

1 WILLIAM P. WOOD  
California Corporations Commissioner  
2 VIRGINIA J. DUNLAP (CA BAR NO. 142221)  
Deputy Commissioner  
3 ALAN S. WEINGER (CA BAR NO. 86717)  
Supervising Counsel  
4 JOAN E. KERST (CA BAR NO. 123351)  
Senior Corporations Counsel  
5 DEPARTMENT OF CORPORATIONS  
71 Stevenson Street, Suite 2100  
6 San Francisco, California 94105  
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7

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. 925-2246
14	COMMISSIONER,	)	
		)	ORDER TO DISCONTINUE VIOLATIONS
15	Complainant,	)	PURSUANT TO CORPORATIONS CODE
		)	SECTION 25249
16	v.	)	
		)	
17	SHEMANO CAPITAL MANAGEMENT	)	
18	GARY J. SHEMANO, President,	)	
		)	
19	Respondents.	)	
20		)	
21		)	

22 TO: Shemano Capital Management  
23 Gary J. Shemano, President  
24 601 California Street, 18<sup>th</sup> Floor  
San Francisco, CA 94108

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1 William P. Wood, the California Corporations Commissioner ("Commissioner") of the  
2 Department of Corporations, finds that:

3 Shemano Capital Management and Gary J. Shemano have continued to violate requirements  
4 of the Corporate Securities Law of 1968 (Corp. Code § 25000 et seq.), hereafter Corporations Code,  
5 and the regulations enacted thereunder (Cal. Code Regs., tit. 10, § 260.000 et seq.).

6 Shemano Capital Management and Gary J. Shemano have violated the following legal  
7 requirements:

- 8 (1) Corporations Code 25241, by failing to maintain books and records;
- 9 (2) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(1),  
10 by failing to maintain journals;
- 11 (3) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(2),  
12 by failing to maintain ledgers or provide the Department access to a general  
13 ledger;
- 14 (4) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(4),  
15 by failing to prepare and maintain cash reconciliations;
- 16 (5) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(6),  
17 by failing to maintain and provide trial balances;
- 18 (6) California Code of Regulations, title 10, section 260.241.3, subdivision (j),  
19 by failing to prepare monthly trial balances and monthly computations of  
20 net capital and aggregate indebtedness;
- 21 (7) California Code of Regulations, title 10, section 260.241.4, subdivision (a),  
22 by failing to amend Shemano Capital Management's application for an  
23 investment adviser's certificate to contain true and accurate information;
- 24 (8) Corporations Code section 25244, by failing to surrender Shemano Capital  
25 Management's investment adviser's certificate, and
- 26 (9) Corporations Code section 25245, by making untrue statements of material  
27 facts in the financial statements filed with the Commissioner by Shemano  
28 Capital Management.

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NOW, BASED UPON THE FOREGOING, AND GOOD CAUSE APPEARING, it is hereby ORDERED under the provisions of Corporations Code section 25249, that Shemano Capital Management and Gary J. Shemano immediately discontinue violating Corporations Code sections 25241, 25244, 25245, and California Code of Regulations, title 10, section 260.241.3, subdivisions (a)(1), (a)(2), (a)(4), (a)(6), (j), and California Code of Regulations, title 10, section 260.241.4, subdivision (a).

Dated: October 22, 2004  
Los Angeles, California

WILLIAM P. WOOD  
California Corporations Commissioner

By: \_\_\_\_\_  
ALAN S. WEINGER  
Supervising Counsel  
Enforcement and Legal Services Division

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8 Attorneys for Complainant

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

12	In the Matter of	)	CASE NO.
13	THE CALIFORNIA CORPORATIONS	)	FILE NO. 925-2246
14	COMMISSIONER,	)	STATEMENT IN SUPPORT OF ORDER
15	Complainant,	)	TO DISCONTINUE VIOLATIONS
16	v.	)	PURSUANT TO CORPORATIONS CODE
17	SHEMANO CAPITAL MANAGEMENT,	)	SECTION 25249 AND COMMISSIONER'S
18	Respondent.	)	INTENTION TO MAKE ORDER FINAL
19		)	(CORPORATIONS CODE SECTION 25251)

21 William P. Wood, the California Corporations Commissioner ("Commissioner") of the  
22 Department of Corporations ("Department"), alleges and charges as follows:

23 1. The Corporate Securities Law of 1968 in California Corporations Code section 25000  
24 et seq., (hereinafter Corporations Code) and the California Code of Regulations, title 10, section  
25 260.000 et seq., contain provisions that govern persons licensed to operate in the securities industry.  
26 To ensure the protection of the public, the Commissioner requires compliance by licensees with the  
27 law and regulations. Licensees are required to keep accurate books and records, to amend their  
28 respective application by providing current information to the facts stated therein and to pay fees.

1           2.       On October 24, 1994, pursuant to Corporation Code section 25230, the  
2 Commissioner issued a valid investment adviser certificate to Shemano Capital Management, a  
3 California corporation. Although Shemano Capital Management's license application (File No.  
4 925-2246) states its investment adviser business would be located at 580 California Street, Suite  
5 2211, San Francisco, California, at all relevant times Shemano Capital Management's office was  
6 located at 601 California Street, 18<sup>th</sup> Floor, San Francisco, California 94108, and it is unclear  
7 where its records are maintained. Gary J. Shemano is Shemano Capital Management's sole  
8 shareholder, officer and director. Gary Shemano and Shemano Capital Management manage  
9 their investment advisory clients' investment portfolios for a fee, have discretionary authority to  
10 purchase and sell securities directly for them and possess a power of attorney from them.

