

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 62982 / September 23, 2010**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3086 / September 23, 2010**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-14066**

**In the Matter of**

**Carlson Capital, L.P.**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO SECTION 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTION 203(e) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER**

**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 Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 203(e) of the Investment Advisers Act of 1940 (“Advisers Act”), against Carlson Capital, L.P. (“CCLP” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, CCLP has submitted an Offer of Settlement (the “Offer”) 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 Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and

Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

### **III.**

On the basis of this Order and Respondent’s Offer, the Commission finds that:

#### **Summary**

These proceedings arise out of violations of Rule 105 of Regulation M of the Exchange Act by CCLP, a registered investment adviser and manager of hedge funds based in Dallas, Texas. Rule 105 prohibits buying an equity security made available through a public offering from an underwriter or broker or dealer participating in the offering after having sold short the same security during a restricted period (generally defined as five business days before the pricing of the offering). The rule provides an exception for the purchase of an offered security in an account that is “separate” from the account through which the same security was sold short.

CCLP makes investment decisions through various strategies, each with dedicated portfolio managers. On four occasions in 2008, CCLP bought offered shares from an underwriter or broker or dealer participating in a public offering after having sold short the same security during the restricted period. In three of these instances, the same CCLP portfolio manager or analyst who directed the short sales also directed the purchase of the offered shares. In the fourth instance, a CCLP portfolio manager from one firm strategy directed the purchase of offered shares after a portfolio manager from another strategy sold short the same security during the restricted period. Because of the firm’s structure, the firm’s trades do not qualify for the separate accounts exception under Rule 105. CCLP’s violative conduct with respect to all four offerings collectively resulted in unlawful profits or loss avoidance of more than \$2.25 million.

#### **Respondent**

1. Carlson Capital, L.P. is a Delaware limited partnership with its principal office in Dallas, Texas. It manages several funds and private accounts, and trading described in this Order refers to trading by the firm on behalf of those funds or private accounts. The firm has been registered voluntarily with the Commission as an investment adviser since 2001 and currently manages approximately \$5.1 billion in investor assets.

#### **Legal Framework**

2. As amended in 2007, Rule 105 of Regulation M provides in pertinent part:

In connection with an offering of equity securities for cash pursuant to a registration statement or a notification on Form 1-A . . . or Form 1-E . . . filed under the Securities Act of 1933 (“offered securities”), it shall be

unlawful for any person to sell short . . . the security that is the subject of the offering and purchase the offered securities from an underwriter or broker or dealer participating in the offering if such short sale was effected during the period (“Rule 105 restricted period”) . . . [b]eginning five business days before the pricing of the offered securities and ending with such pricing . . .

17 C.F.R. § 242.105(a); Short Selling in Connection with a Public Offering, Exchange Act Release No. 56,206, 72 Fed. Reg. 45,094, 45,107 (Aug. 10, 2007) (“Adopting Release on Rule 105”).

3. Subsection (b)(2) of Rule 105 provides that the rule does “not prohibit the purchase of the offered security in an account of a person where such person sold short during the Rule 105 restricted period in a separate account, if decisions regarding securities transactions for each account are made separately and without coordination of trading or cooperation among or between the accounts.” 17 C.F.R. §242.105(b)(2). The Commission’s adopting release on Rule 105 states that it uses “account” as a “general term” that can include diverse types of “separate accounts” such as “portions of a fund,” a “unit,” “departments,” and “identifiable divisions.” Adopting Release on Rule 105, 72 Fed. Reg. at 45,098 n. 64.

4. Rule 105 applies irrespective of the short seller’s intent in effectuating the short sale. “The prohibition on purchasing offered securities . . . provides a bright line demarcation of prohibited conduct consistent with the prophylactic nature of Regulation M.” *Id.* at 45,096. The Commission adopted Rule 105 in an effort to prevent manipulative short selling prior to a public offering and, therefore, “to foster secondary and follow-on offering prices that are determined by independent market dynamics.” *Id.* at 45,094.

### **CCLP’s Structure and Operations**

5. CCLP makes investment decisions through strategies that are run by one or more portfolio managers supported by analysts and traders. During the relevant period, the firm’s strategies included Relative Value Arbitrage (“Relative Value”) and Risk Arbitrage, among others. Each strategy’s investment positions were allocated across the firm’s funds and accounts according to ratios established by the firm, depending on whether the fund or account subscribed to the particular strategy.

### **Respondent’s Violations of Rule 105 of Regulation M**

6. From May to November 2008, CCLP violated Rule 105 with respect to four follow-on or secondary offerings collectively resulting in unlawful profits or loss avoidance of more than \$2.25 million.

