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12 SUPERIOR COURT OF CALIFORNIA  
13 COUNTY OF SAN FRANCISCO  
14

15 Consolidated Management Group, LLC, a  
16 Kansas limited liability company, Consolidated  
Leasing Anadarko Joint Venture, a Kansas  
17 general partnership, and Consolidated Leasing  
18 Hugoton Joint Venture #2, a Kansas general  
partnership

19 Petitioners,

20 vs.

21 CALIFORNIA DEPARTMENT OF  
22 CORPORATIONS,

23 Respondent.  
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28

) Case No. CPF-06-506669

) Unlimited Civil Case

) **OPPOSITION OF RESPONDENT  
DEPARTMENT OF CORPORATIONS TO  
PETITIONERS' MOTION FOR WRIT OF  
ADMINISTRATIVE MANDATE**

) Original Hearing Date: October 31, 2006

) Hearing Date on Writ Petition: Dec. 1, 2006  
Time: 9:30 a.m.

) Dept: 301

) Judge: The Honorable Peter J. Busch

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1 Respondent, PRESTON DuFAUCHARD acting in his official capacity as California  
2 Department of Corporations Commissioner and on behalf of the Department of Corporations,  
3 provides this Opposition to the Petitioners' Memorandum of Points and Authorities in Support of  
4 Petition for Writ of Administrative Mandate.

### 5 I. INTRODUCTION

6 The California Commissioner of Corporations, Preston DuFauchard, and the California  
7 Department of Corporations (collectively "Department of Corporations" or "Department") requests  
8 that this court uphold the findings of the Administrative Law Judge ("ALJ") of the Office of  
9 Administrative Hearings who after a two day hearing on the merits and the live testimony of  
10 witnesses concluded in favor of the Department of Corporations and against Petitioners based on  
11 findings that Petitioners violated the corporate securities laws and requirements of the exemptions  
12 claimed.

13 The dispute between the parties pits form against substance. Petitioners assert that they have  
14 performed all the formal requirements to make a private offering of securities in California. They  
15 contend that because they filed the appropriate forms with the federal and state regulators, the  
16 securities offering they make is exempt from federal and state registration, and that the Department  
17 of Corporations has no authority to question the exemption because federal law, specifically the  
18 National Securities Marketing Act of 1996 ("NSMIA"), preempts the state regulator from doing so.  
19 Petitioners argue in the alternative that the investment interests they offered for sale were not  
20 securities.

21 The Department of Corporations contends that although Petitioners have filed the appropriate  
22 documents related to an exemption from qualification, they failed to conform their conduct in  
23 marketing these securities to the terms required by the exemption; they made a public offering of  
24 unqualified securities instead of limiting themselves to the strictures of a private offering. Since  
25 Petitioners conduct caused the securities to lose the private offering exemption, they lost the  
26 preemption that NSMIA affords to those who conform to exemption requirements, and the  
27 Department of Corporations issued an order requiring plaintiffs to "Desist and Refrain" from  
28 marketing the unqualified securities they were offering.



1 129:1-24). When someone attending the luncheon expressed an interest in possibly investing in a  
2 joint venture they were mailed an offering packet, similar to the offering materials mailed to  
3 investigator Jon Wroten that included a CIM. (Keegan testimony, transcr. p.130:5-22). (The CIMs  
4 are the Department's Exhibit E found at DOC00075-00106 as to Anadarko J.V., and Respondents  
5 Exhibit 5 found at DOC00233-00264 as to Hugoton J.V.)

6 Therefore, the Department determined that the Petitioners were violating the terms of the  
7 Regulation D exemption and were making offers that were within the jurisdiction of state regulation.  
8 On January 23, 2006, the Commissioner issued a Desist and Refrain Order ("D&R") to Kenneth W.  
9 Keegan, Faber Lane Johnston, Brandon Taylor, Guardian Capital Management, Consolidated  
10 Management Group, LLC, Consolidated Leasing Anadarko Joint Venture, and Consolidated Leasing  
11 Hugoton Joint Venture #2. (DOC00020-00023) The D&R alleged violations of the California  
12 Corporations Code, sections 25110 and 25210. These violations were alleged because plaintiffs  
13 were not licensed to sell securities with the Department and, because of their general solicitations  
14 and advertisements, they failed to qualify for the Regulation D exemption from registration.

15 Petitioners requested an administrative hearing on the Order. Initially Guardian Capital  
16 Management, Kenneth Keegan, Faber Johnston, and Brandon Taylor requested a hearing as well, but  
17 their request was withdrawn on March 2, 2006 (DOC00560). A two day hearing on the merits of the  
18 case occurred on March 6-7, 2006. The Administrative Law Judge issued his proposed Decision,  
19 (DOC0001-00016) which was adopted by the Commissioner and became effective July 20, 2006  
20 (DOC00017).

21 Prior to filing their petition for writ of mandate in this court, on July 7, 2006 Petitioners filed  
22 an action for injunction and declaratory relief in USDC Northern District of California, Case No.  
23 C06 4203 JSW. In their federal action Petitioners alleged in the first paragraph of their Verified  
24 Complaint (found in Exhibit C to the declaration of Petitioners' attorney Joel Held filed in this  
25 instant action) that "Abstention from jurisdiction under Younger v. Harris (1971) 401 U.S. 37 is not  
26 appropriate in this case (the federal case), because it is 'readily apparent' that the Commissioner's  
27 actions in issuing the D&R are preempted by NSMIA, and, therefore, 'no significant state interest  
28 (would be) served' by abstention." On July 27, 2006 the Commissioner filed a Motion to Dismiss

1 the Complaint in the federal action based in part on the principle of abstention found in Younger v.  
2 Harris. (Petitioners have provided this court with copies of the briefs they filed with the federal  
3 court, and so the Department has provided through the declaration of Edward Kelly Shinnick copies  
4 of its own briefs, specifically the Motion to Dismiss, Reply to Consolidated's Opposition, and  
5 Opposition to Consolidated's Motion for Preliminary Injunction).

6 On September 20, 2006 District Judge Jeffrey S. White granted the Department's Motion to  
7 Dismiss based on the abstention doctrine and stated in his published opinion: "The Court finds that  
8 the ability of the state's regulatory commission to investigate and possibly regulate issuers of  
9 securities who are in violation of federal and state regulation qualifies as an important state  
10 interest....It is not readily apparent from the pleadings submitted in this matter, or the authority  
11 offered to the Court, that the state's conduct was explicitly preempted by federal law....There is no  
12 dispute that the California state courts may address the issues presented in this action...."

13 Consolidated vs. Preston DuFauchard 2006 U.S. Dist. LEXIS 71111.

### 14 III. STANDARD OF REVIEW

15 Code of Civil Procedure section 1094.5 provides the standard of review of the findings of a  
16 state agency. Aside from questions concerning whether the state agency acted in excess of its  
17 jurisdiction and whether there was a fair trial, the applicable standard of review is whether there was  
18 any prejudicial abuse of discretion. Such abuse findings can only be established if the court  
19 determines that the findings are not supported by substantial evidence, which has been defined as  
20 relevant evidence that a reasonable mind might accept as adequate to support a conclusion,  
21 California Youth Authority v. State Personnel Board (2002) 104 Cal.App.4<sup>th</sup> 575, or as "evidence of  
22 ponderable legal significance...reasonable in nature, credible, and of solid value." Young v. Gannon  
23 (2002) 97 Cal.App.4<sup>th</sup> 209,225. In an appropriate case, the testimony of a single witness may be  
24 sufficient. Duncan v. Department of Personnel Admin. (2000) 77 Cal.App.4<sup>th</sup> 1166.

