BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter:

THE CALIFORNIA CORPORATIONS COMMISSIONER,

Complainant,

v.

SCHULTZ INVESTMENT ADVISORY,

Respondent.

File No.: 135280

OAH No. L2005120719

DECISION

The attached Proposed Decision of the Administrative Law Judge is hereby adopted by the Commissioner of Corporations as its Decision in the above-entitled matter.

This Decision shall become effective on MARCH 9, 2006.

IT IS SO ORDERED this 8th day of MARCH, 2006.

CALIFORNIA CORPORATIONS COMMISSIONER

WAYNE STRUMPFER
Acting California Corporations Commissioner

BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of: THE CALIFORNIA CORPORATIONS COMMISSIONER, Complainant, v. SCHULTZ INVESTMENT ADVISORY, Respondent.	File No. 135280 OAH No. L2005120719

PROPOSED DECISION

Robert S. Eisman, Administrative Law Judge, Office of Administrative Hearings, State of California, heard this matter in Los Angeles, California, on January 3, 2006.

Marlou de Luna, Senior Corporations Counsel, represented Acting California Corporations Commissioner Wayne Strumpfer (complainant). Natalie Rio, Legal Assistant, Department of Corporations, also attended the hearing.

Eric V. Schultz, also known as Eric Vonn Schultz, appeared and represented himself as the sole proprietor of Schultz Investment Advisory (respondent).

Upon the request of counsel for complainant, during the administrative hearing the Statement of Issues was amended by strike out and interlineations such that on page 3, paragragh 8, line 22, was changed to read: "On or about December 17, 2001 . . . ."

Sworn testimony and documentary evidence was received, the record was closed, and the matter was submitted on January 3, 2006.

The issue in this matter is whether the Department of Corporations should deny or issue respondent's application for an investment advisor certificate. Complainant contends that it is in the public interest to deny the investment advisor certificate based

on Mr. Shultz's history as an investment advisor, and bar orders that had been issued against him by both the Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD), i.e., under Corporations Code section 25232, subdivisions (d)(1) and (d)(2). Mr. Schultz contends that granting the investment advisor certificate would not be adverse to the public interest.

Respondent's application is denied for the reasons set forth below.

FACTUAL FINDINGS

1. In April 2005, Eric Schultz filed an application with the Department of Corporations (Department) for registration as an investment advisor under the name of Shultz Investment Advisory (SIA). The application identified Mr. Schultz as the sole proprietor of SIA and contained disclosures pertaining to a prior three-year bar imposed by the SEC, and fines, administrative fees, and a conservatorship related to Mr. Schultz's previous registration with the Department as an investment advisor.

2. On November 28, 2005, Wayne Strumpfer, in his official capacity as the Acting Corporations Commissioner, Department of Corporations, filed a Notice of Intention to Issue Order Denying Investment Advisor Certificate and a Statement of Issues in Support of Notice of Intention to Issue Order Denying Investment Advisor Certificate. Respondent appealed the action and this hearing ensued.

3. From June 1995 to August 1997, respondent was employed at Glenfed Brokerage Services, an investment firm. While at Glenfed, respondent became associated with an investor, Jerry A. Womack (Womack). In the course of their association, Womack presented respondent with an investment plan that respondent viewed as "astounding," in that Womack's investment strategy seemed to result in "fantastic" returns on investments. In fact, Womack's investment strategy was a "ponzi" scheme. [1]

Commencing in September 1997 and continuing through February 2000, respondent was an investment principal employed at Schoff & Baxter, Inc., an investment

[1] "Ponzi" schemes are a type of illegal pyramid scheme named for Charles Ponzi, who duped thousands of New England residents into investing in a postage stamp speculation scheme. In the classic pyramid scheme, participants attempt to make money solely by recruiting new participants into the program. The hallmark of these schemes is the promise of sky-high returns in a short period of time for doing nothing other than handing over your money and getting others to do the same. The perpetrator(s) behind a pyramid scheme may go to great lengths to make the program look like a legitimate investment program. However, despite claims of legitimacy and high returns on investments, money coming in from new investors is merely used to payoff early-stage investors. Eventually the pyramid will collapse.

firm that was a member of the National Association of Securities Dealers (NASD). During the period September 1997 through December 1997, while employed at Schoff & Baxter, respondent advised clients to invest money with Womack. Respondent received a referral fee from Womack for each investor referral he made.

