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6
7 BEFORE THE DEPARTMENT OF CORPORATIONS
8 OF THE STATE OF CALIFORNIA
9

10 In the Matter of) FILE NO. 23505
11)
12 THE CALIFORNIA COMMISSIONER OF)
CORPORATIONS,)
13 Complainant,) STATEMENT IN SUPPORT OF ORDER
14 v.) LEVYING ADMINISTRATIVE PENALTIES
15 STANDARD INVESTMENT CHARTERED,) PURSUANT TO CORPORATIONS CODE
16 INC. doing business as STANDARD) SECTION 25252
INVESTMENT ADVISERS)
17 Respondent.)
18)
19)
20)
21)

22 Jan Lynn Owen, the Commissioner of Corporations ("Commissioner") of the California
23 Department of Corporations ("Department") alleges and charges as follows:

24 1. Standard Investment Chartered, Inc. doing business as Standard Investment Advisers
25 ("Standard Investment") holds a valid and unrevoked investment adviser certificate issued by the
26 Commissioner pursuant to Corporations Code section 25230 on March 14, 2006. Standard
27 Investment is located in 2801 Bristol St., Suite 100, Costa Mesa, California 92626. Standard
28

1 Investment is the investment adviser of Buttonwood Tree Value Partners, LLC (“BTVP”), a fund
2 offered by Standard Investment.

3 2. John H. Norberg (“Norberg”) is the Chairman and Chief Executive Officer of
4 Standard Investment. Norberg is also the managing member of Buttonwood Tree Management, LLC
5 (“BTM”).

6 3. BTM is the general partner and manager of BTVP.

7 4. George Hill (“Hill”) is the chief compliance officer of Standard Investment.

8 5. On December 5, 2011, the Commissioner commenced a regulatory examination of
9 Standard Investment. The examination revealed violations of the Corporate Securities Law of 1968,
10 found at Corporations Code section 25000 et seq. and the rules and regulations promulgated
11 thereunder.

12 6. The violations included the following: Standard Investment 1) charged unsupported
13 administrative fees (Corp. Code, § 25235); 2) borrowed money from clients through fees collected in
14 advance (Corp. Code, § 25238; Cal. Code Regs., tit. 10, section 260.238, subd. (f)); 3) failed to
15 provide an annual audited report to BTVP’s limited partners (Corp. Code, § 25235); 4) failed to
16 verify all funds and securities (Cal. Code Regs., tit. 10, § 260.237, subd. (e)); 5) failed to prepare and
17 maintain accurate financial books and records (Cal. Code Regs., tit. 10, § 260.241.3, subd. (a)); and
18 6) failed to file a true and current Form ADV¹ (Cal. Code Regs., tit. 10, § 260.241.4, subd. (d).)

19 7. Corporations Code section 25235 provides, in relevant part, the following:

20 It is unlawful for any investment adviser, directly or indirectly, in this
21 state:

22 . . .

23 (b) To engage in any transaction, practice, or course of business which
24 operates or would operate as a fraud or deceit upon any client or
25 prospective client.

26 ///

27 ¹ Form ADV is the uniform form used by investment advisers to register with both the Securities and Exchange
28 Commission (SEC) and state securities authorities.

1 8. Corporations Code section 25238 requires investment advisers to promote fair,
2 equitable and ethical principles. Section 25238 provides, in relevant part, the following:

3 No investment adviser licensed under this chapter and no natural
4 person associated with the investment adviser shall engage in
5 investment advisory activities, or attempt to engage in investment
6 advisory activities, in this state in contradiction of such rules as the
7 commissioner may prescribe designed to promote fair, equitable and
8 ethical principles.

9 9. California Code of Regulations, title 10, section 260.238 provides the activities that do
10 not promote fair, equitable or ethical principles. Subdivision (f) of section 260.238 provides as
11 follows:

12 Borrowing money or securities from a client unless the client is a
13 broker-dealer, an affiliate of the adviser, or a financial institution
14 engaged in the business of loaning funds or securities.

15 10. California Code of Regulations, title 10, section 260.237 requires that investment
16 advisers provide verification of all funds and securities. Subdivision (e) of section 260.237, in
17 relevant part, provides as follows:

18 It shall constitute a fraudulent, deceptive or manipulative act, practice
19 or course of business, within the meaning of Section 25235 of the
20 Code, for any investment adviser who has custody or possession of any
21 funds or securities, except prepaid fees for periodic publications or
22 other advisory services, in which any client has any beneficial interest
23 to do any act or take any action, directly or indirectly, with respect to
24 any such funds or securities, unless:

25 . . .

