

State of California - Department of Corporations

1 PRESTON DuFAUCHARD  
California Corporations Commissioner  
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ENDORSED  
FILED  
San Francisco County Superior Court  
  
OCT 25 2006  
  
GORDON PARK-LI, Clerk  
BY ELIZABETH ZALDIVAR  
Deputy Clerk

8 Attorneys for Respondent  
9 CALIFORNIA DEPARTMENT  
OF CORPORATIONS

12 SUPERIOR COURT OF CALIFORNIA  
13 COUNTY OF SAN FRANCISCO

15 Consolidated Management Group, LLC, a  
16 Kansas limited liability company, Consolidated  
Leasing Anadarko Joint Venture, a Kansas  
17 general partnership, and Consolidated Leasing  
Hugoton Joint Venture #2, a Kansas general  
18 partnership,  
19 Petitioners,  
20 vs.  
21 CALIFORNIA DEPARTMENT OF  
22 CORPORATIONS,  
23 Respondent.

) Case No. CPF-06-506669  
) Unlimited Civil Case  
)  
) ANSWER TO PETITION FOR WRIT OF  
ADMINISTRATIVE MANDAMUS

25 Respondent, PRESTON DuFAUCHARD as California Department of Corporations  
26 Commissioner and on behalf of the Department of Corporations, answers the writ of  
27 administrative mandamus ("petition") and admits, denies, and alleges as follows:  
28

1           1. Respondent admits the allegations in paragraph 1 of the petition that on January 23,  
2 2006 the Commissioner issued a Desist and Refrain Order against Petitioners alleging violation of  
3 California Corporations Code section 25110 and that Petitioners timely requested an administrative  
4 hearing and filed various briefs and motions before, during, and after the hearing. Respondent  
5 denies specifically and generally all other allegations of paragraph 1.

6           2. Respondent admits the allegations in paragraph 2 of the petition that on May 5, 2006,  
7 subsequent to a hearing on the merits, the ALJ issued a proposed decision that was subsequently  
8 adopted by the Commissioner on July 19, 2006 and that the ALJ ruled that the interests in joint  
9 interests offered and sold by Petitioners were securities. Respondent denies generally and  
10 specifically all other allegations of paragraph 2. Respondent affirmatively alleges the ALJ found  
11 that the Petitioners offered for sale in California securities that were not qualified in California, were  
12 offered through general solicitations and not exempt, and that the offers of the unqualified non-  
13 exempt securities were in violation California Corporations Code section 25110.

14           3. Respondent admits the allegation in paragraph 3 of the petition that the Petitioners  
15 seek issuance of an alternative writ of mandate and preemptory writ under CCP section 1094.5 to  
16 compel the Commissioner to vacate the D&R and the ALJ's Decision. Respondent denies, generally  
17 and specifically, all other allegations in paragraph 3, including each and every ground alleged in  
18 subparagraphs 3(a) through (h) as support for their request.

19           4. Respondent admits the allegations in paragraph 4 of the petition that Consolidated  
20 Management Group, LLC is a Kansas limited liability company, that Consolidated, Anadarko J.V.  
21 and Hugoton J.V. are located at 410 Urban Drive, Hutchinson, Kansas, 67501. Respondent denies  
22 that Anadarko J.V. and Hugoton J.V. are general partnerships and lacks information and belief  
23 sufficient to answer the remaining allegations and therefore on that basis denies those allegations.  
24 Respondent affirmatively alleges that, as found by the ALJ, the prospectuses and joint venture  
25 agreements for Anadarko J.V. and Hugoton J.V. show that the efforts of Consolidated, not the  
26 investors, are the undeniably significant ones, the essential managerial efforts which effect the  
27 failure or success of the enterprise. (DOC00006 through 00011; DOC00075-000138; DOC00233-  
28 00264 also found at DOC00367-00429.)

1           5. Respondent admits the allegations in paragraph 5 that the Department of Corporations  
2 has been and now is part of the executive branch of the State of California, a division of the  
3 Business, Transportation and Housing Agency, that the Commissioner of Corporations is the head of  
4 the Department of Corporations, and that the Department can be served through the Commissioner at  
5 1515 K Street, Ste. 200, Sacramento, California. Respondent denies, generally and specifically, all  
6 other allegations in paragraph 5.

