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**STATE OF WASHINGTON  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
SECURITIES DIVISION**

IN THE MATTER OF DETERMINING  
Whether there has been a violation of the  
Securities Act of Washington by:

Dennis H. Daug, Jr.,

Respondent.

) Order No. S-14-1530-14-SC01  
)  
) STATEMENT OF CHARGES AND NOTICE OF  
) INTENT TO ENTER ORDER TO CEASE AND  
) DESIST, TO REVOKE REGISTRATION, TO DENY  
) FUTURE REGISTRATIONS, TO IMPOSE A FINE,  
) AND TO CHARGE COSTS  
)  
)  
)  
)

THE STATE OF WASHINGTON TO: Dennis H. Daug, Jr. (CRD No. 1615507)

**STATEMENT OF CHARGES**

Please take notice that the Securities Administrator of the State of Washington has reason to believe that Respondent Dennis H. Daug, Jr. has violated the Securities Act of Washington. These violations justify the entry of an order to cease and desist from such violations pursuant to RCW 21.20.390, to revoke Dennis H. Daug, Jr.'s investment adviser representative registration pursuant to RCW 21.20.110(1), to deny future registration applications made by Dennis H. Daug, Jr. pursuant to RCW 21.20.110(1), to impose an administrative fine pursuant to RCW 21.20.110(1) and RCW 21.20.395, and to charge costs pursuant to RCW 21.20.110(7) and RCW 21.20.390. The Securities Administrator finds as follows:

**TENTATIVE FINDINGS OF FACT**

**Respondent**

1. Dennis H. Daug, Jr. ("Daug") (CRD No. 1615507) is a resident of Seattle, Washington. Between January 2000 and December 31, 2014, Daug was registered with the Washington State Securities Division as an investment adviser representative at Lakeside Capital Management, LLC. Daug was previously

1 registered with the Division as a securities salesperson at UBS Financial Services, Inc. from November  
2 1995 to January 2000 and, prior to that, at various firms from October 1986 to May 1994.

### 3 **Related Parties**

4 2. Lakeside Capital Management, LLC (“Lakeside”) (IARD No. 108155) is a Washington limited  
5 liability company that was formed in 1997 and did business in Seattle, Washington. Lakeside was  
6 registered as an investment adviser with the Securities and Exchange Commission (“SEC”) from January  
7 2000 to December 31, 2014, when it ceased doing business. Daus was the co-owner of Lakeside from  
8 January 2000 to January 2010, and he was Lakeside’s sole owner from January 2010 to December 31, 2014.

9 3. Lending Allocation – 2009, LLC (“Lending Allocation”) is a Washington limited liability company  
10 that was formed in 2009 to act as a private real estate fund. Daus was manager of the fund and Lakeside  
11 was the fund’s adviser. Lending Allocation was a pooled investment vehicle that invested in promissory  
12 notes and in entities that owned promissory notes. Investors in the fund received a proportional share of any  
13 return. Approximately 75 Lakeside clients were invested in Lending Allocation, and nearly all of the  
14 investors in the fund were Lakeside clients.

15 4. Managed Income Opportunities, LLC (“Managed Income”) is a Washington limited liability  
16 company that was formed in 2007 to act as a real estate lending fund. Daus was co-manager of the fund  
17 and Lakeside was the fund’s adviser. To invest in Managed Income, clients made capital contributions  
18 specific to particular loans or investments. Managed Income was not a pooled investment fund; only those  
19 investors who contributed to a particular investment received a beneficial interest in that loan or investment.  
20

### 21 **Nature of the Conduct**

#### 22 **I. Overview**

23 5. While he was registered as an investment adviser representative at Lakeside, Daus breached his  
24 fiduciary duties to his clients. As an investment adviser representative, Daus had a fiduciary duty to act  
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1 primarily for the benefit of his clients. This duty includes, among other things, not engaging in dishonest or  
2 unethical business practices, disclosing material information in the sale of securities, and disclosing  
3 conflicts of interest.