26 (e) all funds and securities of clients are verified by actual examination
27 at least once during each calendar year by an independent certified
28 public accountant or public accountant at a time which shall be chosen
by the accountant without prior notice to the investment adviser. A
certificate of the accountant stating that such person has made an
examination of the funds and securities, and describing the nature and
extent of the examination, shall be filed with the Commissioner
promptly after each examination.

As an alternative to the safeguarding procedures above, investment
advisers who are deemed to have custody due to being an investment
adviser and general partner of a private fund may instead adopt the
following procedures to be exempted from complying with the custody
requirements:

1 (1) The private fund(s) are audited annually by an independent CPA;
2 and

3 (2) At least annually, distributes its audited financial statements,
4 prepared in accordance with generally accepted accounting principles,
5 to all limited partners (or member) and the Commissioner within 120
6 days of the end of its fiscal year; and

7 (3) The Investment Adviser notifies the Commissioner via Form ADV
8 that it is following these procedures.

9 11. California Code of Regulations, title 10, section 260.241.3, requires investment
10 advisers to maintain accurate financial books and records. Subdivision (a) of section 260.241.3, in
11 relevant parts, provides as follows:

12 (a) Every licensed investment adviser shall make and keep true,
13 accurate and current the following books and records relating to such
14 person's investment advisory business:

15 (2) General and auxiliary ledgers (or other comparable records)
16 reflecting asset, liability, reserve, capital, income and expense accounts.

17 (5) All bills or statements (or copies thereof), paid or unpaid, relating to
18 the business of the investment adviser as such.

19 12. California Code of Regulations, title 10, section 260.241.4, subdivision (d) requires
20 investment advisers to file changed information in its Form ADV. Subdivision (d) of section
21 260.241.4 provides as follows:

22 (d) A licensed investment adviser shall file changed information
23 contained in its Form ADV with the Investment Adviser Registration
24 Depository ("IARD") in accordance with its procedures for
25 transmission to the Commissioner.

26 13. The Department's examiners found during the regulatory examination on December 5,
27 2011 that Standard Investment is a licensed investment adviser and as such it is prohibited, under
28 Corporations Code section 25235, from engaging in any course of business which would operate as a
fraud or deceit upon any client. In addition, Corporations Code section 25238 requires Standard
Investment to conduct business in such a way as to promote fair, equitable, and ethical principles. At
the time of the December 5, 2011 examination, Standard Investment through BTM was charging
unsupported administrative fees. A review of the 2011 bank statements for Standard Investment did

1 not reveal any accounting, legal, or other relevant expenses related to BTVP that were paid by
2 Standard Investment or BTM and that would support the administrative fees charged as
3 reimbursement. In fact, the Department's review of the BTVP Sunwest bank statements disclosed
4 that various accounting fees were paid directly by BTVP, and not by Standard Investment or BTM.

5 14. The examination also revealed that Standard Investment through BTM was borrowing
6 money from clients through fees collected in advance. An advance of fund assets based upon an
7 uncertain future gain, even if subsequently earned, constitute "borrowing" of client funds, in violation
8 of Corporations Code section 25238 and California Code of Regulations, title 10, section 260.238,
9 subdivision (f). During the examination, it was disclosed that BTM maintained a record of BTVP's
10 "Schedule of Transactions with Buttonwood." This schedule listed the "advances" that represented
11 fees that Standard Investment hoped would be earned back by BTM through a combination of
12 management fees, performance fees, and administrative fees. The examination revealed that as of the
13 beginning of December 2011, the balance of the amount advanced by BTVP to BTM was \$623,438.
14 It was noted that a large performance fee of \$557,991 earned in the 4th quarter of 2011 decreased the
15 unearned amount to \$65,527. The total advance amounts for all four quarters in 2011 were
16 \$1,300,793. For the first three quarters of 2012, the record reflects a total advanced amount of
17 \$962,500.

18 15. In addition, Standard Investment failed to provide the limited partners of BTVP
19 audited annual reports as warranted in BTVP's Private Placement Memorandum ("PPM"), in
20 violation of Corporations Code section 25235. Page 38 of BTVP's PPM, dated February 24, 2009,
21 stated that an audited annual report of the Fund shall be prepared and mailed to each Limited Partner
22 at the end of each fiscal year. No annual audit had been had conducted for fiscal years ending 2008
23 through 2012.