During 1998, Womack transferred all investor monies he had received into Iris Limited Partnership (Iris LP), a Nevada-based entity that had Womack as its General Partner. Each investor was given a limited partnership interest in Iris LP, commensurate with the amount of their investment. Respondent received a referral fee from Womack for each investor referral he made to the Iris LP.

Respondent did not inform his employer about his investment dealings with Womack and Iris LP. Schoff & Baxter terminated respondent's employment due to his outside investments and the fact that he exposed clients to hgghrisk investments.

Iris LP was part of Womack's ponzi scheme, which resulted in significant losses in consumer investments. During his involvement with Womack, respondent knew or, as a registered investment advisor, should have known, that statements he made to consumers regarding Womack and Womack's investment scheme were untrue, deceptive, unfair, or misleading. Respondent profited from the clients he induced to invest with Womack, investors who were significantly harmed as a result of respondent's misrepresentations.

4. Unaware of respondent's involvement in a ponzi scheme, the Department issued respondent his first investment advisor certificate on September 22, 1998.

5. In January 2000, the Department conducted a regulatory examination of respondent's investment advisor books and records. The examination found that respondent had commingled and mismanaged client funds, resulting in numerous violations of California corporate securities law.

6. As a result of the regulatory examination of respondent's books and records, the Department sought civil action against respondent and SIA. On March 16, 2000, the Corporations Commissioner filed a Complaint for Injunction, Appointment of Receiver, Civil Penalties and Other Ancillary Relief. The Complaint alleged that respondent violated corporate securities laws and regulations by failing to keep true, accurate, and current books and records; commingling investor client funds with the general operating funds of his investment advisor business and his own personal funds; failing to designate himself as an agent or trustee on accounts containing client funds; failing to maintain separate records for each client; failing to invest all client funds as agreed to in agreements; making misrepresentations to clients regarding the investment strategy he was going to use; making excess disbursements of client funds, which resulted in a correlative shortage in the investment pool; failing to send itemized statement to clients; failing to cause a verification audit of client funds and securities by an independent certified public accountant; failing to disclose the timing, methodology, and/or formula used to calculate gains and losses in the investment pool; failing to

disclose those portions of investor funds that may be used to pay distributions to other clients, operating expenses and advisory fees; charging excessive advisory fees; not disclosing that lower fees for comparable services may be available from other sources; failing to maintain proper books and records, including receipts and disbursements, a general ledger or subsidiary ledgers, reconciliations, financial statements and papers, accounts, power of attorney documents, investment advisory contracts and disclosure statements, journal or other record of debits and credits, and computations of net capital; and failing to file annual reports with the Commissioner, as required, between September 1998 and February 2000. The Complaint further alleged that respondent offered and sold unqualified, non-exempt securities, within the state of California, without a permit or other form of qualification authorizing him to offer and sell the securities, and that he made misrepresentations or omitted material facts in connection with the unqualified, nonexempt sales of securities.

7. Under a consent agreement, the Complaint was resolved through a preliminary injunction filed on March 17, 2000, and a final judgment filed on May 2, 2000. The Final Judgment of Permanent Injunction and other Ancillary Relief was filed in the Superior Court of California, County of Ventura, Case No. SC 026199, *People v. Eric Vonn Schultz, as an individual and doing business as Shultz Investment Advisory*. The judgment permanently enjoined respondent from committing and aiding and abetting any acts in violation of the Corporations Code and the regulations promulgated thereunder. It also provided for a receiver, who was initially appointed by the Department on February 18, 2000, to continue receivership over respondent's investment advisory business. The receiver was directed to file with the Corporations Commissioner an application for withdrawal of respondent's investment advisor certificate. Respondent was required to pay various civil penalties and costs associated with the regulatory examination of his books and records and the resulting litigation. Additionally, the judgment authorized the Corporations Commissioner to place specified terms and conditions upon any investment advisor certificate subsequently issued to respondent, including the requirement that a monitor be appointed to oversee his investment advisor business for a period of not less than two years.