11           3.       During 2000 the Department conducted a regulatory examination of Shemano  
12 Capital Management's investment adviser business, which revealed that Shemano Capital  
13 Management failed to keep true, accurate and current books or records at Shemano Capital  
14 Management's business offices. During relevant times Shemano Capital Management failed to  
15 maintain or provide journals and a general ledger, failed to reconcile bank accounts, and failed to  
16 prepare trial balances and compute net capital and aggregate indebtedness on a monthly basis.  
17 Shemano Capital Management also failed to amend the information in Shemano Capital  
18 Management's license application as required by law to contain true and accurate facts about its  
19 business, including the location of its business records. These failures of Shemano Capital  
20 Management prevented the Department from determining as part of its regulatory examination  
21 whether Shemano Capital Management fulfilled the legal requirements of the CSL and parallel  
22 regulations.

23           4.       Corporations Code section 25241 provides that investment advisers are required  
24 to maintain books and records to be examined by the Commissioner. Corporations Code  
25 section, in relevant part, states:

26                   Every investment adviser licensed under Section 25230 shall make  
27                   and keep such accounts, correspondence, memoranda, papers, books,  
28                   and other records and shall file such financial and other reports as  
                    the commissioner by rule requires subject to the limitations . . .

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of Section 222 of the Investment Advisers Act of 1940 with respect to investment advisers. All records so required shall be preserved for the time specified in the rule. All records referred to in this section are subject at any time and from time to time to such reasonable periodic, special, or other examinations by the commissioner, within or without this state, as the commissioner deems necessary or appropriate in the public interest or for the protection of investors.

5. Corporations Code section 25241, augmented by California Code of Regulations, title 10, section 260.241.3, identifies the particular books and records that investment advisers are required to make and to keep current and accurate. Subdivisions (a)(1), (a)(2), (a)(4), and (a)(6) of California Code of Regulations, title 10, section 260.241.3, state:

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

(1) A journal or journals, including cash receipts and disbursements records, and any other records of original entry forming the basis of entries in any ledger.

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

(4) All check books, bank statements, cancelled checks and cash reconciliations of the investment adviser . . .

(6) All trial balances, financial statements, and internal audit working papers, relating to the business of such investment adviser.

6. Corporations Code section 25237 authorizes the Commissioner to prescribe rules for investment advisers who have custody of the clients' securities or funds or who have any power of attorney from their clients to execute transactions. The Commissioner has done so by specifying, among other requirements, the minimum capital requirements such investment adviser must maintain. During relevant times herein, subdivision (a)(2) of California Code of Regulations, title 10, section 260.237.1, stated:

(a) No investment adviser who has any power of attorney from any investment advisory client to execute transactions . . .

1 (2) If the investment adviser has any power of attorney from any  
2 investment advisory client to execute transactions and does not have  
3 regular or periodic custody or possession of any of its investment  
4 advisory clients' securities or funds, except the receipt of prepaid  
5 subscriptions for periodic publications, or other investment advisory  
6 services, it shall at all times have and maintain tangible net capital  
7 of not less than \$5,000.00.

6 7. To verify compliance with the above-described capital requirements the  
7 Commissioner has imposed a specific bookkeeping obligation on investment advisers to maintain  
8 records to prove they possess the minimum capital. Subdivision (j) of California Code of  
9 Regulations, title 10, section 260.241.3, states:

10 (j) Any investment adviser who is subject to the minimum capital  
11 requirements of Section 260.237.1 shall, in addition to the records otherwise  
12 required under this section, maintain a record of the proof of money  
13 balances of all ledger accounts in the form of trial balances and a record of  
14 the computations of net capitals and aggregate indebtedness pursuant to  
15 Section 260.237.1 of these rules (as of the trial balance date). The trial  
16 balances and computations shall be prepared currently at least once a month.

15 8. Corporations Code section 25241 requires all books and records of a licensee to be  
16 subject at any time to examination by the Commissioner. Licensees are required to furnish the  
17 Commissioner true and accurate information about the location of their books and records. To  
18 insure timely updates are provided by licensees to the Department and, as a consequence, are  
19 available to the public, the Commissioner has imposed a specific reporting obligation on investment  
20 advisers to amend their respective application if, and when, changes occur. Licensees are under a  
21 duty to amend their application so that it contains current and accurate information. California Code  
22 of Regulations, title 10, section 260.241.4, states:

23 (a) Each licensed broker-dealer and each licensed investment adviser shall,  
24 upon any change in the information contained in its application for a  
25 certificate (other than financial information contained therein) promptly file  
26 an amendment to such application setting forth the changed information  
27 (and in any event within 30 days after the change occurs).

28 9. In connection with the 2000 regulatory examination the Department examiners found  
Shemano Capital Management did not maintain true and accurate journals in violation of California