25 The Petitioners have the burden of demonstrating that the agency's findings are not  
26 supported by substantial evidence. Young, supra, at 225. The reviewing court is to apply a strong  
27 presumption that the agency's findings are correct. Norris v. State Personnel Bd. (1985) 174  
28 Cal.App.3d 393,396; Desmond v. County of Contra Costa (1993) 21 Cal.App.4<sup>th</sup> 330, 335.

1 Consolidated tries to claim that this court should review the entire record de novo,  
2 misconstruing the California Supreme Court in Bixby v Pierno (1971) 4 Cal.3d 130. In Bixby the  
3 Supreme Court pointed out that there are two types of judicial review of administrative decisions, the  
4 substantial evidence review and the independent judgment review. The Court provided that  
5 independent examination is appropriate only when a "fundamental vested right of the individual" is  
6 affected, such as the right to continue to practice one's trade or profession. (at page 144-145) The  
7 Bixby Court wrote as follows:

8 ".....(T)he courts in (a) case-by-case analysis consider the nature of the right of the  
9 individual: whether it is a fundamental and basic one, which will suffer substantial  
10 interference by the action of the administrative agency, and, if it is such a fundamental right,  
11 whether it is possessed by, and vested in, the individual or merely sought by him. In the latter  
12 case, since the administrative agency must engage in the delicate task of determining whether  
13 the individual qualifies for the sought right, the courts have deferred to the administrative  
14 expertise of the agency. If, however, the right has been acquired by the individual, and if the  
15 right is fundamental, the courts have held the loss of it is sufficiently vital to the individual to  
16 compel a full and independent review.... In determining whether the right is fundamental the  
17 courts do not alone weigh the economic aspect of it, but the effect of it in human terms and  
18 the importance of it to the individual in the life situation. This approach finds its application  
19 in such an instance as the opportunity to continue the practice of one's trade or profession...  
20 'The right to practice one's profession is sufficiently precious to surround it with a panoply of  
21 legal protection.' (Citation.) In Meyer v. Nebraska (1923) 262 U.S. 390, 399.... the United  
22 States Supreme Court listed the right of the individual "to engage in any of the common  
23 occupations of life" as one of several fundamental liberties, which also include the right of  
24 the individual "to acquire useful knowledge, to marry, establish a home and bring up  
25 children, to worship God according to the dictates of his own conscience, and generally to  
26 enjoy those privileges long recognized at common law as essential to the orderly pursuit of  
27 happiness by free men.' (Citations.)" (at pp. 144-145)

28 Independent review is not appropriate here. By no stretch of the imagination can  
29 Consolidated's alleged interest in being free from state regulation of non-exempt offers and sales of  
30 securities be considered a fundamental vested right.

#### 31 **IV. ARGUMENT AND AUTHORITIES**

##### 32 **A. The D&R Order was Properly Issued under Corporations Code section 25532**

33 California Corporations Code ("CC") section 25110 provides that "it is unlawful for any  
34 person to offer or sell in this state any security in an issuer transaction... unless such sale has been  
35 qualified ... or unless such security or transaction is exempted...." California exempts various  
36 transactions from the requirement of qualification; Consolidated is claiming its exemption under CC

1 section 25102.1.

2 Corporations Code section 25102.1 was last amended in 1998 shortly after NSMIA was  
3 enacted to dovetail with the conditions of NSMIA. CC section 25102.1 provides in pertinent part:  
4 "The following transactions are not subject to Sections 25110....(d) Any offer or sale of a security  
5 with respect to a transaction that is exempt from registration under the Securities Act of 1933  
6 pursuant to Section 18(b)(4)(D) of that act...." (Emphasis added.) CC section 25102.1 goes on to  
7 also require the filing of a copy of the completed Form D filed with the SEC, a consent to service of  
8 process, and a \$300 filing fee. Ignoring the language of the statute that does not support its  
9 distorted interpretation, Consolidated argues that under CC section 25102.1 there is nothing  
10 California can do about improper solicitations in its state, so long as someone claiming a 506  
11 exemption has filed notice that they are claiming that exemption and paid a filing fee. It is absurd to  
12 suggest that California would waive enforcement powers as to all those who improperly claim that  
13 their activities would comply with the law. The statute's express language is that the offer or sale  
14 must be one that "is exempt" under the federal Securities Act, not one that merely claims it is  
15 exempt.

16 The Commissioner has authority to issue the D&R Order under CC section 25532(a) that  
17 provides as follows:

18 "(a) If in the opinion of the commissioner, (1) the sale of a security is subject to  
19 qualification under this law and it is being or has been offered or sold without first being  
20 qualified, the commissioner may order the issuer or offeror of the security to desist and  
21 refrain from the further offer or sale of the security until qualification has been made  
22 under this law or (2) the sale of a security is subject to the requirements of *Section*  
23 *25100.1, 25101.1, or 25102.1* and the security is being or has been offered or sold  
*without first meeting the requirements of those sections*, the commissioner may order  
the issuer or offeror of that security to desist and refrain from the further offer or sale of  
the security until those requirements have been met." (Emphasis added.)

24 **B. The ALJ Correctly Concluded that He was not Authorized to Rule on the Issue of**  
25 **NSMIA Preemption**

26 Consolidated has misconstrued the basis for the ALJ's denial of Consolidated's motion  
27 entitled "Motion to Dismiss Based on Preemption and Lack of Authority" wherein they argued that  
28 NSMIA preempts state enforcement authority over their activities (DOC 00516-00523). The ALJ

1 correctly denied the motion, not on preemption grounds, but on the grounds that as part of an  
 2 administrative agency he is prohibited by the California Constitution from determining that the  
 3 scope of NSMIA's preemption prohibits this Department from pursuing an enforcement action  
 4 authorized by California law. An exception allowed by the Constitution occurs when an appellate  
 5 court has determined that there is such preemption, but as the ALJ notes no California appellate  
 6 court has so ruled.

7 In demonstrating the basis for his determination that the D&R Order is enforceable, the ALJ  
 8 cites and quotes CC section 25102.1(d). This code section, as discussed above, provides a California  
 9 exemption with notice filing *if* the offers are exempt under federal law. The ALJ correctly found  
 10 that the Petitioners engaged in non-exempt general solicitations as defined by federal law and upheld  
 11 the D&R Order under CC sections 25102.1(d) and 25532(a).

12 **C. NSMIA Does Not Preempt the Commissioner Because the Transaction Was Not**  
 13 **Exempt under Regulation D**

14 Section 5 of the Securities Act, codified in 15 U.S.C. §77e provides that before a security is  
 15 sold through the mail or through interstate commerce the security must be registered with the SEC.  
 16 Under 15 U.S.C. §77c and d certain securities and transactions are exempted from this registration  
 17 requirement, and in relevant part §77d(2) exempts from registration any "transactions by an issuer  
 18 not involving any public offering."