7           6. Respondent admits the allegations in paragraph 6 of the petition that Consolidated is a  
8 Kansas limited liability company, but Respondent denies that the joint ventures are general  
9 partnerships and Respondent lacks information and belief sufficient to answer the remaining  
10 allegations concerning Petitioners actions and activities and therefore on that basis denies those  
11 allegations.

12           7. Respondent admits the allegations in paragraph 7 of the petition that Hugoton J.V.  
13 was formed in approximately August 2005, Consolidated (as managing venturer) filed with the U. S.  
14 SEC a Form D pursuant to Rule 503 promulgated under the Federal Securities Act and claimed  
15 exemption from registration pursuant to Rule 506 of Regulation D, and also in August of 2005,  
16 Consolidated filed with and served on the Commissioner two copies of the Form D filed with the  
17 SEC for Hugoton J.V., two copies of the U-2 and the \$300 notice filing fee required under California  
18 Code Section 25102.1(d). Respondent denies that the Hugoton joint venture is a general partnership  
19 (see paragraph 4 above) and the allegations of Petitioners concerning the alleged "safe harbor  
20 provisions" and Respondent lacks information and belief sufficient to answer the remaining  
21 allegations concerning Petitioners actions and activities and therefore on that basis denies those  
22 allegations. Respondent affirmatively alleges that the securities were offered and sold in California  
23 through general solicitations, and thus not exempt under Regulation D or under CCP 25102.1(d) as  
24 claimed by Petitioners; and furthermore Respondent alleges that Petitioners failed to show that they  
25 complied with the express terms of the Form D forms they executed and filed, specifically that "(t)he  
26 undersigned issuer (Consolidated) represents that the issuer is familiar with the conditions that must  
27 be satisfied to be entitled to the Uniform Offering Exemption (ULOE) of the state in which this  
28 notice is filed and understands that the issuer claiming the availability of this exemption has the

1 | burden of establishing that these conditions have been satisfied.” (DOC00325 and DOC00354.)

2 |           8. Respondent admits the allegations in paragraph 8 of the petition that Anadarko J.V.  
3 | was formed in approximately November 2005, Consolidated (as managing venturer) filed with the  
4 | U. S. SEC a Form D pursuant to Rule 503 promulgated under the Federal Securities Act and claimed  
5 | exemption from registration pursuant to Rule 506 of Regulation D, and also in November of 2005,  
6 | Consolidated filed with and served on the Commissioner two copies of the Form D filed with the  
7 | SEC for Anadarko J.V., two copies of the U-2 and the \$300 notice filing fee required under  
8 | California Code Section 25102.1(d). Respondent denies that the Anadarko joint venture is a general  
9 | partnership (see paragraph 4 above) and the allegations of Petitioners concerning the alleged “safe  
10 | harbor provisions” and Respondent lacks information and belief sufficient to answer the remaining  
11 | allegations concerning Petitioners actions and activities and therefore on that basis denies those  
12 | allegations. Respondent affirmatively alleges that the securities were offered and sold in California  
13 | through general solicitations, and thus not exempt under Regulation D or under CCP 25102.1(d) as  
14 | claimed by Petitioners.

15 |           9. Respondent denies the allegation in paragraph 9 that the then-acting California  
16 | Commissioner issued a D&R Order against Petitioners for violation of Corporations Code section  
17 | 25210 and admits the remaining allegations of paragraph 9.

18 |           10. In responding to the allegations of paragraph 10 of the petition, Respondent denies  
19 | that the Desist and Refrain Order concluded that only the joint venture interests offered and sold in  
20 | the Hugoton and Anadarko joint ventures are securities; the Desist and refrain Order is much broader  
21 | than that and in relevant part actually reads that the joint venture interests offered and sold by the  
22 | Petitioners are securities. Respondent admits the remaining allegations of paragraph 10.

