

BEFORE THE SECURITIES COMMISSIONER  
OF THE STATE OF KANSAS



In the Matter of:

WATCHMAKER ADVISORS, LLC (CRD #122603) and

Docket No. 12 E 019

DARREN D. UNRUH (CRD# 2810659),

KSC No. 2011-5829

Respondents.

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Pursuant to K.S.A. 17-12a412

**NOTICE OF INTENT TO IMPOSE ADMINISTRATIVE SANCTIONS**

Staff for the Office of the Kansas Securities Commissioner alleges that sufficient evidence exists to provide cause under K.S.A. 17-12a412 to invoke administrative sanctions against Respondents under the Kansas Uniform Securities Act. If the allegations set forth below are found to be true, through either administrative adjudication, failure of the Respondents to make a timely request for hearing, or default of the Respondents, it is the intention of staff to seek an order from the Commissioner to impose sanctions upon the Respondents. Such sanctions may include, *inter alia*, revocation of registration, suspension of registration, conditions or limitations on registration, censure, bar or suspension from association with a broker-dealer or investment adviser registered in the State of Kansas, fines, restitution, disgorgement, an order for costs, and/or a permanent cease and desist order.

If the Respondents wish to contest the facts alleged below or offer evidence and argument to mitigate those facts, then Respondents must file a request for hearing within thirty-three (33) days after the date of mailing on the Certificate of Service attached to this Notice. The request for hearing must be in the manner and form prescribed by K.A.R. 81-11-3 and K.A.R. 81-11-5,

and it must be filed with the Office of the Kansas Securities Commissioner, 109 SW 9<sup>th</sup> St., Suite 600 Topeka, Kansas, 66612. The request for hearing must be verified under oath by the Respondents, and if the Respondents dispute any of the allegations set forth below, Respondents shall specifically deny such allegations or such allegations will be deemed admitted by the Respondents. If a request for hearing is not timely filed, the Commissioner may issue a final order without further proceedings.

In support of such action, staff for the Securities Commissioner alleges and states:

**Allegations of Fact**

1. Respondent Watchmaker Advisors, LLC (Watchmaker) is registered with the Office of the Kansas Securities Commissioner as an investment adviser.
2. Respondent Watchmaker Advisors, LLC has a business address of 7300 College Boulevard, Third Floor, Overland Park, Kansas 66210.
3. Respondent Darren D. Unruh (Unruh) is registered with the Office of the Kansas Securities Commissioner as an investment adviser representative for Respondent Watchmaker.
4. Respondent Unruh has a business address of 7300 College Boulevard, Third Floor Overland Park, Kansas 66210 and a residential address of [REDACTED], [REDACTED].

**Custody**

5. Respondent Watchmaker designated Respondent Unruh as the person responsible for supervision and compliance on its most recent Form ADV (filed 4/28/2011).
6. Respondent Watchmaker designated Respondent Unruh as a control person on its most recent Form ADV (filed 4/28/2011).

7. Respondent Watchmaker is wholly owned by an entity known as Walnut Creek Holdings, LLC.
8. Walnut Creek Holdings, LLC is wholly owned by Respondent Unruh.
9. Respondent Unruh is the only investment adviser representative registered with Respondent, Watchmaker Advisors, LLC.
10. Respondent Watchmaker wholly owns an entity known as Watchmaker Capital Management, LLC.
11. Watchmaker Capital Management, LLC is the general partner of a limited partnership known as Watchmaker Partners, LP.
12. Watchmaker Partners, LP currently operates three hedge funds known as Watchmaker Diversified Fund, Watchmaker Quantitative Strategies Fund and Watchmaker Opportunity Fund I (the hedge funds).
13. Respondent Watchmaker currently serves or, prior to August 31, 2011, served as the investment adviser for the hedge funds.
14. As the sole owner of Watchmaker Capital Management, LLC, Respondent Watchmaker has custody of the funds or securities of the hedge funds for which Watchmaker Capital Management, LLC serves as the general partner.

