

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2514 / May 9, 2006

ADMINISTRATIVE PROCEEDING  
File No. 3-12290

In the Matter of	:	
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HUTCHENS INVESTMENT	:	ORDER INSTITUTING ADMINISTRATIVE
MANAGEMENT, INC.	:	AND CEASE-AND-DESIST PROCEEDINGS,
and WILLIAM HUTCHENS,	:	MAKING FINDINGS AND IMPOSING
	:	REMEDIAL SANCTIONS AND A CEASE-AND-
Respondents.	:	DESIST ORDER PURSUANT TO SECTIONS
	:	203(e), 203(f), AND 203(k) OF THE
	:	INVESTMENT ADVISERS ACT OF 1940
	:	

**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 Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Hutchens Investment Management, Inc. (“HIM”) and pursuant to Sections 203(f) and 203(k) of the Advisers Act against William Hutchens (“Hutchens”) (collectively, “Respondents”).

**II.**

In anticipation of the institution of these proceedings, each Respondent has submitted an Offer of Settlement, 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, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Order”), as set forth below.

**III.**

On the basis of this Order and Respondents’ Offers of Settlement, the Commission finds that:

## **RESPONDENTS**

1. **HIM** (SEC File No. 801-49607) is a New Hampshire corporation that has been registered with the Commission as an investment adviser since 1995. HIM's principal place of business is in Concord, New Hampshire. HIM has approximately 5 employees, 100 clients, and \$200 million in assets under management.

2. **William Hutchens**, 48, of Concord, New Hampshire, is the founder and President of HIM. Hutchens is the largest shareholder of HIM.

### **Summary**

3. HIM and William Hutchens, HIM's president, failed to comply fully with their solicitation, trading, and record-keeping responsibilities. In particular, HIM violated the antifraud and record-keeping provisions of the Advisers Act by failing to disclose that it paid a solicitor for referring certain clients. In addition, HIM failed to comply fully with the Advisers Act requirement that it establish, maintain, and enforce policies and procedures to prevent the misuse of material, nonpublic information. Further, HIM misstated its turnover rate to prospective clients in responses it made to requests for proposals. Further, HIM failed to maintain required records relating to soft dollars and other matters. Finally, HIM filed Forms ADV signed by Hutchens that were materially misleading with respect to these matters. By these actions, HIM violated Sections 204, 204A, 206(1), 206(2), 206(4) and 207 of the Advisers Act and Rules 204-2(a)(5), 204-2(e), 204-3, and 206(4)-3 thereunder, and Hutchens violated Section 207 of the Advisers Act and aided and abetted and caused violations of Sections 204, 204A, 206(1), 206(2) and 206(4) of the Advisers Act and Rules 204-3, and 206(4)-3 thereunder.

### **Background**

4. In February 1997, the Boston District Office examination staff conducted an examination of HIM. That examination revealed that HIM had made improper use of soft dollars.<sup>1</sup> The examination staff sent a deficiency letter following the examination to inform HIM that the firm had improperly used soft dollars in some instances and that it lacked internal controls necessary to ensure that its use of soft dollars was consistent with its brokerage allocation disclosures. HIM, in a letter signed by Hutchens, responded that it would address these problems.

5. In August 1998, the Boston District Office examination staff conducted a routine examination of HIM. That examination revealed that HIM was not in full compliance with the Advisers Act rules relating to fees paid for client referrals. Although HIM did have written contracts with some solicitors, in one instance, HIM had received three referrals from a solicitor with whom HIM had no written contract. In addition, those clients had not been advised in writing of the arrangement between HIM and the solicitor as required. That examination also

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<sup>1</sup> "Soft dollar" practices generally describe arrangements whereby an adviser uses commission dollars generated by its advisory clients' securities trades to pay for research, brokerage, or other products, services or expenses. See S Squared Technology Corp., Advisers Act Rel. No. 1575, 62 SEC Docket 1560, 1561 (August 7, 1996).

found that HIM had no employee trading policy in place to prevent conflicts of interest with client trading and, therefore, might be in violation of Section 204A of the Advisers Act. The staff advised HIM of these violations in a deficiency letter. In HIM's written response to the deficiency letter, Hutchens stated that HIM had since obtained written contracts from all solicitors and representations from the solicitors that they would disclose the solicitation arrangements to clients. Hutchens further stated that it was the policy of HIM that "employees may buy or sell securities for their own account after completing all transaction [sic] for clients."

6. In February 2002, the Boston District Office examination staff conducted another examination of HIM. During the course of that examination, the staff determined that certain of the deficiencies identified during the 1997 and 1998 examinations persisted notwithstanding HIM's representations that those deficiencies would be addressed.

