BEFORE THE
DEPARTMENT OF BUSINESS OVERSIGHT
STATE OF CALIFORNIA

In the Matter of: The Commissioner of Business Oversight Complainant, v. Cornerstone Capital Management, Inc. and Laura Jean Kent Respondent.	OAH No.: 2013050773

DECISION

The attached Proposed Decision of the Administrative Law Judge of the Office of Administrative Hearings, dated October 25, 2013, is hereby adopted by the Department of Business Oversight as its Decision in the above-entitled matter.

This Decision shall become effective on **March 8, 2014**.

IT IS SO ORDERED this **6th** day of **February, 2014**.

COMMISSONER OF BUSINESS OVERSIGHT

/s/
Jan Lynn Owen

BEFORE THE
DEPARTMENT OF BUSINESS OVERSIGHT
STATE OF CALIFORNIA

In the Matter of THE COMMISSIONER OF BUSINESS OVERSIGHT, Complainant, v. CORNERSTONE CAPITAL MANAGEMENT, INC. and LAURA JEAN KENT, Respondents.	OAH No. 2013050773

PROPOSED DECISION

Administrative Law Judge Jill Schlichtmann, Office of Administrative Hearings, State of California, heard this matter on September 17 and 18, 2013, in Oakland, California.

Edward Kelly Shinnick, Enforcement Counsel, represented complainant Jan Lynn Owen, Commissioner of the Department of Business Oversight.

Nicholas Morgan, Attorney at Law, represented respondents Laura Jean Kent, who was present at hearing, and Cornerstone Capital Management, Inc.

The record was left open to receive briefing on respondents' motion to strike portions of consent orders received in evidence as Exhibits 10, 11 and 12. Respondents' brief was timely received and marked for identification as Exhibit B. Complainant's opposition brief was timely received and marked for identification as Exhibit 13. Respondents' reply brief was timely received and marked for identification as Exhibit C. The record closed and the matter was deemed submitted on October 7, 2013.

EVIDENTIARY RULING

Respondents Kent and Cornerstone Capital Management, Inc., (Cornerstone Capital) move to strike the Securities and Exchange Commission (SEC) Consent Order (Exhibit 11), the Commodity Futures Trading Commission (CFTC) Opinion and Order Accepting Offer of Settlement of Cornerstone Capital (Exhibit 12), and the State of Washington, Department of Financial Institutions, Securities Division (Washington Securities Division) Consent Order entered on September 23, 2004 (Exhibit 10), if offered for the truth of the factual matters contained therein. The basis for respondents' motion is that the three orders acknowledge that respondents consented to their entry while neither admitting nor denying the underlying factual allegations. Complainant offered certified copies of the three consent orders and requests that the underlying factual allegations and findings, as well as the orders, be admitted in evidence.

Exhibit 11, the SEC Consent Order is entitled "Order Making Findings and Imposing Remedial Sanctions and a Cease and Desist Order pursuant to sections 203(e), 203(f) and 203(k) of the Investment Advisors Act of 1940."[1] The Consent Order states that respondents submitted an offer of settlement that the SEC determined to accept. It states further that respondents do not admit or deny the findings made by the SEC therein. The Consent Order then states that "on the basis of this Order and Respondents' Offer, the Commission finds that;" it then recites 10 pages of factual findings. Respondents dispute some of the factual findings and object to their admission in this proceeding on grounds of hearsay and because the allegations were never tested in an adjudicatory hearing.

Exhibit 12, the CFTC Opinion and Order states that Cornerstone Capital submitted an offer of settlement that the CFTC determined to accept. The Opinion and Order states that Cornerstone Capital's offer was made without admitting or denying the findings made therein. The Opinion and Order acknowledges that the offer of settlement and the CFTC findings were made prior to adjudication on the merits. The CFTC Opinion and Order revokes Cornerstone Capital's registrations as a Commodity Trading Advisor and Commodity Pool Operator. The basis for the revocations is the findings made by the SEC Order (Exhibit 11).

In Exhibit 10, the Washington Securities Division entered into a Consent Order with respondents in 2004, following issuance of a Summary Order to Cease and Desist containing tentative factual allegations. The tentative factual allegations are distinct from the allegations involved in the SEC order. In the offer to settle the matter, respondents neither admitted nor denied the factual allegations in the Summary Order. The tentative factual allegations were incorporated into the Consent Order. As a result of the Consent Order, respondents agreed to cease and desist violating certain securities registration statutes and anti-fraud statutes in the State of Washington.

