

1 PRESTON DuFAUCHARD
California Corporations Commissioner
2 WAYNE STRUMPFER
Deputy Commissioner
3 ALAN S. WEINGER (86717)
Supervising Attorney
4 JAMES K. OPENSHAW (137667)
Senior Corporations Counsel
5 jopensha@corp.ca.gov
1515 K Street, Suite 200
6 Sacramento, California 95814
Telephone: (916) 322-6998
7 Facsimile: (916) 445-6985

8 Attorneys for the People of the State of California

9
10 UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA – SAN FRANCISCO

11 CONSOLIDATED MANAGEMENT GROUP,
12 LLC, a Kansas limited liability company;
CONSOLIDATED LEASING ANADARKO
13 JOINT VENTURE, a Kansas general
partnership; and CONSOLIDATED LEASING
14 HUGOTON JOINT VENTURE #2, a Kansas
general partnership,

15 Plaintiffs,
16 vs.

17 PRESTON DuFAUCHARD, California
Corporations Commissioner; and
18 CALIFORNIA DEPARTMENT OF
CORPORATIONS.

19 Defendants.
20

Case No.: C 06-4203-JSW

MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF MOTION
TO DISMISS PURSUANT TO RULE 12(b)(6)
FOR FAILURE TO STATE A CLAIM ON
WHICH RELIEF CAN BE GRANTED

DATE: September 1, 2006
TIME: 9:00 a.m.
DEPT: Courtroom 2, 17th Floor
JUDGE: Hon. Jeffrey S. White

FILED VIA E-FILING

21 ///
22 ///
23 ///
24 ///
25 ///
26 ///
27 ///
28 ///

TABLE OF CONTENTS AND AUTHORITIES

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

A.INTRODUCTION.	1
B. STATEMENT OF FACTS.	2
C. LAW AND ARGUMENT.	3
1. PLAINTIFFS FAILED TO STATE FACTS THAT GIVE RISE TO A CLAIM THAT WOULD ENTITLE THEM TO BE HEARD IN THIS COURT.	3
2. PLAINTIFFS FAILED TO EXHAUST THEIR STATE LAW REMEDIES, AND THE COURT SHOULD ABSTAIN FROM HEARING THIS ACTION, INSTEAD DISMISSING IT AS PREMATURE.	4
3. PLAINTIFFS FAILED TO ALLEGE FACTS THAT THEY HAVE SUFFERED A SIGNIFICANT THREAT OF IRREPARABLE INJURY; OR THAT THE BALANCE OF HARDSHIPS FAVORS THE INJUNCTION THEY SEEK, OR WHETHER ANY PUBLIC INTEREST FAVORS GRANTING AN INJUNCTION.	6
4. NSMIA DOES NOT PREEMPT THE COMMISSIONER BECAUSE THE TRANSACTION WAS NOT EXEMPT UNDER REGULATION D.	7
5. THE COMMISSIONER HAD AUTHORITY TO ISSUE THE DESIST AND REFRAIN ORDER BECAUSE THE TRANSACTION WAS NOT EXEMPT UNDER CALIFORNIA LAW AND REGULATION D.	10
6. PLAINTIFF HAS FAILED TO STATE A CLAIM UNDER 42 USC 1983.	12
7. THE ELEVENTH AMENDMENT BARS THIS CLAIM AGAINST THE CALIFORNIA DEPARTMENT OF CORPORATIONS, A SUBDIVISION OF THE STATE OF CALIFORNIA AND PRESTON DuFAUCHARD, THE CORPORATIONS COMMISSIONER.	14
8. PLAINTIFFS FAILED TO PROVIDE A "SHORT AND PLAIN STATEMENT OF FACTS" AND AS A RESULT, DEFENDANTS CANNOT BE SURE WHAT FACTUAL ALLEGATIONS REQUIRE A RESPONSE.	15

///
///
///

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

9. THIS ACTION IS BARRED AS AGAINST BOTH
PRESTON DuFAUCHARD, CORPORATIONS
COMMISSIONER AND ANY OTHER EMPLOYEE
OF THE DEPARTMENT OF CORPORATIONS,
SINCE THEY HAVE QUALIFIED IMMUNITY FROM
CIVIL LIABILITY BASED ON ACTS CONDUCTED IN
THE COURSE OF AN INVESTIGATION AND/OR
LITIGATION AUTHORIZED BY STATUTE THAT WERE
NOT, AT THE TIME, CLEARLY ESTABLISHED VIOLATIONS
OF THE CONSTITUTION, AND THAT WERE SUBJECT
TO IMMUNITIES PURSUANT TO CALIFORNIA
GOVERNMENT CODE §821.6, AND CALIFORNIA
CORPORATIONS CODE §25531 AND §25532.

16
17

D. CONCLUSION.

TABLE OF AUTHORITIES

Cases:

1		
2		
3	<u>Cases:</u>	
4	<i>Abelleira v. District Court of Appeal</i>	
5	17 Cal. 2d 280, 295 (1941)	4
6	<i>AFA Private Equity Fund I v. Miresco Investment Services,</i>	
7	2005 U.S. Dist. LEXIS 22071	11
8	<i>Azer v. Connell</i>	
9	306 F.3d 930, 935 (9th Cir. 2002)	13
10	<i>Beentjes v. Placer County Air Pollution Control Dist.</i>	
11	397 F.3d 775 (9th Cir. 2005)	14, 15
12	<i>Branch v. Tunnell</i>	
13	14 F.3d 449, 453 (9th Cir. 1994)	3
14	<i>Brosseau v. Haugen</i>	
15	543 U.S. 194, 196-198 (U.S. 2004)	16
16	<i>Buist v Time Domain</i>	
17	2005 Ala. LEXIS 120	8, 9, 11
18	<i>Caldwell v. Roseville Joint Union High Sch. Dist.</i>	
19	2005 U.S. Dist. LEXIS 24923, 15-16 (D. Cal. 2005)	14
20	<i>Cervantes v. United States</i>	
21	330 F.3d 1186, 1187 (9th Cir. 2003)	12
22	<i>Clegg v. Cult Awareness Network</i>	
23	18 F.3d 752, 754-55 (9th Cir. 1994)	15
24	<i>Conley v. Gibson</i>	
25	355 U.S. 41, 45-46, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957)	3
26	<i>Conley v. Gibson</i>	
27	355 U.S. 41, 45-46, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957) at 47	15
28	<i>Cook Inc. v. Medtronic, Inc.</i>	
	2006 U.S. Dist. LEXIS 47073, 12-14 (D. Cal. 2006)	3
	<i>Covarrubias v. Ralph's Grocery Co.</i>	
	2004 U.S. Dist. LEXIS 18318, 4-7 (D. Cal. 2004)	6
	<i>Daniels v. Williams</i>	
	474 U.S. 327, 330-31, 88 L. Ed. 2d 662, 106 S. Ct. 662 (1986)	13
	<i>De La Cruz v. Tormey</i>	
	582 F.2d 45, 48 (9th Cir. 1978)	3
	<i>Dollar Rent A Car of Wash., Inc. v. Travelers Indem. Co.</i>	
	774 F.2d 1371, 1374 (9th Cir. 1985)	6

