

1 MARY ANN SMITH
Deputy Commissioner
2 SEAN M. ROONEY
Assistant Chief Counsel
3 MARLOU de LUNA (State Bar No. 162259)
4 Senior Counsel
Department of Business Oversight
5 320 West 4th Street, Suite 750
Los Angeles, California 90013-2344
6 Telephone: (213) 576-7606
7 Facsimile: (213) 576-7181

8 Attorneys for Complainant

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 TO |
| 16 | Complainant, |) | DISCONTINUE VIOLATIONS PURSUANT |
| 17 | v. |) | TO CORPORATIONS CODE SECTION 25249 |
| 18 | BUTTONWOOD TREE MANAGEMENT, LLC |) | AND COMMISSIONER'S INTENT TO MAKE |
| 19 | Respondent. |) | ORDER FINAL |
| 20 | |) | (CORPORATIONS CODE SECTION 25251) |
| 21 | |) | |

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

25 1. Buttonwood Tree Management, LLC (BTM) holds a valid and unrevoked investment
26 adviser certificate issued by the Commissioner under Corporations Code section 25230 on November
27 26, 2014. BTM is the general partner and investment adviser of Buttonwood Tree Value Partners,
28

1 LLC (BTVP). The company is located at 2801 Bristol Street, Suite 100, Costa Mesa, California
2 92626.

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

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

7 4. On or about April 20, 2015, the Commissioner, by and through the Department’s
8 examiners, commenced a regulatory examination of BTM at its business location in Costa Mesa,
9 California. The examination revealed seven 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 5. The violations included the following: BTM 1) charged incentive¹ and management
13 fees in advance for the first quarter of 2015 (Corp. Code, § 25235); and 2) incentive or performance
14 fees (for October 31, 2011 through March of 2015) were not calculated in compliance with BTVP’s
15 2006 and 2009 Private Placement Memorandum (PPM) given that BTM failed to take into account
16 the “high-water mark.”² (Corp. Code, § 25235, Cal. Code Regs., tit. 10, § 260.241.3, subd. (a) (2)).

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

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

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

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

26 _____
27 ¹ Incentive fees are usually in place to tie a manager’s compensation to their level of performance, more specifically their
28 level of financial return. The term incentive fees and performance fees are used here interchangeably.

² 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 (a) Every licensed investment adviser shall make and keep true,
2 accurate and current the following books and records relating to such
person's investment advisory business:

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

5 8. The Department's examiners found during the regulatory examination on April 20,
6 2015 that BTM is a licensed investment adviser and as such it is prohibited, under Corporations Code
7 section 25235, from engaging in any course of business which would operate as a fraud or deceit
8 upon any client. At the time of the April 20, 2015 examination, a review of BTVP's accounting
9 activity during the first quarter of 2015, between January 2 and March 18, showed that BTM made 19
10 withdrawals from BTVP's cash accounts located at International City (account ending 634) and
11 Sunwest Bank (account ending 227) amounting to approximately \$300,000.00. The Department's
12 examiners concluded that these withdrawals from BTVP accounts to BTM accounts were incentive
13 and management fees charged in advance for the first quarter of 2015. Hill confirmed that all
14 transfers from BTVP account ending in 7243 to account ending in 7227 were fees due to BTM.
15 These advanced payments would be in conflict of BTVP's Private Placement Memorandum (PPM),
16 including one dated February 24, 2009, as well as BTVP's limited partnership agreement that
17 indicated the incentive and management fees are to be paid in "arrears."

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

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

1 10. A follow-up letter dated March 21, 2016 to BTM addressed, among other issues, the
2 advancement of fees. Again the Commissioner requested that BTM provide an explanation on “the
3 reason for the withdrawals between January 2, 2015 and March 18, 2015 of approximately
4 \$300,000.” Once again, BTM’s written response of April 12, 2016 was inadequate – BTM provided
5 the same response from its February 5, 2016 response –

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

13 11. During the review of BTVP’s accounting, the Department’s examiners also found that
14 incentive or performance fees 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.” 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
26 high-water mark on a quarterly basis. The recalculation result showed that BTM may have
27 overcharged the limited partners \$1,250,476.00.
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1 12. The Commissioner notified BTM in writing on December 30, 2015 of the
2 Department's findings and instructed BTM to provide a written explanation concerning the incentive
3 fee discrepancy for BTVP.

