INITIAL DECISION RELEASE NO. 289
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11672

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of	:	
	:	
BRANDT, KELLY & SIMMONS, LLC, and	:	INITIAL DECISION
KENNETH G. BRANDT	:	June 30, 2005

APPEARANCES: John S. Yun, Sahil W. Desai, and Michael S. Dicke for the Division of Enforcement, Securities and Exchange Commission

Bradley J. Schram and Brian Witus of Hertz, Schram & Saretsky, P.C., for Respondents Brandt, Kelly & Simmons, LLC, and Kenneth G. Brandt

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision dismisses charges brought against a registered investment adviser and its majority owner. The charges concerned Respondents' use of a $7,500 payment received from a broker-dealer to defray expenses incurred when their clients transferred to that broker-dealer from another.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission (Commission) initiated this proceeding by an Order Instituting Proceedings (OIP) on September 21, 2004. The proceeding was authorized pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (Advisers Act).

The undersigned held a two-day hearing on December 8 and 9, 2004, in Detroit, Michigan. Four witnesses, including Respondent Kenneth G. Brandt (Brandt) testified, and eighty-seven exhibits were admitted into evidence.[1]

---

[1] Citations to the transcript will be noted as "Tr. __." The Division's exhibits will be noted as "Div. Ex. __," and Respondents', as "Resp. Ex. __."

The findings and conclusions in this Initial Decision are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the following posthearing pleadings were considered: (1) the Division of Enforcement's (Division) January 28, 2005, Proposed Findings of Fact and Conclusions of Law and Post-Hearing Brief; (2) Respondents' March 7, 2005, Proposed Findings of Fact and Conclusions of Law; and (3) the Division's March 21, 2005, Reply. All arguments and proposed findings and conclusions that are inconsistent with this Initial Decision were considered and rejected.

B. Allegations and Arguments of the Parties

This proceeding concerns the use of a $7,500 payment to Brandt, Kelly & Simmons, LLC (BKS), a registered investment adviser, from TD Waterhouse Investor Services, Inc. (TDW), a broker-dealer that was custodian of BKS's client accounts and to which BKS directed client trades. The OIP alleges that the $7,500 was intended as fee reimbursements for BKS clients but that, instead, BKS used the money to pay its own operating expenses. Thus, the OIP alleges, BKS and Brandt misappropriated client assets in violation of the antifraud provisions of the Advisers Act, Sections 206(1) and 206(2), and failed to disclose its receipt of the money in Part II, Item 13.A. of its Form ADV in violation of Section 207 of the Advisers Act. The OIP also alleges that Brandt violated and aided and abetted and caused BKS's violations of these provisions. The Division requests disgorgement of $5,000, a cease-and-desist order as to both Respondents, and a requirement that BKS hire a compliance consultant. Additionally, the Division requests second-tier civil penalties of $50,000 against BKS and $25,000 against Brandt and a sixty-day suspension against Brandt.

Respondents argue that they reimbursed clients far more than $7,500 in fees and expenses that the clients incurred when Respondents transferred their business to TDW from their previous broker-dealer. They note that the payment was non-recurring and was not connected in any way to the volume of business BKS provided to TDW. They state that they had already decided to select TDW before the $7,500 payment was negotiated. Respondents request that the proceeding be dismissed.[2] In the alternative, if found liable, Respondents argue that no sanctions be imposed in that their actions were neither egregious, repeated, or involved scienter, and that there is no risk of future violations.

II. FINDINGS OF FACT

A. Respondents and Related Entities

---

[2] Respondents also request an award of legal fees, costs, and expenses wrongfully incurred. This request, which is premature, can only be made under the Equal Access to Justice Act (EAJA), 5 U.S.C. § 504, and Sections 201.31-.59 of the Commission's Rules, 17 C.F.R. §§ 201.31-.59. The EAJA and the cited Commission Rules specify the circumstances under which an award of fees and expenses will be made to a party.

