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8 Attorneys for Complainant

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

12	In the Matter of)	CASE NO.
)	
13	THE CALIFORNIA CORPORATIONS)	FILE NO. 923-3091
14	COMMISSIONER,)	
)	STATEMENT IN SUPPORT OF ORDER
15	Complainant,)	LEVYING ADMINISTRATIVE PENALTIES
)	PURSUANT TO CORPORATIONS CODE
16	v.)	SECTION 25252
)	
17	RHODES INVESTMENT ADVISORY)	
18	(JAMES ERNEST RHODES DBA),)	
)	
19	Respondent.)	
)	
20)	
21)	

22 Demetrios A. Boutris, the California Corporations Commissioner ("Commissioner") of the
23 Department of Corporations ("Department") alleges and charges as follows:

- 24 1. Rhodes Investment Advisory (James Ernest Rhodes DBA) ("RIA") holds a valid and
25 unrevoked investment adviser certificate issued by the Commissioner on July 10, 1995 pursuant to
26 Corporations Code section 25230. RIA is an investment adviser business located at 1221 State
27 Street, El Centro, California 92243. RIA is a sole proprietorship. James Ernest Rhodes is RIA'S
28 sole proprietor.

1 2. On or about April 7, 2003, the Commissioner commenced a regulatory examination of
2 RIA. The examination revealed violations of the reporting provisions of the Corporate Securities
3 Law of 1968 ("CSL")(Corp. Code § 25000 et seq.) and the regulations thereunder found at
4 California Code of Regulations, title 10, ("CCR") (§ 260.000 et seq.).

5 3. These violations consisted of RIA'S failure to file annual financial reports with the
6 Commissioner within 60 days of the end of RIA'S fiscal year. RIA'S fiscal year ends in December.
7 The annual report filing requirement provides the Department with a regulatory mechanism to
8 validate a firm's liquidity and financial integrity on a yearly basis to ensure that licensees maintain
9 the necessary net capital for the protection of the public.

10 4. Corporations Code section 25241 provides that investment advisers are required to
11 maintain books and records that are subject to examination by, and to file such reports as required
12 by, the Commissioner. Corporations Code section 25241 provides, in relevant part, as follows:

13 [E]very investment adviser licensed under Section 25230 shall make and keep such
14 accounts, correspondence, memoranda, papers, books, and other records and shall file such
15 financial and other reports as the commissioner by rule requires....

16 5. CCR section 260.241.2 requires the filing of an annual report by certain investment
17 advisers. Prior to April 3, 2003¹, subdivision (a)(2) of CCR section 260.241.2, provided as follows:

18 (a) General Rule. Subject to the provisions of Subsection (c) of this section, ...every
19 licensed investment adviser subject to the provisions of Section 260.237.1 of these rules,
20 shall file an annual financial report containing the information required by a form or forms to
21 be supplied or approved by the Commissioner, as follows:

22 ...
23 (2) The annual report for investment advisers shall contain a Statement of Financial
24 Condition. Supporting schedules shall contain computations of net capitals, aggregate
25 indebtedness and ratios required under Section 260.237.1 and the certificate of the accountant
26 required under subsection (c) of Section 260.237 of these rules.

27 6. Prior to April 3, 2003, CCR section 260.237.1 set forth the capital requirements for
28 investment advisers. Subdivision (a)(2) of CCR section 260.237.1 provided, in relevant part, as
follows:

¹ Various provisions of the CCR were amended and became effective April 3, 2003. This administrative action is based on violations that occurred under statutes and rules prior to the effective date of the amendments.

1 (a) No investment adviser who has any power of attorney from any investment advisory
2 client to execute transactions . . . shall permit its total aggregate indebtedness to exceed 500%
3 of its tangible net capital or permit its current aggregate indebtedness to exceed its current net
4 capital; and,

5 ...
6 (2) If the investment adviser has any power of attorney from any investment advisory client
7 to execute transactions and does not have regular or periodic custody or possession of any of
8 its investment advisory clients' securities or funds, except the receipt of prepaid subscriptions
9 for periodic publications, or other investment advisory services, it shall at all times have and
10 maintain tangible net capital of not less than \$5,000....

