer activity before the March 4, 2010 date that FINRA authorized it commence operations as well as the fact that the March 1, 2010 purchase was not on behalf of a customer. In addition, SHCM's blotter reflected, inaccurately, that the repurchase of the Gramercy CDO bond from Barclays did not take place until March 17, 2010, when it was actually entered into no later than March 16, 2010. Div. Ex. 138. *See, e.g., In re Joel L. Hurst*, Exch. Act. Rel. No. 41165, 1999 WL 129783, at *2 (Mar. 12, 1999) (settled proceeding) ("the firm's books and records did not reflect the liabilities arising from Hurst's commitments to repurchase the securities involved"). When the Commission's OCIE staff brought issues concerning the accuracy of SHCM's trade blotter to the firm's attention in 2011, SHCM

produced an "updated trade blotter" which continued to reflect inaccurate dates for SHCM's purchases of the Gramercy CDO bond from Citi and Barclays in a second attempt to cover-up Spring Hill's net capital violation. Div. Exs. 87, 174.

F. White and SHCH Aided and Abetted and Caused a Violation by Rafferty of Section 17(a) of the Exchange Act and Rule 17a-3(a)(1) thereunder

The Commission previously charged Rafferty with violating Section 17(a) of the Exchange Act and Rule 17a-3(a)(1) thereunder because it failed to make and keep current books and records as required by those provisions. Specifically, Rafferty's books did not reflect the Gramercy CDO bond, purchased from Citigroup by Spring Hill on March 1, 2010, for at least ten days. Div. Exs. 106, 181. *See, e.g., In re John M. Repine*, Exch. Act Rel. No. 54937, 2006 WL 4245602, at *9 (Dec. 14, 2006) (settled proceeding) ("Because the Registered Representative did not submit tickets or otherwise inform [the broker-dealer] when he bought inverse floaters for forward settlement, the firm's . . . general ledger did not reflect the resulting positions.").

White and SHCH willfully aided and abetted and caused Rafferty's violations of Section 17(a) of the Exchange Act and Rule 17a-3(a)(1) thereunder. White directed Tedeschi to conceal the ticket for Spring Hill's March 1, 2010 purchase of the Gramercy CDO bond until the "sell-side" transaction was complete. SHCH, which was majority owned by White, exercised its "exclusive management" over SHCP and SHCM in a manner that permitted the concealment of the trade ticket under its auspices.

REMEDIES REQUESTED

The Division seeks against each Respondent: a cease-and-desist order; civil penalties pursuant to Section 21B of the Exchange Act and Section 9(d) of the Investment Company Act of 1940 ("Investment Company Act"); accounting and disgorgement pursuant to Section 21B of the Exchange Act, Section 21C of the Exchange Act, and Section 9(e) of the Investment

Company Act; and a determination of appropriate remedial action pursuant to Section 15(b) of the Exchange Act and Section 9(b) of the Investment Company Act, including advisory and collateral bars and a penny stock bar.

RESPONDENT'S AFFIRMATIVE DEFENSES

Respondents have raised the following affirmative defenses:

A. Failure to State a Claim

Based on the evidence relied upon in this memorandum and to be adduced at hearing, Respondents will not be able to sustain this defense as to any of the claims.

B. Right to Jury Trial

The Supreme Court has held that in "cases in which the Government sues in its sovereign capacity to enforce public rights created by statutes within the power of Congress to enact, the Seventh Amendment does not prohibit Congress from assigning the factfindng function, and initial adjudication to an administrative forum." *Atlas Roofing Co., Inc. v. OHSA*, 450 U.S. 442, 450-55 (1977). Accordingly, the instant proceeding does not implicate Respondents' Seventh Amendment rights.

C. Prejudgment/ Denial of Due Process

Respondents appear to suggest that the Commission has prejudged their liability based on the May 15, 2014 Order Instituting Proceedings against Rafferty. However, "the Commission has determined previously that no prejudgment of a non-settling respondent's case occurs especially when – as took place here – the order accepting an offer of settlement expressly states that it was not binding on other non-settling respondents." *John Thomas Capital Mgmt. Group LLC,* Exch. Act. Rel. No. 71415, 2014 WL 294551, at *2 (Jan. 28, 2014) (citing *Edward Sinclair*, Exch. Act Rel. No. 9115, 1971 WL 120487, at *4 (Mar. 24, 1971), *aff'd, Sinclair v. SEC*, 444 F.2d 399, 401 (2d Cir. 1971)).

D. Statute of Limitations

Based on the evidence relied upon in this memorandum and to be adduced at hearing, Respondents will not be able to sustain this defense as to any of the claims.

E. Violations Were Responsibility of Third Parties

Based on the evidence relied upon in this memorandum and to be adduced at hearing, Respondents will not be able to sustain this defense as to any of the claims.

CONCLUSION

The Division of Enforcement intends to demonstrate that Respondents committed the above-described violations of the Exchange Act, and that the requested sanctions are appropriate.

Dated April 28, 2015
New York, New York

DIVISION OF ENFORCEMENT

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CERTIFICATE OF SERVICE

I hereby certify that I served true copies by electronic mail of the foregoing Pre-hearing Brief on the following on the 28th day of April, 2015.

The Honorable Carol Fox Foelak
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