**Books and Records**

15. On March 8, 2011, Assistant Director of Compliance Randy Mullikin, Senior Examiner Shelly Welch, and Senior Examiner Hugo Mayer conducted an onsite inspection of Respondent Watchmaker.
16. During the onsite inspection, Respondent Unruh, as the control person of Respondent Watchmaker, was instructed to produce all ledgers, blotters, or other records showing:

- a. all positions held by each hedge fund,
  - b. all purchases and sales made for each hedge fund, and
  - c. the names of the investors in each hedge fund as well as the value of each investor's interest in each hedge fund.
17. As of December 28, 2011, Respondent Watchmaker had provided a list of all positions held by each hedge fund, but it had not provided a record of all purchases and sales made for each hedge fund, the names of all investors in each hedge fund, nor the value of each investor's interest in each hedge fund.
18. On December 28, 2011, The Office of the Securities Commissioner mailed a written request to Respondent Watchmaker. Said request instructed Respondent Watchmaker to provide the following books and records within 5 days:
  - a. A journal or other record showing all purchases, sales, receipts, and deliveries of securities, including certificate numbers, for all accounts and all other debits and credits to the accounts of Watchmaker Diversified Fund, Watchmaker Opportunity Fund I, and Watchmaker Quantitative Strategies Fund for the time period of January 1, 2010 to December 28, 2011. (Respondent is required to maintain such records pursuant to K.A.R. 81-14-4(c)(1)(B).)
  - b. A separate ledger account for Watchmaker Diversified Fund, Watchmaker Opportunity Fund I, and Watchmaker Quantitative Strategies Fund showing all purchases, sales receipts, and deliveries of securities, the date and price of each purchase and sale, and all debits and credits for the time period of January 1, 2010 to December 28, 2011. (Respondent is required to maintain such records pursuant to K.A.R. 81-14-4(c)(1)(C).)
  - c. Copies of all confirmations of all transactions effected by or for the accounts of Watchmaker Diversified Fund, Watchmaker Opportunity Fund I, and Watchmaker Quantitative Strategies Fund for the time period of January 1, 2010 to December 28, 2011. (Respondent is required to maintain such records pursuant to K.A.R. 81-14-4(c)(1)(D).)
  - d. A record for each security in which Watchmaker Diversified Fund, Watchmaker Opportunity Fund I, and Watchmaker Quantitative Strategies Fund have a position, that shows the name of each client having

any interest in each security, the amount or interest of each client, and the location of each security for the time period of January 1, 2010 to December 28, 2011. (Respondent is required to maintain such records pursuant to K.A.R. 81-14-4(c)(1)(E).)

19. On January 6, 2012, the Office of the Securities Commissioner received a letter from the attorney for Respondent Watchmaker (David J. Haydon of Levy and Craig). Said letter indicated that the books and records referenced in Paragraph 18 were in the process of being assembled. The letter also indicated that "all of the requested information may not be immediately available."
20. As of January 19, 2012, the books and records referenced in Paragraph 18 have not been received by the Office of the Securities Commissioner.

#### **Audited Balance Sheet**

21. Respondent Watchmaker, through its wholly owned subsidiary Watchmaker Capital Management, LLC, has engaged [REDACTED] to act as an independent third party and review all fees, expenses, and capital withdrawals from the hedge funds.
22. [REDACTED] sends approval for the payment of invoices to Respondent Unruh. Unruh then forwards the approval to the qualified custodian for each of the hedge funds.
23. The contract memorializing the agreement between [REDACTED] and Watchmaker Capital Management, LLC states:

Concerning third party requests for payment for services to a Fund, the General Partner may, but shall not be obligated to, present the Independent Representative with a bill showing the amount of payment for such services.
24. Respondent Watchmaker and [REDACTED] entered into the contract for [REDACTED] [REDACTED] to review all fees, expenses and capital withdrawals from the hedge funds on June 26, 2009. However, [REDACTED] began performing accounting services for the

Watchmaker Diversified Fund in 2007 and has continued to provide such services to the present. Therefore, [REDACTED] does not meet the definition of an “independent party” found in K.A.R. 81-14-9(a)(4).

25. On December 28, 2011, The Office of the Securities Commissioner requested Respondent Watchmaker to file its audited balance sheet, as of December 31, 2010, and accompanying report of the independent auditor with the administrator within five days pursuant to K.A.R. 81-14-9(c)(2).
26. Respondent Watchmaker failed to file its audited balance sheet, as of December 31, 2010, and accompanying report within five days of December 28, 2011.
27. In a letter dated January 6, 2012, the attorney for Respondent Watchmaker stated that an audited balance sheet as of December 31, 2010, does not exist for Respondent Watchmaker.

