

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72635 / July 17, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3877 / July 17, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31159 / July 17, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15976

In the Matter of

**LAKESIDE CAPITAL
MANAGEMENT, LLC and
DENNIS H. DAUGS, JR.**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
SECTIONS 203(e), 203(f), AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
AND SECTION 9(b) OF THE INVESTMENT
COMPANY ACT OF 1940, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS AND A CEASE-AND-DESIST
ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against Lakeside Capital Management, LLC (“Lakeside”) and Dennis H. Daus, Jr. (“Daus”) (collectively “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the “Offers”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the

Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offers, the Commission finds that:

Summary

During 2008 through 2012, Dennis H. Daus, Jr., the owner and portfolio manager of investment adviser Lakeside Capital Management, LLC, used over \$8 million in advisory client assets to conduct undisclosed transactions that fraudulently breached his fiduciary duty.

As an investment adviser, Daus had a fiduciary duty to disclose material conflicts of interest to his clients and act in their best interest. Daus breached this duty beginning in 2008 and 2009, when he invested a senior citizen Lakeside client in \$3.1 million in personal loans to himself. Daus used the loans to buy a vacation home and refinance his purchase of a rare automobile, and the loans involved a material conflict of interest between Daus and the client. Yet Daus did not disclose the loans to the client until early 2010. Before this disclosure, Daus paid interest on the loans into the client's brokerage account and likewise paid down part of the loan principal. But the interest rates were low, the loans were unsecured with no set pay-off dates, and the loans were not in the client's best interest. Also, the loans were effected through securities purchases and sales in the client's portfolio without disclosing to her the purpose of those transactions. Shortly after he disclosed the loans to the client, Daus paid her the balance he owed on them.

Daus further breached his fiduciary duty through his undisclosed use of assets of a private fund that he managed and whose investors were nearly all Lakeside advisory clients. In early 2010, Daus diverted \$561,000 from the private fund to make settlement payments to several of his clients who had alleged he mismanaged their assets. Daus later paid the private fund back, but did so without interest. By late 2010, the senior citizen client had threatened to sue Daus for mismanaging her portfolio. Over the next two years, Daus arranged for the private fund to spend about \$2.5 million to buy the client out of several investments she no longer wanted. Over \$2 million of this went to acquire for the private fund investments tied to real estate loans whose borrowers were in default or at risk of defaulting. Daus' personal stake in the foregoing transactions created a material conflict of interest that he did not disclose to the Lakeside clients who were investors in the private fund. The transactions also disadvantaged the private fund while benefiting Daus and were not in the best interest of the fund or its investors who were Lakeside clients. In additional conflicted and undisclosed transactions, Daus directed the private fund to lend out roughly \$1.2 million to facilitate his personal purchase and sale of real estate during 2009 and 2010.

Aided and abetted by Daugs, Lakeside also violated compliance and custody rules under the Advisers Act during 2010 through 2012.

Respondents

1. Lakeside Capital Management, LLC (“Lakeside”) is a Washington limited liability company formed in 1997 and registered with the Commission as an investment adviser since 2000. It conducts business from an office in Seattle, Washington. During the relevant period, Lakeside had approximately \$150 million in assets under management on average and served as investment adviser to about 100 individuals and over thirty private real estate funds.

2. Dennis H. Daugs, Jr. (“Daugs”), age 51, has been Lakeside’s sole owner and portfolio manager and its chief compliance officer since January 2010. Before 2010, Daugs co-owned Lakeside with a partner and another individual was chief compliance officer.

Daugs Fraudulently Liquidated Securities and Invested a Client in \$3.1 Million in Undisclosed Loans to Himself

3. During the relevant period, Daugs managed a large investment portfolio for a senior citizen Lakeside advisory client (“Client A”) and members of her family. As investment advisers, Daugs and Lakeside owed Client A a fiduciary duty to disclose material conflicts of interest to her and act in her best interest.