19 In 1996 the Securities Act was amended by the National Securities Markets Improvement  
 20 Act of 1996 ("NSMIA"). NSMIA was codified in 15 U.S.C. 77r and reads in pertinent part as  
 21 follows:

22 "(a) Scope of exemption. Except as otherwise provided in this section, no law, rule,  
 23 regulation, or order, or other administrative action of any State or any political subdivision  
 thereof -

24 (1) requiring, or with respect to registration or qualification of securities, or  
 25 registration or qualification of securities transactions, shall directly or indirectly  
 apply to a security that -

26 (A) is a covered security....

27 (b) Covered securities. For purposes of this section, the following are covered securities:  
 ....

28 (4) Exemption in connection with certain exempt offerings. A security is a covered  
 security with respect to a transaction that is exempt from registration under this subchapter  
 pursuant to - ....

1 (D) Commission rules or regulations issued under section 77d(2) of this title...."

2 (Emphasis added.)

3 Title 15 U.S.C §77r does not state that a covered security is one that "might" or "may be" or  
4 "could be" exempt. It does not include in the definition of a "covered security" one that does not  
5 meet the terms of the exemption. It expressly states that a security is "covered" only if it "is  
6 exempt". Similar language is found in Corporations Code §25102.1(d). In other words, the offering  
7 must comply with the terms of the exemption in order for the exemption to preempt action by a state  
8 regulatory agency.

9 Regulation D provides exemptions, one of which is Rule 506, which lists requirements that  
10 must be met before an offering of a security is, under §77d(2), one "not involving any public  
11 offering". 17 C.F.R. §230.506. Rule 506 incorporates limiting provisions of Rules 501 and 502  
12 when it states at the outset that "to qualify for an exemption under this section, offers and sales must  
13 satisfy all the terms and conditions of sections 230.501 and 230.502." (Emphasis added.)

14 17 C.F.R. section 230.502(c) provides in pertinent part as follows:

15 "Limitation on manner of offering. Except as provided in section 230.504(b)(1), neither the  
16 issuer nor any person acting on its behalf shall offer or sell the securities by any form of  
general solicitation or general advertising, including, but not limited to, the following:

- 17 (1) Any advertisement, article, notice or other communication, published in any  
18 newspaper, magazine, or similar media broadcast over television or radio; and  
19 (2) Any seminar or meeting whose attendees have been invited by any general  
20 solicitation or general advertising...." (Emphasis added.)

21 Under both state and federal securities law the burden of proving an exemption or the  
22 affirmative defense of preemption is on the issuer. California Corporations Code §25163; see Buist  
23 v. Time Domain (2005) 926 So.2d 290; Grubka v. Webaccess, Intl., Inc. (2006) 445 F.Supp.2d 1259;  
24 SEC v. Ralston Purina Co. (1953) 346 U.S. 119, 126. Petitioners cite no evidence or facts  
25 demonstrating their compliance with the exemption. Indeed, the undisputed evidence is that  
26 Consolidated engaged in activities in California that were not exempt under Regulation D.

27 As found by the ALJ and as the undisputed evidence shows: Consolidated Management  
28 Group, LLC, was the issuer of securities in the form of interests in Anadarko and Hugoton joint  
ventures (DOC00181-00206 and DOC00207-00230); Guardian Capital Management was acting as

1 the exclusive northern California sales agent selling interests in the Anadarko and Hugoton joint  
2 ventures (Keegan testimony, transcr. pp.103:5 to 104:18, 105:1 to 106:5); Guardian Capital  
3 Management offered securities to citizens of California in the form of general solicitations, by way  
4 of telephone calls and mailings of offerings that included a prospectus called a Confidential  
5 Information Memorandum ("CIM") to a Department undercover investigator Jon Wroten (Wroten  
6 testimony, transcr. pp.45:5 to 60:21), and by way of unsolicited invitations to luncheons to members  
7 of the general public, including members of the Los Gatos Chamber of Commerce and other people  
8 in the Los Gatos community, who had no pre-existing relationship with the Petitioners (Keegan  
9 testimony transcr. pp. 112:22 to 115:20, 121:4 to 130:22, 144:6-10, 146:6-25); at the luncheons  
10 power-point presentations were given intended to interest attendees in investing in a Consolidated  
11 joint venture (Keegan testimony, transcr. pp.130:5-11, 127:1-24 and 129:1-24); and when someone  
12 attending a luncheon expressed an interest in investing in a joint venture they were mailed an  
13 offering packet similar to the offering packet mailed to investigator Wroten that included a CIM.  
14 (Keegan testimony, transcr. p.130:5-22)

15 Petitioners' offerings violate the conditions of Regulation D, Rule 506, and are, therefore, not  
16 exempt from qualification in California under that Rule. "A failure to comply with a requirement of  
17 Rule 506 'voids' the exemption, thereby eliminating the possibility of preemption." Buist v. Time  
18 Domain (2005) 926 So.2d 290. Since there is no exemption pursuant to the federal rules, or under  
19 Corporations Code §25102.1, the securities must be qualified as required by Corporations Code  
20 §25110.

21 In Buist v. Time Domain, supra, decided in July 2005, the Supreme Court of the State of  
22 Alabama was presented with the same argument offered by Consolidated in this case at the  
23 administrative level. In the Buist case, the shareholder plaintiffs brought a civil action in state court  
24 for alleged violations of the Alabama Securities Act in the offer and sale of securities. The  
25 defendant corporations filed for a summary judgment arguing that the alleged state securities  
26 violations were preempted by federal law because the securities they sold were "covered securities"  
27 pursuant to Rule 506 of Regulation D. Like plaintiffs here, the Buist defendants tried to support  
28

1 their motion with evidence that they had filed at least two Form D's with the Alabama Securities  
2 Commission. The defendant's motion was denied in part and the appeal ensued.

3 The Alabama Supreme Court on appeal upheld the denial of motion for summary judgment  
4 on the grounds that in order for the state claim to be preempted by federal law the defendant  
5 corporations needed to show that the securities they offered were covered securities that were  
6 exempt under federal law. The court stated that each time the corporate defendant filed a Form D it  
7 "promised a future course of conduct consistent with the requirements for an exempt offering."  
8 Buist v. Time Domain, supra, at p. 297. "In other words, the exempt status of the sale of securities  
9 that deviates from any of the material commitments made in its Form D filing is repealed  
10 retroactively". Id. at p. 298. With the exemption "repealed retroactively," any preemption is  
11 eliminated. The Buist court found that defendant Time Domain "submitted no evidence indicating  
12 that its sales of securities were actually made in conformity with Regulation D" and reversed a  
13 motion for summary judgment in its favor. Id. at p. 298.