4 6. Daus breached his fiduciary duties when he borrowed \$3.1 million from an elderly client (“Client  
5 A”) in order to purchase a vacation home and a rare 1955 Mercedes “Gullwing” automobile. Daus did not  
6 disclose to Client A that he was the borrower on the loans. To facilitate loaning himself the funds, Daus  
7 sold or transferred securities held by Client A without disclosing the purpose of the transactions to Client A.  
8 In addition to borrowing money from Client A, Daus concentrated Client A’s portfolio in investments that  
9 were illiquid and high-risk, which was unsuitable for Client A’s circumstances.

10 7. Daus also breached his fiduciary duties to clients who were invested in Lending Allocation, a  
11 private fund managed by Daus. Daus used more than \$5 million from Lending Allocation in transactions  
12 in which Daus put his own interests ahead of his clients’ interest. Among other things, Daus borrowed  
13 Lending Allocation funds, loaned out Lending Allocation funds in transactions that he had an undisclosed  
14 interest in, and used Lending Allocation funds to purchase distressed investments held by Client A after she  
15 threatened legal action against Daus for mismanagement of her investments. Daus did not disclose his  
16 role and his interest in these transactions, and he did not disclose the conflicts of interest in these  
17 transactions.  
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## 19 **II. SEC Administrative Action**

20 8. After investigating Daus and Lakeside for, among other things, the conduct described above, the  
21 SEC instituted administrative and cease-and-desist proceedings. The SEC found that Daus fraudulently  
22 liquidated securities held by Client A and used her funds to loan himself \$3.1 million. The SEC also found  
23 that Daus used over \$5 million from Lending Allocation and engaged in undisclosed self-dealing. Based  
24 on these findings, the SEC found that Daus and Lakeside willfully violated the Securities Exchange Act of

1 1934 (“Exchange Act”), which prohibits fraudulent conduct in connection with the purchase or sale of  
2 securities, and the Investment Advisers Act of 1940 (“Advisers Act”), which prohibits fraudulent conduct  
3 by an investment adviser.

4 9. On July 17, 2014, Daus and Lakeside settled the administrative and cease-and-desist proceedings  
5 that were instituted by the SEC. In settling the matter, Lakeside agreed to wind-down operations and  
6 engage an independent monitor to oversee the wind-down. Daus and Lakeside were ordered to cease and  
7 desist from violating the Exchange Act and the Advisers Act and to pay a civil penalty of \$250,000. Daus  
8 and Lakeside were also ordered to pay disgorgement of \$302,451 and prejudgment interest of \$37,701. In  
9 addition, Daus was barred from association with any broker, dealer, investment adviser, municipal  
10 securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization  
11 for five years, beginning at the completion of Lakeside’s wind-down.

12 **III. Mismanagement of Client A’s Investments**

13 *A. \$3.1 Million in Loans from Client A*

14 10. Between January 2008 and May 2009, Daus borrowed a total of \$3.1 million from Client A in two  
15 separate transactions. Client A was a Washington resident and longtime client of Daus and Lakeside.  
16 Daus borrowed the funds through Client A’s investment in Managed Income, a private fund co-managed  
17 by Daus.

18 11. First, in approximately January 2008, Daus borrowed \$2.15 million from Client A to purchase a  
19 vacation home in Sun Valley, Idaho. To fund the loan, Daus caused the sale of \$2.15 million of securities  
20 held by Client A. Daus did not disclose to Client A that he sold these securities to fund a loan to himself.  
21 After selling these securities, Daus caused Client A to purchase \$2.15 million of Managed Income  
22 securities. Daus then caused Managed Income to loan himself the proceeds from Client A’s purchase of  
23 Managed Income securities.  
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1 12. In or around May 2009, Daugs borrowed an additional \$950,000 from Client A and used these funds  
2 to refinance his purchase of a 1955 Mercedes "Gullwing" automobile. Daugs had previously purchased the  
3 car, and then refinanced the purchase, using funds from two other Lakeside clients. To refinance the  
4 purchase again, Daugs caused \$950,000 worth of securities held by Client A to be transferred to the  
5 Lakeside client holding the car loan. In return, Client A received \$950,000 worth of Managed Income  
6 securities.

