

**BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF KANSAS**



In the Matter of:

WATCHMAKER ADVISORS, LLC (CRD #122603) and
DARREN D. UNRUH (CRD# 2810659),

Docket No. 12 E 019
KSC No. 2011-5829

Respondents.

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

STIPULATION FOR CONSENT ORDER

This proceeding follows an examination and investigation conducted by the staff of the Office of the Securities Commissioner of Kansas, pursuant to K.S.A. 17-12a411(d) and K.S.A. 17-12a602. As a result of the examination and investigation, staff for the Office of the Securities Commissioner alleges that:

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).

Respondents Watchmaker and Unruh, wishing to obtain disposition of this matter without invoking any right to a hearing before the Securities Commissioner, or his designee, have determined not to contest the issuance of an order by the Commissioner on the basis of the above allegations.

IT IS THEREFORE STIPULATED AND AGREED by and between Respondent Watchmaker, Respondent Unruh and staff for the Securities Commissioner of Kansas that:

1. The Consent Order may be issued by the Kansas Securities Commissioner without further proceedings in this matter.
2. Respondent Watchmaker and Respondent Unruh neither admit nor deny the allegations of the Commissioner's staff.
3. Respondent Watchmaker agrees that:
 - a. it will withdraw its registration as an investment adviser in the State of Kansas within thirty days from the filing of the Consent Order;
 - b. it will not file an application for registration as an investment adviser or broker-dealer in the State of Kansas for two years from the filing of the Consent Order; and
 - c. it will be temporarily barred from associating, in any manner, with an investment adviser or broker-dealer, which is registered in the State of Kansas or conducting business in the State of Kansas, for two years from the filing of the Consent Order.
4. Respondent Unruh agrees that:
 - a. he will withdraw his registration as an investment adviser representative in the State of Kansas within thirty days from the filing of the Consent Order;
 - b. he will not file an application for registration as an investment adviser representative or an agent of a broker-dealer in the State of Kansas for two years from the filing of the Consent Order; and

c. he will be temporarily barred from associating, in any manner, with an investment adviser or a broker-dealer, which is registered in the State of Kansas or conducting business in the State of Kansas, for two years from the filing of the Consent Order.

5. Staff for the Securities Commissioner of Kansas agrees that:

a. after two years from the filing of the Consent Order, said Consent Order shall not be used as a basis for denying an application of Respondent Unruh to register as an investment adviser representative or agent of a broker-dealer in the State of Kansas;

b. the Allegations of Fact recited in this Stipulation for Consent Order shall not be used as the basis for any further actions by The Securities Commissioner of the State of Kansas against Respondent Watchmaker or Respondent Unruh; and

c. any facts known, as of the date of the Consent Order, by staff for the Securities Commissioner of Kansas shall not be used as the basis for any further actions by the Securities Commissioner of the State of Kansas against Respondent Watchmaker or Respondent Unruh.

d. The Consent Order shall be a final and complete resolution of the Notice of Intent to Impose Administrative Sanctions filed in the above-captioned matter on January 25, 2012.

6. Respondent Watchmaker and Respondent Unruh hereby waive their rights to a hearing before the Commissioner with respect to this matter, the issuance of the Consent Order and the above allegations.

7. As used within this document, the phrase “barred from associating in any manner with an investment adviser or broker-dealer” (a) shall not include (i) the leasing of office space from an investment adviser or broker-dealer, or (ii) activities in connection with the termination, liquidation, or winding up of the business and affairs, of any fund to which Respondent

Watchmaker served as an investment adviser, but (b) shall include being an owner, employee, representative or agent of, or acting as a consultant to, an investment adviser or broker-dealer.

APPROVED BY:

[Redacted Signature]

Darren D. Unruh, Individually
Respondent

3/19/2012
Date

[Redacted Signature]

Darren D. Unruh, Managing Director
Watchmaker Advisors, LLC
Respondent

3/19/2012
Date

[Redacted Signature]

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