State of California - Department of Corporations

FILED
Clerk of the Superior Court

MAY 04 2012

By: LEE RYAN, Deputy

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF SAN DIEGO

THE PEOPLE OF THE STATE OF CALIFORNIA, by and through the CALIFORNIA CORPORATIONS COMMISSIONER,

Plaintiff,

vs.

SMARTWEAR TECHNOLOGIES, a San Diego County fictitious business name; SMARTWEAR TECHNOLOGIES, INC., a Delaware corporation; NORMAN FRANK REED, an individual; ROBERT REED, an individual; SEAN BORZAGE BOYD, an individual; and DOES 1 through 10, inclusive,

Defendants,

And

GLOBAL GENERAL TECHNOLOGIES, INC., a Nevada corporation; and LEXIT TECHNOLOGY, INC., a Colorado corporation,

Relief Defendants.

Case No.: 37-2008-00091291-CU-MC-CTL

[~~PROPOSED~~] STATEMENT OF DECISION

Judge: Hon. Ronald S. Prager
Dept: C-71

Plaintiff, the People of the State of California, by and through the California Corporations Commissioner ("Commissioner" or "Plaintiff"), filed a Complaint on September 9, 2008 pursuant to section 25530 of the California Corporate Securities Law of 1968 ("CSL"), California Corporations Code section 25000 et seq., to enjoin Defendants from violating the CSL and for other equitable relief, including restitution and civil penalties. The operative complaint ("Complaint") alleges claims for violations of sections 25110 and 25401[1] against Defendants SmartWear Technologies, Inc. ("SmartWear"), Norman Frank Reed, Robert Reed, Sean Borzage Boyd and Walter Robert Reed (collectively "Defendants"), and constructive trust/unjust enrichment against relief defendants. Defendants and relief defendants are in default.

Plaintiff argues that Defendants are jointly and severally liable for the entire fraudulent investment scheme, pursuant to section 25403, subdivision (a), as control persons of SmartWear.

Plaintiff also argues that Robert Reed is liable for the entire fraudulent investment scheme for providing substantial assistance to the scheme under section 25403, subdivision (b), and pursuant to the alter ego doctrine.

On the morning of June 21, 2011, a court trial began before the Honorable Ronald S. Prager, Judge of the Superior Court of the State of California for the County of San Diego, as to Robert Reed; all other defendants and relief defendants had defaulted. Robert Reed did not appear for trial and the Court found him in default.

In the afternoon of June 21, 2011, the Court received a removal notice filed by a relief defendant, removing the instant action to United State District Court for the Southern District of California. Plaintiff filed a motion to remand and on January 24, 2012 the United States District Court entered an order remanding the instant action to the Superior Court.

On May 4, 2012, a default prove-up proceeding was held before the Honorable Ronald S. Prager. Plaintiff was represented by Alex M. Calero, Senior Corporations Counsel.

After consideration of the evidence presented, the Court makes the following Findings of Fact and Conclusions of Law:

[1] All statutory references are to the California Corporations Code unless otherwise noted.

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FINDINGS OF FACT

1. Beginning in or about August 2005, Defendants offered and sold debentures in SmartWear. The debentures are convertible into shares of stock in SmartWear. The debentures offer 15% interest payments annually.

2. Not a single investor, however, was paid any interest payment on his or her investment in SmartWear.

3. In consideration for purchasing the debentures, investors were given warrants for additional shares of stock in SmartWear.

4. Debentures and warrants in SmartWear were offered and sold to members of the public nationwide by Defendants' salespeople, through unsolicited telephone "cold-calls." SmartWear salespeople, such as Sean Borzage Boyd, Brad Davis, Stuart Davis, Gregory Alexander and Keith Robinson made cold-calls to members of the public in order to solicit them to invest. The telephone cold-calls originated from a telemarketing center in California.

5. Prior to receiving the unsolicited telephone calls, these members of the public were not familiar with and had never met or heard of SmartWear's salespeople or Defendants.