1 Code of Regulations, title 10, section 260.241.3(a)(1). Although Shemano Capital Management did  
2 provide some bank account statements, these were inadequate to suffice as a journal, lacking the  
3 generally accepted accounting principles of a double entry system for recording financial  
4 transactions. Shemano Capital Management did not provide the examiner with access to a general  
5 ledger in violation of California Code of Regulations, title 10, section 260.241.3(a)(2). Examiners  
6 determined that Shemano Capital Management did not prepare and maintain cash reconciliations by  
7 reconciling the cash balances on the bank statements to a general ledger account of Shemano Capital  
8 Management's financial transactions in violation of California Code of Regulations, title 10, section  
9 260.241.3(a)(4). Examiners found that that Shemano Capital Management failed to maintain and  
10 provide the trial balances as required in violation of California Code of Regulations, title 10, section  
11 260.241.3(a)(6). Examiners determined that Shemano Capital Management had power of attorney  
12 and discretion to trade securities within customers' accounts, which required Shemano Capital  
13 Management to meet the capital requirements of California Code of Regulations, title 10, section  
14 260.237.1, and to prove compliance with this requirement by maintaining records in accordance with  
15 California Code of Regulations, title 10, section 260.241.3(j). California Code of Regulations, title  
16 10, section 260.241.3(j), requires that Shemano Capital Management maintain trial balances and  
17 compute net capital and aggregate indebtedness on a monthly basis. Examiners found that Shemano  
18 Capital Management failed to prepare monthly trial balances and compute net capital and aggregate  
19 indebtedness in violation of California Code of Regulations, title 10, section 260.241.3(j). As a  
20 result of Shemano Capital Management's violations of California Code of Regulations, title 10,  
21 section 260.241.3(a) and (j), the Department was unable to determine if Shemano Capital  
22 Management was in compliance with the net capital requirements under California Code of  
23 Regulations, title 10, section 260.237.1. Additionally, Shemano Capital Management violated  
24 California Code of Regulations, title 10, section 260.241.4(a), by failing to amend its application for  
25 an investment adviser certificate to contain true and accurate information, such as the location of its  
26 business records and the number and aggregate market value of the securities portfolios of Shemano  
27 Capital Management's clients managed on a discretionary basis.

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1           10.     On July 31, 2000, the Department sent Shemano Capital Management a regulatory  
2 letter providing written notice and instructing Shemano Capital Management to correct various  
3 violations discovered during the regulatory examination, which included violations of subdivisions  
4 (1), (2), (4), and (6) of California Code of Regulations, title 10, section 260.241.3(a), California  
5 Code of Regulations, title 10, section 260.241.3(j), and California Code of Regulations, title 10,  
6 section 260.241.4(a). The Department's letter notified Shemano Capital Management of the  
7 California Code of Regulations, title 10, section 260.241.4(a), requirement to amend Shemano  
8 Capital Management's application for a certificate to contain factually accurate information, and the  
9 California Code of Regulations, title 10, section 260.241.3, requirement to maintain books and  
10 records relating to the investment advisory business including the following:

- 11                   1. A general journal;
- 12                   2. General and auxiliary ledgers;
- 13                   3. Cash reconciliation of checking accounts;
- 14                   4. Trial balances; and
5. Computations of net capital and aggregate indebtedness.

15           11.     Moreover, from 1999 to 2002 the Department notified Shemano Capital  
16 Management in writing to pay the \$125 annual investment adviser's renewal fee to the  
17 Department. Shemano Capital Management ignored the Department's repeated requests for  
18 payment of the 2002 renewal fee required by Corporations Code section 25608 (q). On February  
19 15, 2002, as a result of Shemano Capital Management's non-payment of the \$125 fee, the  
20 Commissioner summarily revoked Shemano Capital Management's investment adviser  
21 certificate.

22           12.     On June 14, 2002, April 7, 2003, and April 20, 2004, Gary Shemano and  
23 Shemano Capital Management, in financial statements filed under penalty of perjury with the  
24 Department, falsely stated, "[t]he Company is a registered investment advisor in California." In  
25 doing so, Gary Shemano and Shemano Capital Management violated Corporations Code section  
26 25245, by making untrue statements of a material fact in Shemano Capital Management's  
27 financial statements filed with the Commissioner.

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1           13.     During a review of Shemano Capital Management in July 2003, the Department's  
2 examiner was not provided access to a general ledger and other records. The examiner determined  
3 that Shemano Capital Management had still not corrected the deficiencies of the books and records  
4 requirements found during the 2000 examination and continued to violate California Code of  
5 Regulations, title 10, section 260.241.3, subdivisions (a)(1), (a)(2), (a)(4), (a)(6) and (j), and  
6 California Code of Regulations, title 10, section 260.241.4(a), notwithstanding the fact that the  
7 Department informed Shemano Capital Management about them. Thus, Shemano Capital  
8 Management continued to fail to comply with these provisions as required by the securities law.

9           14.     Shemano Capital Management was notified in July 2003 of the above violations,  
10 and again of the Commissioner's revocation of the investment adviser's certificate during the  
11 Department's review. Shemano Capital Management has not surrendered its certificate to the  
12 Department pursuant to Corporations Code section 25244 and continues to act as an investment  
13 adviser without a license.

14           15.     Corporations Code section 25249 authorizes the Commissioner to issue an order  
15 directing any investment adviser to discontinue any violation of the Corporations Code and any  
16 rules promulgated thereunder. Specifically, Corporations Code section 25249 provides, in  
17 relevant part:

18                   If, after examination or investigation, the commissioner has reasonable  
19 grounds to believe that any . . . investment adviser has violated any law or  
20 rule binding upon it, the commissioner shall, by written order addressed to  
21 the . . . investment adviser direct the discontinuance of the violation. The  
order shall be effective immediately, but shall not become final except in  
accordance with the provisions of Section 25251.

22           16.     The procedure for issuance of orders pursuant to Corporations Code section 25249 is  
23 set forth in Corporations Code section 25251, which provides:

24                   (a) No order issued pursuant to Section 25249 or 25250 may become  
25 final except after notice to the affected broker-dealer or investment adviser  
26 of the commissioner's intention to make the order final and of the reasons  
27 for the finding. The commissioner shall also notify the broker-dealer or  
28 investment adviser that upon receiving a request the matter shall be set for  
hearing to commence within 15 business days after receipt of the request.

