

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 6398 / September 5, 2023**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-21607**

**In the Matter of**

**Bluestone Capital  
Management, LLC**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 203(e) AND  
203(k) OF THE INVESTMENT ADVISERS  
ACT OF 1940, MAKING FINDINGS, AND  
IMPOSING REMEDIAL SANCTIONS AND  
A CEASE-AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Bluestone Capital Management, LLC (“Bluestone” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### **Summary**

1. Bluestone, a registered investment adviser, is an investment adviser to private funds. This matter concerns Bluestone's violations of the federal securities laws in connection with the financial statement audits of a private fund that Bluestone advised. Bluestone failed to have the required audits performed and timely distribute annual audited financial statements prepared in accordance with Generally Accepted Accounting Principles ("GAAP") to investors in a private fund that it advised. In addition, Bluestone did not properly describe the status of its fund's financial statement audits when filing its Forms ADV and did not update certain responses in its Form ADV annual updating amendments for multiple years as required by the Form ADV instructions. These failures resulted in violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, commonly referred to as the "custody rule," and Section 204(a) and Rule 204-1(a) thereunder, which required Bluestone to update certain information about Bluestone's private fund audits in its Forms ADV.

#### **Respondent**

2. Bluestone Capital Management, LLC is a Pennsylvania limited liability company with its principal place of business in Wayne, Pennsylvania. Bluestone has been registered with the Commission as an investment adviser since February 25, 2013. On its Form ADV dated March 29, 2023, Bluestone reported that it had approximately \$243 million in regulatory assets under management, including approximately \$45 million managed in pooled investment vehicles.

#### **Other Relevant Entities**

3. The AALII Fund, LP ("AALII Fund") is a private fund formed as a limited partnership. At all relevant times, AALII Capital, LLC, an entity under common control with Bluestone, was the general partner of the AALII Fund. Bluestone has been the investment adviser to the AALII Fund since April 2013.

#### **Bluestone Failed to Obtain and Distribute Required Audited Financial Statements**

4. The custody rule requires that registered investment advisers who have custody of client funds or securities implement an enumerated set of requirements to prevent the loss, misuse, or misappropriation of those assets.

5. An investment adviser has custody of client assets if it holds, directly or indirectly, client funds or securities, or if it has the authority to obtain possession of those assets. *See*

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

Advisers Act Rule 206(4)-2(d)(2). A related person of Bluestone has served as the managing member or general partner of the AALII Fund at all relevant times, and has had the authority to make decisions for, and act on behalf of, the AALII Fund. Bluestone is therefore deemed to have custody of the AALII Fund's assets as defined in Advisers Act Rule 206(4)-2.

6. An investment adviser with custody of client assets must, among other things: (i) ensure that a qualified custodian maintains the client assets; (ii) notify the client in writing of accounts opened by the adviser at a qualified custodian on the client's behalf; (iii) have a reasonable basis for believing that the qualified custodian sends account statements at least quarterly to clients, except if the client is a limited partnership or limited liability company for which the adviser or a related person is a general partner or managing member, the account statements must be sent to each limited partner or member; and (iv) ensure that client funds and securities are verified by actual examination each year by an independent public accountant at a time chosen by the accountant without prior notice or announcement to the adviser. *See* Advisers Act Rule 206(4)-2(a)(1)-(5).

7. The custody rule provides an alternative to complying with the requirements of Advisers Act Rule 206(4)-2(a)(2), (3) and (4) for investment advisers to limited partnerships, limited liability companies, or other types of pooled investment vehicles. The custody rule provides that an investment adviser "shall be deemed to have complied with" the independent verification requirement and is not required to satisfy the notification and account statements delivery requirements with respect to a fund if the fund is subject to audit at least annually and "distributes [the fund's] audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners . . . within 120 days of the end of [the fund's] fiscal year" ("Audited Financials Alternative"). *See* Advisers Act Rule 206(4)-2(b)(4). The accountant performing the audit must be an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board ("PCAOB"). *See* Advisers Act Rule 206(4)-2(b)(4)(ii). An investment adviser to a limited partnership that fails to meet the requirements of the Audited Financials Alternative to timely distribute audited financial statements prepared in accordance with GAAP would need to satisfy all of the requirements of Rule 206(4)-2(a)(2)-(4) to avoid violating the custody rule.