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

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

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

26 16. Corporations Code section 25249 authorizes the Commissioner to issue an order
27 directing any investment adviser to discontinue any violation of any provision of the Corporate
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1 Securities Law of 1968 and any rules and regulations promulgated thereunder. Corporations Code
2 section 25249 provides:

3 If, after examination or investigation, the commissioner has reasonable
4 grounds to believe that any broker-dealer or investment adviser has
5 violated any law or rule binding upon it, the commissioner shall, by
6 written order addressed to the broker-dealer or investment adviser,
7 direct the discontinuance of the violation. The order shall be effective
8 immediately, but shall not become final except in accordance with the
9 provision of Section 25251.

10 17. Corporations Code section 25251 provides:

11 (a) No order issued pursuant to Section 25249 or 25250 may become
12 final except after notice to the affected broker-dealer or investment
13 adviser of the commissioner's intention to make the order final and of
14 the reasons for the finding. The commissioner shall also notify the
15 broker-dealer or investment adviser that upon receiving a request the
16 matter shall be set for hearing to commence within 15 business days
17 after receipt of the request. The broker-dealer or investment adviser
18 may consent to have the hearing commence at a later date. If no
19 hearing is requested within 30 days after the mailing or service of the
20 required notice, and none is ordered by the commissioner, the order
21 may become final without a hearing and the broker-dealer or
22 investment adviser shall immediately discontinue the practices named
23 in the order. If a hearing is requested or ordered, it shall be held in
24 accordance with the provisions of the Administrative Procedure Act
25 (Chapter 5 (commencing with Section 11500) of Part 1 of division 3 of
26 title 2 of the Government Code) and the commissioner shall have all of
27 the powers granted under that act. If, upon the conclusion of the
28 hearing, it appears to the commissioner that the broker-dealer or
investment adviser is conducting business in an unsafe or injurious
manner or is violating any law of this state, or any rule binding upon it,
the commissioner shall make the order of discontinuance final and the
broker-dealer or investment adviser shall immediately discontinue the
practices named in the order.

(b) The broker dealer or investment adviser may within 10 days after
an order is made final commence an action to restrain enforcement of
the order. If the enforcement of the order is not enjoined within 10
days by the court in which the action is brought, the broker-dealer or
investment adviser shall comply with the order.

18. By reason of the foregoing, BTM has willfully violated Corporations Code section
25235 and, and California Code of Regulations, title 10, section 260.241.3, subdivision (a) (2),
justifying the issuance of an Order to Discontinue Violations. BTM, as a licensee, was obligated to
have knowledge of, and to comply with, the provisions of the Corporate Securities Law of 1968 and

1 the regulations thereunder to maintain its investment adviser certificate. Furthermore, BTM has been
2 given the opportunity, but has failed to explain to the Commissioner the seven violations pertaining
3 to the advanced fees (for the first quarter of 2016) and the inaccurate incentive or performance fees
4 charge by BTM (for October 31, 2011 through March of 2015) that were reviewed during the
5 examination conducted in 2013. Therefore, pursuant to Corporations Code section 25249, the
6 Commissioner has issued an order directing BTM to discontinue violating Corporations Code section
7 25235, subdivision (b), and California Code of Regulations, title 10, section 260.241.3, subdivision
8 (a) (2).

9 WHEREFORE, good cause showing, and pursuant to section 25251, the Commissioner
10 hereby notifies BTM of her intention to make final the Order to Discontinue Violations Pursuant to
11 Corporations Code Section 25249 issued on _____.

12 Dated: April 7, 2017

JAN LYNN OWEN
Commissioner of Business Oversight

By: _____
MARLOU de LUNA
Senior Counsel
Enforcement Division

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