6. After receiving cold-calls, members of the public were sent investment solicitation materials by Defendant's salespeople. Robert Reed and Sean Borzage Boyd also sent solicitation materials to potential investors.

7. SmartWear's investment solicitation materials include an executive summary, containing a one-page unaudited financial statement. SmartWear did not have audited financial statements; potential investors and existing investors were not provided audited financial statements.

8. The investment solicitation materials list Robert Reed as SmartWear's president and Walter Robert Reed as a vice president for SmartWear. A copy of SmartWear's website lists Robert Reed and Walter Robert Reed as officers of SmartWear. Walter Robert Reed is the father of Robert Reed. At all relevant times, Robert Reed was the president of SmartWear and Walter Robert Reed was a vice president of SmartWear.

9. Robert Reed also testified that he was the majority shareholder of SmartWear.

10. Correspondence with other businesses list Sean Borzage Boyd as a vice president for

SmartWear. Investors were led to believe that Sean Borzage Boyd was a vice president of SmartWear. At all relevant times, Sean Borzage Boyd was a vice president of SmartWear.

11. Robert Reed and Sean Borzage Boyd both personally spoke on the telephone to potential investors and existing investors. After receiving cold-calls from Defendants' salespeople, potential investors were invited to speak to Robert Reed – and, in fact, did speak to Robert Reed – about SmartWear's business and the investment opportunity in SmartWear.

12. Robert Reed and Sean Borzage Boyd met with potential investors in person to discuss the investment opportunity in SmartWear.

13. SmartWear was purportedly engaged in the business of developing radio frequency identification ("RFID") technology. SmartWear's executive summary represents that Smartwear holds patents on RFID, for example: "With the world's first and only patented, Non-Invasive, Wearable RFID technology, SmartWear is able to offer rapid, secure identification . . . ." Defendants' salespeople told some potential investors that SmartWear held all patents on RFID technology. Robert Reed also personally told potential investors that SmartWear held patents.

14. In fact, SmartWear never held any patents on RFID technology, or patents on anything else for that matter. Instead, SmartWear had only filed patent applications.

15. SmartWear's one-page unaudited financial statement, contained in the executive summary, represents that SmartWear's assets, including patents, were valued at over $8,000,000.

16. However, as stated above, SmartWear had no patents. Further, Robert Reed testified that he was not aware of any basis for claiming that Smartwear's assets were worth $8,000,000.

17. SmartWear's executive summary also represents that investor funds would be used to grow SmartWear's business. Some of Defendants' salespeople also told potential investor that investment funds would be used for SmartWear's business.

18. Defendants' salespeople represented to potential investors that Smartwear had contracts with the Port of Los Angeles and Disney. In fact, Robert Reed and Sean Borzage Boyd personally represented to potential investors that SmartWear had a contract with Disney. Robert Reed also personally told at least one potential investor that SmartWear had a contract with the Port of Los Angeles.

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19. Of the thirteen (13) SmartWear investors providing testimony, it was represented to five (5) investors that Smartwear had a contract with Disney and it was represented to three (3) investors that Smartwear had a contract with the Port of Los Angeles.

20. SmartWear never had any contracts with Disney.

21. SmartWear never had any contracts with the Port of Los Angeles.

22. SmartWear's investment solicitation materials state that SmartWear's corporate headquarters is located at 15934 Wood Valley Trail, Jamul, California 91935. The investment solicitation materials also list an address of P.O. Box 152112, San Diego, CA 92195 for SmartWear.

23. The investment solicitation materials directed investors to send their completed subscription documents and investment funds to SmartWear in San Diego, California. Investors testified that they did, in fact, send their completed subscription documents and investment funds to SmartWear in San Diego, California.

24. After investing, investors received letters from Robert Reed welcoming them to the SmartWear family. Investors also received stock certificates signed by Robert Reed.

25. Some individuals invested with SmartWear on numerous occasions. Securities were sold to individuals who were "unaccredited" investors.