1	<i>Dumas v. Sunnyvale</i> (1965, 1st Dist) 231 Cal. App. 2d 796, 42 Cal Rptr 302, 1965 Cal App LEXIS 1569	4
2		
3	<i>First Brands Corp. v. Fred Meyer, Inc.</i> 809 F.2d 1378, 1381 (9th Cir. 1987)	6
4	<i>Fresh International Corp. v. Agricultural Labor Relations Bd.</i> 805 F.2d 1353, 1357 (9th Cir. 1986)	4, 5
5		
6	<i>Galbraith v. County of Santa Clara</i> 307 F.3d 1119, 1126 (9th Cir. 2002)	3
7	<i>Grubka v. Webaccess, Intl., Inc.</i> U.S. Dist LEXIS 44721 (2006)	8, 10, 13
8		
9	<i>Hamby v. Clearwater Consulting Concepts, LLP, et al.</i> 428 F. Supp. 2d 915; 2006 LEXIS 26886 (ED Ark. 2006)	11
10	<i>Javor v. Taggart</i> (2002) 98 Cal. App. 4th 795, 808	17
11		
12	<i>Lillard v. Stockton</i> 267 F. Supp.2d 1115 (N.D. Okla. 2003)	10
13	<i>Livid Holdings Ltd. v. Salomon Smith Barney, Inc.</i> 403 F.3d 1050, 1055 (9th Cir. 2005).	13
14		
15	<i>McDade v. West</i> 223 F.3d 1135, 1139 (9th Cir. 2000)	13
16	<i>McHenry v. Renne</i> 84 F.3d 1172, 1177-1178 (9th Cir. 1996)	15
17		
18	<i>Mitchell v. Los Angeles Comm. College Dist.</i> 861 F.2d 198, 201 (9th Cir. 1988)	14
19	<i>Morrison v. Gonzales</i> 2006 U.S. Dist. LEXIS 37733, 4-5 (D. Cal. 2006)	15
20		
21	<i>Nat'l Center for Immigrants Rights, Inc. v. INS</i> 743 F.2d 1365, 1369 (9th Cir. 1984)	6
22	<i>No. 84 Employer-Teamster Joint Council Pension Trust Fund v.</i> <i>Am. W. Holding Corp</i>	
23	320 F.3d 920, 931 (9th Cir.), cert. denied, 540 U.S. 966, 157 L. Ed. 2d 311, 124 S. Ct. 433 (2003)	12
24		
25	<i>Parker v. Broom,</i> 820 F.2d 966, 968 (8th Cir. 1987)	11
26	<i>Papasan v. Allain</i> 478 U.S. 265, 286, 106 S. Ct. 2932, 92 L. Ed. 2d 209 (1986)	15
27		
28	<i>Parratt v. Taylor</i> 451 U.S. 527, 535, 68 L. Ed. 2d 420, 101 S. Ct. 1908 (1981)	13

1	<i>Patsy v. Bd. of Regents</i>	
	457 U.S. 496, 516, 73 L. Ed. 2d 172, 102 S. Ct. 2557 (1982)	15
2	<i>Pennhurst State Sch & Hosp. v. Halderman</i>	
3	465 U.S. 89, 100, 79 L. Ed. 2d 67, 104 S. Ct. 900 (1984)	14
4	<i>Sanders v. Kennedy</i>	
	794 F.2d 478, 481 (9th Cir. 1986)	15
5	<i>Saucier v. Katz</i>	
6	533 U.S. 194, 200-202 (U.S. 2001)	16
7	<i>SEC v Ralston Purina Co.</i>	
	(1953) 346 U.S. 119, 126	8, 11
8	<i>Shoemaker v. Myers</i>	
9	(1992) 2 Cal. App. 4th 1407, 1424 [4 Cal. Rptr. 2d 203]	17
10	<i>Temple vs. Gorman</i>	
	201 F. Supp 1238 (2002)	10
11	<i>Thinket Ink Info. Res., Inc. v. Sun Microsystems, Inc.</i>	
12	368 F.3d 1053, 1061 (9th Cir. 2004)	12, 13
13	<i>Warren v. Fox Family Worldwide, Inc.</i>	
	328 F.3d 1136, 1141 n.5 (9th Cir. 2003)	12
14	<i>Younger v. Harris</i>	
15	401 U.S. 37, 27 L. Ed. 2d 669, 91 S. Ct. 746 (1971)	1, 4, 17
16		
17	<u>United States Code</u>	
18	15 U.S.C. §18(b)(4)	11
19	15 U.S.C §77	7
20	15 U.S.C. §77c	7
21	15 U.S.C. §77d(2)	7, 8
22	15 U.S.C. §77e	7
23	15 U.S.C. 77r	7
24	15 U.S.C. 77r(b)(4)	10
25	42 U.S.C. §1983	12, 13, 14
26	///	
27	///	
28		

1	<u>Federal Rules</u>	
2	Federal Rules of Civil Procedure §12(b)(6)	1, 3, 12, 15
3	Federal Rules of Civil Procedure §8(a)	15
4	Federal Rules of Civil Procedure §8(e)	15
5	Federal Rules of Civil Procedure §56(c)(e)	11
6		
7	<u>Federal Regulations</u>	
8	17 C.F.R. §230.501-230.506	2, 8, 9, 10, 11, 12, 13, 14, 16, 17, 18
9	17 C.F.R. §230.501	8
10	17 C.F.R. §230.502	8
11	17 C.F.R. §230.502(c)	8
12	17 C.F.R. §230.504(b)(1)	8
13	17 C.F.R. §230.506	2, 8, 9, 11
14		
15	<u>California Statutes</u>	
16	Corporations Code §25102.1	2, 9, 10, 11, 12, 17
17	Corporations Code §25102.1(d)	7, 13, 17
18	Corporations Code §25110	2, 5, 9, 10, 12, 13
19	Corporations Code §25111	10
20	Corporations Code §25112	10
21	Corporations Code §25113	10
22	Corporations Code §25163	8, 11, 13
23	Corporations Code §25210	2
24	Corporations Code §25531	16, 18
25	Corporations Code §25532	16, 18
26	Corporations Code §25532(a)	12
27	Corporations Code §25532(d)	4
28	Government Code §821.6	16, 17

1	Government Code §11523	4, 17
2		
3	<u>Michigan Statutes</u>	
4	Mich. Comp. Laws Ann. § 451.802(c)	11
5		
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		
26		
27		
28		

1 MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION TO DISMISS
2 PURSUANT TO RULE 12(b)(6) FOR FAILURE TO STATE A CLAIM ON WHICH RELIEF CAN
3 BE GRANTED

4 The defendants, PRESTON DuFAUCHARD, California Corporations Commissioner, and the
5 California Department of Corporations submit the following Memorandum of Points and Authorities
6 in support of their motion to dismiss the lawsuit of plaintiffs, pursuant to Rule 12(b)(6).

7 A. INTRODUCTION.

8 By way of this motion, the California Commissioner of Corporations, Preston DuFauchard,
9 and the California Department of Corporations (collectively “Department of Corporations” or
10 “Department”) seek an order of dismissal of this action on the grounds that another action is pending
11 between the same parties in a State forum, and this federal court should abstain from exercising its
12 jurisdiction over this dispute on the grounds enunciated by the U.S. Supreme Court in *Younger v.*
13 *Harris*, 401 U.S. 37 (1971).