7. HIM retained compliance personnel who had some responsibility for HIM's regulatory compliance, including compliance with the matters discussed above. The staff determined that in some respects HIM's compliance personnel did not adequately perform those functions and that Hutchens and HIM did not ensure that the firm's compliance function was operating effectively.

#### **Undisclosed Solicitor**

8. HIM paid cash fees for client solicitations to an individual without making the necessary disclosures in its Form ADV and to clients. From 1996 through 2001, an HIM client who was also an HIM shareholder (referred to hereafter as "the Solicitor") referred three accounts to HIM. During that same period, HIM paid the Solicitor approximately \$10,000 per year as a purported "consulting fee." The Solicitor and Hutchens consulted with attorneys who informed them (incorrectly) that the Solicitor would be unable to receive referral fees from HIM because the Solicitor was not a registered investment adviser. To compensate the Solicitor for the referrals, Hutchens and the Solicitor verbally agreed that Hutchens would pay the Solicitor what the two agreed to call a "consulting fee." This fee was calculated by taking a percentage of management fees generated from accounts that the Solicitor brought into the firm.

9. There was no written agreement memorializing the arrangement between the Solicitor and Hutchens. The three clients the Solicitor brought into the firm were not informed of the arrangement and were unaware that the Solicitor was receiving a percentage of the management fee that they paid to HIM, but they were not charged any additional fee as a result of the arrangement. HIM's Forms ADV filed during the relevant time period, six of which were signed by Hutchens, did not disclose that HIM compensated the Solicitor for client referrals.

#### **Hutchens' Trading in HIM's Proprietary Account**

10. Hutchens used HIM's proprietary brokerage account as his personal trading account. HIM had a written policy prohibiting employees from trading in their personal accounts until client trades had been placed. This policy should have been applied to trading by Hutchens in the HIM proprietary account because Hutchens' trades in that account included trades that were made the same day and in the same stocks as some client trades. Nevertheless, HIM had no procedures in place to ensure compliance with the policy. As a result, Hutchens sometimes traded stocks in the HIM proprietary account the same day that HIM traded those

stocks for its clients before the client transactions were completed. In some instances, Hutchens received a better price for the stock while in other instances the client received the better price. At no time did any HIM employee ever question Hutchens' trades.

11. In response to Item 9E, Part II of its Forms ADV filed between 1997 and 2000, six of which Hutchens signed, HIM disclosed the fact that it buys or sells securities for itself that it also recommends to clients. However, the firm also stated, "[e]mployees may buy or sell securities for their own account after completing all transactions for clients in accordance with applicant's policy on ethical behavior. Quarterly records are kept and checked for compliance with this policy." Those representations were false in that Hutchens frequently purchased or sold stock in HIM's proprietary account before client transactions were completed. In addition, there was no mechanism in place to ensure compliance with the policy, and HIM took no steps to determine whether Hutchens complied with the policy himself.

### **HIM's Lack of Procedures to Prevent Misuse of Non-public Information**

12. Following its 1998 examination, the Boston District Office examination staff informed HIM, among other things, that it was not in compliance with the Advisers Act because it had no written policies and procedures to prevent the misuse of material non-public information. Although Hutchens represented to the staff in 1998 that HIM had appropriate written policies, HIM did not have such policies. Moreover, Hutchens did nothing to establish the necessary procedures in response to the 1998 examination notwithstanding his representations to the staff, and, as a result, HIM continued to have no written policies and procedures in place in 2002.

### **Misrepresentations to Prospective Clients**

13. From HIM's inception in June 1995 until July 2001, the firm stated to potential clients that its asset turnover rate was 50%.<sup>2</sup> Hutchens knew or was reckless in not knowing that HIM's turnover was much greater than 50% but nonetheless signed responses to requests for proposals (RFPs) HIM had received from prospective clients that misrepresented the firm's turnover rate. While the RFPs in question did not result in any contract awards to HIM, these misrepresentations were material.

14. Hutchens signed at least four responses to RFPs that misrepresented the firm's asset turnover rate for its large cap product. As HIM's president, portfolio manager, and member of the firm's investment committee, Hutchens knew or was reckless in not knowing that the firm's turnover rate in the relevant period was greater than 50% and that it had been increasing over time.

15. Prior to the staff's 2002 examination, HIM was informed (by HIM's internal compliance officer) of the discrepancy between the turnover rate reported on responses to RFPs and HIM's actual turnover rate. At that time, HIM recalculated its turnover rates.

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<sup>2</sup> Turnover is a measure of portfolio activity calculated by dividing the lesser of purchases or sales of securities by the average value of the portfolio securities held during the period. See AICPA, Audits of Investment Companies 247 (May 1, 1994 ed.).