26. SmartWear disclosed that it raised $4,970,639.93 from the sale of debentures and warrants to one hundred and thirty (130) investors. However, based on the discovery of additional investors and review of SmartWear's corporate bank account records, Defendants raised as much as $9,018,544.53 from at least one hundred and forty-eight (148) investors.[2]

27. The Commissioner did not issue a qualification to any of the Defendants to offer or sell securities in the State of California. Nor did any of the Defendants file an application for qualification.

28. In November 2007, an exemption notice – in reliance on the Section 4(2), Regulation D, Rule 506, and the CE exemption under federal securities law – claiming an exemption to the

[2] Prior to Robert Reed's default, Robert Reed was served with Plaintiff's trial brief, provided Robert Reed with notice of Plaintiff's allegations regarding additional investors, additional fraud allegations and increased claims for relief in excess of that pled in the operative complaint.

CSL's qualification requirements was submitted to the Commissioner on behalf of SmartWear. This is the only exemption notice filed by any of the Defendants.

29. Defendants do not have complete records relating to SmartWear's investors. Robert Reed testified that some investors would return incomplete subscription documents along with their investment check; other investors did not return any subscription documents at all with their investment check.

30. This is not the first time that an action has been brought against Defendants for violations of state securities laws. For example, in July 1999, Robert Reed, using the alias N.A. Reed, and Walter Robert Reed were issued a cease and desist order by the Pennsylvania Securities Commission for violation of state securities laws ("Pennsylvania Order") relating to the sale of securities in a previous venture, Toyopia.com. The Pennsylvania Order was issued, in part, against "N.A. Reed," executive vice president of Toyopia.com, and "Walter Reed," vice president of marketing for Toyopia.com.

31. The Pennsylvania Order was served on Robert Reed and Walter Robert Reed.

32. Toyopia.com's investment solicitation materials state that Walter Reed, a vice president of Toyopia.com, previously served as a vice president for Dynatech and holds BS and LLB degrees with graduate studies at UCLA School of Business. SmartWear's records also state that Walter Robert Reed, a vice president of SmartWear, previously served as a vice president for Dynatech and earned BS and LLB degrees with graduate studies at UCLA School of Business.

33. Defendant Walter Robert Reed is the same "Walter Reed," who is the subject of the Pennsylvania Order. Therefore, the Pennsylvania Order was issued against Walter Robert Reed, an officer of SmartWear.

34. Plaintiff introduced voluminous evidence to establish that defendant Robert Reed has used a number of aliases: N.A. Reed, N.A. "Bob" Reed, Norman "Bob" Reed, Norman Anthony Reed, Norman Frank Reed and Norman Reed.

35. Toyopia.com's investment solicitation materials also state that N.A. "Bob" Reed, the executive vice president of Toyopia.com, has 20 years of experience with computer software and served as technical officer of Indigo Software. The investment solicitation materials also state that

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N.A. "Bob" Reed attended Pierce College. SmartWear's records state that Robert Reed, SmartWear's president, has 20 years of experience with computer software and served as technical officer of Indigo Software. Robert Reed admits that he attended Pierce College.

36. Scott Tran, a Toyopia.com investor, testified that he received a letter signed by "Bob Reed," executive vice president of Toyopia.com.

37. In December 2006, a First Amended Complaint was filed in Arizona Superior Court, Maricopa County, in *Lauren Scott and Norman (Bob) Reed v. Vincent Goett, et al.*, Case No. CV2005-014863, relating to the sale of Toyopia.com to Vincent Goett and others ("Arizona Lawsuit"). The sixth cause of action (Count VI) in the Arizona Lawsuit alleges that the defendants breached an employment contract with Norman (Bob) Reed. The terms of the employment contract at issued in County VI reveals that the agreement was actually between Gryffon Company, Inc. and "Robert Reed."

38. SmartWear used the same post office box, P.O. Box 152112, San Diego, CA 92195, as Lauren Scott and Norman (Bob) Reed used in the Arizona Lawsuit. This post office box was opened by Norman Reed on behalf of Toyopia.