8. As directed by the court, the receiver filed with the Corporations Commissioner an application for withdrawal of respondent's investment advisor certificate. The Corporations Commissioner ordered the surrender of the certificate, effective June 29, 2000.

9. On June 19, 2000, respondent reapplied for an investment advisor certificate. The Department issued the certificate on August 31, 2000, subject to an Order containing terms and conditions pertaining to compliance with corporate securities laws and regulations, disclosures to the Department and respondent's clients, tangible net capital, trading strategies, recordkeeping, employment, fees and commissions, client account management, and reporting. Additionally, a monitor was appointed to review and report on respondent, doing business as Schultz Investment Advisory. The Department amended the Order on October 2, 2000, temporarily reducing to $5,000 the

requirement that respondent maintain tangible net capital of not less than $25,000. On October 2001, the requirement reverted back to $25,000.

10. During the period that respondent did business under his second investment advisor certificate, the monitor submitted reports to the Department regarding respondent and SIA. In letters dated June 14 and August 27, 2001, the monitor notified the Department that deficiencies existed in respondent's recordkeeping and that respondent had failed to comply with the Department's Order.

11. The Department did not use the monitor's reports as the basis for seeking disciplinary action against respondent. However, on October 26, 2001, respondent applied to and the Corporations Commissioner accepted the surrender of respondent's investment advisor certificate. Respondent elected to surrender his certificate because he was then facing the reinstated requirement for increased tangible net capital, which would have posed a financial hardship, and an action by NASD was pending against him.

12. On December 17, 2001, NASD, which is a national securities organization, accepted a Letter of Acceptance, Waiver, and Consent signed by respondent. Without admitting or denying allegations of wrongdoing with respect to his participation in private security transactions with Womack, respondent consented to certain findings by NASD and agreed to be "barred from associating with any NASD member firm, in any and all capacities."

NASD found that from August 1997 to about May 1998, respondent engaged in private securities transactions without prior written notice to and written approval from his employer (Schoff & Baxter, Inc.); respondent had established a personal and professional relationship with Womack; from September 1997 through December 1997, respondent sought investors for and referred them to Womack; each investor invested between $2,200 and $250,000 with Womack; from January 1998 through September 1998, Womack transferred all the investor money into Iris LP; respondent received a five percent referral fee from Womack for each investor referral he made to Womack or the Iris LP; and respondent referred more than 90 investors to Womack and Iris LP. The Womack strategy and Iris LP were part of a ponzi scheme that resulted in significant customer losses. Additionally, NASD found that in connection with his marketing and sale of the Iris LP interests, respondent defrauded the public by making untrue statements of material facts and/or omitting to state necessary material facts.

Due to respondent's "demonstrated inability to pay any amount," under the Acceptance and Consent, respondent was not required to provide restitution to consumers for the losses they sustained, or disgorge the commissions and profits he earned from associating with Womack.

13. Respondent did not challenge the NASD action because he did not have the "time, money, or spirit" to oppose the allegations. Additionally, since the SEC did

not require lieensure by NASD to work as an investment advisor, respondent did not view the NASD bar as meaningful.

14. On January 24, 2002, the SEC issued an Order Instituting Public Administrative and Cease-and-Desist Proceeding, Making Findings and Imposing a Cease-and-Desist Order and Sanctions. The Order was based on a settlement entered into between the SEC and respondent, in which respondent did not admit or deny culpability. The SEC's findings correlated with the earlier findings of NASD. Based on respondent's association with Womack, the SEC found that respondent had violated the securities registration, broker-dealer registration, and anti-fraud provisions of the Securities and Exchange Acts. In particular, the SEC's found that

> Schultz relied on Womack's statements regarding the use of funds and the rates of return that could be expected. Although the rates of return Womack claimed to be able to earn were quite extraordinary and clearly should have triggered some skepticism, Schultz failed to investigate Womack's claims. Contrary to Schultz' representations, Womack did not invest the majority of the funds in the stock market. Rather, Womack's trading resulted in a net loss to investors and he misused and misappropriated a large portion of investor funds to pay other investors their principal and purported profits.