Brandt has worked in the securities industry for more than thirty years. Tr. 25-26. He was a registered representative associated with Smith Barney and its predecessors from 1979 to 1996. Tr. 25-26. He was associated with Linsco Private Ledger (LPL), a broker-dealer and registered investment adviser, from 1996 to 2001. Tr. 26-29. In 2001, he and a colleague, Craig Simmons (Simmons), left LPL and established their own investment adviser, BKS. Tr. 34, 91-92, 232. At the time Brandt left LPL, about 90% of his clients were advisory clients and 10% were brokerage clients. Tr. 29-30, 49-50. Brandt currently is 85% owner of BKS. Tr. 84.

Brandt has never been fined or disciplined by the Commission, the NASD, or any other regulatory body. Tr. 90. This proceeding has had a devastating effect on him professionally and personally. Tr. 138-39.

Simmons was born in 1971 and has worked in the securities industry since 1993. Tr. 231-32. He was associated with LPL from 1996 to 2001, when he left to form BKS with Brandt. Tr. 232. He currently has a 9% ownership interest in BKS. Tr. 232. Simmons has never been the subject of a disciplinary action or customer complaint. Tr. 280-81.

BKS is a registered investment adviser; its registration with the Commission became effective and it opened for business in February 2001. Tr. 57. Eventually, about 90% of Brandt's and Simmons's accounts at LPL moved to BKS. Tr. 58. BKS received about $1 million in annual revenue in 2001, 2002, and 2003. Tr. 82-83. BKS had assets under management of about $135 million as of 2003. Tr. 83-84.

B. <u>Brandt and Simmons Establish BKS</u>

Brandt and Simmons decided to strike out on their own because they believed they could offer their clients better service at lower cost than at LPL. Tr. 33-34, 94, 100, 282-83, 288. They believed that at LPL their clients were paying for unneeded services. Tr. 33-34, 282-83. Additionally, LPL planned to become self-clearing, and, based on experience, Brandt and Simmons believed this would cause problems to their clients. Tr. 91-92, 283-84. Also, they believed that the technology that LPL made available to them was inferior to what they might obtain independently. Tr. 92, 282. They understood that they would do less well financially at first, but believed that they would profit in the long run by effecting substantial cost savings for their customers.[3] Tr. 93-94, 100, 288.

BKS needed a custodian and broker-dealer for their clients' brokerage accounts. Tr. 41. Brandt and Simmons considered Schwab, Fidelity, TDW, and others. Tr. 41-42, 236, 284-85. They sought the lowest possible transaction fees and pricing structure for their clients. Tr. 213-14. Eventually they settled on TDW because it offered the lowest fees, technology that met their

[3] At LPL, Brandt had annual commission income of about $300,000, and in addition, about $120,000 in trail commissions. Tr. 93. By comparison, his income from BKS was $300-$350 thousand in 2001 and 2002, less in 2003. Tr. 83.

needs, and good service.[4] Tr. 101-02, 183, 235-36, 285-86. The cost savings to customers included lower or no transaction fees, no annual maintenance fee, and significantly lower 12b-1 fees[5] in the same mutual funds that clients were already holding. Tr. 97-100, 140-41. TDW and BKS estimated that the average account would save more than $500 per year by transferring to TDW. Tr. 98-99, 216, 310; Div. Ex. 5 at TD07553.

Brandt and Simmons hoped that their clients at LPL would follow them to BKS and discussed the benefits and costs of the move with each client. Tr. 56, 110-11, 247-48, 266-67. The costs that a client might incur in transitioning to TDW included IRA termination fees,[6] mutual fund Class B share contingent deferred sales charges (CDSC),[7] bounced check fees, transaction costs from selling stock to put assets under management with BKS – anything related to a customer's transfer from LPL to TDW. Tr. 105-07, 132-33. BKS reimbursed more than $20,000 to clients for their costs of transferring, by giving them credits against their quarterly management fees.[8] Tr. 66, 116-27, 137, 244-46, 298, 300; Resp. Exs. A1-26, D1-5, D7-12, D14-

---

[4] Brandt satisfied himself that TDW would make a reasonable profit from BKS's business and thus would have an incentive to render good service. Tr. 102.