39. In November 1997, Robert Reed was issued a Washington State driver's license under the name "Norman Anthony Reed." This driver's license was used as proof of identification in order to notarize Toyopia.com, Inc.'s articles of incorporation. The Washington State driver's license, issued under the name Norman Anthony Reed, was also used to open a mail box at 2650 Jamacha Rd., Suite 147 box 2, El Cajon, California on behalf of Toyopia.com.

40. In November 2004, Robert Reed was issued a California driver's license under the name "Norman Frank Reed." The California driver's license lists an address of 2650 Jamacha Rd., Suite 147 box 2, El Cajon, California for Norman Frank Reed. The California driver's license, issued under the name Norman Frank Reed, was used as proof of identification in order to notarize the exemption notice submitted to the Commissioner on behalf of SmartWear.

41. In May 2008, a Neveda driver's license was issued to Robert Reed. The person pictured in the Washington State driver's license, issued to Norman Anthony Reed, and the California driver's license, issued to Norman Frank Reed, is the same person pictured in the Nevada

driver's license, issued to Robert Reed.

42. Defendant Robert Reed, using the alias "N.A. Reed," is the subject of the Pennsylvania Order. Therefore, the Pennsylvania Order was issued against Robert Reed, an officer of SmartWear.

43. In March 2003, Sean Borzage Boyd, using the alias Sean Boyd, was issued a cease and desist order by the Texas State Securities Board for violation of state securities laws ("Texas Order") relating to the sale of securities in ESS Environmental.

44. Sean Borzage Boyd had knowledge of and consented, in writing, to the Texas Order.

45. Greg Askay, a retired investigator for the Ventura County (California) District Attorney's office, testified that he spoke to Sean Borzage Boyd about the Texas Order and that Sean Borzage Boyd admitted to using the alias Sean Boyd. Greg Askay also testified that he visited a telemarketing center in California where Sean Borzage Boyd worked.

46. Defendant Sean Borzage Boyd, using the alias "Sean Boyd," is the subject of the Texas Order. Therefore, the Texas Order was issued against Sean Borzage Boyd, an officer of SmartWear.

47. It was not disclosed in SmartWear's investment solicitation materials that officers of SmartWear are subject to disciplinary orders, such as cease and desist orders, for violations of state securities laws. SmartWear could not recall informing any potential investors or existing investors about the Pennsylvania Order or Texas Order.

48. It was also not disclosed to potential investors and existing investors that funds raised from SmartWear's offering of debentures and warrants would be used for purposes unrelated to SmartWear's business. The Commissioner's review of the bank records of SmartWear's corporate account reveals the following:

49. Money was deposited into the SmartWear corporate account in the name of other business, including: (1) $572 paid to the order of "Something Sinful"; (2) $210 paid to the order of "Dregan Homes"; and (3) $4,500 paid for the purchase of stock in "DST Media, Inc.," a company associated with Robert Reed and his sister, Lauren Scott.

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50. Investor funds were withdrawn out of SmartWear's corporate account on behalf of other businesses, including: (1) $15,000 spent on expenses for Janex International, a company associated with Robert Reed's sister, Lauren Scott; and (2) $1,600 spent on expenses related to Aventine Capital, a company associated with Robert Reed's sister.

51. $108,000 of investor funds from SmartWear's corporate account was used for mortgage payments on a private residence owned by Robert Reed's sister, Lauren Scott.

52. Although SmartWear owned no real property, investor funds were used for home related expenses: (1) $23,500 for furniture at Pier 1 Imports, IKEA, and Mor Furniture for Less; (2) $38,200 at home improvement stores (e.g. The Home Depot); and (3) $15,200 on gas and electric bills.

53. Investor funds from SmartWear's corporate account were used to pay legal fees unrelated to SmartWear, including: (1) $70,000 to O'Connor and Campbell, an Arizona-based law firm representing Robert Reed and his sister, Lauren Scott, in the Arizona Lawsuit; (2) $667 for a deposition; and (3) $6,500 used toward the bankruptcy of Robert Reed's sister.