The SEC required that respondent cease and desist from further violations, barred him from associating wihh any broker or dealer, and prohibited him from serving or acting as an employee, officer, director, member of an advisory board, investment advisor or depositor of, or principal underwriter for a registered investment company or affiliate. The bar and prohibition was for a period of three years, after which respondent could reapply to serve or act in any of the barred capacities.

Based on respondent's financial situation, the SEC did not impose a civil penalty or require that he pay disgorgement of $775,000 plus prejudgment interest.

15. The bar imposed by the SEC ended in January 2005. The bar imposed by NASD remains in effect. Respondent did not present any evidence that he had applied to have the NASD bar lifted.

16. Respondent is 38 years old and married. He has four children. Respondent had worked in approximately 12 different financial / investment firms during the period April 1989 through February 2000, and has not engaged in any investment activities since 2001. Since October 2001, respondent has been employed by Classified Cosmetics, where he is currently the head of sales.

Other than preparing for his investment advisor certification examination in April 2005, respondent has not engaged in any continuing education related to investments or investing.

17. Respondent regrets his past association with Womack. In an effort to reimburse defrauded clients who had lost approximately $1.2 million by following respondent's advice and investing with Womack / Iris LP, respondent distributed his own liquidated earnings, which totaled approximately $150,000, to those investors. This amount was well below the amount of financial injury sustained by the investors.

LEGAL CONCLUSIONS

1. The standard of proof in this proceeding is "preponderance of the evidence," meaning that respondent is obliged to adduce evidence that has more convincing force than that opposed to it. The administrative law judge applies this standard of proof because respondent is applying for a license in which he currently holds no vested interest. *(San Benito Foods v. Veneman* (1996) 50 Cal.App.4th 1889, 1893.)

2. The California Corporate Securities Act was designed to prevent deception, exploitation of ignorance, and all unfair dealings in the issuance of securities. It was also designed to protect public against imposition of unsubstantial, unlawful and fraudulent stock and investment schemes, and securities based thereon. (*Sandor v Ruffer, Ballan & Co.* (1970, SD NY) 309 F.Supp. 849, 854; *People v Jaques* (1955, 1st Dist) 137 Cal.App.2d 823, 832.)

3. Corporations Code section 25009 states, in relevant part:

> (a) "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as a part of a regular business, publishes analyses or reports concerning securities. . . .
>
> (b) "Investment adviser" also includes any person who uses the title "financial planner" and who, for compensation, engages in the business, whether principally or as part of another business, of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as part of a regular business, publishes analyses or reports concerning securities. . . .

4. Corporations Code section 25232 states, in pertinent part:

> The commissioner may, after appropriate notice and opportunity for hearing, by order censure, deny a certificate to, or suspend for a period not exceeding 12 months or revoke the certificate of, an investment adviser, **if the commissioner finds that the censure, denial, suspension, or**

revocation is in the public interest and that the investment adviser, whether prior or subsequent to becoming such, or any partner, officer or director thereof or any person performing similar functions or any person directly or indirectly controlling the investment adviser, whether prior or subsequent to becoming such, or any employee of the investment adviser **while so employed has done any of the following:**

[¶] . . . [¶]

(d) Is or has been subject to (1) any order of the Securities and Exchange Commission or the securities administrator of any other state denying or revoking or suspending his or her registration as an investment adviser, or investment adviser representative, or as a broker or dealer or agent, (2) any order of any national securities association or national securities exchange (registered under the Securities Exchange Act of 1934) suspending or expelling him or her from membership in that association or exchange or from association with any member thereof . . . . [Emphasis added.]

Therefore, under Corporations Code section 25232, grounds would exist to deny respondent's certificate as an investment advisor if denial would be in the public interest and the investment advisor had done any of the items enumerated under the statute.