[5] The 12b-1 fee is authorized by Rule 12b-1 under the Investment Company Act. See 17 C.F.R. § 270.12b-1. As adopted in 1980, the rule permits a fund to pay "distribution" expenses, including broker's commissions, and shareholder service expenses from fund assets. For a concise history of the rule, see William P. Dukes and James B. Wilcox, The Difference Between Application and Interpretation of the Law as It Applies to SEC Rule 12b-1 Under the Investment Company Act of 1940, 27 New Eng. L. Rev. 9 (1992).

[6] LPL charged $50 to close an IRA account. Tr. 47. Many clients were not concerned about the $50 IRA fee, or other small fees, because their savings from transferring to TDW would be so great. Tr. 108-09, 111, 247-48. However, if a client complained about it, BKS offered to reimburse the $50. Tr. 154-55. About 50 of about 200 IRA accounts received the $50 reimbursement. Tr. 47, 67, 248-49. Brandt had originally estimated that he might reimburse as much as $15,000 for IRA fees. Tr. 46.

[7] Some clients, who had not been managed clients at LPL, decided to move to BKS and become managed clients, but had Class B shares of mutual funds subject to a substantial CDSC on redemption. Tr. 109. They were offered reimbursement of the CDSC. Tr. 109, 153. The Class B shares theoretically could have been transferred to TDW instead of being redeemed. However, to do so would have been irrational given that the client could transfer to a class of shares that required no sales load and charged lower 12b-1 fees than B shares. At TDW, BKS obtained access to fund classes with no load or load waived and with significantly lower 12b-1 fees than clients were paying in the same funds. Tr. 97-99, 139-41.

[8] The actual amount reimbursed was greater than the amount reflected in Resp. Exs. A1-26, D1-5, D7-12, D14-17, D19, D21-24, D27-31. Those exhibits reflect credits that exceeded an account's quarterly fee and were carried over to the next quarter. If the credit was less than the quarterly fee and did not have to be carried over to the next quarter, there was no separate tracking of the reimbursements. Tr. 66, 116, 133, 251-52, 303-04.

17, D19, D21-24, D27-31. Brandt did not give any fee credits to himself or family members. Tr. 112.

C. $7,500 Fee Reimbursement

After deciding to select TDW, Brandt and Simmons asked TDW for reimbursement of fees that would be incurred by clients transferring from LPL to TDW.[9] Tr. 43-46, 102-03. Brandt's ballpark estimate was that these would amount to about $30,000. Tr. 149, 297; Div. Ex. 14. Brandt and Simmons's principal contact at TDW was Sean Lindenbaum (Lindenbaum); they also had discussions with others, including Lindenbaum's supervisor, Mark Avers (Avers). Tr. 45, 184, 236-37. Eventually BKS and TDW settled on $7,500: on October 10, 2000, Lindenbaum telephoned and left a message for Brandt that TDW would "pay up to $7,500 in term. fees." Tr. 215; Div. Ex. 5 at TD07553. The agreement was memorialized in an October 17, 2000, letter from TDW to Brandt, which stated in reference to this subject, in totality, "TDW is willing to commit up to $7,500 toward account termination fees."[10] Div. Ex. 2 at BKS0020. The amount was not contingent on any particular amount of business or recommendation by TDW. Tr. 103.

The phrase "account termination fees" was not defined in the October 17, 2000, letter or elsewhere. Tr. 208; Div. Ex. 2. The Division argues that "account termination fees" meant, and was restricted to, the $50 fee charged by LPL for closing out IRA accounts. Yet, when TDW refers to IRA accounts, it normally specifies "IRA," because in the securities industry there is a fundamental difference between an IRA and a non-IRA account. Tr. 208-09. Brandt testified that he was never told by TDW and never had any understanding that the $7,500 was for IRA termination fees only, and that he believed that the $7,500 could be used for reimbursement of CDSCs and other charges incurred by clients.[11] Tr. 113, 125. Lindenbaum testified in the Division's direct case that he believed that the $7,500 was only for IRA account termination fees. Tr. 191-92. He testified that he does not remember discussing any fees with BKS other than IRA termination fees.[12] Tr. 196. He testified that entries in his TDW contact detail report referring to "term. fees" and "ind. acct. termination fees" actually referred to IRA termination

---

[9] Schwab and Fidelity also were willing to consider reimbursement of transition costs. Tr. 102-03.