54. $300,000 of investor funds from SmartWear's corporate account was used to pay Robert Reed's mother, Gloria Reed, who was not an employee of SmartWear.

55. Investor funds from SmartWear's corporate account were used for such personal expenses as: (1) $1,600 for dental care for Robert Reed's mother; (2) $71,000 to purchase two luxury automobiles - a 2006 Hummer H2 and a 2003 Jaguar; (3) $17,500 paid to Daimler Chrysler and McCune Chrysler; (4) $3,800 paid to Hot Spring Spa; and (5) $379 for membership to a dating website for more than a two-year period.

56. Robert Reed testified that SmartWear had at most two employees: himself and his brother. Robert Reed also testified that the only addresses used by SmartWear were his apartment, his sister's private residence in San Diego, California and a post office box in San Diego, California.

57. Robert Reed admitted that SmartWear was undercapitalized.

58. SmartWear's books and records, such as corporate minute books, were never kept and did not exist. Records documenting the issuance of approximately 13 million shares of SmartWear stock to Robert Reed and records documenting the dissolution of Smartwear were not kept and did

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not exist.

59. In soliciting one hundred and thirty (130) investors, Defendants misrepresented and/or failed to disclose that:

a. In July 1999, Robert Reed, using the alias N.A. Reed, and Walter Robert Reed were issued a cease and desist order by the Pennsylvania Securities Commission for violation of state securities laws ("Pennsylvania Order") relating to the sale of securities in a previous venture, Toyopia.com. Investors testified that they would have found this information important.

b. In March 2003, Sean Borzage Boyd, using the alias Sean Boyd, was issued a cease and desist order by the Texas State Securities Board for violation of state securities laws ("Texas Order") relating to the sale of securities in ESS Environmental. Investors testified that they would have found this information important.

c. Debentures in SmartWear would pay investors a 15% interest rate annually. However, as detailed in Findings No. 2 above, not a single investor was paid any interest payment on their investment in SmartWear. Investors testified that they would have found this information important.

60. In soliciting five (5) investors, Defendants misrepresented that SmartWear had a contract with Disney. In fact, as detailed in Finding No. 20 above, SmartWear never had a contract with Disney. Investors testified that they would have found this information important.

61. In soliciting three (3) investors, Defendants misrepresented that SmartWear had a contract with the Port of Los Angeles. In reality, as detailed in Finding No. 21 above, SmartWear never had a contract with the Port of Los Angeles. Investors testified that they would have found this information important.

62. In soliciting an additional eighteen (18) investors, Robert Reed misrepresented and/or failed to disclose the facts in Finding No. 59, a - c, above.

63. In soliciting one hundred and forty-eight (148) investors, Robert Reed made additional misrepresentations that:

a. SmartWear had patented technology. As detailed in Finding Nos. 14 above, SmartWear held no patents. Investors testified that they would have found this information important.

b. SmartWear had assets worth over $8,000,000. However, as detailed in Finding Nos. 16 above, SmartWear's assets were not worth millions. Investors testified that they would have found this information important.

c. Investor funds would be used to grow SmartWear's business. It was not disclosed to potential investors that their funds would be used for personal and non-corporate related expenses, as detailed in Finding Nos. 49-55 above. Investors testified that they would have found this information important.

CONCLUSIONS OF LAW

First Cause of Action:

Plaintiff Proved by a Preponderance of the Evidence that Defendants Offered and Sold Unqualified, Non-Exempt Securities in Violation of Section 25110.

1. Section 25110 provides, "It is unlawful for any person to offer and sell in this state any security in an issuer transaction . . . unless such sale has been qualified," or unless exempt.

2. There are five (5) elements that have t o be established to prove a violation of section 25110: (1) a security; (2) was offered or sold; (3) in this state; (4) in an issuer transaction; and (5) without qualification. Establishing that an exemption does not apply is *not* an element of a 25110 violation; under section 25163, "the burden of proving an exemption or an exception from a definition is on the person claiming it." (Corp. Code, § 25163; *SEC v. Ralston Purina Co.* (1953) 346 U.S. 119, 126.)