5. In determining whether denial of respondent's cefificate as an investment advisor is in the public interest, the Corporations Commissioner must consider certain factors relevant to that determination. Because federal precedents reflect the same interests as those underlying Corporations Code section 25232, they furnish reliable authority in construing that section. Thus, it is appropriate to adopt and apply a set of factors that has been used by the SEC in administrative disciplinary proceedings when determining whether, based on the particular circumstances and the entire record of a case, a remedial, disciplinary sanction is in the public interest. (See, e.g., *Building Material & Construction Teamsters' Union v. Farrell* (1986) 41 Cal.3d 651, 658.)

Such a federal precedent was established in, *In The Matter Of Marshall E. Melton and Asset Management & Research, Inc.* (July 25, 2003) 2003 SEC Lexis 1767. In *Melton*, a proceeding before the SEC, a registered investment adviser and its president, who was also associated with a registered broker-dealer, were permanently enjoined, with their consent, from violating antifraud provisions of the securities laws.

> The Commission's determination that a remedial, disciplinary sanction is in the public interest is based on the particular circumstances and entire record of the case. The Commission considers a range of factors relevant to that determination, including: the seriousness of the violation; the isolated or recurrent nature of the violation; the respondent's state of mind; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of the misconduct; the respondent's opportunity to commit future violations; the age of the

violation; and the degree of harm to investors and the marketplace resulting from the violation.

(*Id.* at pp. 4-5.)

6. As indicated in *Melton*, in disciplinary proceedings in which an injunctive complaint was settled by consent, the SEC considers the allegations in the complaint and the circumstances surrounding the injunctive action when making a public interest determination. The SEC has found that such complaints are clearly relevant and has adopted the policy in administrative proceedings based on consent injunctions that the injunctive allegations may be given considerable weight in assessing the public interest. (*Melton, supra*, 2003 SEC Lexis 1767 at pp. 6.)

> [T]he mere issuance of the injunctions, the validity of which has not been attacked, furnishes a statutory basis for revocation if we find such action to be in the public interest. We are of the view that, whether or not the decrees are res judicata, we need not litigate the factual assertions made in the injunctive proceedings in here resolving the issue of public interest, but may give consideration to the fact that registrant has been twceenjoined from engaging in fraudulent and improper conduct in connection with the purchase and sale of securities. . . . [¶] . . .[¶] Thus, the Commission has concluded that a consent injunction, "no less than one issued after trial upon a determination of the allegations, may furnish the sole basis for remedial action . . . if such action is in the public interest." [Footnote omitted.] Indeed, the mere existence of an injunction may support revocation of registration or a bar from participation in the securities industry where the nature of the acts enjoined and the circumstances indicate that such is in the public interest.

(*Id.* at pp. 7-8.)

7. Respondent alone testified at the hearing. He brought no supporting witnesses to attest to his character or rehabilitative efforts. Although respondent did not want to argue the allegations contained in the NASD and SEC actions, respondent presented a letter that he prepared and sent to counsel for complainant. In his letter, respondent contended that complainant has the burden of proving that denial of his investment advisor certificate would be in the public interest. Respondent also contested complainant's allegations that respondent's employer did not know he was selling shares in Iris LP or that in his association with Womack he misrepresented material facts. Respondent stated that his former clients support his return and that he shouldered the cost of the court-ordered audit and receiver "in order to take that burden from the public."

Related to the SEC action, respondent claimed he worked closely with the Federal Bureau of Investigation and was a key witness in the federal prosecution of Womack. Although Womack was convicted of fraud, no criminal charges were filed against respondent.

Respondent claimed he attempted to minimize the impact of his past conduct. He portrayed himself as a fellow-victim who was duped by Womack's misrepresentations, but he did not admit culpability. Rather, respondent attempted to show how he was instrumental in the prosecution of Womack and how the SEC viewed as minor his role in Womack's ponzi scheme. Respondent claimed that the fact the SEC did not levy a civil penalty against him was evidence of his minor involvement in the Womack scheme.