7 13. Daugs did not memorialize either the vacation home loan or the car loan in a promissory note or  
8 similar document. Daugs did not specify a due date for either of the loans. Daugs did not execute a deed of  
9 trust or similar document securing either of the loans. While Daugs paid interest on the loans, the low  
10 interest rates were not commensurate with the risk associated with the undocumented, on-demand, and  
11 unsecured loans. While Client A's account statements reflected her investments in Managed Income, Daugs  
12 did not disclose to Client A the purpose of the investments, or his role in the investments. Daugs also did  
13 not disclose to Client A the material conflicts of interest in the transactions, where Daugs controlled the  
14 lender and was also the borrower.

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16 14. In or around February 2010, Daugs disclosed the vacation home loan and the car loan to Client A.  
17 In response, Client A terminated Lakeside and Daugs. Shortly after, Daugs repaid the car loan and the  
18 vacation home loan by selling the car, and by taking out a mortgage on the vacation home.

19 *B. Mismanagement of Client A's Investment Portfolio*

20 15. In September 2010, Daugs received a complaint from Client A regarding mismanagement of her  
21 investments. In addition to asserting that Daugs took personal loans from Client A to purchase the vacation  
22 home and the car, Client A stated that Daugs invested her funds in illiquid, high-risk investments that were  
23 unsuitable for Client A's circumstances.

1 16. Client A's portfolio was highly concentrated in multiple Washington limited liability companies  
2 ("LLCs") that were managed by Daug. The LLCs were formed to invest in real estate funds and in  
3 promissory notes. In early 2010, approximately 79% of Client A's funds at Lakeside were invested in the  
4 LLCs at issue. This high concentration of illiquid investments was unsuitable because Client A was retired  
5 and lived on her investment income. In addition, Client A was not able to meet her charitable obligations  
6 because the concentration in illiquid investments reduced the amount of cash in her portfolio.

7 17. In her complaint, Client A also stated that Daug failed to disclose information material to  
8 investment in the LLCs including, but not limited to, the self-dealing nature of Daug's relationship to the  
9 LLCs, the nature of the assets of the LLCs, and the illiquidity and risk associated with the LLCs. Client A  
10 also alleged that Daug failed to disclose that he received higher compensation from Client A's investment  
11 in the LLCs than what he would have received from investments more suitable to Client A's circumstances.

12 18. In August 2012, Daug, Lakeside, and Client A entered into an agreement settling Client A's  
13 complaint. Daug and Lakeside agreed to transfer Client A's interest in nine of the LLCs to the real estate  
14 funds in which the LLCs were invested. This transfer would result in Client A being directly invested in the  
15 real estate funds, and not in the LLCs managed by Daug. Daug and Lakeside also agreed to find buyers to  
16 purchase Client A's interest in six other LLCs for a total of \$2.9 million. As described below, Daug used  
17 funds from Lending Allocation to meet some of his obligations under the settlement agreement with Client  
18 A. In addition, Daug used funds from Lending Allocation in transactions that put his own interests ahead  
19 of his clients' interests.

20  
21 **IV. Use of More than \$6.5 Million in Funds from Lending Allocation**

22 19. Between April 2009 and September 2012, Daug used more than \$5 million from Lending  
23 Allocation, a private fund in which several of Daug's clients were invested. Daug, who had a fiduciary  
24 duty to his clients, used the funds from Lending Allocation in transactions that put his interests ahead of his

1 clients' interests. Daug's borrowed funds from Lending Allocation to purchase a rental property, to make  
2 settlement payments to former clients, and to pay down his vacation home loan with Client A. To facilitate  
3 the subsequent repayment of these loans, Daug's used additional Lending Allocation funds. Further, after  
4 Client A threatened Daug's with legal action for mismanagement of her investments, Daug's used funds from  
5 Lending Allocation to buy Client A out of certain investments. Daug's failed to disclose to his clients  
6 invested in Lending Allocation the conflicts of interest in these transactions.