3. Section 25019 defines "securities" to include any "debenture . . . stock, [and] warrant or right to subscribe to or purchase, any of the foregoing."

4. Defendants offered for sale debentures, convertible into shares of stock, and warrants, for additional shares of stock, to members of the public. The convertible debentures, warrants for stock, and stock in SmartWear are "securities."

5. Section 25017(b) defines the terms "offer" and "offer to sell" to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security . . . for value." Section 25017(a) defines the terms "sale" or "sell" to include "every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value."

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6. At least one hundred and thirty (130) investors were offered and sold securities in SmartWear. Thirteen (13) investors testified that they were contacted by Defendants' salespeople and solicited to purchase securities. Those same investors testified that they were sent investment solicitation materials discussing the investment opportunity and spoke with some of the Defendants about the investment in SmartWear. These activities constitute "offers" and "sales" of securities.

7. As set forth in section 25008(a), "[a]n offer or sale of a security is made in this state when an offer to sell is made in this state, or an offer to buy is accepted in this state, or (if both the seller and purchaser are domiciled in the state) the security is delivered to the purchaser in this state." Section 25008(b) states that an offer to buy is made in this state when the offer "originates from this state."

8. SmartWear's investment solicitation materials directed investors to send their completed subscription documents and investment funds to SmartWear at its headquarters in San Diego, California. Investors testified that they did, in fact, send their completed subscription documents and investment funds to SmartWear in San Diego, California.

9. Many investors testified that they received unsolicited telephone cold-calls; SmartWear utilized a telemarketing center in the State of California. Regardless of where the investors reside, the offers and sales of securities in SmartWear occurred in the State of California.

10. "An issuer transaction is one in which 'any portion of the purchase price of any security involved in the transaction will be received indirectly by the issuer.' (Corp. Code, § 25011)" (*People v. O'Neal* (2009) 179 Cal. App. 4th 1494, 1500, fn. 28; see also Corp. Code, § 25010.) An "issuer" includes the "entities" or "persons" who organize or sponsor the business and are primarily responsible for its success or failure. (*SEC v. Murphy* (9th Cir. 1980) 626 F.2d 633, 642-644.)

11. The purported purpose of the offering of securities was to fund the growth of SmartWear. Investors sent their funds to SmartWear for that purpose. Therefore, SmartWear is the issuer of the securities and the securities were offered and sold in "issuer transactions."

12. The offer and sale of securities in SmartWear was not qualified. Therefore, in order for Defendants not to be in violation of CSL section 25110, Defendants must meet their burden that the offer and sale of securities is "exempt" from qualification. Although SmartWear filed an

exemption notice – in reliance on the Section 4(2), Regulation D and the CE exemptions under federal securities law – claiming an exemption to the CSL's qualification requirements, the mere filing of an exemption notice does not automatically exempt securities. (*Consolidated Management Group, LLC v. Dept. of Corp*. (2008) 162 Cal.App.4th 598, 607-608; *Apollo Capital Fund LLC v. Roth Capital Partners LLC* (2007) 148 Cal.App.4th 226, 250.) For an exemption to apply, the offers and sales of securities must actually satisfy the requirements of the exemption. (*Id*. at 246.)

13. In order to meet their burden of showing that the securities in SmartWear are exempt, Defendants' proof must be explicit, exact and not built on conclusory statements. (*Johnston v. Bumba* (N.D. Ill. 1991) 764 F. Supp. 1263, 1273.) Defendants are in default and did not put forth *any* evidence to meet their burden to show that the exemption requirements have actually been met.

14. However, Defendants cannot satisfy the requirements of the Section 4(2) or Regulation D, Rule 506, exemptions because: (a) general solicitation in the form of "cold-calls" were used to offer securities; (b) complete subscription agreements regarding the nature and number of investors were not kept; and (c) Defendants cannot show that investors had access to the requisite information.