### **HIM's Books and Records**

16. During the relevant period, HIM did not have adequate systems or procedures in place to retain and/or retain in an easily accessible location records relating to its business as an investment adviser, including all bills and statements. During the Boston District Office examination staff's 1997 and 1998 examinations, the staff informed HIM that it failed to maintain various records as required by the Adviser Act rules. In both 1997 and 1998, Hutchens represented to the examination staff that HIM would correct the deficiencies identified by the examination staff. Notwithstanding these representations, HIM continued its failure to maintain requisite books and records. For example, HIM failed to maintain invoices received for services provided by two different vendors during the period from January 1998 through December 2001 in connection with HIM's soft dollar program.

### **Violations**

17. As a result of the conduct set forth above, Respondent HIM willfully:
- (a) violated Section 206(4) of the Advisers Act and Rule 206(4)-3 thereunder, in that it engaged in an act, practice or course of business which was fraudulent, deceptive or manipulative, paid a cash fee, directly or indirectly, to a solicitor that was not paid pursuant to a written agreement to which HIM was a party, and made no bona fide effort to ascertain whether the solicitor provided a separate written disclosure document to the clients containing the name of the solicitor, the name of the investment adviser, the nature of the relationship between the solicitor and the investment adviser, the terms of the compensation arrangement, and the amount, if any, for the cost of obtaining his account the client will be charged in addition to the advisory fee;
  - (b) violated Section 204A of the Advisers Act, in that it failed to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of its business, to prevent the misuse of material, nonpublic information by it or any person affiliated with it;
  - (c) violated Sections 206(1) and 206(2) of the Advisers Act, in that it employed devices, schemes, or artifices to defraud any client or prospective client, engaged in transactions, practices or courses of business that operated as a fraud or deceit upon any client or prospective client, engaged in an act, practice or course of business which was fraudulent, deceptive or manipulative;
  - (d) violated Sections 204 and 207 of the Advisers Act and Rule 204-3 thereunder, in that it made an untrue statement of a material fact in reports filed with the Commission and omitted to state in such reports a material fact which was required to be stated therein and failed to furnish each advisory client and prospective advisory client with a written disclosure

statement containing at least the information required by Part II of Form ADV;

- (e) violated Section 204 of the Advisers Act and Rules 204-2(a)(5), and 204-2(e) thereunder, in that it failed to make and keep for prescribed periods: (1) in an easily accessible place all bills or statements (or copies thereof), paid or unpaid, relating to the business of the investment adviser as such ; and (2) all written agreements (or copies thereof) entered into by the investment adviser with any client or otherwise relating to its business as an investment adviser.

18. As a result of the conduct set forth above, Respondent Hutchens willfully:

- (a) violated Section 207 of the Advisers Act in that he made an untrue statement of a material fact in reports filed with the Commission under Section 204 of the Advisers Act and omitted to state in such reports a material fact which was required to be stated therein;
- (b) aided and abetted and caused HIM's violations of Sections 204, 204A, 206(1), 206(2) and 206(4) of the Advisers Act and Rules 204-3 and 206(4)-3, thereunder as set forth in Paragraph 17 above.

### **Undertakings**

19. Respondent Hutchens has undertaken to provide to the Commission, within 10 days after the end of the three-month suspension period described in Section IV.D. below, an affidavit that he has complied fully with the sanctions described therein.

20. Respondent HIM has undertaken to do the following:

#### **A. Compliance Consultant**

1. Has retained, or within 30 days of the date of entry of the Order will retain, the services of a Compliance Consultant not unacceptable to the staff of the Commission (the "Independent Consultant"). The Independent Consultant will be retained to perform certain procedures and review certain practices of HIM. Among other services, the Independent Consultant shall perform a mock SEC inspection; review all policies, procedures, advisory agreements, and compliance documents; and review personal securities transactions. The Independent Consultant's compensation and expenses shall be borne exclusively by HIM.
2. Require that the Independent Consultant:
  - a. Comprehensively review HIM's policies and procedures relating to its engagement of solicitors, its disclosure of the engagement of solicitors, securities trading by HIM personnel, prevention of the

misuse of non-public information, advertising and compliance with books and records requirements. Respondent will cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to HIM's files, books, records and personnel as requested for the review.