A. *Violations Resulting From Purchases of Offering Shares by the Same Portfolio Managers Who Sold Short During the Restricted Period*

7. On April 30 and May 1, 2008, CCLP sold short a total of 100,000 shares of Equitable Corporation (“EQT”). The firm portfolio manager who sold short these shares then directed the purchase of 100,000 shares of EQT in a follow-on offering that was announced on May 5, 2008, and priced on May 6, 2008 at \$67.75 per share. The offering price exceeded the prices at which the firm had sold short. By purchasing the offered shares despite having shorted the stock during the restricted period, CCLP improperly obtained a discount from the stock’s market price and avoided losses of \$31,600.

8. On June 10 and June 11, 2008, CCLP sold short 202,500 shares of Rockwood Holdings, Inc. (“ROC”). After markets closed on June 11, 2008, ROC announced the overnight sale of shares of stock by existing ROC shareholders in an underwritten offering. The same CCLP analyst who had sold short the ROC shares directed the firm to buy offered shares from the underwriter. Before the market opened on the morning of June 12, 2008, the firm confirmed an allocation from the underwriter of 150,000 shares at a price of \$38.90 per share. Because the firm sold short shares of ROC during the five-day restricted period that preceded the offering, the firm’s purchase of offered shares violated Rule 105. The difference between CCLP’s proceeds from the first 150,000 shares it sold short and the price for the offered shares was \$500,200.

9. On September 18 and 19, 2008, CCLP sold short over 500,000 shares of Capital One Corp. (“COF”). The portfolio manager responsible for most of these short sales then directed the purchase of 325,000 shares of COF in a follow-on offering that was announced on September 23, 2008, and priced after the close of trading on September 24, 2008 at \$49 per share. The offering price generally exceeded the prices at which the firm had sold short. By purchasing the offered shares despite having shorted the stock during the restricted period, CCLP improperly obtained a discount from the stock’s market price and avoided losses of \$665,503.

10. The investment personnel at CCLP who directed the firm’s participation in the above-described offerings either misunderstood or were unaware of Rule 105’s requirements during the relevant time period. CCLP’s compliance manual did not address Rule 105, and the firm conducted no formal firm-wide training addressing Rule 105 during this period. To comply with Rule 105, CCLP relied on the efforts of one firm trader to coordinate the review of the firm’s prior short sales (“Rule 105 reviews”) before it participated in offerings. The firm, however, did not have policies and procedures sufficient to prevent the firm from participating in the offerings discussed in this Order. Subsequently, during the Commission staff’s investigation, CCLP conducted firm-wide training addressing Rule 105, amended its compliance manual to include the rule, and implemented an automated system to facilitate Rule 105 reviews.

B. *Violation Resulting From Purchase of Offering Shares After A Different Portfolio Manager Sold Short*

11. CCLP bought 600,000 shares of Wells Fargo & Co. (“WFC”) stock in a follow-on offering that was announced on November 5, 2008 and priced after the close of trading on

November 6, 2008 at \$27 per share. The firm's Relative Value strategy directed this purchase. Before the market opened on the morning of November 6, 2008, the head Risk Arbitrage portfolio manager received an instant message stating that the Relative Value strategy intended to participate in the offering.

12. Approximately a month before the transactions at issue, the Risk Arbitrage strategy established a short position in WFC as a hedge to its purchases of the stock of Wachovia Bank ("Wachovia"), in connection with the two banks' intended merger. On November 6, 2008, the day of the offering, the Risk Arbitrage strategy sold short 398,225 shares of WFC at prices that exceeded the offering price. The strategy also bought additional Wachovia shares at a total dollar value roughly equivalent to the WFC shares it sold short that day. At the time, the Risk Arbitrage portfolio manager who made these decisions was unfamiliar with Rule 105. Meanwhile, when the Relative Value portfolio manager directed the purchase of the offered WFC shares, she was familiar with Rule 105, but it was not her practice to check the firm's prior short sales outside of her own portfolio before participating in an offering.

13. Although the CCLP strategy that participated in the WFC offering was different than the strategy that sold short during the restricted period, the two strategies are not "separate accounts" under Rule 105. Because the above-described WFC transactions do not qualify for the separate accounts exception set forth in Rule 105(b)(2), CCLP's purchase of the offered WFC shares after having made restricted period short sales violated the rule.

14. In its adopting release, the Commission stated that in order for the separate accounts exception to apply, "there can be no communication of securities positions, investment decisions or other trading matters between accounts." Adopting Release on Rule 105, 72 Fed. Reg. at 45,099.<sup>1</sup> Here, even assuming CCLP's Risk Arbitrage and Relative Value strategies may be considered "accounts," they were not "separate" under Rule 105(b)(2) and the guidance set forth in the adopting release. First, information about securities positions and investment decisions was available to all of the firm's employees and sometimes communicated between strategies. All portfolio managers received or could access detailed reports of each others' positions and trades on a daily basis. They routinely consulted with each other about companies in which they had overlapping positions or interest. In addition, CCLP's Investment Committee had members from each of the strategies who discussed some of the firm's more important positions at its weekly