8. Contrary to respondent's representation, as part of the consent agreement in the Department's action, the court ordered respondent to pay the full costs, fees, and expenses of the receivership and the fees and expenses related to the Corporations Commissioner's examination. Additionally, respondent was not assessed a civil penalty by the SEC, not because of the minor role he played in the Womack scheme, but because he demonstrated that his financial condition would not allow for payment of the fine. In that respondent represented otherwise, he was not forthright and honest, and this affected the credibility of his testimony.

9. Respondent did not provide any additional verification of his rehabilitation; he only provided the letter that he prepared and sent to counsel for complainant. Although respondent indicated that he regrets his past involvement with Womack, given the serious nature of his violations, including (a) the inducement of clients who were significantly harmed through participation in Womack's illegal investment scheme; (b) respondent's repeated failure to comply with the laws and regulations pertaining to investment advisors, as evidenced by the results of the Department's regulatory examination, his involvement with Womack / Iris LP, and the findings in the monitor's reports; and (c) the lack of assurance that he would not commit future violations if given the opportunity, there is insufficient basis for concluding that respondent is sufficiently rehabilitated or that it would be in the public interest to grant him an investment advisor certificate at this time.

10. With due consideration of the entire record in this matter and the foregoing SEC policies regarding factors that apply to public interest determinations, respondent's offer of mitigating circumstances, including his personal financial loss, the lifting of the SEC bar, and his attempts to provide some restitution to investors, is not sufficient to overcome the fraudulent activities and violations alleged in the Department, NASD, and SEC actions. (See, e.g., *Mann v. Department of Motor Vehicles* (1999) 76 Cal.App.4th 312, 324; self-interested testimony is not sufficient to outweigh the protracted and aggravated nature of respondent's fraudulent conduct.)

11. Complainant has established by a preponderance of the evidence that grounds exist to deny respondent's application for an investment advisor certificate, pursuant to Corporation's Code section 25232, subdivision (d)(1). (Factual Findings 14 and 15; Legal Conclusions 4 through 10.)

12. Complainant has established by a preponderance of the evidence that grounds exist to deny respondent's application for an investment advisor certificate,

pursuant to Corporation's Code section 25232, subdivision (d)(2). (Factual Findings 12 and 15; Legal Conclusions 4 through 10.)

13. The objective of a disciplinary proceeding is to protect the public and maintain integrity, high standards, and preserve public confidence in the regulated profession or occupation.[2] The purpose of proceedings of this type is not to punish respondent. In particular, the statutes and regulations relating to investment advisors are designed to protect the public from any potential risk of harm.[3] The law looks with favor upon those who have been properly reformed.[4] To that end, respondent bears the burden to establish his reformation against a history of violating the laws and regulations that apply to investment advisors. (See *Martin v. Alcoholic Bev. App. Bd.* (1950) 52 Cal.2d 259, 265 (the burden of proof may properly be placed upon the applicant in application proceedings).)

14. In light of the foregoing factual findings and legal conclusions, respondent has not met his burden of establishing by a preponderance of the evidence that the Corporations Commissioner should authorize and issue him an investment advisor certificate. The fact that respondent had been permanently or temporarily enjoined by order or judgment of a court of competent jurisdiction and by regulatory agencies from violating the laws regulating investment advisors has especially serious implications for the public interest. Therefore, it is in the public interest to deny respondent's application for an investment advisor certificate.

ORDER

WHEREFORE, THE FOLLOWING ORDER is hereby made:

Respondent's application for an investment advisor certificate is DENIED.

January 19, 2006.

ROBERT S. EISMAN
Administrative Law Judge
Office of Administrative Hearings

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[2] *Camacho v. Youde* (1975) 95 Cal.App.3d 161, 165; *Clerici v. Department of Motor Vehicles* (1990) 224 Cal.App.3d 1016, 1030-1031; *Fahmy v. Medical Bd. of California* (1995) 38 Cal.App.4th 810, 816.
[3] *Lopez v. McMahon* (1988) 205 Cal.App.3d 1510, 1516; *Arneson v. Fox* (1980) 28 Cal.3d 440.
[4] *Resner v. State Bar* (1967) 67 Cal.2d 799, 811.