[10] Avers provided this language to Lindenbaum, who drafted the letter. Tr. 203-05. TDW's compliance officer, Maria Seedner, reviewed and approved the letter. Tr. 205-07. BKS did not draft any of the language in the letter. Tr. 207.

[11] The Division complains that, during the investigation that preceded this proceeding, Respondents did not argue that they had reimbursed charges in addition to IRA fees. However, the Division had notice of Respondents' defense from their prehearing brief.

[12] Lindenbaum, the only witness from TDW who testified, had no knowledge of conversations that Brandt or Simmons had with other TDW employees. Tr. 211-12.

fees. Tr. 193-94, 229; Div. Ex. 5 at TD07551, TD0553. However, his testimony on cross-examination was inconsistent with this: he testified that he discussed with Brandt and Simmons a wide variety of fees and charges that clients would incur in transferring to TDW. Tr. 223, 318. The undersigned has concluded that Lindenbaum's direct testimony was biased in favor of placing himself and his employer, TDW, in the best possible light with Commission staff.[13] Accordingly, it is found that Lindenbaum's discussions with BKS about fees and charges were not restricted to IRA termination fees and that TDW did not restrict the $7,500 to reimbursement of IRA termination fees only.

TDW placed the $7,500 payment in BKS's sundry account at TDW in May 2001.[14] Tr. 60, 244-45; Div. Ex. 7A at 3. TDW annotated the entry in its records as "reimbursement of termination fees," with no mention of "IRA." Tr. 113; Div. Ex. 7A at 3. From there, the funds were wired to BKS's operating account at the Huntington National Bank. Tr. 60-61, 244. BKS did not segregate the $7,500. Tr. 65, 112. It had always expected to reimburse clients in excess of that amount. Tr. 267, 298.

---

[13] Official notice is taken, pursuant to 17 C.F.R. § 201.323, of the fact that TDW settled a proceeding related to its actions concerning BKS and two other investment advisers. TD Waterhouse Investor Servs., Inc., 83 SEC Docket 2870 (Sept. 21, 2004). At the hearing Lindenbaum was represented by TDW's attorney, Richard D. Marshall of Kirkpatrick & Lockhart, the predecessor of Kirkpatrick & Lockhart Nicholson Graham LLP. Tr. 196.

[14] The sundry account was a holding account for all monies that TDW credited to BKS; funds were transferred from there to BKS's bank account. Tr. 61, 244; Div. Exs. 7A-7H.

D. BKS's Form ADV

Brandt and Simmons understood that they are ultimately responsible for compliance.[15] Tr. 48, 62, 233, 239. Lindenbaum and Avers referred Brandt and Simmons to several firms that would help them with their compliance obligations. Tr. 47-48, 183-86, 198, 238-39. BKS selected National Regulatory Services (NRS) in November 2000.[16] Tr. 158-60, 237; Div. Exs. 16, 18, 19. NRS undertook to provide full-service turnkey compliance services, including creating and updating BKS's compliance manual, preparation of Forms ADV, and other services. Tr. 128-29; Resp. Ex. C. BKS desired to be in full compliance with all requirements; it provided NRS with all the documentation and information that it requested and held nothing back so that NRS could prepare its Forms ADV with full disclosure.[17] Tr. 80-81, 130.

Forms ADV that BKS filed in February 2001, September 2002, and June 2003 listed, in response to Item 13.A. of Part II, in general terms, benefits that it might receive on an ongoing basis from TDW, but did not mention the $7,500 payment. Tr. 75-77; Div. Exs. 9B at 14-15, 10B at 33-34, 11B at BKS00272-73. The Forms ADV were reviewed and approved by Maria Seedner, TDW's compliance director, who had also reviewed the October 17, 2000, letter that contained the agreement to pay the $7,500. Tr. 205-07, 225-27; Div. Ex. 8 at 1. TDW never told BKS that it should disclose the $7,500 on its Form ADV.[18] Tr. 203, 210-11.