1 The broker-dealer or investment adviser may consent to have the hearing  
2 commence at a later date. If no hearing is requested within 30 days after  
3 the mailing or service of the required notice, and none is ordered by the  
4 commissioner, the order may become final without a hearing and the  
5 broker-dealer or investment adviser shall immediately discontinue the  
6 practices named in the order. If a hearing is requested or ordered, it shall  
7 be held in accordance with the provisions of the Administrative Procedure  
8 Act (Chapter 5 (commencing with Section 11500) of Part 1 of Division 3  
9 of 2 of the Government Code), and the commissioner shall have all of the  
10 powers granted under that act. If, upon the conclusion of the hearing, it  
11 appears to the commissioner that the broker-dealer or investment adviser  
12 is conducting business in an unsafe or injurious manner or is violating any  
13 law of this state or any rule binding upon it, the commissioner shall make  
14 the order of discontinuance final and the broker-dealer or investment  
15 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.

15 17. In April 2003 the Department wrote to Shemano Capital Management requesting  
16 information concerning its investment advisory activities. Again in July 2003 the Department  
17 inquired of Shemano Capital Management about its activities. Shemano Capital Management  
18 has not complied with the Department's requests and continues to violate the CSL requirements.

19  
20 18. Shemano Capital Management during relevant times violated the CSL and  
21 regulations thereunder, which justifies the issuance of an Order to Discontinue Violations.  
22 Shemano Capital Management, having applied for and secured an investment adviser certificate,  
23 is obligated to have knowledge of and comply with the provisions of the Corporations Code and  
24 the regulations thereunder to maintain its investment adviser certificate.

25 19. In summary by reason of the foregoing, Shemano Capital Management willfully  
26 violated the following provisions:

27 (1) Corporations Code 25241 by failing to maintain books and records;  
28

- 1 (2) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(1),
- 2 by failing to maintain journals;
- 3 (3) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(2),
- 4 by failing to maintain ledgers or provide the Department access to a general
- 5 ledger;
- 6 (4) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(4),
- 7 by failing to prepare and maintain cash reconciliations;
- 8 (5) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(6),
- 9 by failing to maintain and provide trial balances;
- 10 (6) California Code of Regulations, title 10, section 260.241.3, subdivision (j),
- 11 by failing to prepare monthly trial balances and monthly computations of
- 12 net capital and aggregate indebtedness;
- 13 (7) California Code of Regulations, title 10, section 260.241.4, subdivision (a),
- 14 by failing to amend Shemano Capital Management's application for an
- 15 investment adviser's certificate to contain true and accurate information;
- 16 (8) Corporations Code section 25244 by failing to surrender Shemano Capital
- 17 Management's investment adviser's certificate; and
- 18 (9) Corporations Code section 25245 by making untrue statements of
- 19 material facts in the financial statements filed with the
- 20 Commissioner by Shemano Capital Management.

21 Therefore, pursuant to Corporations Code section 25249 the Commissioner has issued an  
22 Order directing Shemano Capital Management to discontinue violating Corporations Code  
23 section 25241; subdivisions (1), (2), (4), and (6) of California Code of Regulations, title 10,  
24 section 260.241.3(a); California Code of Regulations, title 10, section 260.241.3(j); California  
25 Code of Regulations, title 10, section 260.241.4(a); Corporations Code sections 24244 and  
26 25245.

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WHEREFORE, good cause showing and pursuant to Corporations Code section 25251 the California Corporations Commissioner hereby notifies Shemano Capital Management of his intention to make final the "Order to Discontinue Violations Pursuant to Corporations Code Section 25249" issued October 22, 2004.

Dated: October 22, 2004  
San Francisco, California

WILLIAM P. WOOD  
California Corporations Commissioner

By: \_\_\_\_\_  
JOAN E. KERST  
Senior Corporations Counsel  
Enforcement and Legal Services Division

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12	THE CALIFORNIA CORPORATIONS	)	FILE NO. 925-2246
	COMMISSIONER,	)	
13		)	STATEMENT IN SUPPORT OF ORDER
		)	LEVYING ADMINISTRATIVE PENALTIES
14	Complainant,	)	PURSUANT TO CORPORATIONS CODE
	v.	)	SECTION 25252 AND CLAIM FOR
15		)	ANCILLARY RELIEF PURSUANT TO
	SHEMANO CAPITAL MANAGEMENT,	)	CORPORATIONS CODE SECTION 25254
16		)	
	Respondent.	)	
17		)	
18		)	

19 William P. Wood, the California Corporations Commissioner ("Commissioner") of the  
20 Department of Corporations ("Department"), alleges and charges as follows:

21 **INTRODUCTION AND JURISDICTION**

22 1. The Corporate Securities Law of 1968, set forth in Corporations Code<sup>1</sup> section  
23 25000 et seq., and California Code of Regulations, title 10, section 260.000 et seq., contain  
24 provisions that govern persons who operate in the securities industry. To ensure the protection  
25 of the public, the Legislature mandates that persons dealing in securities follow explicit legal  
26 requirements. The Commissioner gives effect to these legislative mandates by promulgating  
27

28 <sup>1</sup> Hereinafter the California Corporations Code will be referred to as Corporations Code.

1 comprehensive regulations to insure compliance with the Corporate Securities Law and by  
2 enforcing the Corporate Securities Law.

3 **FACTS**

4 2. On October 24, 1994, pursuant to Corporations Code section 25230, the  
5 Commissioner issued an investment adviser certificate to Shemano Capital Management, a  
6 California corporation. Although Shemano Capital Management's initial license application  
7 (File No. 925-2246) states its investment adviser business would be located at 580 California  
8 Street, Suite 2211, San Francisco, California, at all relevant times Shemano Capital  
9 Management's office was located at 601 California Street, 18<sup>th</sup> Floor, San Francisco, California  
10 94108, and it is unclear where its records are maintained. Gary J. Shemano is Shemano Capital  
11 Management's sole shareholder, officer and director. Gary Shemano and Shemano Capital  
12 Management manage their investment advisory clients' investment portfolios for a fee, have  
13 discretionary authority to purchase and sell securities directly for them and possess a power of  
14 attorney from them.