23 |           11. Respondent admits the allegations in paragraph 11 of the petition that on February  
24 | 21, 2006 Petitioners filed with the Department of Corporations their Request for Hearing, Motion to  
25 | Dismiss, and Notice of Defense, and also filed a separate brief and Motion to Dismiss Based on  
26 | Preemption and Lack of Authority on February 27, 2006 and a Reply in Support of that motion on  
27 | March 6, 2006, but Respondent denies, generally and specifically, all other allegations of paragraph  
28 | 11 including each and every assertion, argument and legal conclusion asserted. Respondent

1 affirmatively alleges that Respondent filed with the ALJ and served Petitioner the following briefs  
2 addressing Petitioners' assertions, argument and legal conclusions: a March 3, 2006 brief prior to the  
3 administrative hearing (See DOC00156 to 00162) and post administrative hearing briefs on March  
4 20, 2006 (See DOC00163 to 00177) and April 5, 2006 (See DOC00178 to 00180).

5 12. Respondent admits the allegation in paragraph 12 of the petition that on March 6 and  
6 7, 2006 the Petitions and counsel for the Commissioner proceeded with the scheduled hearing before  
7 an ALJ at the OAH in Oakland, CA and at the hearing the Petitions reurged their motions, but  
8 Respondent denies, generally and specifically, all other allegations of paragraph 12, including each  
9 and every assertion, argument and legal conclusion reurged.

10 13. Respondent denies that the Commissioner "confirmed the D&R" Order, but  
11 Respondent admits the other allegations of paragraph 13 of the petition. Respondent affirmatively  
12 alleges that the ALJ rendered his proposed decision within 30 days of the matter being "deemed  
13 submitted" and Respondent filed with the ALJ post administrative briefs on March 20, 2006 (See  
14 DOC00163 to 00177) and April 5, 2006 (See DOC00178 to 00180).

15 14. Respondent admits the allegations of paragraph 14 of the petition. Respondent  
16 affirmatively asserts that Petitioners (Plaintiffs in the Federal Complaint) alleged in the first  
17 paragraph of their Verified Complaint (found in Exhibit C to the declaration of Petitioners' attorney  
18 Joel Held) that "Abstention from jurisdiction under Younger v Harris, 401 U.S. 37 (1971) is not  
19 appropriate in this case, because it is 'readily apparent' that the Commissioner's actions in issuing  
20 the D&R are preempted by NSMIA, and, therefore, 'no significant state interest (would be) served'  
21 by abstention." In the federal action on July 27, 2006 the Commissioner filed a Motion to Dismiss  
22 the Complaint based in part on the principle of abstention found in Younger v. Harris, and on August  
23 18, 2006 a Reply to Consolidated's Opposition. (It is requested this court take judicial notice of the  
24 papers filed in USDC Northern District of California, Case No. C 06 4203 JSW). On September 20,  
25 2006 District Judge Jeffrey S. White granted the Department's Motion to Dismiss based on the  
26 abstention doctrine and stated in his published opinion: "The Court finds that the ability of the state's  
27 regulatory commission to investigate and possibly regulate issuers of securities who are in violation  
28 of federal and state regulation qualifies as an important state interest....It is not readily apparent

1 from the pleadings submitted in this matter, or the authority offered to the Court, that the state's  
2 conduct was explicitly preempted by federal law.... There is no dispute that the California state  
3 courts may address the issues presented in this action...." (Consolidated vs. Preston DuFauchard  
4 2006 U.S. Dist. LEXIS 71111.)

5 15. Respondent denies the allegations of paragraph 15 of the petition. The Petitioner  
6 distorts the language and intent of CC Section 25532(a). Respondent affirmatively alleges that  
7 under Corporations Code Section 25532(a) if in the opinion of the Commissioner the sale of a  
8 security that is being or has been offered or sold without first meeting the requirements of Sections  
9 25110, 25100.1, 25101.1, or 25102.1, the Commissioner has the discretion to order an issuer to  
10 desist and refrain from the further offer or sale of the security until those requirements have been  
11 met. CC section 25532(a) provides that in order for a transaction to be exempt under section  
12 25102.1, Petitioners need to meet all requirements of subparagraph (d) of that section, including the  
13 requirement that any offer or sale of a security "is exempt" from registration under Regulation D.  
14 The petitioners failed to conform their conduct in marketing their securities to the contours provided  
15 by the exemption claimed; they made a public offering of unqualified securities instead of limiting  
16 themselves to the strictures of a private offering. Petitioners' conduct caused the securities to lose  
17 the private offering exemption.

