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10 BEFORE THE DEPARTMENT OF CORPORATIONS  
11 OF THE STATE OF CALIFORNIA

13 In the Matter of: ) CRD NO.: 165821  
14 THE COMMISSIONER OF BUSINESS )  
15 OVERSIGHT, ) STATEMENT IN SUPPORT OF ORDER 1)  
16 Complainant, ) IMPOSING ADMINISTRATIVE PENALTIES  
17 v. ) PURSUANT TO CORPORATIONS CODE  
18 BUTTONWOOD TREE MANAGEMENT, LLC ) SECTION 25252 AND 2) RESTITUTION  
19 Respondent. ) PURSUANT TO CORPORATIONS CODE  
20 ) SECTION 25254  
21 )

22 Jan Lynn Owen, the Commissioner of Business Oversight (Commissioner), alleges and  
23 charges as follows:

24 I.

25 **Jurisdiction and Venue**

26 1. The Commissioner, as head of the Department of Business Oversight (Department), is  
27 authorized to administer and enforce the provisions of the Corporate Securities Law of 1968 (CSL)

1 (Corp. Code, § 25000 et seq.) and the regulations promulgated thereunder at title 10 of the California  
2 Code of Regulations (Cal. Code Regs., tit.10, § 260.000 et seq.).

3 2. The Commissioner brings this action to impose administrative penalties against  
4 Respondent Buttonwood Tree Management, LLC (BTM) pursuant to Corporations Code section  
5 25252 and to recover ancillary relief for the limited partners of Buttonwood Tree Value Partners,  
6 LLC (BTVP) under section 25254 of the Corporations Code, and the rules and regulations  
7 promulgated thereunder.

## 8 II.

### 9 Statement of Facts

10 3. BTM holds a valid and unrevoked investment adviser certificate issued by the  
11 Commissioner under Corporations Code section 25230 on November 26, 2014. BTM is the general  
12 partner and investment adviser of Buttonwood Tree Value Partners, LLC (BTVP). The company is  
13 located at 2801 Bristol Street, Suite 100, Costa Mesa, California 92626.

14 4. John H. Norberg (Norberg) was the managing member of BTM until his death in  
15 December of 2016. To date, the managing member of BTM remains unknown.

16 5. George Hill (Hill) was the chief compliance officer of BTM from November 2013  
17 until January of 2016. Mark Mittman is the present chief compliance officer.

18 6. On or about April 20, 2015, the Commissioner, by and through the Department's  
19 examiners, commenced a regulatory examination of BTM at its business location in Costa Mesa,  
20 California.

21 7. In the course of the examination, the Department's examiners reviewed a document  
22 identified as "Analysis of Receivables/Payables from/to BTM 2014," a copy of which was obtained  
23 from the company. The Analysis of Receivables/Payables from/to BTM 2014 showed that as of  
24 December 31, 2014, the management fees due to BTM were \$640,711.00. The Department's  
25 examiners verified that this was in fact the amount owed to BTM as of December 31, 2014. On  
26 March 24, 2015, bank records show that \$640,711.00 was withdrawn from BTVP's Farmers &  
27 Merchants bank account and deposited into BTM's bank account. Accordingly, as of March 24,  
28 2015, BTM's management fees for 2014 had been paid.

1           **Advancement of Fees**

2           8.       A review of BTVP's accounting activity during the first quarter of 2015, between  
3 January 2 and March 18, showed that BTM made 19 withdrawals from BTVP's cash accounts  
4 located at International City (account ending 634) and Sunwest Bank (account ending 227)  
5 amounting to approximately \$300,000.00. The Department's examiners concluded that these  
6 withdrawals from BTVP accounts to BTM accounts were incentive and management fees charged in  
7 advance for the first quarter of 2015. Hill confirmed that all transfers from BTVP account ending in  
8 7243 to account ending in 7227 were fees due to BTM. These advanced payments would be in  
9 conflict of BTVP's Private Placement Memorandum (PPM), including one dated February 24, 2009,  
10 as well as BTVP's limited partnership agreement that indicated the incentive and management fees  
11 are to be paid in "arrear."