**Bonding and Adjusted Net Worth**

28. Respondent Watchmaker does not have a surety bond for at least \$35,000.00.
29. The last balance sheet submitted to the Office of the Securities Commissioner for Respondent Watchmaker was as of March 15, 2011.
30. The only asset of significant value listed on the balance sheet referenced in Paragraph 29 above, is an interest in the Watchmaker Diversified Fund that is held by Watchmaker Capital Management, LLC.
31. The majority of assets held by the Watchmaker Diversified Fund are illiquid investments.
32. Respondent Watchmaker has not provided audited financial statements or any other independent evidence that verifies the value of Watchmaker Capital Management’s interest in the Watchmaker Diversified Fund.

33. If the value of the interest in the Watchmaker Diversified Fund is excluded as an asset, Respondent Watchmaker, as of March 15, 2011, would have a negative adjusted net worth.

#### **Registration**

34. The registration of Respondent Watchmaker as an investment adviser in the State of Kansas terminated on December 31, 2010 for failure to renew.
35. Respondent Watchmaker did not renew its registration as an investment adviser in the State of Kansas until January 31, 2011.
36. The registration of Respondent Unruh as an investment adviser representative in the State of Kansas terminated on December 31, 2010 for failure to renew.
37. Respondent Unruh did not reregister as an investment adviser representative in the State of Kansas until March 15, 2011.
38. Respondent Watchmaker received payment for management fees from the Watchmaker Quantitative Strategies Fund for services rendered in January and February of 2011.

#### **Form U4 Disclosure**

39. On April 25, 2006, the State of Kansas filed a tax warrant in Johnson County District Court, Case No. 06TW649, in the amount of \$2,237.65 against Respondent Unruh.
40. The tax warrant in Case No. 06TW649 remained outstanding until August 14, 2006.
41. The tax warrant in Case No. 06TW649 was never reported on the Form U4 of Respondent Unruh.

## Allegations of Law

### Custody

42. Respondent Watchmaker wholly owns an entity that is the general partner of a limited partnership that operates three hedge funds. Therefore, Respondent Watchmaker Advisors, LLC is an investment adviser deemed to have custody of client funds or securities pursuant to K.A.R. 81-14-9(a)(2)(A)(iii).

### Books and Records

43. Respondent Watchmaker failed to maintain, at its principal place of business, a journal or other record showing all purchases, sales, receipts, and deliveries of securities, including certificate numbers, for all accounts and all other debits and credits to the accounts in violation of K.A.R. 81-14-4(c)(1)(B), K.A.R. 81-14-4(f)(1), and K.A.R. 81-14-4(f)(5)(A).
44. Respondent Watchmaker failed to maintain, at its principal place of business, a separate ledger account for each client showing all purchases, sales, receipts, and deliveries of securities, the date and price of each purchase and sale, and all debits and credits, in violation of K.A.R. 81-14-4(c)(1)(C), K.A.R. 81-14-4(f)(1), and K.A.R. 81-14-4(f)(5)(A).
45. Respondent Watchmaker failed to maintain, at its principal place of business, copies of confirmations of all transactions effected by or for the account of any client, in violation of K.A.R. 81-14-4(c)(1)(D), K.A.R. 81-14-4(f)(1), and K.A.R. 81-14-4(f)(5)(A).
46. Respondent Watchmaker failed to maintain, at its principal place of business, a record for each security in which any client has a position that shows the name of each client having any interest in each security, the amount or interest of each client, and the location or each security, in violation of K.A.R. 81-14-4(c)(1)(E), K.A.R. 81-14-4(f)(1), and K.A.R. 81-14-4(f)(5)(A).

### **Audited Balance Sheet**

47. Respondent Watchmaker failed to maintain an audited balance sheet, in violation of K.A.R. 81-14-9(c)(1).
48. Respondent Watchmaker failed to file its audited balance sheet with the Office of the Securities Commissioner within five days of a request to file such balance sheet, in violation of K.A.R. 81-14-9(c)(2).