After the Commission began to investigate this matter BKS filed an amendment to Item 13.A. of Part II of its Form ADV that disclosed the $7,500.[19] Tr. 78-79, 162-64, 306; Div. Exs. 20-21.

---

[15] BKS now has a specific chief compliance officer. Tr. 233-34. This is a requirement of 17 C.F.R. § 275.206(4)-7(c), which became effective February 5, 2004. Compliance Programs of Investment Companies and Investment Advisers, 81 SEC Docket 3447, 68 Fed. Reg. 74714 (Dec. 24, 2003).

[16] The NRS employee who assisted BKS was Jeremy Johnson. Tr. 158-60; Div. Exs. 16, 18, 19, 20. Johnson, a lawyer, was not working as a lawyer at NRS. Tr. 158, 165-66. His work on the BKS account started shortly after his September 25, 2000, arrival at NRS. Tr. 158, 167-68.

[17] Johnson does not recall having the October 17, 2000, letter when he prepared BKS's Forms ADV. Tr. 161-62. BKS, however, had no motive to withhold the letter from NRS.

[18] TDW did not have any formal protocols for handling the $7,500 payment; it was an ad hoc arrangement. Tr. 200-01. Later, TDW developed a Sales Incentive Program that included a procedure whereby investment advisers were instructed to disclose any payments from TDW on their Forms ADV. Tr. 200-03.

[19] The amendment also disclosed that TDW provided BKS with up to $5,000 for Centerpiece Software consulting and training fees. Div. Exs. 20, 21. The OIP does not allege any violations involving the Centerpiece payment.

III. CONCLUSIONS OF LAW

The record shows that BKS and Brandt worked diligently to establish a business plan that would save their clients a substantial amount of money. Did they, however, defraud them as well? It is concluded that the answer is "No" – BKS and Brandt did not violate the antifraud provisions.

A. Advisers Act Antifraud Provisions

BKS and Brandt are charged with willfully violating the antifraud provisions of the Advisers Act. Brandt is also charged with willfully aiding and abetting and causing BKS's violations. Sections 206(1) and 206(2) of the Advisers Act make it unlawful for any investment adviser, by jurisdictional means, to directly or indirectly:

> 1) employ any device, scheme, or artifice to defraud any client or prospective client, or
>
> 2) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any client or prospective client.

Section 207 of the Advisers Act makes it unlawful for "any person willfully to make" material misstatements and omissions in applications and reports filed with the Commission under the Advisers Act.

Scienter is required to establish violations of Section 206(1) of the Advisers Act. SEC v. Steadman, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). It is "a mental state embracing intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976); see also Aaron v. SEC, 446 U.S. 680, 686 n.5, 695-97 (1980); SEC v. Steadman, 967 F.2d at 641. Recklessness can satisfy the scienter requirement. See David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997); see also SEC v. Steadman, 967 F.2d at 641-42; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is conduct which is "'highly unreasonable' and . . . 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.'" Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1978) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977)).

Scienter is not required to establish a violation of Section 206(2) of the Advisers Act; a showing of negligence is adequate. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); see also SEC v. Steadman, 967 F.2d at 643 & n.5; Steadman v. SEC, 603 F.2d 1126, 1132-34 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981).

Material misrepresentations and omissions violate Sections 206(1), 206(2), and 207 of the Advisers Act. The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest. See SEC v. Steadman, 967 F.2d at 643; see also Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976). Investment advisers are fiduciaries and have an affirmative duty of utmost good faith and full and fair disclosure of all material facts. See Capital Gains Research Bureau, Inc., 375 U.S. at 191-92, 194, 201.

BKS is accountable for the actions of its responsible officers, including Brandt. See C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988) (citing A.J. White & Co. v. SEC, 556 F.2d 619, 624 (1st Cir. 1977)). A company's scienter is imputed from that of the individuals controlling it. See SEC v. Blinder, Robinson & Co., 542 F. Supp. 468, 476 n.3 (D. Colo. 1982) (citing SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972)). As an associated person of BKS, Brandt's conduct and scienter are also attributed to the firm. See Section 203(e) of the Advisers Act.