18 16. Respondent denies the allegations of paragraph 16. Under CC Section 25532(d) and  
19 Government Code Section 11500 et seq. when a hearing is requested it shall be held and certain  
20 evidence can be taken at the hearing. In this instant case the Office of Administrative Hearings held  
21 the hearing.

22 17. Respondent denies generally and specifically the allegations of paragraph 17 that the  
23 D&R Order served as an accusation under Government Code Section 11503 and that the D&R  
24 alleged violations of CC Section 25210 as to Petitioners. Respondent affirmatively alleges that an  
25 accusation under section 11503 pertains to an action a public agency takes in regards to a right,  
26 authority, license or privilege (such as an existing broker dealer license), and that is not the case  
27 here. Petitioners used Guardian Capital Management as their Northern California sales agent  
28 offering for sale securities in Petitioners' joint ventures and Guardian Capital Management was not

1 licensed to do so. The D&R alleges that Petitioners and Guardian Capital Management violated  
2 section 25110 but alleges that only Guardian Capital Management violated CC Section 25210. Prior  
3 to the administrative hearing below, Guardian Capital Management and its employees Ken Keegan,  
4 Faber Johnston and Brandon Taylor withdrew their requests for a hearing to contest the D&R Order  
5 as it relates to them.

6 18. Respondent denies the Petitioner's allegation in paragraph 18 that the Respondent's  
7 decision is invalid, and specifically responds to paragraph 18 subsections as follows:

8 a. Respondent denies that it acted without jurisdiction as alleged in paragraph 18  
9 subsection "a" of the petition, and responds to Petitioners sub-subsections of paragraph 18 as  
10 follows:

11 (i) Respondent generally and specifically denies the allegations of sub-subsection (i) of  
12 paragraph 18a of the petition. The Petitioner distorts the language and intent of CC Section 25532.  
13 Respondent affirmatively alleges that Corporations Code section 25532 provides that in order for a  
14 transaction to be exempt under section 25102.1, Petitioners need to meet all requirements of  
15 subparagraph (d) of that section, including the requirement that any offer or sale of a security "is  
16 exempt" from registration under Regulation D. Petitioners have not shown that their offers of  
17 securities were exempt under Regulation D or CC section 25102.1(d).

18 (ii) Respondent generally and specifically denies the allegations of sub-subsection (ii) of  
19 paragraph 18a of the petition. Under NSMIA and Corporations Code §25102.1(d), the offering must  
20 comply with the terms of the exemption in order for the exemption to preempt action by a state  
21 regulatory agency. As found by the ALJ, petitioners do not fall within the exemption, and the  
22 security was subject to qualification as set forth in Corporations Code §25110.

23 (iii) Respondent admits the allegation of sub-subsection (iii) of paragraph 18a of the  
24 petition that under Corporations Code section 25102.1(d) an offer of a sale of a security with respect  
25 to a transaction that is exempt from registration pursuant to Section 18(b)(4)(D) is exempt from  
26 California Code Section 25110 (requiring qualification or registration) if a copy of the Form D is  
27 filed with Respondent, a consent to service of process is filed, and notice filing fee is paid, but  
28 Respondent denies generally and specifically each and every other allegation in this sub-section (iii).

1 Respondent contends that although petitioners have filed the appropriate documents related to an  
2 exemption from registration, they failed to conform their conduct in marketing these securities to the  
3 contours provided by the exemption; they made a public offering of unregistered securities instead of  
4 limiting themselves to the strictures of a private offering. Petitioners' conduct caused the securities  
5 to lose the private offering exemption.