4. In January 2008, Daugs used \$2.15 million from Client A’s portfolio to purchase a ski vacation home for himself. To effect this transaction, Daugs caused Lakeside to transfer the \$2.15 million from Client A’s IRA account at a custodian broker-dealer directly to the escrow account he used to purchase the ski home. A total of \$2.15 million in securities were sold from Client A’s account to generate the cash transferred to the escrow account.

5. At this time, Lakeside was adviser to Managed Income Opportunities, LLC (“MIO”), a private fund. MIO’s investment objective was to acquire securities including debt instruments, either directly or through special purpose entities, and pass on resulting income to its investors. Daugs caused Lakeside to record the \$2.15 million cash transfer to the escrow account as Client A purchasing \$2.15 million in securities issued by MIO, and MIO then loaning \$2.15 million to Daugs. MIO was structured so that each investment it made was funded by a discrete contribution from one or more of its investors, with only the contributing investor(s) receiving a beneficial interest in that investment. Lakeside therefore treated Client A as the sole beneficial investor in a \$2.15 million loan from MIO to Daugs.

6. In May 2009, Daugs similarly used assets from Client A’s portfolio to refinance his purchase of a rare 1955 Mercedes “Gullwing” automobile. Daugs had purchased the auto in January 2009 and refinanced the purchase in April 2009 through a loan from a different Lakeside client. To pay this client the \$950,000 Daugs owed on the loan, Lakeside transferred to the client securities of a private fund (not MIO) owned by Client A and valued at \$950,000. Daugs caused

Lakeside to record this as Client A purchasing an additional \$950,000 in MIO securities and becoming the sole beneficial investor in a \$950,000 loan from MIO to Daus.

7. The fact that Client A was invested in MIO was shown on IRA account statements and tax forms prepared for her based on information Lakeside provided. But these documents did not disclose to Client A that Daus had used her MIO investments to make loans to himself to buy a ski home and refinance his auto purchase. Daus did not otherwise disclose these facts to Client A until early 2010. Also, a written directive in Lakeside's files required that Client A approve any investment of her assets in a private fund like MIO, and Daus' usual practice was to obtain client approval for investments in private funds. Yet Daus did not obtain Client A's approval for the investments in MIO he used to buy the ski home and refinance the auto purchase.

8. During 2008 and 2009, Daus made regular interest payments on the ski home loan (at the prime rate) and on the auto loan (at prime plus two percent) into Client A's IRA account. He also paid down approximately \$150,000 in principal on the ski home loan through two payments into the account during 2008. Lakeside kept records of these payments, the loan interest rates, and the loan principal amounts. But Daus did not execute a promissory note or similar instrument memorializing the terms of either the ski home loan or the auto loan. He also did not execute a deed of trust or any other instrument securing either loan or otherwise provide collateral for the loans. And Daus did not set any firm date by which he would pay back the loan principal, which totaled \$3.1 million.

9. Daus concealed from Lakeside's chief compliance officer at the time that Daus had not disclosed to Client A that he used her MIO investments for his ski home and auto.

10. Daus had a material conflict of interest in using Client A's assets for the ski home and auto. As borrower, Daus had an interest in loan terms that favored him, such as a low interest rate and no collateral. As the beneficial lender, Client A had interests in a high interest rate and collateral that would allow her to recover her investment if Daus failed to pay back the loans. Daus did not disclose this conflict of interests to Client A. Moreover, the loans were not in Client A's best interest. The low interest rates Daus paid were incommensurate with the risk to Client A presented by the lack of documentation, collateral, and set pay-off dates for the loans. And to effect the loans, MIO securities and other securities were purchased and sold in Client A's portfolio. These transactions were fraudulent because their purpose was neither disclosed to nor approved by Client A.