14 The dispute between the parties pits form against substance. Plaintiffs assert that they have
15 performed all the formal requirements to make a private offering of securities in California. They
16 contend that because they filed the appropriate forms with the federal and state regulators, the
17 securities offering they make is exempt from federal and state registration, and that the Department of
18 Corporations has no authority to question the exemption because federal law preempts the state
19 regulator from doing so. The Department of Corporations contends that although plaintiffs have filed
20 the appropriate documents related to an exemption from registration, they failed to conform their
21 conduct in marketing these securities to the contours provided by the exemption; they made a public
22 offering of unregistered securities instead of limiting themselves to the strictures of a private offering.
23 Since plaintiffs’ conduct caused the securities to lose the private offering exemption, the Department
24 of Corporations issued an order requiring plaintiffs to “Desist and Refrain” from marketing the
25 unregistered securities they were offering.

26 Rather than initiating an action in federal court immediately after the Department of
27 Corporations issued its Desist and Refrain Order (“D&R”), plaintiffs elected to challenge the D&R in
28 a state administrative hearing. The administrative hearing concluded in favor of the Department of
29 Corporations and against plaintiffs, based on a factual finding that plaintiffs violated the requirements

1 of the exemption. The order from that administrative proceeding has not yet become final. In
2 addition, there exists a recognized and orderly avenue of appeal in the state system for plaintiffs to
3 pursue. Instead of continuing on the course of action in the state forum plaintiffs initially selected,
4 they seek to jump ship, hoping to land in this federal forum to collaterally attack the state
5 proceedings. This Court should reject plaintiffs' attempt to do so.

6 B. STATEMENT OF FACTS.

7 In August of 2005 and again in November of 2005, plaintiffs filed a "Form D" exemption
8 with the Commissioner in order to sell securities in California without state registration pursuant to
9 California Corporations Code §25102.1. This Form D, pursuant to Regulation D of the Securities
10 Act of 1933, had previously been filed with the Securities and Exchange Commission. In order to
11 qualify for an exemption pursuant to Regulation D, the applicant cannot offer securities by any form
12 of general solicitations or general advertising. *Regulation D, Rule 506, 17 C.F.R. §230.506.*

13 Almost immediately following the plaintiffs' filings, the Department of Corporations learned
14 that plaintiffs offered the securities by way of mass mailings and seminars where the potential
15 investors who attended had no pre-existing relationship with the offeror plaintiffs. Therefore, the
16 Department determined that the plaintiffs were violating the terms of the Regulation D exemption
17 and were making offers that were within the jurisdiction of state regulation. In their Complaint,
18 plaintiffs do not allege any facts to demonstrate they acted in compliance with Regulation D.

19 On January 23, 2006, the Commissioner issued a Desist and Refrain Order ("D&R") to
20 Kenneth W. Keegan, Faber Lane Johnston, Brandon Taylor, Guardian Capital Management,
21 Consolidated Management Group, LLC, Consolidated Leasing Anadarko Joint Venture, and
22 Consolidated Leasing Hugoton Join Venture #2. The D&R alleged violations of the California
23 Corporations Code, sections 25110 and 25210. These violations were alleged because plaintiffs were
24 not licensed to sell securities with the Department and, because of their general solicitations and
25 advertisements, they failed to qualify for the Regulation D exemption from registration.

26 Defendants requested an administrative hearing on the Order, which was held on March 6-7,
27 2006. The Administrative Law Judge issued his proposed Decision, which was adopted by the
28 Commissioner and became effective July 20, 2006. A true and correct copy of the Decision is

1 attached as Exhibit 1. Plaintiffs have a right to appeal from this Decision to the California Superior
 2 Court. At the time of this writing, the time for plaintiffs to seek an appeal from the Administrative
 3 Law Judge has not expired. Plaintiffs can argue that the superior court has the ability to review the
 4 facts *de novo*. In addition, the superior court has jurisdiction to rule on the question of whether the
 5 Department's administrative action against plaintiffs is preempted by federal law, which the
 6 Administrative Law Judge could not address. From the superior court, plaintiffs have a right of
 7 appeal to the California Court of Appeals and can ultimately seek review in the California Supreme
 8 Court.

9 Instead of pursuing these avenues for redress, plaintiffs filed this action in federal court on
 10 July 7, 2006. Plaintiffs ask this court for the same relief they can seek in the California superior
 11 court. Because plaintiffs have adequate remedies in the state system, the Department seeks an order
 12 of dismissal based on the abstention doctrine. In addition, plaintiffs' complaint is inadequate. By
 13 failing to state they have met the essential elements of the requirements for the exemption they seek,
 14 plaintiffs cannot claim the benefits of the exemption in this federal court action, and the authority of
 15 the state regulator is not, as a matter of law, preempted. As a result, plaintiffs failed to state facts that
 16 would give rise to a claim in federal court and the action should be dismissed.

17 C. LAW AND ARGUMENT.

18 1. PLAINTIFFS HAVE FAILED TO STATE FACTS THAT GIVE RISE TO A CLAIM 19 THAT WOULD ENTITLE THEM TO BE HEARD IN THIS COURT.

20 A motion to dismiss is proper under Rule 12(b)(6) where the pleadings fail to state a
 21 claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6). A motion to dismiss
 22 should not be granted unless it appears beyond a doubt that a plaintiff can show no set
 23 of facts supporting his or her claim. *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S. Ct.
 99, 2 L. Ed. 2d 80 (1957); see also *De La Cruz v. Tormey*, 582 F.2d 45, 48 (9th Cir.
 1978).

24 As a general rule, "a district court may not consider any material beyond the pleadings
 25 in ruling on a Rule 12(b)(6) motion." *Branch v. Tunnell*, 14 F.3d 449, 453 (9th Cir.
 1994), overruled on other grounds, *Galbraith v. County of Santa Clara*, 307 F.3d
 1119, 1126 (9th Cir. 2002) (citation omitted). *Cook Inc. v. Medtronic, Inc.*, 2006 U.S.
 26 Dist. LEXIS 47073, 12-14 (D. Cal. 2006)

26 ///

27 ///

28 ///

1 2. PLAINTIFFS FAILED TO EXHAUST THEIR STATE LAW REMEDIES, AND
2 THE COURT SHOULD ABSTAIN FROM HEARING THIS ACTION, INSTEAD DISMISSING IT
AS PREMATURE.

3 Plaintiffs failed to pursue an appeal of the Decision of the Commissioner, effective July 20,
4 2006. The mechanism for seeking review of the administrative decision in this case is to file a writ
5 with the appellate division of the superior court. *California Government Code §11523*.

6 Where the object of a particular proceeding is to establish that a local board acted arbitrarily,
7 capriciously or fraudulently, there is no distinction between an action for an injunction and
8 declaratory relief and proceeding in mandamus or certiorari. *Dumas v. Sunnyvale* (1965, 1st Dist)
9 231 Cal. App. 2d 796, 42 Cal Rptr 302, 1965 Cal App LEXIS 1569; *Abelleira v. District Court of*
10 *Appeal* (1941) 17 Cal. 2d 280, 295.