14 The Buist court provides a thoughtful analysis of the federal Securities Act and Regulation D  
15 and states that NSMIA amended the Securities Act "to obviate the necessity of registering certain  
16 securities with both state and federal governments by providing that under certain conditions state  
17 laws are preempted by the Securities Act." (Emphasis added.) The Buist case discusses the two  
18 cases cited by Petitioners, Temple v. Gorman (2002) 201 F. Supp. 1238 and Lillard v. Stockton  
19 (N.D. Okla. 2003) 267 F. Supp.2d 1115, the former decision written by a federal district court judge  
20 in Florida and the later written by a magistrate and adopted by a district court judge in Oklahoma.  
21 As the Buist court notes, Temple arrived at its decision "ipse dixit", the Temple court simply makes  
22 an unsupported assertion "without any accompanying analysis; Lillard in turn simply relies upon  
23 Temple." Buist v. Time Domain, supra, at page 19. The Buist court dismisses these two district  
24 court cases, as this court should here, noting they did not fully analyze the facts and can only serve  
25 as "persuasive" and not controlling authority. A district court in a post-Buist case cited by  
26 Petitioners, Pinnacle v. Levin (2006) 417 F.Supp 2d 1073, merely cites Temple and Lillard without  
27 analysis.

28 As observed by the court in Grubka v. Webaccess, Intl., Inc. (2006) 445 F.Supp.2d 1259:

1 The Temple court read language into the statute that does not appear there. A  
2 security is covered if it "is exempt from registration . . ." 15 U.S.C., §77r(b)(4).  
3 Nowhere does the statute indicate that a security may satisfy the definition if it is *sold*  
4 *pursuant to* a putative exemption. If congress had intended that an offeror's  
5 representation of exemption should suffice it could have said so, but did not. Such an  
6 intent seems unlikely, in any event; that a defendant could avoid liability under a state  
7 law simply by claiming its alleged compliance with Regulation D is an unsavory  
8 proposition and would eviscerate the statute." (at p. 1270.) (Emphasis added.)

9 Curiously, in their moving papers Consolidated quotes from a recent U. S. Supreme  
10 Court case, Merrill Lynch v. Dabit (2006) 126 U.S. 1503, that actually undermines  
11 Consolidated's preemption argument. In Dabit the Supreme Court considered not NSMIA  
12 but the Securities Litigation Uniform Standards Act of 1998 (SLUSA) that prohibits class  
13 action lawsuits under state law which allege fraudulent misrepresentations in connection with  
14 the purchase or sale of a "covered security". (Id. at p. 1506.) Unlike the instant case, in Dabit  
15 there was no question that the security was a covered security. Moreover, in finding that  
16 SLUSA preempted the state law holder class action of the kind alleged by Dabit, the  
17 Supreme Court wrote, "we do not lose sight of the 'general presumption that Congress does  
18 not cavalierly pre-empt state law causes of action.' Medtronic, Inc. v Lohr, 518 U.S. 470,  
19 485" and noted that under SLUSA enforcement proceedings brought by a state agency were  
20 preserved. (Id. at p. 1514.) To accept Consolidated's preemption argument is contrary to the  
21 general presumption recently re-enforced by the Supreme Court in Dabit.

22 Petitioners assert the Commissioner has no authority to examine the offering, but cite no  
23 evidence that they actually complied with the requirements of the exemption, and indeed the  
24 evidence establishes that the Petitioners did not comply with the exemption requirements.

#### 25 **D. The ALJ May and Did Properly Consider the Risk Capital Test**

26 Consolidated argues on the one hand that what it offered was not a security, and then  
27 inconsistently that it has offered a "covered security" and as such is entitled to preemption, is  
28 exempted, and is outside the scope of reach of Corporations Code section 25532. When  
Consolidated filed its Anadarko J.V. and Hugoton J.V. Form D's with the SEC and copies with the  
Department of Corporations (Respondents Exhs. 1 and 2 at DOC00181-00206 and DOC00207-  
00230), Consolidated represented that it was offering and selling "securities" under a 506 exemption

1 and thus not required to register and submit its offerings to closer regulatory scrutiny. Specifically,  
2 Lloyd Nuns, the manager of Consolidated, stated in cover letters to the Commissioner that the offer  
3 and sales were made "under Rule 506 of Federal SEC Regulations D, only to accredited investors  
4 and the leasehold interest (sic) are covered securities as defined in Section 18(b)(4) of the Securities  
5 Act of 1933" (DOC00182 and DOC00209). For Consolidated to argue now that it did not offer a  
6 "security" is contradictory and not credible, and should be rejected out of hand. The issue is  
7 nonetheless addressed.

8 Consolidated tries to argue that, in finding its offers of interests in joint ventures to be offers  
9 of securities, the ALJ should not have considered the Risk Capital Test because the attorneys below  
10 did not address it. Consolidated cites no authority for its position and indeed there should be nothing  
11 that prevents a judge from applying applicable law.

12 The ALJ actually found the subject offerings to be securities under both federal and state  
13 tests. In his proposed decision, after citing both the federal and state codes defining a "security", the  
14 ALJ writes that "under both state and federal law, the courts may, upon a sufficient factual showing,  
15 look past the general partnership form of an enterprise and treat the interests in the enterprise as  
16 investment contracts, and therefore as securities. (Citations.)" (DOC00004) The ALJ then discusses  
17 a Ninth Circuit case that further develops the Howey test, SEC v. Glenn W. Turner Enterprises (9<sup>th</sup>  
18 Cir. 1973) 474 F.2d 476, and discusses the adoption of elements of the Glenn W. Turner case by a  
19 state appellate court applying the Risk Capital test, People v. Graham (1985) 163 Cal.App.3d 1159.  
20 The ALJ concludes, "Under the Glenn W. Turner test and risk capital test, the interests in Anadarko  
21 and Hugoton are securities". (DOC00008)

22 In addition, the California appellate court in People v. Graham did the very thing  
23 Consolidated claims the ALJ should not have done; despite both parties below having argued the  
24 Howey test and ignored the Risk Capital test, the court considered the Risk Capital test. People v.  
25 Graham, supra, at p. 1166. Regardless, no matter what test is applied in this instant case, the joint  
26 venture interests Consolidated offered for sale were securities.

27 **E. The ALJ Properly Applied the Risk Capital Test**

28 One of the principal purposes underlying securities law "is to protect investors by promoting

1 full disclosure of information necessary to informed investment decisions." SEC v. Capital Gains  
2 Research Bureau (1963) 375 U.S. 180, 186. Because it is impossible to define precisely all cases in  
3 which investors need the protection of federal or state disclosure laws, the definition of a security or  
4 investment contract "embodies a flexible rather than a static principle, one that is capable of  
5 adaptation to meet the countless and variable schemes devised by those who seek the use of the  
6 money of others on the promise of profits." SEC v. W.J. Howey Co. (1946) 328 U.S. 293, 299.

7 The definition of "security" under Section 2(a)(1) of the federal Securities Act of 1933 (15  
8 U.S.C. 77b(1)) served as the model for the definition of "security" provided in Corporations Code  
9 section 25109. People v. Figueroa (1986) 41 Cal. 3d 714, 727 fn. 14. Both statutes define a  
10 "security" by providing a virtually identical list of examples of instruments that constitute a  
11 "security", rather than by attempting to set out an all-inclusive formula. Both definitions include  
12 investment contract, or in general, any interest or instrument commonly known as a security.  
13 Neither definition specifically includes a "general partnership"; however, the U.S. Supreme Court  
14 has provided that in determining whether interests are securities, the focus is to be on the economic  
15 realities of the underlying transaction and not on the name it carries. United Housing Foundation,  
16 Inc. v. Forman (1975) 421 U.S. 837, 849. The California Supreme Court stated that the "critical  
17 question" that needs to be resolved is "whether a transaction falls within the regulatory purpose of  
18 the law regardless of whether it involves an instrument which comes within the literal language of  
19 the definition." People v. Figueroa, supra, at p. 735.