11. In February 2010, over two years after he took the ski home loan, Daus first disclosed that loan and the auto loan to Client A. She then terminated Lakeside and Daus as her advisers. By May 2010, Daus paid Client A the balance he owed on both the ski home and auto loans. By September 2010, Client A had threatened to sue Daus and Lakeside for mismanaging her portfolio, and in August 2012, she reached a settlement with Daus and Lakeside without filing a lawsuit. The settlement, however, did not require Daus or Lakeside to compensate Client A for the incommensurately low interest rates she had received from Daus on the ski home and auto loans, and Daus retained the economic benefit of the low interest rates.

Daug's Used Over \$5 Million From the Lending Allocation Fund in Undisclosed Self-Dealing

12. Daug's also made extensive, undisclosed personal use of the assets of Lending Allocation – 2009, LLC (“LAF”), a private real estate fund he managed and for which Lakeside served as adviser. Nearly all of LAF’s investors were pre-existing individual advisory clients of Lakeside to whom Daug's and Lakeside owed a fiduciary duty.

13. LAF had approximately \$19 million in assets during the relevant period. LAF’s purpose was to generate income for its investors by investing its assets in promissory notes secured by real estate or in special purpose entities that owned such promissory notes. During 2009 through 2012, however, Daug's used approximately \$5.2 million of LAF’s assets: (1) to make cash payments to Client A and other disgruntled Lakeside clients who threatened him with legal action; (2) in a circular transaction through which he returned these payments to LAF; (3) to buy Client A out of investments she no longer wanted; and (4) to facilitate his own purchase and sale of real estate.

14. First, in September 2009, several Lakeside clients threatened legal action against Daug's and Lakeside for mismanaging their assets. In January 2010, Daug's diverted \$561,000 from LAF to make settlement payments to these clients. Daug's had the \$561,000 transferred from an account of a real estate developer who frequently borrowed from LAF to bank accounts Daug's established and controlled. In return, Daug's treated the \$561,000 as a credit against amounts the real estate developer owed LAF. In April 2010, Daug's used another \$100,000 from LAF to pay a portion of what he owed Client A on the ski home loan. Daug's provided no collateral for this \$100,000 or for the \$561,000, and he paid LAF no interest on these amounts (until a belated payment during the Commission staff’s investigation).

15. Second, in early 2011, LAF’s outside accountants identified the \$561,000 and \$100,000 transfers while reviewing LAF’s books and brought them to Daug's’ attention. Daug's then paid the total \$661,000 back to LAF in April 2011. He did so, however, using LAF’s own cash in a circular transaction. First, Daug's directed LAF to provide an \$840,000 loan to the real estate developer. The real estate developer then used that money to pay Daug's \$800,000 for an option to purchase a half interest in Daug's’ ski home. Daug's then used the same money to pay the \$661,000 back to LAF. As part of the deal, Daug's gave the real estate developer the ability to potentially extend the termination date of his \$6 million line of credit with LAF.

16. Third, after Daug's entered a tolling agreement with Client A in September 2010, he directed LAF to spend approximately \$2.5 million to buy Client A out of several Lakeside investments she no longer wanted. Two of these investments, described below, were distressed because they were tied to real estate loans at risk of non-payment.

a. In December 2010, LAF spent approximately \$340,000 to acquire the first distressed investment, Client A’s MIO investment in a real estate loan. The borrowers on the loan had a history of making late payments, as Daug's knew, and worse, the borrowers soon defaulted. This left LAF as the investor in a non-performing loan, with the only

prospect for recovering its \$340,000 being a sale of the property that secured the loan. Moreover, another lender had a claim on the property superior to LAF's, as Daugs knew.

b. In September 2012, Daugs directed LAF to buy the second distressed investment—Client A's investment in yet another private fund that in turn was invested in a promissory note. Daugs and Lakeside's settlement with Client A the month before had obligated Lakeside to find a buyer to pay Client A \$1.7 million for this investment, which LAF did, although Client A had paid only \$1.1 million for it. And as Daugs knew, the promissory note underlying the Client A investment was in default. Again, LAF became invested in a non-performing asset and could recover its \$1.7 million only through a sale of the property that secured the promissory note.