11 The Decision at the administrative level was adopted by the Commissioner and declared
12 effective July 20, 2006. *See Exhibit 1*. Under Government Code §11523, the process for challenging
13 the decision is by a “petition for a writ of mandate” in the state superior court within thirty days from
14 the effective date of the Decision. Plaintiffs filed their action on July 7, 2006, even before the
15 Decision was issued by the Administrative Law Judge. Plaintiffs initiated the administrative
16 proceeding by challenging the D&R Order, requiring an administrative hearing under Corporations
17 Code §25532(d), foregoing their opportunity to seek injunctive relief in either the state or federal
18 court immediately after the Order was issued. They should now be obliged to allow the state
19 administrative process play out, including a writ filed in the appellate division of the superior court
20 and, if necessary, to higher appellate courts. If plaintiffs ultimately do not prevail on their argument
21 through the California Supreme Court, they can then seek redress in the federal court system.

22 The principle of abstention found in *Younger v. Harris*, 401 U.S. 37, 27 L. Ed. 2d 669, 91 S.
23 Ct. 746 (1971) should apply in this case. The tests found in *Younger* and subsequent interpretive
24 cases apply to ongoing state administrative proceedings, and, particularly this case. *Fresh*
25 *International Corp. v. Agricultural Labor Relations Bd.*, 805 F.2d 1353, 1357 (9th Cir. 1986). In
26 *Fresh International*, the court found that abstention applied because the state proceedings were under
27 way before the federal proceeding was initiated and had moved beyond the “embryonic stage” (*At p.*
28 *1358*.) and because “California has an important state interest” in the case. *At p. 1361*. Here, the

1 administrative process had proceeded through an evidentiary hearing which was completed in March
2 2006 and a decision had not been issued by the Administrative Law Judge when the plaintiffs filed
3 their Complaint. The “important state interest” is that of the Commissioner, as the regulator of
4 securities transactions in the state, being able to investigate and take necessary action against an
5 issuer who is determined to have violated an exemption to the qualification requirement of
6 Corporations Code §25110. There is no dispute that in the administrative process, plaintiffs were
7 found, based on evidence that was presented, to have violated the provisions of the exemption they
8 now claim preempts the Commissioner’s action.

9 The *Fresh International* court was also dealing with possible preemption of state action,
10 although by an ERISA statute. However, the court found that the aggrieved party, BCI, had an
11 adequate opportunity to raise the preemption defense in the state proceeding, including the appellate
12 court. Specifically referring to the provision of the California Constitution, article III, section 3.5
13 which “prohibits a California administrative agency from considering preemption questions” the
14 court stated: “it seems clear that the court of appeal is the exclusive and original forum for such
15 questions.” *At p. 1362*. The court found that the BCI plaintiff “did, however, raise the preemption
16 issue before the ALJ . . . and it clearly *could have* presented it to the court of appeal in its petition for
17 review.” *Ibid*. As indicated in Exhibit 1 and the Complaint (paragraph 20), plaintiffs raised the
18 preemption issue and the Administrative Law Judge specifically refrained from considering
19 preemption citing the same section of the California Constitution that was mentioned in *Fresh*
20 *International*. Like the BCI plaintiff in *Fresh International*, plaintiffs here should be required to
21 proceed through the state appellate process to argue that the Commissioner abused his discretion by
22 proceeding in the face of a claimed exemption and/or preemption to the exercise of the regulatory
23 authority.

24 It is certainly likely that the appellate division of the superior court or the state appellate
25 courts can render a decision on whether the action of the Commissioner, and, therefore the
26 administrative decision upholding that action, is consistent with California law or not. Plaintiffs have
27 not filed any writ or appeal. Until the appellate remedies are exhausted, plaintiffs should be barred from
28 collaterally attacking the results in this Federal forum. The complaint seeking an injunction is

1 premature and the court should abstain from hearing this action.

2 3. PLAINTIFFS FAILED TO ALLEGE FACTS THAT THEY HAVE SUFFERED A
3 SIGNIFICANT THREAT OF IRREPARABLE INJURY; OR THAT THE BALANCE OF
4 HARDSHIPS FAVORS THE INJUNCTION THEY SEEK, OR WHETHER ANY PUBLIC
5 INTEREST FAVORS GRANTING AN INJUNCTION.

6 "The traditional test for granting preliminary injunctive relief requires the applicant to
7 demonstrate: (1) a likelihood of success on the merits; (2) a significant threat of irreparable injury; (3)
8 that the balance of hardships favors the applicant; and (4) whether any public interest favors granting
9 an injunction. *Dollar Rent A Car of Wash., Inc. v. Travelers Indem. Co.*, 774 F.2d 1371, 1374 (9th
10 Cir. 1985). The Ninth Circuit also uses an alternative test that requires the applicant to demonstrate
11 either a combination of probable success on the merits and the possibility of irreparable injury, or
12 serious questions going to the merits and that the balance of hardships tips sharply in the applicant's
13 favor. *First Brands Corp. v. Fred Meyer, Inc.*, 809 F.2d 1378, 1381 (9th Cir. 1987). The two tests
14 represent a continuum of equitable discretion, whereby "the greater the relative hardship to the
15 moving party, the less probability of success must be shown." *Nat'l Center for Immigrants Rights,*
16 *Inc. v. INS*, 743 F.2d 1365, 1369 (9th Cir. 1984). *Covarrubias v. Ralph's Grocery Co.*, 2004 U.S.
17 Dist. LEXIS 18318, 4-7 (D. Cal. 2004).

18 The D&R Order was issued on January 9, 2006. The administrative hearing was conducted
19 over March 6 and 7, 2006, after which a Decision was issued by the Administrative Law Judge in
20 favor of the Commissioner and against the plaintiffs. That Decision became effective July 20, 2006.
21 If plaintiffs really believed that the action of the Commissioner was preempted by its filing of
22 Regulation D notices and that the Commissioner had no power to issue the administrative order, any
23 "hardship" would have occurred immediately upon service of the D&R Order. Plaintiffs' delay of
24 more than seven months before seeking an injunction belies the sense of urgency they attempt to
25 present in this court.

26 Plaintiffs failed to allege any facts supporting their request for injunctive relief. Since the
27 issue of preemption and application of the Regulation D provisions is certainly undecided (although
28 plaintiffs lost on the issue at the administrative level), plaintiffs cannot demonstrate a likelihood of
success on the merits. Nor have they alleged any facts that there is a significant threat of irreparable

1 injury simply because they cannot raise investment capital in California. Nothing precludes plaintiffs
 2 from raising capital in all other states, so the balance of hardships does not favor plaintiffs, but favors
 3 the Commissioner on behalf of the investing public. For that same reason, the public interest of the
 4 Commissioner on behalf of the investing public should prevail over the narrow interest of plaintiffs in
 5 seeking to sell their investments in California in violation of applicable qualification/registration
 6 requirements. There are no facts alleged to support the request for injunctive relief.

7 4. NSMIA DOES NOT PREEMPT THE COMMISSIONER BECAUSE THE
 8 TRANSACTION WAS NOT EXEMPT UNDER REGULATION D.