15 3. During 2000 the Department conducted a regulatory examination of Shemano  
16 Capital Management's investment adviser business, which revealed that Shemano Capital  
17 Management failed to keep true, accurate and current books or records at Shemano Capital  
18 Management's business offices. During relevant times Shemano Capital Management failed to  
19 maintain or provide journals and a general ledger, failed to reconcile bank accounts, and failed to  
20 prepare trial balances and compute net capital and aggregate indebtedness on a monthly basis.  
21 Shemano Capital Management also failed to amend the information in Shemano Capital  
22 Management's license application as required by law to contain true and accurate facts about its  
23 business, including the location of its business records. These failures of Shemano Capital  
24 Management prevented the Department from determining during its regulatory examination  
25 whether Shemano Capital Management fulfilled the legal requirements of the Corporate  
26 Securities Law and parallel regulations.

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4. Corporations Code section 25241 provides that investment advisers are required to maintain books and records to be examined by the Commissioner which, in relevant part, states:

Every investment adviser licensed under Section 25230 shall make and keep such accounts, correspondence, memoranda, papers, books, and other records and shall file such financial and other reports as the commissioner by rule requires, subject to the limitations of . . .

Section 222 of the Investment Advisers Act of 1940 with respect to investment advisers. All records so required shall be preserved for the time specified in the rule. All records referred to in this section are subject at any time and from time to time to such reasonable periodic, special, or other examinations by the commissioner, within or without this state, as the commissioner deems necessary or appropriate in the public interest or for the protection of investors.

5. Corporations Code section 25241, augmented by California Code of Regulations, title 10, section 260.241.3, identify the particular books and records that investment advisers are required to make and to keep current and accurate. Subdivisions (a)(1), (a)(2), (a)(4), and (a)(6) of California Code of Regulations, title 10, section 260.241.3, state:

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

- (1) A journal or journals, including cash receipts and disbursements records, and any other records of original entry forming the basis of entries in any ledger.
- (2) General and auxiliary ledgers (or other comparable records) reflecting asset, liability, reserve, capital, income and expense accounts . . .
- (4) All check books, bank statements, cancelled checks and cash reconciliations of the investment adviser . . .
- (6) All trial balances, financial statements, and internal audit working papers, relating to the business of such investment adviser.

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1           6.       Additionally, Corporations Code section 25237 authorizes the Commissioner to  
2 prescribe rules for investment advisers who have custody of the clients' securities or funds or  
3 who have any power of attorney from their clients to execute transactions. The Commissioner  
4 has done so by specifying, among other requirements, the minimum capital requirements such  
5 investment adviser must maintain. During relevant times herein subdivision (a)(2) of California  
6 Code of Regulations, title 10, section 260.237.1, stated:

7                   (a) No investment adviser who has any power of attorney from any  
8 investment advisory client to execute transactions . . .

9                               (2) If the investment adviser has any power of attorney from any  
10 investment advisory client to execute transactions and does not have  
11 regular or periodic custody or possession of any of its investment  
12 advisory clients' securities or funds, except the receipt of prepaid  
13 subscriptions for periodic publications, or other investment advisory  
14 services, it shall at all times have and maintain tangible net capital of  
15 not less than \$5,000.00.

16           7.       To verify compliance with the above-described capital requirements the  
17 Commissioner has imposed a specific bookkeeping obligation on investment advisers to maintain  
18 records to prove they possess the minimum capital. Subdivision (j) of California Code of  
19 Regulations, title 10, section 260.241.3, states:

20                   (j) Any investment adviser who is subject to the minimum capital  
21 requirements of Section 260.237.1 shall, in addition to the records  
22 otherwise required under this section, maintain a record of the proof of  
23 money balances of all ledger accounts in the form of trial balances and a  
24 record of the computations of net capitals and aggregate indebtedness  
25 pursuant to Section 260.237.1 of these rules (as of the trial balance date).  
26 The trial balances and computations shall be prepared currently at least  
27 once a month.

28           8.       Corporations Code section 25241 requires all books and records of a licensee to  
be subject at any time to examination by the Commissioner. Licensees are required to furnish  
the Commissioner true and accurate information about the location of their books and records.  
To insure licensees provide timely updates to the Department and, as a consequence to the  
public, the Commissioner has imposed a specific reporting obligation on investment advisers to

1 amend their respective application if, and when, changes occur. Licensees are under a duty to  
2 amend their application so that it contains current and accurate information in accordance with  
3 California Code of Regulations, title 10, section 260.241.4, which states:

4 (a) Each licensed broker-dealer and each licensed investment adviser  
5 shall, upon any change in the information contained in its application for a  
6 certificate (other than financial information contained therein) promptly  
7 file an amendment to such application setting forth the changed  
8 information (and in any event within 30 days after the change occurs).

9 9. In connection with the 2000 regulatory examination, the Department examiners  
10 found Shemano Capital Management did not maintain true and accurate journals in violation of  
11 California Code of Regulations, title 10, section 260.241.3(a)(1). Although Shemano Capital  
12 Management did provide some bank account statements, these were inadequate to suffice as a  
13 journal, lacking the generally accepted accounting principles of a double entry system for  
14 recording financial transactions. Shemano Capital Management did not provide the examiner  
15 with access to a general ledger in violation of California Code of Regulations, title 10, section,  
16 260.241.3(a)(2). Examiners determined that Shemano Capital Management did not maintain and  
17 prepare cash reconciliations by reconciling the cash balances on the bank statements to a general  
18 ledger account of Shemano Capital Management's financial transactions in violation of  
19 California Code of Regulations, title 10, section 260.241.3(a)(4). Examiners found that  
20 Shemano Capital Management failed to maintain and provide the trial balances as required in  
21 violation of California Code of Regulations, title 10, section 260.241.3(a)(6). Examiners  
22 determined that Shemano Capital Management had power of attorney and discretion to trade  
23 securities within customers' accounts, which required Shemano Capital Management to meet the  
24 capital requirements of California Code of Regulations, title 10, section 260.237.1, and to prove  
25 compliance with this requirement by maintaining records in accordance with California Code of  
26 Regulations, title 10, section 260.241.3(j). California Code of Regulations, title 10, section  
27 260.241.3(j), requires that Shemano Capital Management maintain trial balances and compute  
28 net capital and aggregate indebtedness on a monthly basis. Examiners found that Shemano  
Capital Management failed to prepare monthly trial balances and compute net capital and