24 16. Moreover, the examination disclosed that Standard Investment failed to comply with
25 California Code of Regulations, title 10, section 260.237, subdivision (e), which requires any
26 investment adviser who has custody or possession of any client funds or securities to conduct a
27 surprise verification of client funds and securities. Investment advisers deemed to have custody "due
28 to being an investment adviser and general partner of a private fund may instead adopt the following

1 procedures,” which are summarized as follows: (1) an annual audit of the private fund by an
2 independent CPA; (2) annual distribution of audited financial statements to all limited partners and
3 the Commissioner within 120 days of the end of its fiscal year; and (3) notification of the
4 Commissioner via Form ADV that it is following these procedures. (Cal. Code Regs., tit. 10, §
5 260.237, subd. (e)). Standard Investment, by virtue of being an investment adviser and general
6 partner of a private fund, is deemed to have custody of the funds and securities of BTVP. However,
7 Standard Investment failed to engage an independent CPA to have a surprise verification of client
8 funds and failed to adopt the alternative procedures set forth in California Code of Regulations, title
9 10, section 260.237, subdivision (e) for investment advisers who are deemed to have custody of any
10 client funds or securities. Furthermore, in 2011 there were a total of 46 requests for withdrawals
11 amounting to \$1,375,793 from client funds without evidence of authorization by an independent
12 accountant of these withdrawal requests. Consequently, BTVP was not compliant with California
13 Code of Regulations, title 10, section 260.237, subdivision (e).

14 17. Additionally, the examination revealed that Standard Investment did not prepare and
15 maintain accurate financial books and records as required by California Code of Regulations, title 10,
16 section 260.241.3, subdivision (a). The general ledger and other financial records did not reflect the
17 liability associated with the borrowing of client funds through the collection of unearned management
18 and performance fees from BTVP. Also, Standard Investment did not provide bills or statements to
19 support the quarterly administrative fee of \$63,750. Standard Investment indicated the quarterly
20 administrative fee represented reimbursements of fees and expenses for the operating and periodic
21 expenses of BTVP. As a result of Standard Investment’s failure to maintain true, current and
22 accurate books and records, the Department is not able to determine Standard’s true liabilities.

23 18. Furthermore, the examination also showed that Standard Investment electronically
24 filed an untrue and inaccurate Form ADV brochure with the Investment Adviser Registration
25 Depository (“IARD”) as required by California Code of Regulations, title 10, section 240.241.4,
26 subdivision (d).

27 19. On July 25, 2012, the Department sent Standard Investment a regulatory letter
28 explaining the violations discovered during the examination commenced on December 5, 2011,

1 including violations of Corporations Code sections 25235 and 25238, and California Code of
2 Regulations, title 10, sections 260.237, subdivision (e), 260.238, subdivision (f), 260.241.3,
3 subdivision (a) and 260.241.4, subdivision (d). Standard Investment responded by letters dated July
4 26, 2012 and September 5, 2012.

5 20. In response to the regulatory letter of July 25, 2012, Standard Investment provided the
6 Department with an explanation for each of the violations cited in the letter. With respect to the
7 administrative fees, Standard Investment claimed that the fees were for “general administrative,
8 operational and ministerial functions related to servicing the BTVP fund.” However, Standard
9 Investment could not provide the examiners with bills, statements or calculations to substantiate the
10 amounts charged.

11 In response to the money borrowed from clients through fees collected in advance, Standard
12 Investment asserted that it was permissible for such advances to occur under BTVP’s PPM. Standard
13 Investment also claimed that it was unaware that an advance of management fees would raise
14 concern. Upon discovery that such a practice may not fully comply with the Department’s rules and
15 regulations the firm has discontinued the payment and collection of “advances to Management.”
16 Standard Investment continued to advance management, performance and administrative fees through
17 the third quarter of 2012.

18 Standard Investment claimed unintentional oversight in response to its failure to provide
19 BTVP’s limited partners with an audited annual report for fiscal years ending 2010 and 2011.
20 Standard Investment provided a copy of the engagement letter from McGladrey LLP, dated July
21 2012, to conduct audits of BTVP for 2008, 2009, 2010, and 2011. To date the audit for those fiscal
22 years are still pending.