6 b. Respondent denies generally and specifically the allegations of paragraph 18 subsection  
7 "b" of the Petition.

8 c. Respondent denies generally and specifically the allegations of paragraph 18 subsection  
9 "c" of the Petition. Petitioners distort the ALJ's legal analysis and conclusion. The conclusion of the  
10 ALJ that the joint venture interests Petitioners sold were securities was based on relevant and  
11 applicable federal and state case law, and the ALJ specifically found that under the federal Glenn W.  
12 Turner test the interests in Anadarko and Hugoton are securities. (DOC00009-00011)

13 d. Respondent denies generally and specifically the allegations of paragraph 18 subsection  
14 "d" of the Petition.

15 e. Respondent denies generally and specifically the allegations of paragraph 18 subsection  
16 "e" of the Petition.

17 f. Respondent denies generally and specifically the allegations of paragraph 18 subsection  
18 "f" of the Petition.

19 g. Respondent admits the allegations of subsection (g) of paragraph 18 of the petition that  
20 under CCP section 1094.5 the review of the validity of a final administrative order or decision  
21 extends to whether there was any prejudicial abuse of discretion, but Respondent denies generally  
22 and specifically the remainder of paragraph 18g; a finding of abuse of discretion can only be  
23 established if the court determines that the findings are not supported by substantial evidence and the  
24 Respondent denies that the ALJ committed abuse of discretion much less prejudicial abuse of  
25 discretion. Respondent responds to Petitioners sub-subsections of paragraph 18g as follows:

26 (i) Respondent admits the allegations of sub-subsection (i) of paragraph 18g of the petition  
27 that the ALJ affirmed the D&R with respect to the Hugoton J.V. and the petitioner correctly quotes  
28



1 from a portion of the transcript on March 7, 2006 but Respondent denies generally and specifically  
2 all other allegations of sub-subsection (i) of paragraph 18g.

3 (ii) Respondent denies generally and specifically the allegations of sub-subsection (ii) of  
4 paragraph 18g of the petition.

5 (iii) Respondent denies generally and specifically the allegations of sub-subsection (iii) of  
6 paragraph 18g of the petition.

7 (iv) In responding to the allegations of sub-subsection (iv) of paragraph 18g of the petition,  
8 Respondent admits that the limited portion of the record quoted by Petitioners does not misquote a  
9 portion of Mr. Keegan's testimony, specifically that Keegan testified that he never asked a first-time  
10 attendee at a luncheon for a check to participate in the Anadarko or Hugoton joint ventures, but  
11 Respondent denies generally and specifically the other allegations of sub-subsection (iv) of  
12 paragraph 18g of the petition.

13 (v) In responding to the allegations of sub-subsection (v) of paragraph 18g of the petition  
14 Respondent admits that over a three-month period prior to December 1, 2005 Jon Wroten was  
15 conducting an investigation of "H.W." (it was agreed at the hearing below that during the course of  
16 those proceedings the subject of that investigation would be referred to as "H.W." in lieu of using his  
17 real name) that included prior telephone conversations and providing him with a phone number, but  
18 Respondent denies generally and specifically all other allegations of sub-subsection (v) of paragraph  
19 18g of the petition.

20 h. In responding to the allegations of subsection (h) of paragraph 18 of the petition  
21 Respondent admits that a verbatim transcript of the March 6-7, 2006 hearing is attached as Exhibit A  
22 to the Declaration of Joel Held, and that the Petitioners requested from the Department of  
23 Corporations the Administrative Record pursuant to Government Code Section 11523, but  
24 Petitioners expressly wrote that their request for the Record did not include the court reporter's  
25 transcript, and Respondent denies generally and specifically the other allegations of subsection (h) of  
26 paragraph 18 of the petition.

27 19. In responding to the allegations of paragraph 19 of the petition, Respondent admits  
28 that a hearing took place and evidence was submitted pursuant to Corporations Code section

1 25532(d) and California Government Code Section 11500, and that the Respondent subsequently  
2 adopted the Proposed Decision from the ALJ, and that since Petitioner's action against the  
3 Department of Corporations was dismissed in the federal court, review by this Court pursuant to  
4 CCP. 1094.5 is proper when a petition has been filed. Respondent's deny all other allegations of  
5 paragraph 19 and specifically deny Petitioners' allegation that they do not have a plain, speedy, and  
6 adequate remedy in the ordinary course of law.