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<sup>1</sup> In the adopting release, the Commission listed the following non-exclusive indicia of separateness: (1) The accounts have separate and distinct investment and trading strategies and objectives; (2) Personnel for each account do not coordinate trading among or between the accounts; (3) Information barriers separate the accounts, and information about securities positions or investment decisions is not shared between accounts; (4) Each account maintains a separate profit and loss statement; (5) There is no allocation of securities between or among accounts; and (6) Personnel with oversight or managerial responsibility over multiple accounts in a single entity or affiliated entities, and account owners of multiple accounts, do not have authority to execute trades in individual securities in the accounts and in fact, do not execute trades in the accounts, and do not have the authority to pre-approve trading decisions for the accounts and in fact, do not pre-approve trading decisions for the accounts." Adopting Release on Rule 105, 72 Fed. Reg. at 45,098-99.

meetings. Portfolio managers also sometimes learned of other strategies' investment decisions – including decisions to participate in offerings – from the firm's trading desk. The firm's traders worked in a centralized location, routinely exchanged information amongst themselves, and in some cases traded on behalf of multiple strategies. Thus, a portfolio manager considering participation in an offering might already know or easily could find out whether another portfolio manager recently had sold short the same stock, and vice versa.

15. Second, CCLP's Chief Investment Officer supervised the strategies and had ultimate authority over the firm's positions. He played an active managerial role, regularly reviewing these positions and consulting with subordinate portfolio managers about investment ideas. Moreover, he maintained authority to require any portfolio manager to seek his pre-approval for trades if he so desired. In short, CCLP's Chief Investment Officer exercised oversight over the firm's multiple strategies and did not refrain from influencing trading decisions within the strategies.

16. Finally, the Commission stated in the adopting release that separate accounts have "personnel that are prohibited from coordinating trading between or among accounts." Id. CCLP did not prohibit its personnel from coordinating trading between or among strategies. Id.

17. CCLP's structure allowed information to be shared across strategies regarding the WFC transactions at issue. Risk Arbitrage received an electronic communication reflecting Relative Value's intention to participate in the offering on November 6, 2008, before it sold short WFC stock that same day. In addition, on November 6, 2008, the firm's Chief Investment Officer knew that Risk Arbitrage had sold short WFC during the prior weeks and could be expected to sell additional shares, and he (like Risk Arbitrage) received information reflecting Relative Value's plan to participate in the offering. Accordingly, the firm's strategies did not make their WFC trading decisions separately. Rather, the timely shared information presented the portfolio managers with opportunities – whether or not deliberately realized – to coordinate their trades and to gain profit for certain funds they jointly managed and for CCLP as a whole. The circumstances of the trades also contravened the prophylactic purpose of Rule 105. See Adopting Release on Rule 105, 72 Fed. Reg. at 45,099 (cautioning that "[i]nformation leakage" caused by insufficient barriers or training "can give rise to either deliberate or inadvertent coordination of shorting into an offering").

18. Certain of CCLP's strategies – including Risk Arbitrage and Relative Value – were run by portfolio managers who followed different investment approaches and generally made their own trading decisions. These portfolio managers also were compensated through bonuses largely based on the performances of their own portfolios. These factors alone, however, did not make the strategies separate under Rule 105(b)(2) given the nature of CCLP's structure and operations described above.

19. The difference between CCLP's proceeds from the November 6, 2008 restricted short sales of WFC by the Risk Arbitrage strategy and the price for 398,225 offering shares purchased by the Relative Value strategy was \$739,350. CCLP also improperly obtained a benefit

of \$319,733 by purchasing the remaining 201,775 of the 600,000 offering shares at a discount from WFC stock's market price.

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20. With respect to each of the offerings of EQT, ROC, COF, and WFC described above, CCLP “purchas[ed] the offered securities from an underwriter or broker or dealer . . . participating in the offering” after having sold short the same security “during the period . . . [b]eginning five business days before the pricing of the offered securities and ending with such pricing.” 17 C.F.R. § 242.105(a). As a result of this conduct, CCLP willfully<sup>2</sup> violated Rule 105 of Regulation M under the Exchange Act.

### **CCLP's Remedial Efforts**

21. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by CCLP.

## **IV.**

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M under the Exchange Act.

B. Respondent is censured.

C. Respondent shall, within fourteen (14) days of the entry of this Order, pay a civil penalty of \$260,000, disgorgement of \$2,256,386, and prejudgment interest of \$136,848 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. § 3717. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the 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 CCLP as a Respondent in these proceedings and the file number of these proceedings, a

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<sup>2</sup>A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

copy of which cover letter and money order or check shall be sent to Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549-5720A.

By the Commission.

Elizabeth M. Murphy  
Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), on the Respondent and its legal agent.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray  
Chief Administrative Law Judge  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-2557

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