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[1] The Investment Advisers Act of 1940 can be found at United States Code, title 15, section 80b.

Respondents argue that because they neither admitted nor denied the factual findings contained within the orders, and because the factual findings were adopted by the regulatory agencies prior to adjudication, the underlying facts cannot be admitted for their truth in this proceeding because they are unreliable, irrelevant and prejudicial hearsay statements.[2]

Corporations Code section 25256, subdivision (a), provides:

> For any . . . investment adviser, a disciplinary action taken by the State of California, another state, an agency of the federal government, or another country for an action substantially related to the activity regulated under this division may be grounds for disciplinary action by the commissioner. *A certified copy of the record of disciplinary action taken against the licensee . . . shall be conclusive evidence of the events related therein.*

(Emphasis added.)

Thus, statutory authority deems certified copies of the record of prior disciplinary action by a regulatory agency to be conclusive evidence of the events related therein in this proceeding. Moreover, administrative hearsay is admissible in this proceeding pursuant to Government Code section 11513. Government Code section 11513 provides that this hearing need not be conducted according to the technical rules of evidence, and that any relevant evidence shall be admitted if it is the sort of evidence on which responsible persons are accustomed to rely in the conduct of serious affairs. Findings made by regulatory agencies are generally presumed to be reliable. (See, e.g., *Option Resource Group v. Chambers Development Co., supra,* 967 F.Supp. 846, 851; *Beech Aircraft Corp. v. Rainey* (1988) 488 U.S. 153.) Respondents' motion to strike Exhibits 10, 11 and 12 is denied.

FACTUAL FINDINGS

Introduction

1. The Department of Business Oversight[3] (department) is the agency responsible for enforcement of the California Corporate Securities Law, Corporations Code section

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[2] Respondents also argue that because the orders contain language to the effect that the parties agree that the factual findings are not binding on respondents in another proceeding, the department is prohibited from offering them in this matter. That language does not control the outcome here. (See, e.g., *Option Resource Group v. Chambers Development Co.* (W.D.Pa. 1996) 967 F.Supp. 846, 851.)

[3] On July 1, 2013, the Department of Corporations and the Department of Financial Institutions merged to form the Department of Business Oversight in accordance with the

25000 et seq., and the regulations promulgated thereunder at Code of Regulations, title 10, section 260.000 et seq.

2. On November 29, 2012, Corporations Counsel Edward Kelly Shinnick, on behalf of Jan Lynn Owen, Commissioner of Business Oversight, issued a notice of intention to issue orders denying the application of Cornerstone Capital for an investment adviser certificate pursuant to Corporations Code sections 25232 and 25256, and barring Kent from a position of employment, management or control of any investment adviser, broker-dealer or commodity adviser pursuant to Corporations Code sections 25232.1 and 25256. On the same day, Shinnick filed a statement of issues in support of the notice of intention to issue the orders. Respondents timely requested a hearing and this hearing ensued.

3. Cornerstone Capital first registered with the SEC on July 3, 1996, and with California on July 10, 1996. Cornerstone Capital withdrew its SEC registration on July 18, 1997. In May 1999, Cornerstone Capital applied for an investment adviser certificate in California. On July 20, 1999, the department approved the application. On September 28, 2006, Cornerstone Capital surrendered its investment adviser certificate in California because it managed more than $25 million in assets, and was therefore within SEC jurisdiction. Cornerstone Capital re-registered with the SEC as of May 31, 2006.

4. As part of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111 –203, H.R. 4173) enacted on July 21, 2010, Congress expanded state authority to register and regulate investment adviser firms with assets under management from $25 million to $100 million. Following the enactment of this legislation, many investment adviser firms previously registered with the SEC applied to register with state regulatory agencies. Because Cornerstone Capital was managing less than $100 million, it applied for an investment adviser certificate in California on May 16, 2012.

5. Complainant seeks to deny respondents' application in light of their disciplinary history with the SEC, CFTC and the Washington Securities Division, and because respondents failed to fully disclose that disciplinary history. Complainant seeks to bar Kent from a position of employment, management or control of any investment adviser, broker-dealer or commodity adviser for the same reasons.