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

14 In 1996 the Securities Act was amended by the National Securities Markets Improvement Act
 15 of 1996 (“NSMIA”). NSMIA was codified in 15 U.S.C. 77r that reads in pertinent part as follows:

16 “(a) Scope of exemption. Except as otherwise provided in this section, no law, rule,
 17 regulation, or order, or other administrative action of any State or any political subdivision
 thereof –

18 (1) requiring, or with respect to registration or qualification of securities, or
 registration or qualification of securities transactions, shall directly or indirectly
 19 apply to a security that –

(A) is a covered security....

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

21
 22 (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 –

(D) (SEC) rules or regulations issued under section 77d(2) of this title....”

24 (Emphasis added.)

25 Title 15 U.S.C §77 does not state that a covered security is one that “might” or “may be” or
 26 “could be” exempt. It does not include in the definition a “covered security” one that does not meet
 27 the terms of the exemption. It expressly states that a security is “covered” only if it “is exempt”.
 28 Similar language is found in Corporations Code §25102.1(d). In other words, the offering must

1 comply with the terms of the exemption in order for the exemption to preempt action by a state
 2 regulatory agency. Plaintiffs have not alleged facts demonstrating their compliance with the
 3 exemption.

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

9 17 C.F.R. section 230.502(c) provides in pertinent part as follows:

10 “Limitation on manner of offering. Except as provided in section 230.504(b)(1), neither the
 11 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:

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

15 It is commonly recognized in both state and federal securities law that the burden of proving
 16 an exemption or the affirmative defense of preemption is on the issuer. *California Corporations*
 17 *Code §25163; see Buist v Time Domain*, 2005 Ala. LEXIS 120; *Grubka v. Webaccess, Intl., Inc.* U.S.
 18 Dist LEXIS 44721 (2006); *SEC v Ralston Purina Co.* (1953) 346 U.S. 119, 126. Plaintiffs have not
 19 pled any facts to demonstrate compliance with Regulation D. Specifically, what triggered an
 20 investigation by the Department of Corporations was evidence showing that the Consolidated
 21 plaintiffs, as the issuers of the securities in the form of interests in joint ventures, and Guardian
 22 Capital acting in a sales capacity on their behalf, offered securities to citizens of California in the
 23 form of general solicitations by way of telephone calls and messages (“cold calls”), unsolicited
 24 mailings, advertising, invitations to luncheon/presentations and seminars attended by the general
 25 public who had no pre-existing relationship with the plaintiff issuer. These offerings violate the
 26 conditions of Regulation D Rule 506 and are, therefore, not exempt from qualification in the state
 27 under that Rule, contrary to plaintiffs’ claims.

28 Plaintiffs have not stated any claim within the jurisdiction of this court because they have not

1 pled facts that they fully complied with the requirements of Regulation D. If the offer is not in
2 compliance with Regulation D, then there is no exemption pursuant to the federal rules, or under
3 Corporations Code §25102.1, and the securities must be qualified as required by Corporations Code
4 §25110. “A failure to comply with a requirement of Rule 506 ‘voids’ the exemption, thereby
5 eliminating the possibility of preemption.” *Buist v Time Domain*, 2005 Ala. LEXIS 120.

6 In *Buist v. Time Domain, supra*, decided in July 2005, the supreme court of the State of
7 Alabama was presented with the same argument offered by plaintiffs in this case at the administrative
8 level. In the *Buist* case, the shareholder plaintiffs brought a civil action in state court for alleged
9 violations of the Alabama Securities Act in the offer and sale of securities. The defendant
10 corporations filed for a summary judgment arguing that the alleged state securities violations were
11 preempted by federal law because the securities they sold were “covered securities” pursuant to Rule
12 506 of Regulation D. Like plaintiffs here, the *Buist* defendants tried to support their motion with
13 evidence that they had filed at least two Form D’s with the Alabama Securities Commission. The
14 defendant’s motion was denied in part and the appeal ensued.

15 The Alabama supreme court on appeal upheld the denial of motion for summary judgment on
16 the grounds that in order for the state claim to be preempted by federal law the defendant
17 corporations needed to show that the securities they offered were covered securities that were exempt
18 under federal law. The court stated that each time the corporate defendant filed a Form D it
19 “promised a future course of conduct consistent with the requirements for an exempt offering.” *At*
20 *926 So.2d 297*. “In other words, the exempt status of the sale of securities that deviates from any of
21 the material commitments made in its Form D filing is repealed retroactively.” *Id., at p. 298*. With
22 the exemption “repealed retroactively,” any preemption is eliminated. The *Buist* court found that
23 defendant Time Domain “submitted no evidence indicating that its sales of securities were actually
24 made in conformity with Regulation D” and reversed a motion for summary judgment in its favor.
25 *Ibid.*

26 The *Buist* court provides a thoughtful analysis of the federal Securities Act and Regulation D
27 and states that NSMIA amended the Securities Act “to obviate the necessity of registering certain
28 securities with both state and federal governments by providing that under certain conditions state

1 laws are preempted by the Securities Act.” (Emphasis added.) The *Buist* case discusses the two cases
 2 cited by plaintiffs, *Temple vs. Gorman* 201 F. Supp 1238 (2002) and *Lillard v. Stockton*, 267 F.
 3 Supp.2d 1115 (N.D. Okla. 2003), the former decision written by a federal district court judge in
 4 Florida and the later written by a magistrate and adopted by a district court judge in Oklahoma.
 5 Plaintiffs relied on *Temple* in making their argument in the administrative hearing. As the *Buist* court
 6 notes, *Temple* arrived at its decision “ipse dixit”; the *Temple* court simply makes an unsupported
 7 assertion “without any accompanying analysis; *Lillard* in turn simply relies upon *Temple*.” *Buist v*
 8 *Time Domain, supra*, at page 19. The *Buist* court dismisses these two district court cases, as this
 9 court should here, noting they did not fully analyze the facts and can only serve as “persuasive” and
 10 not controlling authority.

11 As the court in *Grubka v. Webaccess, Intl., Inc., supra*, U.S. Dist LEXIS 44721 (2006),
 12 observed:

13 The *Temple* court read language into the statute that does not appear there. A security
 14 is covered if it “is exempt from registration . . .” 15 U.S.C., §77r(b)(4). Nowhere
 15 does the statute indicate that a security may satisfy the definition if it is *sold pursuant*
 16 *to a putative exemption*. If congress had intended that an offeror’s representation of
 17 exemption should suffice it could have said so, but did not. Such an intent seems
 18 unlikely, in any event; that a defendant could avoid liability under a state law simply
 19 by claiming its alleged compliance with Regulation D is an unsavory proposition and
 20 would eviscerate the statute.” At p. 28-29. (Emphasis added.)

21 That is the case here. Plaintiffs assert the Commissioner has no authority to examine the
 22 offering, but allege no facts that they actually complied with the requirements of the exemption.

23 5. THE COMMISSIONER HAD AUTHORITY TO ISSUE THE DESIST AND
 24 REFRAIN ORDER BECAUSE THE TRANSACTION WAS NOT EXEMPT UNDER
 25 CALIFORNIA LAW AND REGULATION D.