8. In 2018 through 2021, with respect to the AALII Fund, Bluestone purported to rely on the Audited Financials Alternative to comply with the custody rule, but Bluestone failed to have the required audits performed, and, thus, the audited financial statements for those years were never delivered to the AALII Fund's limited partners. Accordingly, Bluestone did not satisfy the requirements of the Audited Financials Alternative in Rule 206(4)-2(b)(4) for the AALII Fund. It was therefore obligated to comply with Advisers Act Rule 206(4)-2(a)(2), (3) and (4), which Bluestone also failed to do.

**Bluestone Failed to Amend Information  
In Its Forms ADV Concerning Private Fund Audits**

9. Item 7.B of Form ADV, Part 1A requires an investment adviser to state whether it is an adviser to any private fund. In that case, the adviser must also complete Section 7.B.(1) of Form ADV, Part 1A, Schedule D.

10. Section 7.B.23.(a) requires an investment adviser to disclose information for each private fund managed by the adviser, including: (i) whether the private fund's financial statements are subject to an annual audit (Section 7.B.23.(a)(1)); (ii) whether those financial statements, if annually audited, are prepared in accordance with GAAP (Section 7.B.23.(a)(2)); (iii) an identification of the auditing firm and whether the firm is an independent public accountant registered with the PCAOB that is subject to the PCAOB's regular inspection (Section 7.B.23.(a), (b), (d), (e), and (f)); and (iv) whether the private fund's audited financial statements for the most recently completed fiscal year have been distributed to fund investors (Section 7.B.23.(g)).

11. Section 204(a) of the Advisers Act and Rule 204-1(a) thereunder require a registered investment adviser to amend its Form ADV at least annually, and more frequently as required by the instructions to Form ADV. According to those instructions, an adviser must amend its Form ADV each year by filing an annual updating amendment within 90 days after the end of its fiscal year. When an adviser submits its annual updating amendment, it must update its Form ADV, including its responses to all items in Part 1A and Schedule D.

12. In its Form ADV filing dated March 30, 2017, Part 1A, Schedule D, Section 7.B (1), with respect to the AALII Fund, Bluestone answered "Yes" to the question in paragraph 23(a)(1) "Are the private fund's financial statements subject to an annual audit," and "Yes" to the question in paragraph 23(g) "Are the private fund's audited financial statements for the most recently completed fiscal year distributed to the private fund's investors?" Bluestone also provided auditor information in response to Section 7.B.23(b) through 7.B.23(f). The following years, when it filed its annual updating amendments on March 28, 2018, March 26, 2019, March 27, 2020, March 29, 2021, and March 27, 2022, respectively, Bluestone did not update and amend these responses even though the AALII Fund's financial statements were no longer subject to an annual audit and audited financial statements were no longer distributed to the AALII Fund's limited partners. Accordingly, in 2019, 2020, 2021, and 2022, Bluestone failed to update and amend these responses in the Forms ADV as required by the instructions.

**Violations**

13. As a result of the conduct described above, Bluestone willfully<sup>2</sup> violated Sections 204(a) and 206(4) of the Advisers Act and Rules 204-1(a) and 206(4)-2 thereunder.

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<sup>2</sup> "Willfully," for purposes of imposing relief under Section 203(e) of the Advisers Act "means no more than that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). The decision in *The Robare Group, Ltd. v. SEC*, which construed the term "willfully" for purposes of a differently structured statutory provision,

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Bluestone's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 204(a) and 206(4) of the Advisers Act and Rules 204-1(a) and 206(4)-2 thereunder.

B. Respondent is censured.

C. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$75,000 to the Commission for transfer to the general fund of the United States Treasury, subject to the Securities Exchange Act of 1934 Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Bluestone as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Nikolay Vydashenko, Assistant

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does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has "willfully omit[ted]" material information from a required disclosure in violation of Section 207 of the Advisers Act).

Regional Director, Fort Worth Regional Office, Securities and Exchange Commission, 1801  
Cherry Street, Suite 1900, Unit 18, Fort Worth, Texas 76102.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman  
Secretary