17. Finally, Daugs directed LAF to make two loans totaling approximately \$1.2 million to facilitate his personal purchase and sale of a residential rental property. Daugs bought the property in April 2009 using \$490,000 he borrowed from LAF as part of the purchase price. In September 2010, Daugs sold the same property to the real estate developer—who borrowed \$700,000 from LAF to pay Daugs for the property.

18. Daugs had large personal stakes in effecting the foregoing transactions and also was a principal of Lakeside, the adviser to LAF and nearly all its investors. The transactions therefore involved material conflicts of interest for Daugs. Daugs did not disclose these conflicts of interest or the transactions to Lakeside's advisory clients who were LAF investors.

19. Daugs also did not act in the best interests of LAF or Lakeside advisory clients who were LAF investors. He provided no interest or collateral for the \$661,000 he took from LAF and then used to pay disgruntled clients. He returned the money only after the outside accountants discovered it was missing, doing so with a transaction that used LAF's own cash and exposed LAF to additional credit risk but provided it no offsetting benefit. And when Daugs directed LAF to acquire the distressed Client A investments, he put LAF at a disadvantage while advancing his own interests.

20. At times during the relevant period, the Lakeside clients who invested in LAF paid management fees to Lakeside based on their assets invested in LAF. At other times, LAF paid a management fee to an entity owned and controlled by Daugs that was designated LAF's manager under its limited liability company structure. These fees were based in part on the LAF assets described above that consisted of loans made to Daugs or for his benefit and investments LAF acquired at Daugs' direction in conflicted transactions.

Lakeside Had an Inadequate Compliance Manual

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

22. During 2010 through 2012, Lakeside's compliance manual did not include policies and procedures specific to the firm's extensive engagement in managing private funds. In particular, the manual lacked provisions reasonably designed to prevent violations of the Advisers Act arising from failures to disclose material conflicts of interest or act in the best interest of clients in connection with related-party transactions involving the private funds.

23. During 2010 through 2012, Daug's was Lakeside's sole owner and portfolio manager and its chief compliance officer and responsible for Lakeside's compliance with Rule 206(4)-7.

Lakeside Violated the Custody Rule

24. Rule 206(4)-2 under the Advisers Act, commonly known as the "Custody Rule," requires registered investment advisers with custody of client funds or securities to implement certain controls designed to protect those client assets from loss, misappropriation, misuse, or the adviser's insolvency.

25. Under the Custody Rule, Lakeside was required to maintain client funds and securities at a qualified custodian in a separate account for each client under that client's name, or in accounts that contained only clients' funds and securities under Lakeside's name as agent or trustee for the clients. During 2010 through at least 2012, however, Lakeside routinely held cash belonging to its various private fund clients in three bank accounts established in the name of law firms employed by Lakeside.

26. An adviser to a pooled investment vehicle relying on the audit approach found in Rule 206(4)-2(b)(4) must distribute audited financial statements for the pool to the pool's investors within 120 days after the pool's fiscal year end (or 180 days for funds of funds). For audit years 2010 and 2011, Lakeside relied on the audit approach and frequently failed to deliver audited financial statements for the private funds (i.e., pooled investment vehicles) it advised by the required deadlines.

27. During 2010 through 2012, Daug's was Lakeside's sole owner and portfolio manager and its chief compliance officer and responsible for Lakeside's compliance with the Custody Rule.

Violations

28. As a result of the conduct described above, Respondents willfully violated Section 10(b) of the Exchange Act and Rules 10b-5(a) and 10b-5(c) thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

29. As a result of the conduct described above, Respondents willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

30. As a result of the conduct described above, Lakeside willfully violated Section 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder, and Daugs willfully aided and abetted and caused Lakeside's violations of these provisions.

Undertakings

Lakeside has undertaken as follows:

31. Lakeside shall not solicit or accept new investments, including but not limited to capital contributions to private funds, from its clients or others, and Lakeside shall not solicit or accept new clients.