7 20. Respondent lacks sufficient information and belief to be able to answer the allegations of  
8 paragraph 20 of the petition and, based on that lack of information or belief, denies generally and  
9 specifically each and every allegation in paragraph 20.

10 21. The Petition lacks legal authority and specificity by reference to the record of the alleged  
11 error of law and prejudicial abuse of discretion. Petitioners fail to cite evidence in the Record that  
12 support their arguments. Absence support in the Record for the relief they seek, Petitioners instead  
13 resort to general argument.

14 FIRST AFFIRMATIVE DEFENSE

15 (Failure to State a Cause of Action)

16 1. Petitioner's petition fails to allege facts sufficient to constitute claims upon which  
17 relief can be granted.

18 SECOND AFFIRMATIVE DEFENSE

19 (No Abuse of Discretion)

20 2. The administrative findings and decision were not the result of an abuse of discretion.

21 THIRD AFFIRMATIVE DEFENSE

22 (Uncertainty)

23 3. The petition is uncertain, vague, ambiguous, improper and unintelligible.

24 FOURTH AFFIRMATIVE DEFENSE

25 (Right to apply other affirmative defenses reserved)

26 4. Because the petition only alleges conclusions of fact and law, answering Respondent  
27 cannot fully anticipate all affirmative defenses that may be applicable to this action. Accordingly,  
28 the right to assert additional affirmative defenses, if and to the extent that such affirmative defenses

1 are applicable, is hereby reserved.

2 WHEREFORE, Respondent prays for judgment against Petitioners as follows:

- 3 1. That the petition for writ of administrative mandamus be denied;
- 4 2. That Petitioners take nothing by virtue of their petition herein;
- 5 3. That the Court dismiss Petitioners' Petition for Writ of Administrative Mandamus
- 6 with prejudice;
- 7 4. For reasonable attorneys fees and costs of suit; and
- 8 5. For such other and further relief as this Court deems just and proper.

9 Dated: October 25, 2006

10 Respectfully Submitted,

11 PRESTON DuFAUCHARD  
12 California Corporations Commissioner

13 By: \_\_\_\_\_  
14 Edward Kelly Shinnack  
15 Corporations Counsel  
16 Enforcement Division

1 PROOF OF SERVICE

2 **Re: DEPARTMENT OF CORPORATIONS' ANSWER TO PETITION FOR WRIT OF**  
3 **ADMINISTRATIVE MANDAMUS**

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 October 25, 2006, following ordinary  
8 business practices, I placed for collection and at the offices of the State of California,  
9 Department of Corporations, 71 Stevenson Street, Suite 2100, San Francisco, CA, 94105-2980 (I  
10 am familiar with the practice of the offices of the Department of Corporations for collection and  
11 processing of correspondence, and that practice is the correspondence so placed for collection is,  
12 in the ordinary course of business, deposited the same day in the United States Postal Service)  
13 the attached true and correct copies of:

14  
15 **CALIFORNIA DEPARTMENT OF CORPORATIONS'**  
**ANSWER TO PETITION FOR WRIT OF ADMINISTRATIVE MANDAMUS**

16 in a sealed envelope, with postage fully prepaid, addressed as follows:

17 **Attorneys for Petitioners**

18 Joel Held  
19 Laura O'Rourke  
20 Baker & McKenzie LLP  
21 2300 Trammell Crow Center  
22 2001 Ross Avenue  
23 Dallas, Texas 75201

Christopher Van Gundy  
Baker & McKenzie LLP  
Two Embarcadero Center, 24<sup>th</sup> Floor  
San Francisco, CA 94111

24 I declare under penalty of perjury that the foregoing is true and correct and that this  
25 declaration was executed October 25, 2006 at San Francisco, California.

26 Edward Kelly Shinnick

27 \_\_\_\_\_

28