Respondents' History of Regulatory Discipline

SEC ORDER

6. On September 16, 2008, the SEC instituted public administrative and cease and desist proceedings against Kent and Cornerstone Capital. In response to the proceedings, respondents submitted an Offer of Settlement that the SEC accepted. Without admitting or denying the factual allegations contained therein, respondents consented to the

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Governor's reorganization of state departments and agencies to provide services more efficiently and effectively.

entry of an Order Making Findings and Imposing Remedial Sanctions. As a result, on March 20, 2009, the SEC made findings which are summarized as follows:

1) From 1997 to 2004, respondents invested approximately $15 million in five investments. Over time, respondents became aware of substantial evidence demonstrating that the value of each of the investments was severely impaired;

2) Despite that knowledge, respondents continued to issue periodic client account statements in which they listed the "market price" and the "total market value" of these investments as remaining unchanged from their original cost. Respondents also made numerous material misrepresentations and omissions about the status of the investments, including the fact that some of the promoters were subsequently convicted of fraud. Respondents knew, or were reckless or negligent in not knowing, that the values of investments had been impaired, yet they continued to charge a one percent assets under management fee based on the initial cost of the investments, collecting hundreds of thousands of dollars more than they would have had the investments been properly valued; and,

3) By failing to properly value the impaired investments, and by misrepresenting and failing to disclose material facts about the investments, respondents willfully violated sections 206, subdivision (1), and 206, subdivision (2), of the Investment Advisors Act of 1940, which make it "unlawful to employ any device, scheme, or artifice to defraud any client or prospective client; and to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

7. Respondents submitted sworn statements of their financial condition to the SEC dated October 30, 2008 and November 6, 2008, and other evidence that asserted their inability to pay prejudgment interest and a civil penalty. As a result of respondents' sworn representations to the SEC regarding their financial condition, a civil penalty was not assessed. However, respondents agreed: 1) to undertake, among other things, hiring an independent consultant to review and establish the valuations of alternative private investments for the next 12 quarters; 2) to submit future valuation changes to the consultant for a period of three years; 3) to refrain from making valuating changes in alternative private investments until after they are approved by the independent consultant over the three-year period; 4) to provide a copy of the order to their existing and prospective clients; and, 5) to link the order to the firm's website. In addition, respondents agreed to pay disgorgement of $335,758 in installments, to be paid in total by March 31, 2012. Respondents were also ordered to cease and desist from committing or causing any violations or future violations of sections 206, subdivisions (1) and (2) of the Investment Advisers Act[4] and were censured.

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[4] Section 206 of the Investment Advisers Act states: "It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly (1) to employ any device, scheme, or artifice to defraud any

8. The SEC Order did not revoke respondents' SEC registration.

CFTC OPINION AND ORDER

9. Beginning in October 18, 2002, Cornerstone Capital was registered with the CFTC as a Commodity Trading Advisor and Commodity Pool Operator. Pursuant to statute,[5] the CFTC may revoke the registration of a registrant who has been found within the past 10 years to have violated the Investment Advisers Act of 1940 or any rule or regulation where such violation involves fraud. As a result of the findings contained in the SEC Order, the CFTC sought to disqualify Cornerstone Capital from registration with the CFTC. On September 30, 2010, the CFTC accepted a settlement offer from Cornerstone Capital consenting to revocation of its registrations. In its opinion and order, the CFTC revoked Cornerstone Capital's registrations.

WASHINGTON CONSENT ORDER AND ORDER

10. On October 31, 2000, the Washington Securities Division issued a summary order to cease and desist against respondent Kent, Cornerstone Asset Management[6] and Cornerstone Investment Circle, LLC. The Washington Securities Division made certain tentative allegations and conclusions, including the following:

1) In January 1998, Kent travelled to Washington to meet with prospective clients who were inexperienced investors and held herself and her firm out to be a federally registered investment adviser, which was untrue;

2) Kent engaged in a scheme to defraud through the offer and sale of fictitious securities, through a "bank debenture program" that involved the trading of bank to bank debentures by major European banks. Kent represented that the bank debentures were viable financial instruments and that the program was in compliance with all laws and was backed by assets of a multi-billion dollar corporation. Kent further represented that the bank debenture program would provide a 75 to 95 percent "conservative" annual return, plus a two percent monthly income.

3) The prospective clients invested over $500,000 in the bank debenture program, beginning in January 1998.

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client or prospective client; [or] (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client; . . . ."

[5] See, section 8a(2)(E) of the Commodity Exchange Act (7 U.S.C. § 12a(2)(E)).

[6] At hearing Kent advised that Cornerstone Asset Management was a non-existent entity; it appears that the order should have referred to Cornerstone Capital.

4) Notwithstanding Kent's representations, the SEC and other federal regulatory agencies indicated that financial instruments denominated as bank debentures that bear high yields are not bona fide financial instruments and are advanced for the purpose of defrauding investors.