12           9.       In a letter to BTM dated December 30, 2015, the Commissioner notified the company  
13 of the Department's findings and provided BTM an opportunity to explain the withdrawals. But in its  
14 written response of February 5, 2016, BTM failed to provide any explanation about the withdrawals  
15 from BTVP to BTM accounts during the first quarter of 2015. BTM stated only that:

16                   BTM withdrew management fees and incentive fees for 2014 and first  
17                   quarter 2015 during the highlighted period. BTM believes further  
18                   review of DBO calculations will show BTM acted within its contracted  
19                   rights. . . In addition to the outstanding amount due BTM at 12/31/14,  
20                   BTM was also entitled to management fees and incentive fees for the  
21                   first quarter of 2015 ending March 31st. This amount totaled \$472,249  
22                   (unpaid \$130,970).

23           10.      A follow-up letter dated March 21, 2016 to BTM addressed, among other issues, the  
24 advancement of fees. Again the Commissioner requested that BTM provide an explanation on "the  
25 reason for the withdrawals between January 2, 2015 and March 18, 2015 of approximately  
26 \$300,000." Once again, BTM's written response of April 12, 2016 was inadequate – BTM provided  
27 the same response from its February 5, 2016 response –  
28

1 BTM withdrew management fees and incentive fees for 2014 and first  
2 quarter 2015 during the highlighted period. BTM believes further  
3 review of DBO calculations will show BTM acted within its contracted  
4 rights . . . In addition to the outstanding amount due BTM at 12/31/14,  
5 BTM was also entitled to management fees and incentive fees for the  
6 first quarter of 2015 ending March 31st. This amount totaled \$472,249  
7 (unpaid \$130,970).

8 11. Based on bank records analysis and information provided by the company, BTM  
9 charged incentive and management fees in advance for the first quarter of 2015 in violation of  
10 BTVP's PPM including one dated February 24, 2009, as well as BTVP's limited partnership  
11 agreement that indicated the management and incentive fees are to be paid in "arrears."

#### 12 **Overcharge of Incentive Fees**

13 12. During the review of BTVP's accounting, the Department's examiners also found that  
14 incentive or performance fees<sup>1</sup> were not calculated in compliance with BTVP's 2006 and 2009 PPM  
15 given that BTM failed to take into account the "high-water mark."<sup>2</sup> BTVP's 2006 and 2009 PPM  
16 stated that "the Incentive Allocation is subject to a high-water mark. That is, the general partner may  
17 receive an incentive allocation as to a particular limited partner's investment on a particular  
18 allocation date only to the extent that the Limited Partner has experienced cumulative profits as of  
19 that date." Similarly, BTM's December 2012 Form ADV, Part 2A (Item 6 Performance Based Fees)  
20 stated that new investors would only be charged incentive allocations on cumulative profits by  
21 observing a "high-water mark." As a result of its failure to take into account the high-water mark,  
22 BTM charged incentive allocations on quarterly profits regardless of whether the investor was  
23 recouping a prior loss or if BTM had previously charged an incentive allocation on some of those  
24 same profits in a prior period. The Department's examiners reviewed BTM's incentive allocation  
25 calculations for October 31, 2011 through March 2015 and recalculated the fees taking into account a

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27 <sup>1</sup> Incentive fees are usually in place to tie a manager's compensation to their level of performance, more specifically their  
level of financial return. The term incentive fees and performance fees are used here interchangeably.

28 <sup>2</sup> High-water mark refers to the highest peak in value that an investment fund or account has reached. High-water marks  
ensure that investors do not have to pay performance fees for poor performance.

1 high-water mark on a quarterly basis. The recalculation result showed that BTM may have  
2 overcharged the limited partners \$1,250,476.00.

3 13. The Commissioner notified BTM in writing on December 30, 2015 of the  
4 Department's findings and instructed BTM to provide a written explanation concerning the incentive  
5 fee discrepancy for BTVP.

6 14. In its written response dated February 5, 2015, BTM disagreed with the  
7 Commissioner's findings that the high-water mark calculations were not computed as required. BTM  
8 stated that the company's independent accountant, Scott Morris (Morris), recalculated the incentive  
9 fees from March 31, 2011 to March 31, 2016 and found no overcharges. However, the  
10 Commissioner's review of BTM's recalculation showed that the accounting figures for each limited  
11 partner (Capital Before Incentive Fees) provided in BTM's response are different than the Capital  
12 Before Incentive Fees obtained during the Department's examination commenced on April 20, 2015,  
13 specifically, in its response, the Capital Before Incentive Fees showed increased values for each of  
14 the limited partners. BTM did not disclose the changes in BTVP's accounting records and did not  
15 disclose whether the limited partners were notified of their increase in value.