1. Aiding and Abetting; Causing

In addition to being charged with committing primary violations, Brandt is charged with "aiding and abetting," and with "causing," primary violations of Advisers Act Sections 206(1), 206(2), and 207 by BKS.

For "aiding and abetting" liability under the federal securities laws, three elements must be established: (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; also conceptualized as scienter in aiding and abetting antifraud violations; and (3) that the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation. See Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000); Woods v. Barnett Bank of Ft. Lauderdale, 765 F.2d 1004, 1009 (11th Cir. 1985); Investors Research Corp. v. SEC, 628 F.2d 168, 178 (D.C. Cir. 1980); IIT v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980); Woodward v. Metro Bank of Dallas, 522 F.2d 84, 94-97 (5th Cir. 1975); SEC v. Coffey, 493 F.2d 1304, 1316-17 (6th Cir. 1974); Russo Sec. Inc., 53 S.E.C. 271, 278 & n.16 (1997); Donald T. Sheldon, 51 S.E.C. 59, 66 (1992), aff'd, 45 F.3d 1515 (11th Cir. 1995); William R. Carter, 47 S.E.C. 471, 502-03 (1981). A person cannot escape aiding and abetting liability by claiming ignorance of the securities laws. See Sharon M. Graham, 53 S.E.C. 1072, 1084 n.33 (1998), aff'd, 222 F.3d 994 (D.C. Cir. 2000). The knowledge or awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant. See Ross v. Bolton, 904 F.2d 819, 824 (2d Cir. 1990); Cornfeld, 619 F.2d at 923, 925; Rolf, 570 F.2d at 47-48; Woodward, 522 F.2d at 97.

For "causing" liability, three elements must be established: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his or her conduct would contribute to the violation. Robert M. Fuller, 80 SEC Docket 3539, 3545 (Aug. 25, 2003), pet. denied, No. 03-1334, 2004 U.S. App. Lexis 12893 (D.C. Cir. 2004). A respondent who aids and abets a violation also is a cause of the violation under the federal securities laws. See Graham, 53 S.E.C. at 1085 n.35. Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. See KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1175 (2001), recon. denied, 74 SEC Docket 1351 (Mar. 8, 2001), pet. denied sub nom. KPMG, LLP, 289 F.3d 109 (D.C. Cir. 2002). It is assumed that scienter is required to establish secondary liability for causing a primary violation that requires scienter. Id.

2. Willfulness

The Division requests sanctions pursuant to Sections 203(f), (i), and (k) of the Advisers Act. The Commission must find willful violations to impose sanctions under Sections 203(f) and (i) of the Advisers Act. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. See Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Steadman v. SEC, 603 F.2d 1126, 1135 (5th Cir. 1979); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

B. Antifraud Violations

The OIP alleges that BKS and Brandt misappropriated $7,500 in client assets by using TDW's $7,500 payment to pay for operating expenses instead of passing on the $7,500 in fee reimbursements to clients and that they failed to inform the clients of the misappropriation, thus violating Sections 206(1) and 206(2) of the Advisers Act. Further, the OIP alleges that BKS and Brandt violated Section 207 of the Advisers Act by failing to disclose the $7,500 payment on Part II, Item 13.A. of its Form ADV.

1. Section 206

The record shows that BKS reimbursed clients for more than $20,000 – far more than $7,500 – for fees they incurred in transferring from LPL to TDW. Thus, there was no misappropriation of client assets and consequently no material misrepresentations or omissions concerning a misappropriation of client assets.[20]

Brandt and Simmons disclosed to each client individually the benefits and costs of changing from LPL to TDW. The Division argues that BKS and Brandt violated Section 206 by offering a $50 reimbursement to IRA account holders who complained about the fee rather than offering $50 to all IRA account holders, whether they complained or not. The OIP does not, however, allege that BKS and Brandt distributed the $50 payments based on impermissible criteria. The OIP alleges that they misappropriated the $7,500.