### **Bonding and Adjusted Net Worth**

49. Respondent Watchmaker failed to maintain a surety bond in the amount of \$35,000.00, in violation of K.A.R. 81-14-9(e).
50. Respondent Watchmaker LLC failed to maintain an independently verifiable adjusted net worth of \$35,000.00, in violation of K.A.R. 81-14-9(d)(3).
51. The third party engaged by Respondent Watchmaker to review fees, expenses, and capital withdrawals does not forward approval for the payment of invoices to the qualified custodian, as is required by K.A.R. 81-14-9(b)(G)(ii). Therefore, Respondent Watchmaker does not qualify for an exemption to maintain an audited balance sheet under K.A.R. 81-14-9(c)(3) nor an exemption to maintain the proper adjusted net worth under K.A.R. 81-14-9(d)(3).
52. The third party engaged by Respondent Watchmaker to review fees, expenses, and capital withdrawals does not review *all* fees, expenses, and capital withdrawals, as is required by K.A.R. 81-14-9(b)(G)(i). Therefore, Respondent Watchmaker Advisors, LLC does not qualify for an exemption to maintain an audited balance sheet under K.A.R. 81-14-9(c)(3) nor an exemption to maintain the proper adjusted net worth under K.A.R. 81-14-9(d)(3).

53. The third party engaged by Respondent Watchmaker to review fees, expenses, and capital withdrawals is not *independent* as is required by K.A.R. 81-14-9(b)(1)(G)(i). Therefore, Respondent Watchmaker does not qualify for an exemption to maintain an audited balance sheet under K.A.R. 81-14-9(c)(3) nor an exemption to maintain the proper adjusted net worth under K.A.R. 81-14-9(d)(3).

#### **Registration**

54. Respondent Watchmaker conducted investment advisory services in the state of Kansas at a time when it was not registered as an investment adviser with the State of Kansas, in violation of K.S.A. 17-12a403(a).
55. Respondent Unruh conducted activities as an investment adviser representative in the State of Kansas at a time when he was not registered as an investment adviser representative in the State of Kansas, in violation of K.S.A. 17-12a404(a).
56. Respondent Watchmaker employed or associated with an individual (Darren D. Unruh), who was required to be registered as an investment adviser representative in the State of Kansas, at a time when such individual was not registered with the State of Kansas as an investment adviser representative, in violation of K.S.A. 17-12a403(d).

#### **Form U4 Disclosure**

57. Respondent Unruh and Respondent Watchmaker failed to properly update the Form U4 of Darren D. Unruh to reflect an outstanding tax warrant within 30 days of the date the tax warrant was filed, in violation of K.A.R. 81-14-1(c)(3).

#### **Supervision**

58. Pursuant to K.S.A. 17-12a412(d)(9) an investment adviser has failed to reasonably supervise an investment adviser representative if the investment adviser representative

commits a violation of the Kansas Uniform Securities Act or a rule adopted under such act while subject to the supervision of the investment adviser. Therefore:

- a. The violation of K.S.A. 17-12a404, referenced in Paragraph 55, by Respondent Unruh for conducting activities as an investment adviser representative at a time when he was not registered as an investment adviser representative constitutes a failure by Respondent Watchmaker to reasonably supervise Respondent Unruh, in violation of K.S.A. 17-12a412(d)(9).
- b. The violation of K.A.R. 81-14-1(c)(3), referenced in Paragraph 57, of Respondent Unruh for failure to properly update his Form U4 constitutes a failure by Respondent Watchmaker to reasonably supervise Respondent Unruh, in violation of K.S.A. 17-12a412(d)(9).

Entered at Topeka, Kansas, this 25<sup>th</sup> day of January, 2012.



Erin M. Hoestje, #22042  
Senior Staff Attorney

Certificate of Service

I hereby certify that on this 25th day of January, 2012, copies of the above Notice of Intent to Impose Administrative Sanctions, were sent by certified mail, return receipt requested, addressed to the following:

David Haydon  
Levy & Craig  
1301 Oak Street, Suite 500  
Kansas City, Missouri 64106

Watchmaker Advisors, LLC  
7300 College Boulevard, Third Floor  
Overland Park, Kansas 66210

Darren D. Unruh  
[REDACTED]

[REDACTED]  
Michelle Lancaster  
Legal Assistant