26 California Corporations Code §25110 provides that “it is unlawful for any person to offer or
 27 sell in this state any security in an issuer transaction... unless such sale has been qualified under
 28 Section 25111, 25112 or 25113... or unless such security or transaction is exempted . . .” (Emphasis
 added.) California exempts various transactions from the requirement of qualification or
 “registration” and plaintiffs base their assertion of exemption on Corporations Code §25102.1.

Corporations Code §25102.1 provides in pertinent part: “The following transactions are not
 subject to Sections 25110...(d) Any offer or sale of a security with respect to a transaction that is

1 exempt from registration under the Securities Act of 1933 pursuant to Section 18(b)(4) of that act...”
2 (Emphasis added.) This California statute was last amended in 1998 shortly after NSMIA was
3 enacted, clearly to dovetail with the conditions of NSMIA. Section 25102.1 goes on to require the
4 filing of a copy of the completed Form D filed with the SEC, a consent to service of process, and a
5 filing fee, and there is no dispute that plaintiffs filed a “506 Notice” with California. However,
6 §25102.1 expressly provides that it offers no protection unless the offer or sale is exempt under the
7 federal Securities Act including Regulation D.

8 According to Corporations Code §25163: “In any proceeding under this law, the burden of
9 proving an exemption or an exception from a definition is upon the person claiming it.” Under
10 federal law, plaintiffs have the burden of proving an exemption or the affirmative defense of
11 preemption as well. *See Buist v Time Domain, supra*, at page 13-14, and *SEC v Ralston Purina Co.*
12 (1953) 346 U.S. 119, 126. In order to claim the exemption and support the request for an injunction,
13 plaintiffs must show its offering was exempt under either California law or under federal law. The
14 court in *Hamby v. Clearwater Consulting Concepts, LLP, et al.* 428 F. Supp. 2d 915; 2006 LEXIS
15 26886 (E.D. Ark. 2006), in declining to award summary judgment in favor of the issuer, stated:

16 The defendants have the burden of proving an exemption from the registration
17 requirements. *See Parker v. Broom, 820 F.2d 966, 968 (8th Cir. 1987)*. Hamby
18 correctly points out that defendants have offered no affidavits or deposition testimony
19 that the other investors were accredited investors under Regulation D. Other than the
20 recitations in the Partnership Agreement tracking the requirements of Regulation D,
the defendants have offered no evidence that their sales of the security at issue met the
requirements for an exemption under *Rule 506*. The defendants have not shown that
the sales were exempt as a matter of law. *Cf. Fed. R. Civ. P. 56(c)(e)*. (Emphasis
added.)

21 Similarly, the court in *AFA Private Equity Fund 1 v. Miresco Investment Services*, 2005 U.S.
22 Dist. LEXIS 22071, denied defendant broker dealer’s motion to dismiss, stating:

23 Accordingly, SMH must present evidence showing that the securities at issue here are
24 exempt from registration under the rules adopted by the SEC under § 4(2). Moreover,
it is SMH's burden, as the party relying on the exemption, to establish that the
25 exemption applies and that all conditions of the exemption have been satisfied. *See*
e.g., S.E.C. v. Ralston Purina Co., 346 U.S. 119, 126-27, 97 L. Ed. 1494, 73 S. Ct. 981
26 (1953). Likewise, under Michigan's Uniform Security Act, it is SMH's burden, as the
27 person claiming it, to prove that an exemption applies. *Mich. Comp. Laws Ann. §*
451.802(c). Accordingly, because the burden of proving the availability of an
28 exemption from registration falls on SMH, Plaintiff has properly stated a claim for
relief.

1 Plaintiffs have alleged no facts to demonstrate that they complied with the Regulation D
2 requirements. As a result, there is no federal cause of action and injunctive relief is not supported by
3 facts. The offerings to California citizens were not exempt either under California law or federal law,
4 so they should have been qualified or registered in California under §25110, but they were not.

5 The Commissioner had authority to issue this Desist & Refrain Order under §25532(a)
6 because the securities were offered without first being qualified and failed to meet the requirements
7 of §25102.1:

8 “If, in the opinion of the commissioner [of the Department of Corporations], (1) the
9 sale of a security is subject to qualification under this law and it is being or has been
10 offered or sold without first being qualified, the commissioner may order the issuer or
11 offeror of that security to desist and refrain from the further offer or sale of the
12 security until qualification has been made under this law or (2) the sale of a security is
13 subject to the requirements of Section... 25102.1 and the security is being or has been
14 offered or sold without first meeting the requirements of those sections, the
15 commissioner may order the issuer or offeror of that security to desist and refrain from
16 the further offer or sale of the security until those requirements have been met.”

17 The Decision by the Administrative Law Judge found, based on evidence submitted, that
18 plaintiffs violated the conditions of the Regulation D filing. Rather than filing an appeal, plaintiffs
19 seek to relitigate the facts and issues in this federal court lawsuit. Based on the findings of the
20 Administrative Law Judge, however, plaintiffs do not fall within the exemption and the security was
21 subject to qualification as set forth in Corporations Code §25110. There is no claim under Federal
22 law.

23 6. PLAINTIFF HAS FAILED TO STATE A CLAIM UNDER 42 USC 1983.

24 Accepting the facts alleged by plaintiff as true, there is no remedy under any federal
25 constitutional principal or statute. See *Cervantes v. United States*, 330 F.3d 1186, 1187 (9th Cir.
26 2003); *Warren v. Fox Family Worldwide, Inc.*, 328 F.3d 1136, 1141 n.5 (9th Cir. 2003); *No. 84*
27 *Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 931
28 (9th Cir.), cert. denied, 540 U.S. 966, 157 L. Ed. 2d 311, 124 S. Ct. 433 (2003). A Rule 12(b)(6)
dismissal is appropriate if it appears beyond doubt that the plaintiff can not prove any set of facts in
support of the claim entitling plaintiff to relief. *No. 84 Employer-Teamster Joint Council*, 320 F.3d at
931. It is appropriate to dismiss a complaint without leave to amend if it is clear that the complaint
could not be saved by any amendment. *Thinket Ink Info. Res., Inc. v. Sun Microsystems, Inc.*, 368

1 F.3d 1053, 1061 (9th Cir. 2004); *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 403 F.3d 1050,
2 1055 (9th Cir. 2005).

3 There is no relief for plaintiff in the federal court.

4 To establish a prima facie case under 42 U.S.C. § 1983, a plaintiff must demonstrate
5 that (1) the action complained of occurred "under color of law," and (2) the action
6 resulted in a deprivation of a constitutional right or a federal statutory right. *McDade*
7 *v. West*, 223 F.3d 1135, 1139 (9th Cir. 2000) (citing *Parratt v. Taylor*, 451 U.S. 527,
535, 68 L. Ed. 2d 420, 101 S. Ct. 1908 (1981), overruled on other grounds by *Daniels*
v. Williams, 474 U.S. 327, 330-31, 88 L. Ed. 2d 662, 106 S. Ct. 662 (1986)). *Azer v.*
Connell, 306 F.3d 930, 935 (9th Cir. 2002).