32. Lakeside shall continue the process of winding down its operations begun before the entry of this Order. Within thirty (30) days of entry of this Order, Lakeside shall engage, at its own expense, an independent monitor ("Monitor") who is not unacceptable to the Commission staff, to:

- i. oversee the completion of the winding down of Lakeside's operations;
- ii. submit to the Commission staff, by sixty (60) days after the entry of this Order (or by such later date as the staff may approve) a report on the wind-down activities conducted by Lakeside before the Monitor was engaged;
- iii. starting thirty (30) days after the Monitor is engaged, submit to the Commission staff monthly reports describing the status of the wind-down and the status of all assets of Lakeside clients; and
- iv. report any potential irregularities or misconduct involving Lakeside to the Commission staff on an ongoing basis.

33. Lakeside shall fully cooperate with the Monitor and provide the Monitor with access to any and all accounting and financial records and other documents and information the Monitor may request for review in the course of his/her/its duties.

34. Where practicable, Lakeside shall provide the Monitor with five (5) days advance notice of all transactions involving more than \$10,000 of Lakeside client assets; and for transactions where such notice is not practicable, Lakeside shall provide the Monitor with notice of the completed transaction within two (2) business days after completion.

35. Lakeside shall retain the Monitor from the date of the engagement of the Monitor until six (6) months from the entry of this Order, or until such earlier date when Lakeside has ceased operations.

36. Lakeside shall require the Monitor to enter into an agreement which provides that for the period of engagement and for a period of two (2) years from completion of the

engagement, the Monitor shall not enter into any employment, consultant, attorney-client, auditing, or other professional relationship with Lakeside, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Monitor will require that any firm with which he/she/it is affiliated or of which he/she/it is a member, and any person engaged to assist the Monitor in performance of his/her/its duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing, or other professional relationship with Lakeside, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years after the engagement.

37. Within thirty (30) days of entry of this Order, Lakeside shall confirm in writing to the Commission staff that the payments to Lending Allocation – 2009, LLC and Client A ordered in Section IV.E below have been made. Lakeside shall be responsible for any and all tax compliance obligations associated with the payments ordered in Section IV.E and may obtain professional services as necessary or appropriate to satisfy such obligations. The costs and expenses of such professional services or otherwise satisfying tax compliance obligations shall be borne by Lakeside and shall not be deducted from the payments ordered in Section IV.E.

38. Within thirty (30) days of the entry of this Order, Lakeside shall provide a copy of the Order to each of its advisory clients, and to each investor in Lending Allocation – 2009, LLC who is not an advisory client, by mail or email.

39. Lakeside shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Lakeside agrees to provide such evidence. The certification and supporting material shall be submitted to Tracy L. Davis, Assistant Regional Director, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, CA 94104, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 21C of the Exchange Act, Sections 203(e), 203(f), and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondents cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder.

B. Dauge, and hereby is:

(i) barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

(ii) prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter

with the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by Dauge will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Dauge, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. As an exception to Section IV.B above, for a period of six (6) months from the entry of this Order, Dauge may continue to associate with Lakeside and its affiliates solely for the purpose of winding down Lakeside's operations with oversight from the Monitor as provided in Sections III.32 through III.36 above.

E. Respondents shall pay disgorgement of \$302,451 and prejudgment interest of \$37,701, for which Respondents are jointly and severally liable, to the Securities and Exchange Commission. In satisfaction of Respondents' obligation to pay disgorgement and prejudgment interest, Respondents shall, within ten (10) days of the entry of this Order, pay \$72,138 to Lending Allocation – 2009, LLC, and pay \$268,014 to Client A. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

F. Respondents shall, within ten (10) days of the entry of this Order, pay a civil money penalty of \$250,000, for which Respondents are jointly and severally liable, to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

- (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Lakeside and Daus as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Tracy L. Davis, Assistant Regional Director, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, CA 94104.

- G. Respondents are censured.
- H. Lakeside shall comply with the undertakings enumerated in Sections III.31 through III.39 above.

By the Commission.

Jill M. Peterson
Assistant Secretary