The Division argues that reimbursement of CDSCs paid by clients was a marketing expense that should have been borne by BKS because the clients could have retained their B shares and not paid the CDSCs. However, by this logic, reimbursement of the IRA fees was also a marketing expense since the IRA account holders could have stayed at LPL and not paid the IRA fees.

---

[20] Since BKS reimbursed the clients with credits against their quarterly fees, it is literally true that BKS used TDW's actual cash payment for its own expenses. To conclude that this was a misappropriation of the $7,500 would mistakenly exalt form over substance.

Not only did BKS reimburse clients far more than $7,500, the record shows that BKS and Brandt worked diligently to secure a custodian that would save their clients a substantial amount of money compared to what they had been paying LPL. In sum, there was no scheme to defraud, no material misrepresentations or omissions, and no violation of Sections 206(1) or 206(2) of the Advisers Act.

2. Section 207

The OIP alleges that BKS and Brandt violated Section 207 of the Advisers Act because they failed to disclose receipt of the $7,500 on Item 13.A. of Part II of BKS's Forms ADV.[21] Item 13.A. of Part II of Form ADV is entitled "Additional Compensation." It asks, "Does applicant or a related person have any arrangements, oral or in writing, where it: is paid cash or receives some economic benefit (including commissions, research, or non-research services) from a non-client in connection with giving advice to clients?" The allegation that Section 207 was violated is based on the assumption that BKS misappropriated the $7,500 so that the funds were compensation to BKS. However, this assumption is inconsistent with the finding that BKS distributed more than $7,500 to clients. BKS was not obligated to disclose the $7,500 payment because it was not compensation to BKS and because BKS did not misappropriate it. The economic benefit of the $7,500 was conferred on clients, not BKS. Accordingly, BKS was not required to disclose the $7,500 payment in response to Item 13.A.[22]

Assuming, arguendo, that BKS was required to disclose the payment in response to Item 13.A., its failure to do so was mitigated by its subsequent amendment to disclose the payment when it learned that Commission staff considered that it should be disclosed. Further, considering the Steadman factors, no sanction is necessary in the public interest.[23] The putative

[21] The OIP also alleges that the Forms ADV failed to disclose that BKS misappropriated TDW's $7,500 payment. This allegation is mooted by the conclusion, supra, that BKS did not misappropriate the payment.

[22] In its Post-Hearing Brief, the Division also references Item 12.B., which asks, "Does applicant or a related person suggest brokers to clients?" If so, the applicant is directed to describe "the factors considered in selecting brokers and determining the reasonableness of their commissions." The OIP, however, does not allege any deficiency in BKS's response to Item 12.B.

[23] When the Commission determines administrative sanctions, it considers:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d at 1140 (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)).

violation was isolated and scienter is absent. BKS and Brandt even hired an independent compliance expert, NRS, to help them with their compliance responsibilities, including preparation of Forms ADV.[24] The record is clear that BKS and Brandt held no information or documents back from NRS and had no intention or motive to hold back documents concerning the $7,500. The record shows that Brandt sincerely desires to comply with all requirements applicable to investment advisers and considers himself ultimately responsible for BKS's compliance. While BKS and Brandt remain in the investment adviser business, the likelihood of future violations is essentially nonexistent.

IV. ULTIMATE CONCLUSIONS

It is concluded that BKS and Brandt did not violate Sections 206(1), 206(2), or 207 of the Advisers Act. Further, Brandt did not willfully aid and abet or cause violations of Sections 206(1), 206(2), or 207 of the Advisers Act. Accordingly, the proceeding will be dismissed as to both Respondents.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on March 1, 2005.

---

[24] In discussing the cost of new rules for small investment advisers, the Commission referenced, approvingly, the use of independent compliance experts. Compliance Programs of Investment Companies and Investment Advisers, 81 SEC Docket 3447, 3458 & n.105, 68 Fed. Reg. 74714, 74724 & n.105 (Dec. 24, 2003).

VI. ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED that this administrative proceeding IS DISMISSED as to Brandt, Kelly & Simmons, LLC, and Kenneth G. Brandt.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

____

Carol Fox Foelak
Administrative Law Judge