7 *A. Borrowing Funds from Lending Allocation*

8 20. Between April 2009 and April 2010, Daug's borrowed more than \$1.15 million from Lending  
9 Allocation in three separate transactions. First, in April 2009, Daug's borrowed \$490,000 from Lending  
10 Allocation to purchase a rental property in Seattle. Daug's did not disclose to clients who were invested in  
11 Lending Allocation that he was the borrower on the loan.

12 21. Next, in approximately January 2010, Daug's borrowed \$561,000 from Lending Allocation to fulfill  
13 obligations that he and Lakeside had under an agreement settling complaints by former clients. To borrow  
14 the funds, Daug's advanced \$561,000 from Lending Allocation's trust account to an entity of which he was  
15 the principal. Daug's did not provide security for the \$561,000 loan, and he did not specify a due date or an  
16 interest rate for the loan.

17 22. Finally, in approximately April 2010, Daug's advanced an additional \$100,000 from Lending  
18 Allocation's trust account to an entity of which he was the principal. Daug's used the funds to make a  
19 payment on the vacation home loan from Client A. Daug's did not provide security for the \$100,000 loan,  
20 and he did not specify a due date or an interest rate for the loan.

21 23. Daug's did not disclose to clients who were invested in Lending Allocation that the purpose of the  
22 \$561,000 and \$100,000 loans was to make payments to former clients. Further, Daug's did not disclose that  
23 Daug's put his own interests ahead of his clients' when he borrowed \$661,000 from the fund in unsecured,  
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1 on-demand, and no-interest loans. Daug's also did not disclose the material conflicts of interest in the loans,  
2 where Daug's controlled the lender and was also the borrower.

3 *B. Using Lending Allocation Funds to Facilitate Loan Repayments*

4 24. Between September 2010 and April 2011, Daug's repaid the loans described above in two separate  
5 transactions. In both instances, Daug's did not have the funds to pay-off the loans from Lending Allocation.  
6 Instead, Daug's used an additional \$1.54 million of Lending Allocation funds to facilitate his repayment of  
7 the loans. In transactions that concealed Daug's role and interest in the loans, Daug's caused Lending  
8 Allocation to loan funds to a real estate developer with whom Daug's often did business. The developer then  
9 paid or loaned the funds to Daug's to repay Lending Allocation.

10 25. The first of these transactions occurred in September 2010, after Daug's determined that he should  
11 not have borrowed funds from Lending Allocation to purchase his rental property in Seattle. To repay the  
12 \$490,000 loan, Daug's sold his rental property to the real estate developer. To facilitate the sale, Daug's  
13 caused Lending Allocation to loan \$700,000 to the developer, who then paid Daug's \$700,000 for the rental  
14 property. After receiving the funds, Daug's paid Lending Allocation the balance that he owed on his  
15 \$490,000 loan.  
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17 26. By April 2011, Lakeside's outside accountants had inquired about the \$661,000 that Daug's  
18 borrowed from Lending Allocation. To repay these loans, Daug's caused Lending Allocation to loan  
19 \$840,000 to the real estate developer. The developer then used the funds from Lending Allocation to loan  
20 \$800,000 to Daug's. The \$800,000 loan was related to an option to purchase a one-half interest in Daug's  
21 vacation home in Sun Valley, Idaho. In the option agreement, Daug's gave the developer the ability to  
22 extend the end-date of an unrelated line-of-credit that the developer held with Lending Allocation. After  
23 receiving the funds from the developer, Daug's repaid the \$661,000 that he owed to Lending Allocation.  
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1 27. Daugs did not disclose to clients who were invested in Lending Allocation that he had a role and an  
2 interest in the \$1.54 million in loans made to the real estate developer. Further, Daugs did not disclose that  
3 Daugs put his interests ahead of his clients' when, in the sale of the option, he extended the end-date of the  
4 developer's line-of-credit. Daugs also did not disclose the material conflicts of interest in the transactions,  
5 where Daugs controlled the lender and also had an interest in the loans being made.