5) Kent did not disclose: 1) the use of the investment funds; 2) the sales costs and commissions; 3) the identity and address of relevant parties, including the program manager and facilitator; 4) the history of the trading program; 5) the identity of the issuer of the bank debentures; 6) the risks specific to the offering; 7) the extent of liquidity; and, 8) the effects of government regulation in the banking and investing industries.

6) On May 1, 1999, the clients contacted Kent and attempted to liquidate a portion of their investment in order to meet financial obligations. By October 1999, the clients had not received their funds despite repeated requests to Kent. On November 1, 1999, the clients made a formal written demand for the immediate return of all of their funds. On December 9, 1999, Kent responded in writing, stating that she had informed the program managers of the demand and they were working on it. As of October 31, 2000, Kent had not returned any of the funds.

7) Respondents were not registered to sell securities in Washington. Kent was not registered as a securities salesperson, investment advisor or broker-dealer at that time.

11. As a result of the Consent Order, Kent, Cornerstone Capital and Cornerstone Investment Circle, LLC were ordered to cease and desist from offering and selling securities in any manner in violation of the securities registration and anti-fraud sections of the Washington Securities Law,[7] and from acting as an unregistered securities broker-dealer or salesperson. The Consent Order was signed on September 9, 2004.

Respondents' Application for Investment Adviser Certification

12. Cornerstone Capital provides security portfolio management of $26,696,539, and is therefore no longer eligible to remain registered with the SEC. On May 16, 2012, Kent applied to the department for investment adviser certification in California on behalf of Cornerstone Capital. At the time of the application, the business was located in California. It is now located in Guam.

13. In applying for investment adviser certification, an applicant completes the Uniform Application for Investment Adviser Registration (Form ADV) online which is transmitted electronically through the web-based Investment Adviser Registration Depository, operated by the Financial Industry Regulatory Authority.

14. Near the top of the first page the Form ADV contains the following warning:

[7] Revised Code of Washington, title 21, chapter 21.20, sections 010 and 140.

> **WARNING**: Complete this form truthfully. False statements or omissions may result in denial of your application, revocation of your registration, or criminal prosecution.

15. Kent signed the Form ADV on behalf of Cornerstone Capital under penalty of perjury on May 16, 2012.

16. Kent reported on the Form ADV that Cornerstone Capital was formed by her in California in 1997, and that she is the president, sole owner and sole employee of Cornerstone Capital.

17. In 2011, Kent provided over 100 clients with investment advisory services through Cornerstone Capital. Between 51 and 75 percent of Cornerstone Capital's clients were individuals who were not of high net worth. The rest of her clients were high net worth individuals. Kent is compensated through a percentage of assets under her management. Kent provides management services to security portfolios. At the time of her application to the department, she reported that she managed 194 accounts. Kent is also an adviser to private investment funds. Kent reported on the Form ADV that she is an adviser to Cornerstone Investment Circle, LLC, a private fixed income fund with a gross asset value of $6,494,802. Kent reported that there were 78 beneficial owners of the Cornerstone Investment Circle, LLC fund.

DISCIPLINARY HISTORY DISCLOSURES

18. Item 11 of the Form ADV application asks about disciplinary history. Question C, subdivision (2), asks whether the SEC or the CFTC ever "found you or your advisory affiliate to have been involved in a violation of SEC or CFTC regulations or statutes? Kent answered "No." The correct answer was "Yes."

19. Question C, subdivision (3), asks whether the SEC or CFTC ever "found you or any advisory affiliate to have been a cause of an investment-related business having its authorization to do business denied, suspended, revoked, or restricted?" Kent answered "No." The correct answer was "Yes."

20. Question C, subdivision (4), asks whether the SEC or CFTC ever "entered an order against you or any advisory affiliate in connection with investment-related activity?" Kent correctly answered "Yes;" however, in subsequent questions, Kent only disclosed the SEC order and did not mention the CFTC order.

21. Question C, subdivision (5), asks whether the SEC or CFTC ever "imposed a civil monetary penalty on you or any advisory affiliate, or ordered you or any advisory affiliate to cease and desist from any activity?" Kent answered "No." The correct answer was "Yes."

22. Question D, subdivision (4), asks whether any other federal regulatory agency, *any state regulatory agency*, or any foreign financial regulatory authority in the past 10 years "entered an order against you or any advisory affiliate in connection with an investment-related activity." (Emphasis added.) Kent answered "No." Because the Washington Securities Division had entered an order against respondents, the correct answer was "Yes."