8 In this case, plaintiffs completely fail to articulate any facts which "result in a
9 deprivation of a constitutional right or a federal statutory right." *Ibid*.

10 Under NSMIA states are precluded from "imposing laws, rules, regulations, orders, or other
11 administrative actions that require issuers of "covered securities" to register or qualify securities
12 transactions." The Commissioner has not imposed any laws, rules, regulations or orders, except as a
13 result of plaintiffs' failure to follow the specifications of Regulation D by offering the investments by
14 way of a general solicitation, for example phone calls, "cold calls, unsolicited mailings and the
15 marketing seminar. The counterpart exemption in California applies only so long as the offeror is in
16 compliance with Regulation D. Corresponding Corporations Code §25102.1(d) permits a "notice
17 filing" of a Regulation D exemption, but applies only if the security actually "is exempt" from
18 registration pursuant to Regulation D. Logic dictates that if the offering is not exempt, §25102.1(d)
19 does not apply and §25110 requires qualification in the state. If it were otherwise, an offeror could
20 violate Regulation D, which in turn would constitute a violation of the state qualification/ registration
21 statutes, but be free from scrutiny if the SEC failed to initiate an investigation, effectively creating an
22 unregulated market of fraudulent offerings. *See Grubka v. Webaccess International, Inc.*, 2006 U.S.
23 Dist. LEXIS 44721, at 28. The burden of proving an exemption is upon the one claiming it.
24 *California Corporations Code §25163*.

25 Plaintiffs' argument that this is not a security, but if it is, the Regulation D filing precludes
26 any qualification requirement in California, is inherently contradictory. Even if plaintiffs submitted a
27 "protective" filing under Regulation D in an abundance of caution, they were obliged to follow its
28 provisions in order to claim the exemption and the related preemption under both Federal and state

1 securities law. The factual finding at the administrative level was that plaintiffs violated the
2 conditions of Regulation D by offering the investment in a general solicitation to unqualified
3 investors. The legal finding was that plaintiffs offered a security in the form of an investment
4 contract. So plaintiffs were unquestionably in violation of state registration statutes and the
5 Commissioner's action was justified.

6 It can be reasonably inferred that plaintiffs were, however, apparently not quite sure that the
7 offering is not a security because they filed the paperwork to claim the Regulation D exemption and
8 preemption. That being the case, it would be essential that the provisions of Regulation D be
9 followed, if for no other reason but the one presented here, a determination that the offering was a
10 security. Even if the determination that the offering is a security was remote, full compliance with
11 the exemption is critical, or plaintiffs would be *per se* in violation of the qualification/registration
12 statutes. Absent complete compliance with the provisions of the exemption, plaintiffs subject
13 themselves to just the scrutiny they complain of here. Without full compliance, plaintiffs cannot
14 claim that they were offering a "covered security" for purposes of the Federal statute, nor can they
15 claim the exemption from registration/qualification and its preemptive effect under either Federal or
16 state law. Plaintiffs have not alleged compliance with the requirements of Regulation D and as a
17 result, plaintiffs have not stated a claim under Federal law.

18 7. THE ELEVENTH AMENDMENT BARS THIS CLAIM AGAINST THE
19 CALIFORNIA DEPARTMENT OF CORPORATIONS, A SUBDIVISION OF THE STATE OF
CALIFORNIA AND PRESTON DuFAUCHARD, THE CORPORATIONS COMMISSIONER.

20 The Eleventh Amendment to the Constitution bars actions against a state governmental entity
21 in federal court. *Caldwell v. Roseville Joint Union High Sch. Dist.*, 2005 U.S. Dist. LEXIS 24923,
22 15-16 (D. Cal. 2005) *citing Mitchell v. Los Angeles Comm. College Dist.*, 861 F.2d 198, 201 (9th Cir.
23 1988) and *Pennhurst State Sch & Hosp. v. Halderman*, 465 U.S. 89, 100, 79 L. Ed. 2d 67, 104 S. Ct.
24 900 (1984). The court stated "because the District is a state agency, it possesses Eleventh
25 Amendment immunity from plaintiff's claims for damages and for injunctive relief" and then granted
26 defendants' motion to dismiss: *Id.* Certainly, should there be a valid cause of action based on
27 U.S.C. §1983, there is no bar under the Eleventh Amendment. In this case, however, there is no valid
28 Constitutional claim and the case should be dismissed under the Eleventh Amendment. See *Beentjes*

1 v. *Placer County Air Pollution Control Dist.*, 397 F.3d 775 (9th Cir. 2005) and *Patsy v. Bd. of*
2 *Regents*, 457 U.S. 496, 516, 73 L. Ed. 2d 172, 102 S. Ct. 2557 (1982) (superseded on other grounds).

3 8. PLAINTIFFS FAILED TO PROVIDE A "SHORT AND PLAIN STATEMENT" OF
4 FACTS AND AS A RESULT, DEFENDANTS CANNOT BE SURE WHAT FACTUAL
ALLEGATIONS REQUIRE A RESPONSE.

5 As this Court has ruled:

6 Federal Rule of Civil Procedure 8(a) requires a plaintiff to set forth "a short and plain
7 statement of the claim showing that the pleader is entitled to relief." "Each averment
8 of a pleading shall be simple, concise and direct. No technical forms of pleading or
9 motions are required." Fed. R. Civ. P. 8(e). Thus, a plaintiff need not "set out in detail
10 the facts upon which he bases his claim. To the contrary, all the Rules require is 'a
11 short and plain statement of the claim' that will give the defendant fair notice of what
12 the plaintiff's claim is and the grounds on which it rests." *Conley [v. Gibson]*, 355 U.S.
13 41, 45-46, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957)] at 47.

14 In ruling on a Rule 12(b)(6) motion, the complaint is construed in the light most
15 favorable to the non-moving party and all material allegations in the complaint are
16 taken to be true. *Sanders v. Kennedy*, 794 F.2d 478, 481 (9th Cir. 1986). The court,
17 however, is not required to accept legal conclusions cast in the form of factual
18 allegations if those conclusions cannot reasonably be drawn from the facts alleged.
19 *Clegg v. Cult Awareness Network*, 18 F.3d 752, 754-55 (9th Cir. 1994) (citing
20 *Papasan v. Allain*, 478 U.S. 265, 286, 106 S. Ct. 2932, 92 L. Ed. 2d 209 (1986)).
21 *Morrison v. Gonzales*, 2006 U.S. Dist. LEXIS 37733, 4-5 (D. Cal. 2006)

22 This case presents a very interesting "complaint" that appears to be in the form of a
23 memorandum of points and authorities in support of a motion. Indeed, the "complaint" is nearly
24 identical to the points and authorities plaintiffs filed in support of their motion for injunction, set for
25 hearing on September 8, 2006. FRCP Rule 8 requires a "short and plain statement" to be set out in
26 the complaint, "showing that the pleader is entitled to relief." *See Morrison v. Gonzales. supra*, 2006
27 U.S. Dist. LEXIS 37733, 4-5 (D. Cal. 2006). Since the "complaint" contains not only "facts" but
28 extensive citation to statutory and case law authority, compounded with argument about the meaning
of related legal principles, defendants cannot understand what allegations they should be responding
to in the Answer. *See McHenry v. Renne*, 84 F.3d 1172, 1177-1178 (9th Cir. 1996).