6 *C. Using Lending Allocation Funds to Purchase Client A's Investments*

7 28. Between February 2010 and September 2012, in order to avoid litigation and settle Client A's  
8 complaint, Daugs used \$2.5 million from Lending Allocation to buy Client A out of certain investments.  
9 Two of these investments were tied to promissory notes that were at risk of default, or were in default, at the  
10 time that Lending Allocation purchased the investments.

11 29. In approximately December 2010, Daugs caused Lending Allocation to purchase the first of these  
12 distressed investments. Lending Allocation spent approximately \$340,000 to buy Client A out of an  
13 investment that was tied to a home loan in second position with a history of late payments. After Lending  
14 Allocation purchased the loan, the borrowers defaulted.

15 30. In approximately September 2012, Daugs caused Lending Allocation to purchase the second  
16 distressed investment from Client A. As described above, about a month earlier Daugs, Lakeside, and  
17 Client A entered into a settlement agreement. Under the agreement, Lakeside was obligated to find a buyer  
18 to purchase Client A's interests in six LLCs. Daugs used Lending Allocation to fulfill part of this  
19 obligation: he caused Lending Allocation to purchase Client A's interest in one of the LLCs for \$1.7  
20 million. At the time of the purchase, the LLC was invested in a secured promissory note that was in default.

21 31. Daugs did not disclose to clients who were invested in Lending Allocation that Daugs used Lending  
22 Allocation funds to purchase some of Client A's investments after she threatened litigation for  
23 mismanagement of her investments. Daugs did not disclose the interest that he had in Lending Allocation's  
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1 purchase of Client A's investments. Further, Daus did not disclose that Daus put his own interests ahead  
2 of his clients' when he used Lending Allocation funds to purchase investments from Client A to avoid  
3 litigation, and to fulfill obligations under a settlement agreement. Daus also did not disclose the material  
4 conflicts of interest in these transactions, where Daus controlled the purchaser and also had in interest in  
5 the purchase occurring.

6  
7 Based upon the above Findings of Fact, the following Conclusions of Law are made:

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9 **CONCLUSIONS OF LAW**

10 1. Dennis H. Daus, Jr. violated RCW 21.20.020 by engaging in an act, practice, or course of business  
11 which operates or would operate as a fraud or deceit upon another person, and by engaging in dishonest or  
12 unethical practices. As set forth in the Tentative Findings of Fact, Daus borrowed funds from clients and,  
13 in certain instances, did not disclose that he was the borrower on the loan, did not execute a document  
14 memorializing the loans, did not secure the loans, did not disclose the purpose of the loans, did not disclose  
15 his role in the loans, did not disclose his interest in the loans, and did not disclose when he put his own  
16 interests ahead of his clients' interests. Daus also loaned out client funds in transactions that concealed  
17 Daus's role and interest in the loans. Such conduct is grounds for revocation of Daus's investment  
18 adviser representative registration, and for denial of future broker-dealer, securities salesperson, investment  
19 adviser, or investment adviser representative registration applications by Daus, imposition of a fine, and  
20 charging of costs pursuant to RCW 21.20.110(1)(b) and RCW 21.20.110(7).

21  
22 2. In connection with the sale and purchase of securities, Dennis H. Daus, Jr. made untrue statements  
23 of material fact or omitted to state material facts necessary to make the statements made, in light of the  
24 circumstances under which they were made, not misleading. As set forth in the Tentative Findings of Fact,

1 Daus caused the purchase and sale of securities held by his clients without disclosing the purpose of the  
2 transaction, his role in the transaction, his interest in the transaction, and the material conflicts of interest in  
3 the transaction. Such conduct violates RCW 21.20.010, and it is grounds for revocation of Daus's  
4 investment adviser representative registration, and for denial of future broker-dealer, securities salesperson,  
5 investment adviser, or investment adviser representative registration applications by Daus, imposition of a  
6 fine, and charging of costs pursuant to RCW 21.20.110(1)(b) and RCW 21.20.110(7).