16 15. A follow-up letter dated March 21, 2016 was sent to BTM informing the company yet  
17 again that it "failed to take high-water marks into account when calculating its performance fees and  
18 as a result, the performance or incentive fees "continue to be charged incorrectly."

19 16. BTM's written response of April 11, 2016 was also inadequate in that the explanation  
20 concerning the calculation of its performance fees was incomprehensible – Morris, BTM's  
21 independent accountant, stated that the difference between the Capital Before Incentive Fee (Original  
22 Accounting) calculation and the Capital Before Incentive Fee (Response Accounting) cited in the  
23 Commissioner's March 12, 2016 letter is a "comparison of gross income vs. net income" and  
24 therefore, "No meaningful conclusion can be drawn from such a comparison." Morris also asserted  
25 that "in redoing the incentive calculations for the February 5, 2016 response, we first received and  
26 fixed the high-water mark from inception. The Commissioner's findings remains the same – BTM  
27 failed to take into account the high-water mark in calculating its incentive or performance fees.

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III.

**The Commissioner is Authorized to Impose Administrative Penalties Against Any Investment Adviser for Willful Violations of Any Provisions of the CSL**

17. Corporations Code section 25235 provides, in relevant part:

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

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

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

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

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

19. Corporations Code section 25252 provides, in relevant part:

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

(b) Any broker-dealer or investment adviser that willfully violates any provision of this division to which it is subject, or that willfully violates 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 ten thousand dollars (\$10,000) for the second violation, and not more than fifteen thousand dollars (\$15,000) for each subsequent violation.

20. As discussed in paragraphs 7. through 10. above, BTM's withdrawals from BTVP amounting to approximately \$300,000.00 were incentive and management fees charged in advance for the first quarter of 2015 in violation of BTVP's PPM including one dated February 24, 2009.



1 reasonable attorney's fees and investigative expenses for the services  
2 rendered, for deposit into the State Corporations Fund for the use of the  
3 Department of Business Oversight.

3 (c) After the exhaustion of the review procedures provided in  
4 accordance with the provisions of the Administrative Procedure Act,  
5 Chapter 5 (commencing with *Section 11500*) of Part 1 of Division 3 of  
6 Title 2 of the Government Code, the commissioner may apply to the  
7 appropriate superior court for a judgment in the amount of the  
8 administrative penalty and costs awarded in a final decision and order  
9 compelling the respondent, or the named or cited person, to comply  
10 with the final decision of the commissioner brought under this division.  
11 The application shall include a certified copy of the final decision of  
12 the commission and shall constitute a sufficient showing to warrant the  
13 issuance of the judgment and order from superior court.

10 25. As discussed in paragraphs 11. through 15. above, BTM failed to take into account the  
11 high-water mark in calculating its incentive or performance fees in keeping with BTVP's PPM, thus  
12 overcharging BTVP \$1,250,476.00. BTM's written responses of March 12 and April 11, 2016 were  
13 inadequate in explaining the calculation of BTM's performance or incentive fees.

14 26. BTVP's limited partners/investors are entitled to recover the overcharge of BTM's  
15 performance or incentive fees amounting to-\$1,250,476.00 because BTM failed to take into account  
16 the high-water mark in accordance with BTVP's 2006 and 2009 PPM.

17 **V.**

18 **Conclusion**

19 Based upon the foregoing, good cause showing, and pursuant to Corporations Code section  
20 25252, the Commissioner prays for an order imposing administrative penalties in the total amount of  
21 \$90,000.00 for violations of section 25235 of the Corporations Code, subdivision (b). Pursuant to  
22 Corporations Code section 25252, subdivision (b), the penalties are calculated as follows: for the  
23 seven violations noted during the April 20, 2015 examination, \$5,000.00 for the first violation,  
24 \$10,000 for the second violation, and \$15,000 for each subsequent violation.

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Based upon the foregoing, good cause showing, and pursuant to Corporations Code section 25254, the Commissioner prays for an order requiring BTM to refund or credit the limited partners of BTVP in the amount of \$1,250,476.00.

Dated: April 7, 2017

JAN LYNN OWEN

Commissioner of Business Oversight

By: \_\_\_\_\_

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Enforcement Division