This confusion is exacerbated because the "complaint" is verified. Defendants seriously
question how the declarant, a "Principal for Consolidated Management Group, LLC," can verify as
"true and correct" the "contents" of a "complaint" that includes paragraph after paragraph of nothing
more than citations to various legal principles and argument about the meaning of those principles.

1 The complaint inappropriately forces defendants to respond to plaintiffs' legal arguments. It appears
2 that most of the "complaint" is law and argument, not a "statement of facts" in support of a cause of
3 action.

4 Prior to any answer being filed, plaintiffs should be compelled to file an amended complaint,
5 this time setting out only a "short and plain" statement of facts and leave the "argument" for another
6 pleading. Further, since plaintiffs have apparently now sought a preliminary injunction by way of a
7 motion, the motion should be taken off calendar until such time as the "complaint" is amended to
8 comply with the federal rules to which defendants can appropriately file an answer or response.

9 9. THIS ACTION IS BARRED AS AGAINST BOTH PRESTON DuFAUCHARD,
10 CORPORATIONS COMMISSIONER AND ANY OTHER EMPLOYEE OF THE DEPARTMENT
11 OF CORPORATIONS, SINCE THEY HAVE QUALIFIED IMMUNITY FROM CIVIL LIABILITY
12 BASED ON ACTS CONDUCTED IN THE COURSE OF AN INVESTIGATION AND/OR
13 LITIGATION AUTHORIZED BY STATUTE THAT WERE NOT, AT THE TIME, CLEARLY
14 ESTABLISHED VIOLATIONS OF THE CONSTITUTION, AND THAT WERE SUBJECT TO
15 IMMUNITIES PURSUANT TO CALIFORNIA GOVERNMENT CODE §821.6, AND
16 CALIFORNIA CORPORATIONS CODE §25531 AND §25532.

17 There is no policy or procedure of the Department over which Mr. DuFauchard has authority
18 that is being challenged by plaintiffs. Plaintiffs do not allege that any California statute is
19 unconstitutional. As set forth in *Saucier v. Katz*, 533 U.S. 194, 200-202 (U.S. 2001), actions against
20 government employees are barred if no Constitutional right is implicated by the conduct and even if a
21 right were implicated, it was not "clearly established" that the conduct would violate the Constitution.
22 *Brosseau v. Haugen*, 543 U.S. 194, 196-198 (U.S. 2004). The court in *Brosseau* stated:

23 "If the law at [the time of the conduct] did not clearly establish that the . . . conduct
24 would violate the Constitution, the officer should not be subject to liability, or indeed,
25 even the burdens of litigation." *At p. 198.*

26 As indicated above, the investigation of the offering and the resulting administrative order
27 were specifically authorized by state law in Corporations Code §25531 and §25532. The issues
28 raised by plaintiffs' argument, that Regulation D preemption occurs upon filing, rather than upon
compliance, as the Commissioner asserts, have not been definitively decided. There is no "clearly
established" violation based on the conduct of the Commissioner. As a result, the plaintiff's action is
barred as to any executive or employee of the Department, as all related activities are considered part
of instituting or prosecuting any judicial proceeding within the scope of employment. The

1 Commissioner was acting within his authority in the conduct of an administrative proceeding brought
2 by the state department, and any action of the employee is protected from liability by qualified
3 immunity. Indeed, Government Code §821.6 states:

4 As provided in Government Code section 821.6, "[a] public employee is not liable for
5 injury caused by his instituting or prosecuting any judicial or administrative
6 proceeding within the scope of his employment, even if he acts maliciously and
7 without probable cause." (Hereafter section 821.6.)

8 Section 821.6 covers the initiation or prosecution of judicial or administrative
9 proceedings where the target may or may not be a state employee. The policy behind
10 section 821.6 is to encourage fearless performance of official duties. . . . State officers
11 and employees are encouraged to investigate and prosecute matters within their
12 purview without fear of reprisal from the person or entity harmed thereby. Protection
13 is provided even when official action is taken maliciously and without probable
14 cause." (*Shoemaker v. Myers* (1992) 2 Cal. App. 4th 1407, 1424 [4 Cal. Rptr. 2d
15 203].) *Javor v. Taggart*, (2002) 98 Cal. App. 4th 795, 808.

16 This "prosecutorial" immunity applies to the circumstances alleged by plaintiffs. Plaintiffs
17 allege that the defendants unlawfully proceeded in violation of the asserted NSMIA preemption, but
18 there are no facts alleged that the plaintiffs were in compliance with the conditions giving rise to the
19 preemption of NSMIA and Regulation D, so the Commissioner's action was authorized by law. The
20 investigation and resulting administrative order were conducted pursuant to the Commissioner's
21 authority under the California Corporate Securities Law. Plaintiff has not challenged the
22 Constitutionality of §25102.1, just the "interpretation" of that section by the Commissioner. The
23 remedy for this is the California appellate courts.

24 D. CONCLUSION.

25 Plaintiffs failed to allege the facts that would give rise to a valid claim under federal law.
26 Plaintiffs have not exhausted their state law remedies, specifically the appellate procedure set forth in
27 Government Code §11523. As a result, the court should abstain from hearing this action under the
28 *Younger* doctrine and dismiss the action.

Plaintiffs failed to allege any facts that confirm they complied with all the requirements of
Regulation D and demonstrate that they could avail themselves of that exemption/preemption and
Corporations Code §25102.1(d). The Department of Corporations, through its Commissioner, is and
was authorized by state law to investigate and prosecute violations of the Corporate Securities Law.
In this case, the Commissioner received information that led him to believe that plaintiffs were not

1 complying with their Regulation D filing as required. As a result, an investigation was warranted.

2 Having determined plaintiffs were not in compliance with the conditions of the Regulation D
3 exemption, the Commissioner proceeded as required by Corporations Code §25531 and §25532,
4 issuing a D&R Order and initiating an administrative process. Plaintiffs did not prevail in arguing
5 their position at the administrative level. Their remedy is an appeal in the state superior court.

6 Plaintiffs' complaint violates the basic requirement of a "short and plain statement" of the
7 facts supporting the causes of action and asserted relief, by offering a confusing mixture of facts, law
8 and argument, remarkably similar to their memorandum of points and authorities in support of their
9 motion for a preliminary injunction.

10 There is no support for the allegations that any act or omission of the Commissioner or the
11 Department constituted a "clearly established" violation of the Constitution. Possible case law
12 conflicts as to whether this action was preempted support the reasonable conclusion of the
13 Commissioner that an investigation was necessary and having confirmed lack of compliance with the
14 exemption by plaintiffs, the administrative order was appropriate. As a result, there is no Federal
15 statute upon which plaintiffs can base their claim and no Federal claim has been stated. The
16 Commissioner respectfully requests that the Court grant this motion and dismiss this action in its
17 entirety with prejudice.

18 DATED: July 27, 2006

19 Respectfully submitted,
20 PRESTON DuFAUCHARD
21 California Corporations Commissioner

22
23 By /s/ James K. Openshaw
24 JAMES K. OPENSHAW
25 Senior Corporations Counsel
26
27
28