- b. In a report to HIM, recommend policies and procedures that are reasonably designed to ensure future compliance by HIM with the federal securities laws, including, but not limited to, Sections 204, 204A, 206(1), 206(2), 206(4) and 207 of the Advisers Act and Rules 204-2(a)(5), 204-2(e), 204-3, and 206(4)-3 thereunder. The report shall include a description of the review performed, the conclusions reached, the Independent Consultant's recommendations for changes in or improvements to HIM's policies and procedures, and a procedure for implementing the recommended changes in or improvements to HIM's policies and procedures.
  - c. Deliver said report to the Commission's staff within ninety (90) days of the issuance of the Order.
  - d. Enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with HIM, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Boston District Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with HIM, 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 years after the engagement.
3. Adopt all recommendations by the Independent Consultant in the report within six (6) months after its issuance; provided, however, that within thirty (30) days of the Independent Consultant's report, HIM may in writing advise the Commission staff and the Independent Consultant of any recommendations that it considers to be unduly burdensome or impractical. HIM may propose in writing an alternative procedure designed to achieve the same objective to the Independent Consultant and the Commission's staff. The Consultant shall reasonably evaluate HIM's alternative procedure and HIM shall abide by the Independent

Consultant's determination with regard thereto and adopt such recommendations.

4. Within six (6) months after the issuance of the Independent Consultant's report, submit to the Commission's staff an affidavit attesting to its implementation of the recommendations contained in the Report, setting forth the details of such implementation.
5. Not terminate the Independent Consultant without the prior approval of the Commission staff and shall not have any attorney-client relationship with the Independent Consultant and shall not seek to invoke the attorney-client privilege or any other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports or other documents to the Commission staff.

**B. Notice to Clients Regarding Order**

Within 30 days following the entry of this Order, maintain on its website for a period of six months a link to this Order in a manner not unacceptable to the staff, and notify each existing investment advisory client of (a) the entry of this Order, and (b) the fact that this Order is available through HIM's website. Such notification shall be sent in the form of a letter not unacceptable to the staff of the Commission. HIM shall notify the staff of the Commission by mail directed to Kevin M. Kelcourse, Senior Counsel, Securities and Exchange Commission, Boston District Office, 33 Arch Street, 23<sup>rd</sup> Floor, Boston, MA 02110 when this undertaking is completed.

**C. Certification**

No later than one (1) year after the date of entry of this Order, HIM shall certify to the Commission in writing that it has fully adopted and complied in all material respects with the requirements set forth in this section.

**D. Recordkeeping**

HIM shall preserve for a period of not less than six years, the first two years in an easily accessible place, any record of HIM's compliance with the undertakings set forth herein.

21. For good cause shown, the Commission's staff may extend any of the procedural dates set forth above.

**IV.**

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in Hutchens' and HIM's respective Offers of Settlement.



Accordingly, **it is hereby ORDERED:**

- A. Pursuant to Section 203(k) of the Advisers Act, that Respondent HIM cease and desist from committing or causing any violations and any future violations of Sections 204, 204A, 206(1), 206(2), 206(4) and 207 of the Advisers Act and Rules 204-2(a)(5), 204-2(e), 204-3, and 206(4)-3 thereunder.
- B. Pursuant to Section 203(k) of the Advisers Act, that Respondent Hutchens cease and desist from committing or causing any violations and any future violations of Sections 204, 204A, 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rules 204-3 and 206(4)-3 thereunder.
- C. Pursuant to Section 203(e) of the Advisers Act, that Respondent HIM be, and hereby is, censured.
- D. Pursuant to Section 203(f) of the Advisers Act, Respondent Hutchens is hereby suspended from association with any investment adviser for a period of three months beginning from the date of entry of this Order.
- E. Pursuant to Section 203(i) of the Advisers Act, that Respondent HIM shall pay a civil monetary penalty in the amount of \$40,000 to the United States Treasury in three equal installments as follows: \$13,333.33 within 120 days of the entry of this Order, an additional \$13,333.33 within 240 days of the entry of this Order, and the final \$13,333.34 within 365 days of entry of this Order. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the United States Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Hutchens Investment Management, Inc. as the Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to David P. Bergers, Associate District Administrator, Securities and Exchange Commission, Boston District Office, 33 Arch Street, 23<sup>rd</sup> Floor, Boston, MA 02110.
- F. Pursuant to Section 203(i) of the Advisers Act, that Respondent Hutchens shall pay a civil monetary penalty in the amount of \$25,000 to the United States Treasury in installments as follows: \$8,333.33 within 120 days of the entry of this Order, an additional \$8,333.33 within 240 days of the entry of this Order, and the final \$8,333.34 within 365 days of entry of this Order. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the United States Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Hutchens as the Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or

check shall be sent to David P. Bergers, Associate District Administrator,  
Securities and Exchange Commission, Boston District Office, 33 Arch Street, 23<sup>rd</sup>  
Floor, Boston, MA 02110.

- G. Respondents shall comply with the undertakings enumerated in Section III above.

By the Commission.

Nancy M. Morris  
Secretary