20 The U.S. Supreme Court recently re-affirmed that the definition of a security under federal  
21 law should be broadly construed since the purpose of Congress "in enacting the securities laws was  
22 to regulate *investments*, in whatever form they are made and by whatever name they are called."  
23 SEC v. Edwards (2004) 540 U.S. 389, 393 (quoting Reves v. Ernst & Young (1990) 494 U.S. 56,  
24 61). Thus, the definition of security is sufficiently broad "to encompass virtually any instrument that  
25 might be sold as an investment." Edwards, supra, at 393.

26 In determining what constitutes a security, Consolidated would have the court apply early  
27 unmodified interpretations of the Risk Capital test as first presented in Silver Hills Country Club v.  
28 Sobieski (1961) 55 Cal.2d 811, and the federal Howey test as first presented in SEC v. W.J. Howey

1 (1946) 328 U.S. 293. These tests, however, have evolved considerably over time in California and  
2 in the 9<sup>th</sup> Circuit. The court in People v. Graham, *supra*, at 1165-1166, discussed this history as  
3 follows:

4 “Considerable scholarly debate has ensued on the proper definition of a “security”. In  
5 SEC v. Howey, the U.S. Supreme Court suggested the following definition: ‘a contract,  
6 transaction or scheme whereby a person invests his money in a common enterprise and is led  
7 to expect profits solely from the efforts of the promoter or a third party....’ The final prong  
8 of the Howey test, requiring that profits be derived ‘solely’ from the efforts of others has  
9 proved to be a troublesome one. Some courts have interpreted the requirement quite literally,  
10 holding that any participation, whether or not of a managerial nature, is sufficient to take the  
11 transaction out of the security category. (Citations.) In SEC v. Glenn W. Turner (9<sup>th</sup> Cir.  
12 1973) 474 F.2d 476, 482 the Ninth Circuit proffered a more liberal construction: ‘Strict  
13 interpretation of the requirements that profits to be earned must come ‘solely’ from the  
14 efforts of others has been subject to criticism. (Citations.) Adherence to such an  
15 interpretation could result in a mechanical, unduly restrictive view of what is and what is not  
16 an investment contract. It would be easy to evade by adding a requirement that the buyer  
17 contribute a modicum of effort.... Rather we adopt a more realistic test, whether the efforts  
18 made by those other than the investor are the undeniably significant ones, those essential  
19 managerial efforts which affect the failure or success of the enterprise. (Citation.)’ ”

20 The California court in People v. Graham adopted the broad definition of the “solely”  
21 element of the Howey test as expressed in Glenn Turner and added it as an element to the Risk  
22 Capital Test that had been evolving in California since first presented in 1961 in Silver Hills: “We  
23 do not read Silver Hills as holding that certain other elements ought not to be considered in  
24 determining whether the investment constitutes a ‘security’.... In particular, we believe the  
25 requirement that the investor not exercise managerial control over the enterprise is ‘implicit in the  
26 risk capital test as derived from (Silver Hills)’....In that sense, our conclusion has the effect of  
27 merging elements of both the Howey test and the risk capital test....Thus, under California law, an  
28 investment may constitute a security notwithstanding that investor participation is contemplated or  
required as long as the investor is not involved in “those essential managerial efforts which affect the  
failure or success of the enterprise.” (at pp. 1167-1168)

Consolidated’s efforts in these joint ventures are undeniably the significant ones, those  
essential managerial efforts which affect the failure or success of the enterprise. As noted by the  
ALJ, Consolidated as managing venturer will have plenary authority over day-to-day operations;  
Consolidated brings to the ventures its 100 year industry history and experience managing six

1 similar joint ventures; Consolidated brings its "affiliates" to the ventures from whom they will  
2 purchase and to whom they will lease the drilling equipment pursuant to non-arm's length  
3 transactions conducted by Consolidated; and Consolidated is located in Kansas close to the remote  
4 locations where the drilling is to take place. Undeniably, a Chamber of Commerce member from  
5 California investing in these joint ventures would be substantially powerless to affect its success.

6 All the other elements of the Risk Capital test as are easily met: it is undisputed that the funds  
7 are being raised for a business venture; the transaction is being offered indiscriminately to the public  
8 at large (as discussed above, Consolidated's unsolicited offers to members of a Chamber of  
9 Commerce and an undercover Department investigator, with whom the Petitioners had no prior  
10 relationship, is a public offering under federal and state law); and the investors money is  
11 substantially at risk because it is inadequately secured (in capital letters and bold print the CIMs  
12 warn that the investments involve a high degree of risk and other than the drilling equipment itself  
13 the risk is not secured.) Under the Risk Capital test the joint venture interests Consolidated has  
14 offered are securities.

15 Of interest is how similar the facts underlying the offer of an investment found to be a  
16 security in People v. Graham are to our instant case. There an offer to sell a partnership interest was  
17 made to an undercover investigator working for a district attorney. This was found by the court to  
18 be a non-exempt public offer because the investigator had no pre-existing personal or business  
19 relationship with the defendant and, although describing himself to the defendant as a successful and  
20 experienced real estate investor, the court found the investigator was not a "sophisticated investor"  
21 within the meaning of the exemption. Likewise, Consolidated's offer in our instant case to  
22 Department of Corporations investigator Jon Wroten did not comply with very similar federal  
23 conditions for a non-public exemption.

24 **F. Consolidated Offered Securities under the Federal Test**

25 The ALJ found that Consolidated has offered securities under both risk capital test and the  
26 federal test. SEC v. W.J. Howey (1946) 328 U.S. 293, 298, is considered to have provided an early  
27 seminal definition of a security: "a contract, transaction or scheme whereby a person (1) invests  
28 money in (2) a common enterprise and is led to (3) expect profits solely from the efforts of the

1 promoter or a third party." The investment scheme in Howey involved the sale of sections of a  
2 citrus grove to individuals. The seller also offered the purchasers separate service contracts to care  
3 for and harvest the citrus crop. In finding a security, the Court looked to the fact that such small plots  
4 needed someone to economically develop them, most investors were geographically distant, and  
5 most investors entered into service contracts with the seller. These facts, as in our instant case,  
6 indicated that the investors had little or no actual control over the management of the enterprise and  
7 required the protection of the disclosure requirements of the securities laws.

8 As noted in our previous discussion, in order to ensure that the securities laws not be easily  
9 circumvented by agreements requiring a "modicum of effort" on the part of investors, the word  
10 "solely" in the third prong of the Howey test has evolved and has not been construed literally. In  
11 SEC v. Glenn W. Turner, supra, the 9<sup>th</sup> Circuit Court of Appeals adopted a more "realistic" approach  
12 that examines "whether the efforts made by those other than the investor are undeniably significant  
13 ones, those essential managerial efforts which affect the failure or success of the enterprise." (at page  
14 482).