23. In response to Question No. 2, in section Part II, on page 40 of the application, Kent described the principal sanction of the SEC settlement as follows:

> Principal Sanction: Disgorgement
> Other Sanctions: None. Under terms of settlement CCM agreed to disgorge $320,000 in mgmt. fees coll. (about 25% of fees [collected on these private placements]), not agreeing that such fees were improper. Terms [included] commonplace (normal) consent to censure, cease and desist order, and agreement to retain [independent consultant] to value private [placement programs].

24. In response to Question No. 7, in section Part II, on page 40 of the application, Kent described the allegations related to the SEC regulatory action as follows:

> Looking in [hindsight] the SEC alleged that CCM and Laura J. Kent knew or should have known that the [value of certain private placement programs within some Cornerstone Capital portfolios] were impaired when they charged asset based mgmt. fees on quarterly [portfolio] reviews (which included those positions). CCM had maintained its [private placements] at cost, which was its policy. The SEC alleged that by maintaining the value at cost, CCM ended up collecting higher [management] fees by the proportionate [percentage] the SEC inferred should have been marked [down] and did not communicate all [information] it knew or should have known about the [programs].

25. This description was inaccurate and incomplete. Kent should have quoted the exact language of the SEC Order in responding to Question No. 7 the application. In addition, Kent should have described the CFTC and Washington Securities Division orders in response to questions on pages 38 through 40.

FIRM BROCHURE: PART 2B OF FORM ADV

26. Form ADV, Part 2B, requires the applicant to submit a firm brochure that it intends to send to firm clients. The firm brochure must include certain information and disclosures. As part of the Form ADV application to the department, Kent submitted a brochure Cornerstone Capital intended to provide to its investors. Under Item 3, entitled "Disciplinary Action," the brochure states:

> During a routine audit by the SEC, questions were raised regarding the valuation of certain private placement positions held in some client portfolio accounts and the assessed management fees related to those private placement positions. Looking in hindsight, the SEC alleged that Cornerstone and Laura Kent knew or should have known that the value of certain private placement programs were impaired when Cornerstone charged asset based management fees on its quarterly portfolio reviews. Cornerstone Capital Management had maintained these residual private placement positions at cost, which was its policy. The SEC alleged that by maintaining the values at cost, Cornerstone ended up collecting higher management fees by the proportionate percent the SEC inferred they should have been marked down. Additionally, the SEC felt Cornerstone did not communicate all information it knew or should have known about the programs. In the settlement, Cornerstone and the SEC agreed that a percentage of the management fees attributable to those private placements would be returned to the impacted clients. No penalties or fines were involved or assessed.

27. This description was inaccurate and incomplete. Moreover, respondents did not describe the disciplinary action taken by the CFTC or the Washington Securities Division.

28. The brochure references client assets being "allocated across asset classes such as gold and silver, currencies and commodities indices." Complainant alleges that respondents are not permitted to invest in these asset classes as a result of the CFTC revocations.

Amended Application and Firm Brochure

29. After being advised that the department intended to deny her application due to the SEC action, the undisclosed CFTC license revocations and the Washington Securities Division Order, on September 20, 2012, Kent filed an amended Form ADV, including an amended firm brochure. In the amended application, Kent correctly answered the questions in Item 11 about prior disciplinary actions. In the amended firm brochure, Kent added the following:

> On September 23, 2004, the Washington Securities Division entered a Consent Order against Laura Kent, Cornerstone Capital Management, Inc., and Cornerstone Investment Circle, LLC. The Division had entered a Summary Order to Cease and Desist against them in October 2000. The Division alleged that Laura Kent, doing business as Cornerstone Capital Management, Inc., and representing herself as a federally

> registered investment adviser, offered and sold to Washington residents unregistered interests in Cornerstone Investment Circle, LLC. Those proceeds were then purportedly used to purchase fictitious securities, i.e., "Prime Bank Instruments." At the time of the offer and sale of the LLC interests and the "Prime Bank Instruments", Laura Kent was not registered as an investment adviser or a securities salesperson, either federally or in any state. Pursuant to the terms of the Consent Order, Laura Kent was ordered to cease and desist from violations of the registration and anti-fraud provisions of the Washington Securities Act.

30. Kent also added the following paragraph regarding the CFTC Order:

> Based on the SEC's Order, the Commodity Futures Trading Commission (CFTC) issued an Order on 9/30/2010 revoking Cornerstone's registrations as a Commodity Trading Advisor and a Commodity Pool Operator pursuant to Section 8a(2)(E) of the Commodity Exchange Act.