1 aggregate indebtedness in violation of California Code of Regulations, title 10, section  
2 260.241.3(j). As a result of Shemano Capital Management's violations of California Code of  
3 Regulations, title 10, sections 260.241.3(a) and (j), the Department was unable to determine if  
4 Shemano Capital Management was in compliance with the net capital requirements under  
5 California Code of Regulations, title 10, section 260.237.1. Additionally, Shemano Capital  
6 Management violated California Code of Regulations, title 10, section 260.241.4, by failing to  
7 amend its application to include, but not limited to, necessary information, such as the location of  
8 its business records and the number and aggregate market value of the securities portfolios of  
9 Shemano Capital Management's clients managed on a discretionary basis.

10 10. On July 31, 2000, the Department sent Shemano Capital Management a  
11 regulatory letter providing written notice and instructing Shemano Capital Management to  
12 correct various violations discovered during the regulatory examination, which included  
13 violations of subdivisions (1), (2), (4), and (6) of California Code of Regulations, title 10, section  
14 260.241.3(a), California Code of Regulations, title 10, section 260.241.3(j), and California Code  
15 of Regulations, title 10, section 260.241.4. The Department's letter notified Shemano Capital  
16 Management of the California Code of Regulations, title 10, section 260.241.4, requirement to  
17 amend Shemano Capital Management's application for a certificate to contain factually accurate  
18 information, and the California Code of Regulations, title 10, section 260.241.3, requirement to  
19 maintain books and records relating to the investment advisory business. Specifically, the books  
20 and records Shemano Capital Management was required to maintain included the following:

- 21 1. A general journal;
- 22 2. General and auxiliary ledgers;
- 23 3. Cash reconciliation of checking accounts;
- 24 4. Trial balances; and
- 25 5. Computations of net capital and aggregate indebtedness.

26 11. Moreover, from 1999 to 2002 the Department notified Shemano Capital  
27 Management in writing to pay the \$125 annual investment adviser's renewal fee to the  
28 Department. Shemano Capital Management ignored the Department's repeated requests for

1 payment of the 2002 renewal fee required by Corporations Code section 25608 (q). On February  
2 15, 2002, as a result of Shemano Capital Management's non-payment of the \$125 fee, the  
3 Commissioner summarily revoked Shemano Capital Management's investment adviser  
4 certificate. On February 19, 2002, the Commissioner served Gary Shemano, Shemano Capital  
5 Management and Shemano Capital Management's Compliance Officer by certified mail with an  
6 Order Summarily Revoking Certificate ("Order") dated February 15, 2002, along with a  
7 transmittal letter for Shemano Capital Management's failure to pay the renewal fee of \$125.  
8 In addition, the Commissioner demanded the return of the investment adviser certificate issued to  
9 Shemano Capital Management pursuant to Corporations Code section 25244.

10 12. During a review of Shemano Capital Management during July 2003 the  
11 Department's examiner was not provided access to a general ledger and other records. The  
12 examiner determined that Shemano Capital Management had still not corrected the deficiencies  
13 of the books and records requirements found during the 2000 examination and continued to  
14 violate California Code of Regulations, title 10, section 260.241.3, subdivisions (a)(1), (a)(2),  
15 (a)(4), (a)(6) and (j), and California Code of Regulations, title 10, section 260.241.4,  
16 notwithstanding the fact that the Department informed Shemano Capital Management about  
17 them. The examiners also determined that Shemano Capital Management during 2002, 2003 and  
18 2004 continued to act as an investment adviser, but without a license or certificate to do so.  
19 Shemano Capital Management is actively engaged in the business of managing security  
20 portfolios of investment advisory clients, including Golden Gate Partners, L.P., ("GGP"), by  
21 advising them about the value of securities or as to the advisability of investing in, purchasing or  
22 selling securities. In exchange for these investment advisory services Shemano Capital  
23 Management receives a management fee as compensation. Thus, Shemano Capital Management  
24 continued to fail to comply with Corporate Securities Law provisions as required by law.

25 13. Corporations Code section 25230 prohibits an "investment adviser," as defined in  
26 Corporations Code section 25009, from conducting business as an investment adviser in this  
27 State unless the investment adviser has a certificate, then in effect, from the Commissioner.  
28 Corporations Code section 25230, in relevant part, states:

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(a) It is unlawful for any investment adviser to conduct business as an investment adviser in this state unless the investment adviser has first applied for and secured from the commissioner a certificate, then in effect, authorizing the investment adviser to do so . . .

14. Shemano Capital Management was notified in July 2003 of the above violations, and again of the Commissioner's revocation of the investment adviser's certificate during the Department's review. Shemano Capital Management has not surrendered its certificate to the Department pursuant to Corporations Code section 25244, and Gary Shemano and Shemano Capital Management have violated Corporations Code section 25244. Gary Shemano and Shemano Capital Management continue to act as an investment adviser without a license in violation of Corporations Code section 25230.

15. Corporations Code section 25245, states:

It is unlawful for any person willfully to make any untrue statement of a material fact in any application, notice, or report filed with the commissioner under this part, or willfully to omit to state in any such application, notice, or report any material fact which is required to be stated therein.