15 The Third, Fifth, Sixth, and Tenth Circuit Courts have since adopted the Glenn W. Turner  
16 9<sup>th</sup> Circuit Court's interpretation of Howey's third prong, including Williamson v. Tucker (5<sup>th</sup> Cir.  
17 1981) 645 F.2d 404, at 418; Goodwin v. Elkins Co. (3<sup>rd</sup> Cir. 1984) 730 F.2d 99, 103; Odom v.  
18 Slavik, (5<sup>th</sup> Cir. 1983) 703 F.2d 212, 215; Crowley v. Montgomery Ward Co. (10<sup>th</sup> Cir. 1975) 570  
19 F.2d 875, 877. As stated by the California appellate court in People v. Graham, supra, at page 1166,  
20 "Arguably, the U.S. Supreme Court has acquiesced in the Glenn Turner modification: 'The  
21 touchstone (of the Howey test) is the presence of an investment in a common venture premised on a  
22 reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of  
23 others.'" United Housing Foundation v. Forman (1975) 421 U.S. 837, 852.

24 Williamson v. Tucker, supra, provides examples of relationships, any one of which alone  
25 could render a joint venture a security: "A general partnership or joint venture interest can be  
26 designated a security if the investor can establish, for example, that (1) an agreement among the  
27 parties leaves so little power in the hands of the partner or venturer that the arrangement in fact  
28 distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced

1 and unknowledgeable in business affairs that he is incapable of intelligently exercising his  
2 partnership or venture powers; or (3) the partner or venturer is so dependent on some unique  
3 entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager  
4 of the enterprise or otherwise exercise meaningful partnership or venture powers.” (at p. 424.)

5 A post- Glenn Turner case, Parvin v. Davis Oil (1975) 524 F.2d 112, is a 9<sup>th</sup> Circuit Court of  
6 Appeals case that is similar to our instant case. The California investor in Parvin bought fractional  
7 interests in oil and gas leases from an out of state seller who would conduct oil exploration  
8 operations. The court found that even though the investor had substantial experience with  
9 investments in the oil and gas field, the significant managerial functions affecting the success of the  
10 enterprise were to be the sellers, and thus the interests were found to be securities.

11 In Long v. Shultz Cattle (1989) 881 F.2d 129 the court applying Howey, Glen Turner, and  
12 Williamson found an investment in a cattle feeding program to be a security. That court considered  
13 it significant that even though the investor could by agreement theoretically manage aspects of the  
14 program the investor did not have significant prior experience needed to care for or feed cattle, lived  
15 far removed from the cattle, and was solicited through advertisements in regular newspapers that  
16 were intended to attract a large number of inquiries without regard to one’s actual knowledge of the  
17 cattle feeding business. All these factors indicated that the investors could not exercise significant  
18 control over the enterprise.

19 All the factors considered significant in the Long and Parvin cases are present in our instant  
20 case as well: the lack of experience in the oil and gas field on the part of Jon Wroten (transcr.  
21 pp.50:13 to 52:15) and members of the Los Gatos Chamber of Commerce (Keegan testimony  
22 transcr. pp.130:23 to 131:9), the distance between the solicited California residents and the Midwest  
23 wells and drilling equipment (Keegan testimony transcr. pp.131:23 to 132:1 and pp.133:7 to 133:18,  
24 and Wroten testimony transcr. pp.46:6 to 52:15), and the general solicitation through the distribution  
25 of invitations to luncheon power-point presentations to persons without regard to their background  
26 or experience. (Keegan testimony transcr. pp. 121:12 to 131:9)

27 A Confidential Information Memorandum (DOC00075-00106) was part of the offering  
28 materials Guardian Capital mailed to Jon Wroten (transcr. pp.53:12 to 60:21), and virtually identical

1 CIMs were mailed by Guardian Capital to persons expressing an interest in investing in one of the  
2 joint ventures following a luncheon presentation (transcr. p130:5 to 130:22). These CIMs provide  
3 further evidence of the significant control Consolidated would have over the success or failure of  
4 these joint ventures and the lack of control given investors. The CIMs provide that Consolidated as  
5 the managing venturer is to have 100% of the right to control day to day operations. Contrary to  
6 Consolidated's claim, aside from the ability to remove Consolidated by a majority vote, the CIMs  
7 give the non-managing investors very limited voting power. The only occasions the non-managing  
8 venturers may vote on the purchase of equipment is if the drilling equipment is no longer available  
9 (which is unlikely to occur since the equipment is to be purchased from one of Consolidated's  
10 "Affiliates") or if less than the full amount of the offerings in the respective venture is obtained  
11 (\$6,200,000 in Anadarko and \$5,800,000 in Hugoton).

12 According to the CIMs, the drilling equipment "will be purchased" from one of  
13 Consolidated's "Affiliates" that share the same principals as Consolidated, and the drilling is to be  
14 preformed by either Consolidated or one of Consolidated's "Affiliates" that share the same  
15 principals as Consolidated. So the subject drilling equipment is purchased from one of  
16 Consolidated's Affiliates, by the joint venture which is managed by Consolidated, and then leased to  
17 Consolidated or one its Affiliates, all of whom share the same principals. As constructed by  
18 Consolidated, these joint ventures are hardly simple business ventures that investors can easily  
19 control.

20 The notion that anyone, to whom these joint ventures were offered in California, could  
21 envision himself as actively or significantly involved in a gas drilling enterprise is absurd. In  
22 offering for sale these joint venture interests Consolidated has clearly offered securities under the  
23 modern three-prong Howey test; the investors invest money, in a common enterprise, and rely on  
24 Consolidated's significant and essential managerial efforts for the failure or success of the enterprise.

25 **G. There is Substantial Evidence that Hugoton J.V. Violated the Corporations Code**

26 The ALJ properly affirmed the D&R with respect to Hugoton J.V. The petitioner correctly  
27 quotes from a portion of the transcript on March 7, 2006, when during the hearing below the  
28 attorney for the Department, discussed the status of the evidence as to the specific joint venture

1 Hugoton J.V. The ALJ at the Petitioners request had stricken the testimony of the Department's  
2 witness, Randall Avey. It had been the Department's plan to submit its evidence against Hugoton  
3 through Randall Avey. However, at the time and largely through Kenneth Keegan's testimony there  
4 was in fact substantial evidence that Hugoton J.V. violated Corporation Code 25110 as alleged in the  
5 D&R. Keegan was an adverse witness, an agent of Consolidated, and indeed a subject in the D&R,  
6 who through his attorney withdrew his request for a hearing shortly before the hearing below.  
7 Statements by counsel regarding the effect of Keegan's testimony on the state of the evidence is not  
8 evidence.

9 Moreover, the Petitioners have not fully presented the record. The Petitioners moved to  
10 dismiss Hugoton J.V. at the hearing below but the ALJ stated that according to his review of the  
11 APA (Administrative Procedure Act) he did not have the power to dismiss a case as to a respondent  
12 for want of evidence and could only write a proposed decision recommending dismissal unless the  
13 Department was willing to stipulate to a dismissal, which the Department stated it was not willing to  
14 do (transc. p.275:18 to 276:4). Obviously, since the ALJ's decision did not recommend dismissal  
15 but rather found that the evidence supported the D&R allegations against Hugoton, this shows that  
16 the ALJ concluded that the record contained substantial evidence against that particular joint  
17 venture.