31. Respondents did not correct the incomplete description of the SEC order in the amended application.

Respondents' Evidence

32. Kent graduated from Michigan State University with a Bachelor's degree in economics in 1971. She earned a Master's degree in economics in 1975 from Wayne State University. In 1978, Kent was awarded a Master's degree in Business Administration from Stanford University. Kent holds Series 3, 7, 24, 63 and 65 securities licenses. From 1983 to 1994, she was a registered representative with the broker-dealer Kidder, Peabody & Co. At Kidder, Peabody & Co., Kent managed individual and corporate portfolios as a stockbroker. Between 1994 and 1996, Kent was a registered representative of Cornerstone Investments, a branch of a broker-dealer, Investment Architects, Inc. She founded Cornerstone Capital in 1996. Kent has been the sole owner of Cornerstone Capital. Through Cornerstone Capital, Kent has been an investment adviser for 19 years; she has worked with many of her clients since the mid-1980's. Many of Kent's clients enjoyed great performance in their portfolios for years.

33. Kent applied for registration with the department as required by the change in the law. Kent filled out the Form ADV that was submitted in this matter with help from her assistant and an outside compliance firm. She reviewed the Form ADV before signing it and submitting it on May 16, 2012.

34. Kent had well over 100 clients at the time she entered into the SEC Consent Order; she lost some of her clients after sending them a copy of the order. At the time of

filing this Form ADV, Kent still had over 100 clients. She now has only 20 to 25 clients because she has a different vision of how she wants to run the business.

35. Kent is the manager of Cornerstone Investment Circle, LLP; she has not advised anyone to invest in Cornerstone Investment Circle, LLP since 2005.

36. Regarding the conduct underlying the SEC order, Kent was selling memberships in private funds that she was managing. A number of successful programs succeeded; five did not. Between 1994 and 2004, she and Cornerstone Capital invested $15 million in those five investments. Some of the promoters of these five funds were convicted of fraud. Her clients became aware of the convictions. Kent considers Cornerstone Capital to have been a victim in the wrongdoing by the promoters of these programs.

37. One program involved debt and equity investments in the foreign currency exchange business. The program was located in Costa Rica. Kent reports having done due diligence before investing her clients' funds in the program in 1999. In 2002, Costa Rican authorities raided the business, seized its assets and froze its bank accounts. One promoter of the business was arrested and later convicted of financial fraud; another fled and remains missing. Kent traveled several times to Costa Rica on behalf of her clients and met with prosecutors. The SEC alleged that respondents had clear indications by at least December 2002 that the value of the investments was impaired, and yet sent statements showing the investments were valued at the original cost and management fees were collected on that value. Kent denies that she knew or should have known that the investments had become worthless at that time.

38. In another program, between 1997 and 1999, respondents invested client funds through Cornerstone Investment Circle in two programs referred to as the Promissory Note Program and the Precious Metals and Mining Program. The funds were loaned to a private company and evidenced by promissory notes. The company was supposed to make monthly interest payments to respondents' clients. In 2000, the company defaulted on the loans and declared bankruptcy. In April 2001, the company's two promoters pled guilty to charges they had defrauded investors in unrelated investments; they were sentenced to 18 months in federal prison for fraud. The SEC alleged that respondents learned of the promoters' guilty pleas in 2001. In early 2002, respondents started foreclosure proceedings against the company, and on February 4, 2003, respondents filed a lawsuit against the company and its promoters alleging fraud. Respondents obtained a summary and default order but were unable to collect on the judgments. In May 2002, respondents disclosed to clients that they had instituted foreclosure proceedings. In August 2004, respondents disclosed the promoters' guilty pleas. In February 2006, respondents advised investors that they had filed a lawsuit against the company. According to the SEC, between February 2003 and 2008, respondents continued to charge management fees based on the original value of the investments. Kent states that it was the company practice to continue valuing the investments at the original cost, but they have changed this practice.

39. In June 2004, respondents invested client funds in an Indemnity Bond Bridge Program through Cornerstone Investment Circle. Cornerstone Investment Circle was to be repaid the full amount of client funds plus interest by August 2004, however, by December 2005, it still had received no payments. In December 2005, FBI agents informed respondents that the promoters had been indicted for fraud, and Cornerstone Investment Circle was later named as a defrauded investor. Kent testified at the criminal trial and the promoters were sentenced to terms of seven and 13 years in prison.