7 3. Dennis H. Daus, Jr. engaged in dishonest or unethical business practices as defined by WAC 460-  
8 24A-220. As set forth in the Tentative Findings of Fact, Daus borrowed money from clients,  
9 recommended unsuitable investments to Client A, failed to disclose his role in certain transactions, failed to  
10 disclose his interest in certain transactions, and failed to disclose material conflicts of interest in certain  
11 transactions. Such conduct is grounds for revocation of Daus's investment adviser representative  
12 registration, and for denial of future broker-dealer, securities salesperson, investment adviser, or investment  
13 adviser representative registration applications by Daus, imposition of a fine, and charging of costs  
14 pursuant to RCW 21.20.110(1)(g) and RCW 21.20.110(7).

15 4. Dennis H. Daus, Jr. is the subject of an Order by the SEC finding that he violated the Exchange Act  
16 and the Advisers Act, ordering him to cease and desist from violations of the Exchange Act and Advisers  
17 Act, and barring him from association with any broker, dealer, or investment adviser for five years. Being  
18 the subject of such an Order is grounds for revocation of Daus's investment adviser representative  
19 registration, and for denial of future broker-dealer, securities salesperson, investment adviser, or investment  
20 adviser representative registration applications by Daus, imposition of a fine, and charging of costs  
21 pursuant to RCW 21.20.110(1)(e), RCW 21.20.110(1)(f), RCW 21.20.110(1)(m), and RCW 21.20.110(7).  
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## **NOTICE OF INTENT TO ORDER THE RESPONDENT TO CEASE AND DESIST**

Pursuant to RCW 21.20.390(1) and based upon the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order that Dennis H. Daug, Jr. cease and desist from violations of RCW 21.20.020 and RCW 21.20.010.

## **NOTICE OF INTENT TO REVOKE REGISTRATION**

Pursuant to RCW 21.20.110(1) and based upon the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order that the investment adviser representative registration of Dennis H. Daug, Jr. be revoked.

## **NOTICE OF INTENT TO DENY FUTURE REGISTRATIONS**

Pursuant to RCW 21.20.110(1) and based upon the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order that any broker-dealer, securities salesperson, investment adviser, or investment adviser representative registration applications that Dennis H. Daug, Jr. may file in the future be denied.

## **NOTICE OF INTENT TO IMPOSE A FINE**

Pursuant to RCW 21.20.110(1) and RCW 21.20.395 and based upon the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order that Dennis H. Daug, Jr. shall be liable for and shall pay an administrative fine of \$40,000.

## **NOTICE OF INTENT TO CHARGE COSTS**

Pursuant to RCW 21.20.110(7) and RCW 21.20.390 and based upon the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order that Dennis H. Daug, Jr. shall be liable for and shall pay the costs, fees, and other expenses incurred in the administrative investigation and hearing of this matter, in an amount not less than \$1,800.

**AUTHORITY AND PROCEDURE**

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This Statement of Charges is entered pursuant to the provisions of Chapter 21.20 RCW and is subject to the provisions of Chapter 34.05 RCW. The respondent, Dennis H. Daug, Jr., may make a written request for a hearing as set forth in the NOTICE OF OPPORTUNITY TO DEFEND AND OPPORTUNITY FOR HEARING accompanying this Order. If the respondent does not make a hearing request in the time allowed, the Securities Administrator intends to adopt the above Tentative Findings of Fact and Conclusions of Law as final and to enter a permanent order to cease and desist as to the respondent, to impose any fines sought against the respondent, and to charge any costs sought against the respondent.

Signed and Entered this 27th day of February 2015.



William M. Beatty  
Securities Administrator

Approved by:



Suzanne Sarason  
Chief of Enforcement

Presented by:



Holly Mack-Kretzler  
Financial Legal Examiner

Reviewed by:



Robert Kondrat  
Financial Legal Examiner Supervisor

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**STATEMENT OF CHARGES AND NOTICE  
OF INTENT TO ENTER ORDER TO  
CEASE AND DESIST, TO REVOKE  
REGISTRATION, TO DENY FUTURE  
REGISTRATIONS, TO IMPOSE A FINE,  
AND TO CHARGE COSTS**

**DEPARTMENT OF FINANCIAL INSTITUTIONS  
Securities Division  
PO Box 9033  
Olympia WA 98507-9033  
360-902-8760**