11 Subdivision (c) of CCR section 260.237.1 provided that for purposes of CCR section
12 260.237.1(a), all financial information shall be determined in accordance with generally accepted
13 accounting principles.

14 7. The Department's examiner found during the regulatory exam on April 7, 2003, that
15 RIA had discretionary power to execute transactions in the brokerage accounts of its investment
16 adviser clients. Therefore, prior to April 3, 2003, RIA was required to meet the capital requirements
17 provided for under CCR section 260.237.1(a)(2) and to show proof of compliance with this
18 regulation by filing annual financial reports required by CCR section 260.241.2. At the time of the
19 April 7, 2003, examination, RIA had failed to submit its annual financial statements for the years
20 1998 through 2002, in violation of CCR section 260.241.2(a). As a result of RIA'S violation of
21 CCR section 260.241.2(a), the Department was unable to determine, at the end of RIA'S fiscal year,
22 if the firm was in compliance with the net capital requirements of CCR section 260.237.1.

23 8. On May 9, 2003, the Department sent RIA a regulatory letter notifying the firm of the
24 exceptions discovered during the April 7, 2003 examination, including the violation of CCR section
25 260.241.2(a). Mr. Rhodes responded on behalf of RIA by letter on May 21, 2003. In this letter, Mr.
26 Rhodes claimed that he failed to submit timely annual financial reports because he did not
27 understand the requirement to file them. However, he stated that they would be timely filed in the
28 future, since they had "...been added to the firm's year-end task list."

9. A prior regulatory examination of RIA conducted by the Department on April 11,
1997 revealed, in part, the same failure to file an annual financial report. On April 18, 1997, the
Department sent a letter notifying RIA of its failure to file its annual financial report for 1996, in

1 violation of CCR section 260.241.2(a). Mr. Rhodes replied by letter dated May 7, 1997, stating that
2 all the deficiencies noted in the Department's April 18, 1997 letter, including the late filing of the
3 annual financial report, would be corrected. Mr. Rhodes submitted a second letter to the
4 Department, dated May 14, 1997, that stated in part "In the future annual financial reports will be
5 filed in a timely manner."

6 10. Corporations Code section 25252, which became effective January 1, 1999,
7 authorizes the Commissioner to issue an order levying administrative penalties against any
8 investment adviser for willful violations of any provision of the CSL and any rules promulgated
9 thereunder. Specifically, Corporations Code section 25252 provides, in relevant part:

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

12 ...
13 (b) Any broker-dealer or investment adviser that willfully violates any provision of this
14 division to which it is subject, or that willfully violates any rule or order adopted or issued
15 pursuant to this division and to which it is subject, is liable for administrative penalties of not
16 more than five thousand dollars (\$5,000) for the first violation, not more than ten thousand
17 dollars (\$10,000) for the second violation, and not more than fifteen thousand dollars
18 (\$15,000) for each subsequent violation.

19 11. By reason of the foregoing, RIA has willfully violated Corporations Code section
20 25241 and CCR section 260.241.2(a), justifying the imposition of administrative penalties. RIA, as
21 a licensee, was obligated to have knowledge of, and to comply with, the provisions of the CSL and
22 the regulations thereunder to maintain its investment adviser certificate. Furthermore, on April 18,
23 1997, the Department notified RIA of the annual financial report filing requirement. RIA has
24 continued to violate both Corporations Code section 25241 and CCR section 260.241.2(a), despite
25 the Department's actual notification and Mr. Rhodes's assurances of future compliance.

26 12. Therefore, pursuant to Corporations Code section 25252, the Commissioner seeks
27 administrative penalties for RIA's failure to file required financial reports in willful violation of
28 Corporations Code section 25241 and CCR section 260.241.2(a).

WHEREFORE, good cause showing, and pursuant to Corporations Code section 25252, the
California Corporations Commissioner prays for an order levying administrative penalties in the
amount of \$750.00 for each violation for a total of \$1,500.00.

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Dated: November 19, 2003

DEMETRIOS A. BOUTRIS
California Corporations Commissioner

By: _____
NICHOLAS LANZA
Senior Corporations Counsel
Enforcement and Legal Services Division