40. In another program, between May and August 2003, respondents invested client funds in two small energy companies for the installation and operation of a power cogeneration unit at a grain mill in central California. The investment consisted of a promissory note to be paid back in seven years with 12 percent interest. Respondents learned in early 2005 from a third party that the promoters' statements in the contract were false. The SEC alleged that respondents became aware in early 2005 that the value of the investment was impaired, but they continued to assess and collect management fees on the program.

41. Kent claims that her clients were aware of the problems encountered with these investments. Kent reports that although her clients were assessed management fees on these investments, she did not collect the fees. She disagrees that she was aware that the investments were worthless while collecting fees; Kent hoped to collect on the assets owned by the various programs.

42. As a result of the Consent Order, respondents were required to disgorge management fees in the amount of $335,758 by March 31, 2012. To date, réspondents have paid $252,000. Kent last made a payment in September 2012. Kent has been unable to pay the full amount because of the downturn in the economy and because her mother had a stroke and it has been necessary for her to spend time and money caring for her mother. Kent has been in touch with the SEC regarding adjusting the payment schedule. Kent states that the SEC has yet to disburse much of the money she has already paid.

43. Kent disputes many of the SEC findings; she entered into the settlement agreement with the SEC for business reasons. The CFTC Order was based entirely on the SEC Order. Because Kent was no longer using the Commodity Trading Advisor and Commodity Pool Operator registrations, she decided to consent to the revocations.

44. According to Kent, the CFTC revocations do not prohibit Cornerstone Capital from investing in assets being "allocated across asset classes such as gold and silver, currencies and commodities indices" as described in the firm brochure.

45. Kent disagrees with the findings contained in the Washington order. She signed the Consent Order on September 9, 2004, but the facts underlying the order occurred much earlier and the parties had reached a settlement in 2000. Kent decided to consent to the order because it simply required her follow the law, which she planned to do in any event. Kent agrees that she was not registered to sell securities in Washington, which resulted from her forgetting to file a one-page registration exemption form prior to meeting with the

clients. According to Kent, her clients invested in a corporate note, not in a bank debenture program as alleged by the Washington Securities Division. Kent is aware that bank debenture programs are a scam.

46. Kent states that although the settlement was reached in 2000, the Washington Securities Division attorney failed to prepare the order until 2004. She thinks of the order as having been entered in 2000 since that was when the settlement was reached. For this reason, she did not think the Washington order had to be listed on the Form ADV, which only asks about discipline imposed within the past 10 years.

47. Kent asserts that she gave all of the disciplinary history to a compliance firm that she hired at considerable expense, and that the compliance firm failed to report the history accurately. Kent presented no documentation or testimony from the outside compliance firm to support this testimony. Kent states that when she reviewed the Form ADV and firm brochure before signing it, she inadvertently failed to note the omissions. This testimony was not persuasive.

48. On respondents' 2006 Form ADV, which was submitted to the SEC, Kent disclosed the Washington Securities Division order.[8] Investment advisers are required to update their disciplinary history with the Investment Adviser Registration Depository with a Form U4. The Form U4 is not available to the public. When Kent filed her Form U4 with the Investment Adviser Registration Depository on November 12, 2009, she disclosed the Washington Securities Division order.

49. Kent asserts that because her clients received copies of the SEC Order, the description in the firm brochure submitted to the department with the Form ADV was sufficient; moreover, it was reviewed and approved by her attorney. No documentation or testimony was offered from her attorney to support this claim.

50. Kent tried to correct her failure to report the full disciplinary history by filing an amended Form ADV on September 20, 2012. She also requested to withdraw the application because she has moved her business to Guam; however, the SEC did not consent to a withdrawal of the application.[9]

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[8] The SEC and CFTC discipline occurred after this application was filed.

[9] California Code of Regulations, title 10, section 250.16, provides that an applicant may withdraw an application only with the consent of the commissioner.

LEGAL CONCLUSIONS

Cause to Deny Cornerstone Capital's Application

FAILURE TO DISCLOSE DISCIPLINARY HISTORY

1. Corporations Code section 25232, subdivision (a), provides that the commissioner may deny an application for an investment adviser certificate if the commissioner finds that a denial is in the public interest and that the applicant has willfully made or caused to be made any false or misleading statements with respect to material fact, or has willfully omitted to state in the application or report any material fact which is required to be stated therein.

2. In this matter, respondents failed to disclose the Washington Securities Division Order and the CFTC Order. (Factual Findings 18 through 22.) In addition, their description of the SEC order was incomplete and inaccurate. (Factual Findings 24 through 27.) Cause to deny respondents' investment adviser certificate application exists pursuant to Corporations Code section 25232, subdivision (a).