18 The following shows the substantial evidence to support the ALJ's finding that Hugoton J.V.  
19 violated Corporations Code section 25110: Ken Keegan of Guardian Capital Management testified  
20 that two of the joint ventures Guardian Capital Management was marketing for Consolidated were  
21 Anadarko J.V. and Hugoton J.V. (transc. pp.105:1 to 106:5); some of the invitations Guardian  
22 Capital Management mailed to over 200 members of the Los Gatos Chamber of Commerce were to a  
23 luncheon specifically intended to generate interest in the possibility of investing in the Hugoton joint  
24 venture (transc. p.124:6-18; pp.126:17 to 127:24); at the luncheons Guardian Capital Management  
25 provided a power-point presentation that included showing documents like those offering materials  
26 Guardian Capital Management mailed to Jon Wroten Exhibit E (transc. p.128:3-14; pp.129:1-  
27 130:11); and when someone at the luncheon expressed an interest in possibly investing in the joint  
28 ventures Guardian Capital Management would send them offering material similar to Exhibit E

1 including a prospectus or CIM (transcr. p.130:13-21). In addition, Petitioners themselves placed into  
2 evidence the CIM relating to Hugoton J.V., Respondent's Exhibit 5, that Keegan said he sent to each  
3 person he introduced to that investment (transcr. p.146:6-25; DOC00233-00264), and Petitioners  
4 also placed into evidence Respondent's Exhibit 2, the Form D 506 notice that Consolidated filed  
5 with the Department indicating they intended to offer and in fact sold in California securities in the  
6 form of Hugoton joint ventures under the exemptions claimed (transcr. p.17:1-8; DOC00343 to  
7 00366).

8 **H. The Findings of the ALJ Challenged by Consolidated are Supported by Substantial**  
9 **Evidence**

10 As to the first Finding of Fact challenged by Consolidated in their moving papers, Kenneth  
11 Keegan of Guardian Capital testified that some of the potential investors who attended the luncheons  
12 probably had no experience or background in the oil and gas industry (transcr. pp.130:23 to 131:90)  
13 and would be investing in an enterprise many states away (transcr. p.133:7-18). The Petitioners  
14 argue that the ALJ committed a prejudicial abuse of discretion when he found that Keegan was  
15 trying to get participants to invest in drilling equipment when in fact they would be investing in joint  
16 ventures that would purchase the drilling equipment. The distinction is immaterial and would not be  
17 worth addressing if it were not also incorrect. The cover letter to Exhibit E that Guardian Capital  
18 sent to Jon Wroten aka John Fox, enclosing offering materials including an Anadarko CIM or  
19 prospectus, expressly states that as an investor "you are the owner of the equipment". (See  
20 DOC00037.)

21 As to the second challenged Finding of Fact, it is difficult to understand how Keegan's  
22 testimony that he never asked a first-time attendee at a luncheon for a check to participate in the  
23 Anadarko or Hugoton joint ventures, somehow challenges the ALJ's finding that at the luncheons  
24 Keegan offered participants the opportunity to invest. There is substantive evidence to support this  
25 finding: Keegan testified that "the luncheon was something Guardian Capital provided for potential  
26 investors" (transcr. p. 127:1-4), "to develop interest" in investing in the two joint ventures (transcr.  
27 p.127:10-24), and to give an attendee an opportunity to invest in a joint venture (transcr. p.129:1-  
28 24); Keegan further testified that at the luncheons he gave PowerPoint presentations through which

1 he displayed items contained in the offering packet Guardian Capital Management mailed to Jon  
2 Wroten (Exhibit E) (transcr. p.130:5-11), and when someone expressed an interest at the luncheon  
3 Keegan would provide them with an offering packet similar to Exhibit E that included a Private  
4 Placement Memorandum or CIM (transcr. p.130:13-22).

5 As to the third challenged Finding of Fact, the contact between Jon Wroten and H.W. was  
6 not a "pre-existing relationship" of any relevance or significance. As the ALJ found, Jon Wroten's  
7 first contact with Guardian Capital Management was on December 1, 2005, when during an  
8 undercover investigation not related to Petitioners, H.W. asked Mr. Wroten if he would be interested  
9 in receiving information regarding an investment and Mr. Wroten assented (transcr. pp.45:5 to  
10 46:24; pp.82:6-83:6). The relevant relationship is the one between Jon Wroten and Consolidated,  
11 and there was no prior relationship whatsoever. All on one day, December 1, 2005, Guardian  
12 Capital's Faber Johnston (someone Wroten did not previously know) telephoned Mr. Wroten, tried  
13 to interest him in an investment opportunity in an oil and gas drilling equipment leasing joint venture  
14 managed by Consolidated with a potential of returning 21% annually, and sent him offering  
15 materials, admitted as Exhibit E, including a questionnaire and Anadarko JV prospectus or CIM.  
16 (transcr. pp.45:8 to 47:21; 50:6-9; 53:12 to 57:24; 60:9-18). Furthermore, Kenneth Keegan admitted  
17 at the hearing that Guardian Capital Management had no pre-existing relationship with some of the  
18 Los Gatos Chamber of Commerce persons who were mailed luncheon invitations. (transcr. p.144:6-  
19 10)

20 **I. The Court Reporter's Transcript is More than Adequate**

21 The Court Reporter is certified (CSR No. 11027) and was provided by an independent branch  
22 of the State, the Office of Administrative Hearings ("OAH"). Indeed, in their letter to the  
23 Department of Corporations requesting a copy of the Administrative Record, Petitioners' expressly  
24 asked that the transcript of the hearing be provided by the OAH and not the Department of  
25 Corporations.

26 The Court Reporter's transcript contains some errors, but no more than most transcripts and  
27 no more than one would expect from any device relying on human input. As the court can readily  
28 see by reading any portion of the transcript, but even in those pages Petitioners' counsel cites as

1 most egregious, the errors are not significant and where there is an error the transcript can be readily  
2 understood from its immediate context (e.g. the transcript reads "presumption" at times when it  
3 likely should read "preemption"). There are no missing portions alleged and Petitioners' counsel has  
4 not proffered any evidence that he claims was presented at the hearing that is not included in the  
5 transcript.

6 Furthermore, the one page from the transcript Petitioners cite as containing something more  
7 than typographical errors is Kenneth Keegan's non-responsive answer to a question during direct  
8 examination. The question concerned whether Keegan used any additional criteria aside from home  
9 ownership to invite Los Gatos residents to the luncheon presentations. Mr. Keegan's response to  
10 this particular question was rambling and incoherent, so it is actually most likely the transcript was  
11 accurately reported. Even if there are errors they are not significant and Consolidated has not shown  
12 prejudice.