16. On June 14, 2002, April 7, 2003, and April 20, 2004, Gary Shemano and Shemano Capital Management, in financial statements filed under penalty of perjury with the Department, falsely represented Shemano Capital Management as "a registered investment advisor in California." Thus, Gary Shemano and Shemano Capital Management also violated Corporations Code section 25245, by making untrue statements of a material fact in Shemano Capital Management's reports filed with the Commissioner.

17. In addition to the above-identified violations, Gary Shemano and Shemano Capital Management violated Corporations Code section 25235, which states:

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

(a) To employ any device, scheme, or artifice to defraud any client or prospective client.

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

1 Gary Shemano and Shemano Capital Management used an artifice or course of business to  
2 defraud clients and prospective clients by referring to their experience in the securities industry,  
3 but never disclosing the revocation by the Commissioner that prohibited Shemano Capital  
4 Management from acting as an investment adviser. Gary Shemano and Shemano Capital  
5 Management managed the securities portfolios of senior citizens, IRA account(s) and/or  
6 retirement funds of clients without disclosing to them that Shemano Capital Management was  
7 unlicensed. Shemano Capital Management continued to act as an investment adviser after being  
8 ordered to cease such activities, willfully violating Corporations Code sections 25230 and 25244,  
9 and the Commissioner's Revocation Order. Thus, Gary Shemano and Shemano Capital  
10 Management violated Corporations Code section 25235.

11 18. Gary Shemano formed GGP, for the purpose of investing in securities. Shemano  
12 Capital Management is the general partner of GGP and acted as the investment adviser for GGP.  
13 Gary Shemano or Shemano Capital Management offered and sold limited partnership interests in  
14 GGP to potential investors, which Gary Shemano described as "a 'fund of funds' and a 'brain trust'  
15 of some of the finest hedge fund managers available." From 1994 and continuing thereafter, Gary  
16 Shemano and Shemano Capital Management offered or sold limited partnership interests to  
17 investors. The limited partnership interests of GGP offered and sold by Gary Shemano and  
18 Shemano Capital Management are securities. Gary Shemano through Shemano Capital  
19 Management manages GGP's investment portfolio and has authority to purchase and sell  
20 securities directly on behalf of GGP. The investments Gary Shemano and Shemano Capital  
21 Management bought and sold for the investment account of GGP are securities.

22 19. The Corporate Securities Law prohibits misrepresentations and omissions of  
23 material facts in connection with securities transactions. Corporations Code section 25401, states:

24 It is unlawful for any person to offer or sell a security in this state or buy  
25 or offer to buy a security in this state by means of any written or oral  
26 communication which includes an untrue statement of a material fact or  
27 omits to state a material fact necessary in order to make the statements  
made, in light of the circumstances under which they were made, not  
misleading.

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1           20. Gary Shemano or Shemano Capital Management made, or caused to be made,  
2 misrepresentations and omissions of material facts in connection with the offer or sale of a  
3 security or the offer to buy a security as follows.

4           a. The misrepresentations of material facts include:

5                       Shemano Capital Management was registered with the State of  
6                       California as an investment adviser;

7           b. The omissions of material facts include:

8                       (1) Shemano Capital Management failed to maintain the books  
9                       and records required by California law to be kept by an  
10                      investment adviser;

11                     (2) Shemano Capital Management and Gary Shemano failed to  
12                      amend its application to contain accurate and true information;

13                     (3) Shemano Capital Management and Gary Shemano had not  
14                      paid the required 2002 renewal fee for its investment adviser's  
15                      license;

16                     (4) Shemano Capital Management's investment adviser license  
17                      had been revoked by the Commissioner on February 15,  
18                      2002;

19                     (5) Shemano Capital Management and Gary Shemano failed to  
20                      surrender the investment adviser certificate to the  
21                      Commissioner as required;

22                     (6) Shemano Capital Management operated as an unlicensed investment  
23                      adviser; and

24                     (7) Shemano Capital Management and Gary Shemano were receiving a  
25                      percentage of investors' funds as compensation for unlicensed  
26                      activities.

27           As enumerated above, Shemano Capital Management or Gary Shemano made multiple  
28           misrepresentations and/or omissions of material facts prohibited by the Corporate Securities Law.  
          Thus, Shemano Capital Management and/or Gary Shemano violated Corporations Code section  
          25401.

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1           21.     Shemano Capital Management and Gary Shemano violated the Corporate  
2 Securities Law and regulations thereunder, which justifies the issuance of an order levying  
3 administrative penalties. Shemano Capital Management, having applied for and secured an  
4 investment adviser certificate, is obligated to have knowledge of and comply with the provisions  
5 of the Corporate Securities Law and regulations. Gary Shemano, a licensed securities  
6 professional who has been operating in the securities industry for many years, is also obligated to  
7 have knowledge of and comply with provisions of the Corporate Securities Law and regulations.

8           22.     Corporations Code section 25252 authorizes the Commissioner to issue  
9 an order levying administrative penalties against any investment adviser for willful violations of  
10 any provisions of the Corporate Securities Law and any rules promulgated thereunder.

11 Corporations Code section 25252 provides, in relevant part:

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

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

22                     (d) The administrative penalties available to the commissioner  
23                     pursuant to this section are not exclusive, and may be sought and  
24                     employed in any combination with civil, criminal, and other  
25                     administrative remedies deemed advisable by the commissioner to  
26                     enforce the provisions of this division.

27           23.     Shemano Capital Management's clients are entitled to relief, including restitution for  
28 payment of the investment advisory fees paid to Shemano Capital Management in 2002, 2003 and  
2004, and other ancillary relief, pursuant to Corporations Code section 25254. Shemano Capital  
Management's clients are entitled to recover the loss of their principal and receive interest at the  
legal rate during 2002, 2003 and 2004, and receive compensation for any other damages that  
occurred when Shemano Capital Management was acting as an unlicensed investment adviser.