DISCIPLINE BY THE SEC

3. Corporations Code section 25232, subdivision (d), provides that the commissioner may deny an application for an investment adviser certificate if the applicant has been subject to any SEC order, or state securities regulatory order necessary to protect the investor.

In this matter, the SEC and the Washington Securities Division entered into consent orders to protect investors. (Factual Findings 6 through 11.) Cause to deny respondents' investment adviser certificate application exists pursuant to Corporations Code section 25232, subdivision (d).

VIOLATIONS OF THE INVESTMENT ADVISERS ACT OF 1940

4. Corporations Code section 25232, subdivision (e), provides that the commissioner may deny an application for an investment adviser certificate if the applicant has violated the Investment Advisers Act of 1940 and orders were issued for the protection of consumers.

The SEC found that respondents had violated the Investment Advisers Act of 1940, and issued an order for the protection of investors. In addition, the CFTC revoked Cornerstone Capital's registrations to protect consumers based on the SEC's findings. (Factual Findings 6 through 9.) Cause to deny respondents' investment adviser certificate application exists pursuant to Corporations Code section 25232, subdivision (e).

CFTC REVOCATIONS

5. Corporations Code section 25232, subdivision (f), provides that the commissioner may deny an application for an investment adviser certificate if the applicant has been subject to any order of the CFTC revoking registration under the Commodity Exchange Act for the protection of an investor.

The CFTC revoked respondents' Commodity Trading Advisor and Commodity Pool Operator registrations under the Commodity Exchange Act for the protection of investors. (Factual Finding 9.) Cause to deny respondents' investment adviser certificate application exists pursuant to Corporations Code section 25232, subdivision (f).

VIOLATION OF SIMILAR REGULATORY SCHEME

6. Corporations Code section 25232, subdivision (h), provides that the commissioner may deny an application for an investment adviser certificate if the applicant has violated any provision of the California Securities Law, or any similar regulatory scheme. The anti-fraud law in California is very similar to the anti-fraud provisions of the Investment Advisers Act of 1940. Section 206, subdivision (1), of the Advisers Act, which the SEC found respondents had violated, is identical to Corporations Code section 25235, subdivision (a).

Cause to deny respondents' investment adviser certificate application therefore exists pursuant to Corporations Code section 25232, subdivision (h).

Cause to Bar Laura Kent from Positions of Employment, Management or Control of any Investment Adviser, Broker-Dealer or Commodity Adviser

7. Corporations Code section 25232.1 provides in pertinent part that the commissioner may bar from any position of employment, management or control of any investment adviser, broker-dealer or commodity adviser, any officer or employee of an investment adviser if she finds that the bar is in the public interest and that the person has committed any act or omission enumerated in Corporations Code section 25232, subdivisions (a), (e), (f) or (g), or is subject to any order specified in subdivision (d).

In this matter, respondent Kent has committed acts or omissions enumerated in Corporations Code section 25232, subdivisions (a), (e) and (f), and is subject to an order specified in subdivision (d). (Legal Conclusions 1 through 5.) Cause therefore exists to bar Kent from any position of employment, management or control of any investment adviser, broker-dealer or commodity adviser.

Conclusion

8. The regulatory scheme designed to protect investors in California depends upon full disclosure of required information by licensees. Kent's failure to disclose the

CFTC and Washington Securities Division orders on the Form ADV, or fully describe the SEC order, is serious. Moreover, the fact that respondents have been the subject of disciplinary actions by three different regulatory agencies is troubling and raises questions about Kent's trustworthiness as an investment adviser. Kent did not provided evidence of rehabilitation and has not paid restitution in full pursuant to the schedule ordered by the SEC. That the SEC chose not to revoke Kent's registration based on its investigation does not require the department to grant registration in California, especially in light of Kent's failure to disclose her complete disciplinary history on this application.

It is in the public interest to deny Cornerstone Capital's application for an investor adviser certificate and to bar Kent from any position of employment, management, or control of any investment adviser, broker-dealer or commodity adviser.

ORDER

1. The application of Cornerstone Capital Management, Inc., for an investment adviser certificate is denied.

2. Laura Jean Kent is barred from any position of employment, management, or control of any investment adviser, broker-dealer or commodity adviser.

DATED: 10/25/13

/s/
JILL S LICHTMANN
Administrative Law Judge
Office Administrative Hearings