13 Instead of supporting the Petitioners argument, the cases they cite compel its rejection. In  
14 each case the petitioners cite, the transcript of the hearing below was either non-existent or missing  
15 in substantial part. In Frase v. Gourley (2000) 85 C.A.4<sup>th</sup> 762 the hearing below was tape-recorded  
16 only and the agency had erased the entire testimony of the plaintiff and his expert; in Hothem v.  
17 CCSF (1986) 186 C.A.4<sup>th</sup> 702 the hearing was tape-recorded only and the recording was too poor to  
18 be transcribed; in Ocheltree v. Gourley (2002) 102 C.A.4<sup>th</sup> 1013 the record of the hearing had not  
19 been prepared for the trial court to review; in Buckhart v. S.F.R.R.S.A.B. (1988) 197 C.A.3d. 1032  
20 the hearing below was tape-recorded but not prepared or transcribed; in Santa Cruz Redevelopment  
21 Agency v. Izant (1995) 37 C.A.4<sup>th</sup> 141 the court reporters notes from the first of a two day trial were  
22 missing; and in Alburger v. Greene (1986) 185 C.A.3d 1308 three days of the court reporter's  
23 transcript were missing.

24 Petitioner misconstrues the case it cites, Frase v. Gourley, supra. The court in that case stated  
25 at page 765:

26 When a licensee files a petition for writ of mandamus to challenge the DMV's  
27 decision... 'review shall be on the record of the hearing.' (Citation.) The burden of supplying a  
28 record sufficient for review is on the licensee (CCP section 1094.5(a)... That burden is met  
when the licensee makes a proper request on the DMV to prepare and certify the record because  
the DMV records and transcribes the hearing (Citation.), has sole custody and control of the

1 recordings and other evidence, and has a duty to maintain an adequate record. (Hothem, supra.)

2 In our instant case, unlike the DMV, the Department of Corporations did not have sole  
3 custody and control of the transcript, that was the province of an independent branch of the State, the  
4 Office of Administrative Hearings. Indeed Consolidated did not even include the DOC in its  
5 correspondence with OAH complaining about portions of the transcript (attached as an Exhibit to  
6 attorney Joel Held's declaration). Moreover, the court reporter's transcript below may not be  
7 perfect, but it is certainly more than "an adequate record".

8 **J. The ALJ Properly Allowed Nassi's Declaration and Jon Wroten's Testimony**

9 The declaration of Ronee Nassi was properly admitted by the ALJ as hearsay evidence used  
10 for the purpose of supplementing or explaining other evidence under Government Code Section  
11 11513. The only ALJ finding referring to Nassi is Factual Finding 6 and she is cited as supportive of  
12 Kenneth Keegan's live testimony. Keegan testified at the hearing below that Nassi was one of the  
13 Los Gatos Chamber of Commerce members he invited to a luncheon (transc. p.140:9-20). Keegan  
14 also testified that some of the persons he was providing luncheon power-point presentations to,  
15 trying to interest them in investing in Consolidated joint ventures, had no experience in the oil and  
16 gas industry and they lived in California miles away from Kansas or Oklahoma where the drilling  
17 was to occur (transc. p.130:23 to 133:18); in Nassi's declaration she states that she was one of those  
18 persons.

19 Petitioners also complain about the admission of Jon Wroten's testimony at the hearing  
20 below (between pages 43 and 48 of the hearing transcript) concerning two telephone conversations,  
21 one with H.W. and the second with Faber Johnston of Guardian Capital. H.W.'s statements asking  
22 Wroten if it would be okay to have someone call him about a potential investment were admissible  
23 as foundational as to how Jon Wroten came to receive a telephone call from Faber Johnson of  
24 Guardian Capital. It is curious that Petitioners object to H.W. statements since if they are not  
25 admitted then Faber Johnston's telephone call comes completely out of the blue and there is still no  
26 evidence of a prior relationship.

27 Faber Johnson's telephone statements, soliciting Wroten's investment in a Consolidated joint  
28 venture, are admissible under the hearsay exception of party admission and also under Government

1 Code Section 11513 as supplemental to Keegan's testimony concerning public solicitations. Keegan  
2 testified that Consolidated engaged his company, Guardian Capital Management, to be its exclusive  
3 Northern California sales force to develop capital and interest investors into investing in  
4 Consolidated joint ventures (transc. pp. 103:5 to 104:18) and that Faber Johnston was Keegan's son-  
5 in-law authorized by Guardian Capital Management to solicit by telephone possible investors in the  
6 Anadarko and Hugoton joint ventures (transc. p. 113:2-22 and p.115:4-20).

7 **V. CONCLUSION**

8 The Petitioners offered for sale in California securities in the form of joint venture interests  
9 that were not preempted from California securities law. The ALJ has found based on substantial  
10 evidence that Petitioners offers were securities, were public offerings, that Petitioners engaged in  
11 general solicitations, and their offers were thereby not exempt from qualification under federal and  
12 state exemptions. This court is respectfully requested to confirm the findings of the ALJ below and  
13 in the Desist & Refrain Order that the offers of these unqualified non-exempt securities were in  
14 violation of California Corporations Code section 25110.

15  
16 Dated: November 20, 2006

17 Respectfully Submitted,

18 PRESTON DuFAUCHARD  
19 California Corporations Commissioner

20  
21 By: ~~EDWARD KELLY SHINNICK~~  
22 Corporations Counsel  
23 Enforcement Division  
24  
25  
26  
27  
28

1 PROOF OF SERVICE

2 **Re: OPPOSITION OF RESPONDENT DEPARTMENT OF CORPORATIONS TO**  
3 **PETITIONERS' MOTION FOR WRIT OF ADMINISTRATIVE MANDATE**

4 I, Edward Kelly Shinnick, declare as follows:

5 I work in the City and County of San Francisco, California. I am over the age of eighteen  
6 years and not a party to the within entitled action; my current business address is 71 Stevenson  
7 Street, Suite 2100, San Francisco, CA, 94105-2980. On November 20, 2006, following ordinary  
8 business practices, I sent by facsimile, and placed for collection and at the offices of the State of  
9 California, Department of Corporations, 71 Stevenson Street, Suite 2100, San Francisco, CA,  
10 94105-2980 (I am familiar with the practice of the offices of the Department of Corporations for  
11 collection and processing of correspondence, and that practice is the correspondence so placed  
12 for collection is, in the ordinary course of business, deposited the same day in the United States  
13 Postal Service), the attached true and correct copies of:

14 **OPPOSITION OF RESPONDENT DEPARTMENT OF CORPORATIONS TO**  
15 **PETITIONERS' MOTION FOR WRIT OF ADMINISTRATIVE MANDATE**

16 to the recipients whose facsimile numbers are listed below, and in a sealed envelope, with  
17 postage fully prepaid, addressed as follows:

18 **Attorneys for Petitioners**

19  
20 Joel Held  
21 Baker & McKenzie LLP  
22 2300 Trammell Crow Center  
23 2001 Ross Avenue  
24 Dallas, Texas 75201  
25 *By fax 214-978-3099*

26 Christopher Van Gundy  
27 Baker & McKenzie LLP  
28 Two Embarcadero Center, 24<sup>th</sup> Floor  
San Francisco, CA 94111  
*By fax 415-576-3099*

I declare under penalty of perjury that the foregoing is true and correct and that this  
declaration was executed November 20, 2006 at San Francisco, California.

27 Edward Kelly Shinnick