23 With respect to Standard Investment’s failure to verify client funds and securities, Standard
24 Investment represented that it was in negotiations with multiple accounting firms to approve
25 withdrawals. Upon selection of the accounting firm to perform the independent representative role it
26 would forward a copy of the engagement letter to the Department. To date Standard Investment has
27 not forwarded copies of an engagement letter from an accounting firm that would act as an
28 independent representative to review and approve withdrawals from BTVP. In addition, Standard

1 Investment has not demonstrated that it has selected a qualified custodian who has agreed to disburse
2 funds from BTVP only upon receipt of approval by an independent representative, in accordance with
3 the PIMS No-Action Letter of October 21, 1991.

4 As to Standard Investment's failure to maintain accurate financial books and records, the firm
5 asserted, among other reasons, that the fees were for "general administrative, operational and
6 ministerial functions related to servicing the BTVP fund." However, the failure to record the
7 advances as liabilities overstates Standard Investment's equity and understates the value of the
8 limited partners' interest in the partnership. Failure to record the liability also results in failure to
9 disclose the loan from clients, which is a direct violation of investment adviser rules. Moreover, a
10 significant amount of liabilities may cause a firm to be deficient in net capital and negatively affect
11 its ability to conduct business and continue as a going concern.

12 In response to the filing of an untrue and inaccurate Form ADV brochure with IARD,
13 Standard Investment declared that the firm amended its Form ADV to be accurate. However, the
14 most recent Form ADV brochure has not been amended and still contains inaccuracies. Standard
15 Investment filed its most recent brochure electronically through IARD on March 12, 2012. However,
16 the cover page was still dated March 31, 2011. The brochure was untrue and inaccurate in that the
17 description of billing practices indicated that fees were not billed in advance. However, the actual
18 billing practice of Standard Investment is to bill management and performance fees in advance.

19 21. Corporations Code section 25252 authorizes the Commissioner to issue an order
20 levying administrative penalties against any investment adviser for willful violations of any provision
21 of the Corporate Securities Law of 1968 and any rules and regulations promulgated thereunder.

22 Corporations Code section, in relevant part, provides:

23 The commissioner may, after appropriate notice and opportunity for
24 hearing, by orders, levy administrative penalties as follows:

25 . . .

26 (b) Any broker-dealer or investment adviser that willfully violates any
27 provision of this division to which it is subject, or that willfully violates
28 any rule or order adopted or issued pursuant to this division and to
which it is subject, is liable for administrative penalties of not more
than five thousand dollars (\$5,000) for the first violation, not more than

1 ten thousand dollars (\$10,000) for the second violation, and not more
 2 than fifteen thousand dollars (\$15,000) for each subsequent violation.
 3 22. By reason of the foregoing, Standard Investment has willfully violated Corporations
 4 Code sections 25235 and 25238, and California Code of Regulations, title 10, sections 260.237,
 5 subdivision (e), 260.238, subdivision (f), 260.241.3, subdivision (a) and 260.241.4, subdivision (d).
 6 Standard Investment as a licensee, was obligated to have knowledge of, and to comply with, the
 7 provisions of the Corporate Securities Law of 1968 and the rules and regulations thereunder to
 8 maintain its investment adviser certificate. On July 25, 2012, the Department notified Standard
 9 Investment of these violations.

10 23. Therefore, pursuant to Corporations Code section 25252, the Commissioner seeks
 11 administrative penalties for Standard Investment’s willful violations of the Corporate Securities Law
 12 of 1968 and the rules and regulations adopted pursuant to it.

13 WHEREFORE, good cause showing, and pursuant to Corporations Code section 25252, the
 14 California Commissioner of Corporations prays for an order levying administrative penalties in the
 15 amounts as follows, for willful violations of the Corporations Code sections 25235 - - \$30,000 and
 16 25238 - - \$5,000, and the following sections of title 10 of the California Code of Regulations: section
 17 260.237, subdivision (e) - - \$5,000; section 238, subdivision (f) - - \$5,000; section 260.241.3,
 18 subdivision (a) - - \$5,000; 260.241.4, subdivision (d) - - \$5,000, for a total of \$55,000.

19 Dated: April 22, 2013
 20 Los Angeles, California

JAN LYNN OWEN
 Commissioner of Corporations

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 22 By: _____
 23 MARLOU de LUNA
 24 Sr. Corporations Counsel
 25 Enforcement Division
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