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24. Corporations Code section 25254, in pertinent part, states:

(a) If the commissioner determines it is in the public interest, the commissioner may include in any administrative action brought under this part a claim for ancillary relief, including, but not limited to, a claim for restitution or disgorgement or damages on behalf of the persons injured by the act or practice constituting the subject matter of the action, and the administrative law judge shall have jurisdiction to award additional relief.

(b) In an administrative action brought under this part, the commissioner is entitled to recover costs, which in the discretion of the administrative law judge may include an amount representing reasonable attorney's fees and investigative expenses for the services rendered, for deposit into the State Corporations Fund for the use of the Department of Corporations.

25. In summary by reason of the foregoing, Shemano Capital Management and Gary Shemano willfully violated the following provisions:

- (1) Corporations Code 25241 by failing to maintain books and records;
- (2) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(1), by failing to maintain journals;
- (3) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(2), by failing to maintain ledgers or provide the Department access to a general ledger;
- (4) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(4), by failing to prepare and maintain cash reconciliations;
- (5) California Code of Regulations, title 10, section 260.241.3, subdivision (a)(6), by failing to maintain and provide trial balances;
- (6) California Code of Regulations, title 10, section 260.241.3, subdivision (j), by failing to prepare monthly trial balances and monthly computations of net capital and aggregate indebtedness;
- (7) California Code of Regulations, title 10, section 260.241.4, subdivision (a), by failing to amend Shemano Capital Management's application for an investment adviser's certificate to contain true and accurate information;

- 1 (8) Corporations Code section 25244 by failing to surrender Shemano Capital
- 2 Management's investment adviser's certificate;
- 3 (9) Corporations Code section 25245 by making untrue statements of
- 4 material facts in the financial statements filed with the
- 5 Commissioner by Shemano Capital Management
- 6 (10) Corporations Code section 25230 by conducting
- 7 business as an investment adviser without a certificate, then in
- 8 effect, from the Commissioner; and
- 9 (11) Corporations Code section 25235 by using an artifice or
- 10 course of business to defraud clients and prospective clients.

11 **PRAYER**

12 **WHEREFORE**, good cause showing, pursuant to Corporations Code section 25252 the  
13 California Corporations Commissioner prays for an Order Levying Administrative Penalties  
14 against Respondents, Shemano Capital Management and Gary Shemano, as follows:

15 1. That pursuant to Corporations Code section 25252 the Commissioner  
16 levy administrative penalties in the amount of \$750 for each of Shemano Capital Management's  
17 books and records violations including:

- 18 Corporations Code section 25241;
- 19 California Code of Regulations, title 10, section 260.241.3(a), subdivision (1);
- 20 California Code of Regulations, title 10, section 260.241.3(a), subdivision (2);
- 21 California Code of Regulations, title 10, section 260.241.3(a), subdivision (4);
- 22 California Code of Regulations, title 10, section 260.241.3(a), subdivision (6); and
- 23 California Code of Regulations, title 10, section 260.241.3(j).

24 2. That pursuant to Corporations Code section 25252 the Commissioner  
25 levy administrative penalties for violation of California Code of Regulations, title 10, section  
26 260.241.4, subdivision (a), in the amount of \$1,250.

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1           3.       That pursuant to Corporations Code section 25252 the Commissioner levy  
2 administrative penalties for violation of Corporations Code section 25230, in the amount of  
3 \$2,500 for each of at least four (4) instances and \$2,500 for each additional instance of  
4 unlicensed activity according to proof.

5           4.       That pursuant to Corporations Code section 25252 the  
6 Commissioner levy administrative penalties for violation of Corporations Code section  
7 25235, in the amount of \$5,000 for each of at least three (3) instances of using an artifice or  
8 course of business to defraud a client or prospective client.

9           5.       That pursuant to Corporations Code section 25252 the Commissioner  
10 levy administrative penalties for violation of Corporations Code section 25244, in the amount of  
11 \$1,500.

12           6.       That pursuant to Corporations Code section 25252 the Commissioner  
13 levy administrative penalties for violation of Corporations Code section 25245, in the amount of  
14 \$5,000 for each of the three (3) false statements filed with the Commissioner.

15           7.       That pursuant to Corporations Code section 25252 the Commissioner levy  
16 administrative penalties for violation of Corporations Code section 25401, in the amount of  
17 \$5,000 for each of at least three (3) instances of an untrue statement or omission of material fact.

18           **WHEREFORE**, good cause showing, pursuant to Corporations Code section 25254 the  
19 Commissioner hereby prays for an order of ancillary relief against Shemano Capital  
20 Management and Gary Shemano consisting of:

21                   (1) disgorgement of management fees received by Shemano  
22                   Capital Management and Gary Shemano while operating as an  
23                   unlicensed investment adviser during 2002, 2003 and 2004 in an  
                    amount of at least \$7,865, or more according to proof;

24                   (2) restitution to clients/investors for the loss of principal in the  
25                   amount of at least \$50,952, or more according to proof, and  
26                   interest in the amount of at least \$87,253.20, or more according to  
27                   proof, during the time Shemano Capital Management and Gary  
28                   Shemano were operating as an unlicensed investment adviser; and

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(3) recovery of costs, investigative expenses and attorney's fees in an amount of at least \$15,000.

Dated: October 22, 2004  
San Francisco, California

WILLIAM P. WOOD  
California Corporations Commissioner

By: \_\_\_\_\_  
JOAN E. KERST  
Senior Corporations Counsel  
Enforcement and Legal Services Division