15. First, in order to qualify for the Regulation D, Rule 506, exemption neither the issuer nor any person acting on its behalf can offer or sell the securities by general solicitation. (17 C.F.R. § 230.502, subd. (c); see also *SEC v. Credit First Fund, LP* (C.D. Cal. 2006) 2006 U.S. Dist. LEXIS 96697, *43.) Similarly, under the Section 4(2) exemption an issuer may not engaged in a "public offering" of securities. (15 U.S.C. § 77d(2).) To determine whether a public offering has taken place, such factors as the manner of the offering and the relationship of the offerees to the issuer are considered. (*SEC v. Credit First Fund, LP*, *supra*, 2006 U.S. Dist. LEXIS 96697, *37-38.)

16. Engaging in telephone "cold-calls" to offerees is a form of general solicitation. (*SEC v. Credit First Fund, LP*, *supra*, 2006 U.S. Dist. LEXIS 96697, *43-44; *Johnston v. Bumba* (N.D. Ill. 1991) 764 F. Supp. 1263, 1275 [Where the offeror initiates "cold calls" to solicit offerees, the offer is a general solicitation, not a private offering].) Because unsolicited telephone "cold-calls" were made to members of the public, the securities in SmartWear were offered through a public offering.

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17. Second, in order to qualify for an exemption under Regulation D, Rule 506, the securities can not be sold to more than 35 "unaccredited" investors. (17 C.F.R. § 230.506(b)(2)(i).) Similarly, the applicability of the Section 4(2) exemption rests upon whether the particular class of investors affected needs the protection of the securities laws. (*SEC v. Ralston Purina Co., supra*, 346 U.S. 119, 124.) This places a duty on the issuer not only to "pre-qualify" offerees, but also to keep records to substantiate that each offeree is pre-qualified and able to fend for herself. (*SEC v. Life Partners, Inc.* (D.D.C. 1996) 912 F.Supp. 4, 10.) As stated above, Defendants do not have complete investor records; Robert Reed testified that some investors would return incomplete subscription agreements while other investors returned no subscription agreements at all. Without complete subscription documents, Defendants cannot prove that each offeree did not need the protection of the securities laws. (See *Marks v. FSC Sec. Corp.* (6th Cir. 1989) 870 F.2d 331, 337; *SEC v. Life Partners, Inc.* (D.D.C. 1996) 912 F.Supp. at 10 ["defendants have the burden of identifying all offerees, . . . and because [they] cannot provide this information, defendants' offerings do not qualify for the exemption under section 4(2)."].) Securities were sold to unaccredited investors. Therefore, Defendants cannot produce evidence to substantiate the nature and number of investors.

18. Third, both the Regulation D, Rule 506, and Section 4(2) exemptions require that specific information be provided to potential investors. With regard to the Section 4(2) exemption, after the government demonstrates that the requisite relationship did not exist with offerees, it is incumbent upon the party claiming the exemption to produce evidence that investors had available all necessary information. (*SEC v. Murphy*, *supra*, 626 F.2d at p. 647.) The information required is quite extensive: "'Schedule A of the Securities Act, 15 U.S.C. § 77aa (1958), lists 32 categories of information that should be included in a registration statement . . . A purchaser of unregistered stock must be shown to have been in a position to acquire similar information about the issuer.' [citation omitted]" (*Id.* at p. 647.) Defendants cannot show that every investor received the requisite information for the Section 4(2) exemption to apply. The Regulation D, Rule 506, exemption only applies if unaccredited investors are provided with audited financial statements. (17 C.F.R. §§ 230.502(b)(2)(i)(B)(2); 230.506; see also *SEC v. Empire Development Group*, LLC (S.D.N.Y. 2008) Defendants cannot prove that audited financial statements were provided to unaccredited investors

because Defendants do not know how many unaccredited individuals invested in SmartWear and further, SmartWear never had audited financial statements.

19. Defendants also failed to comply with the conditions of the CE exemption, which provides an exemption from registration requirements for offers and sale of securities that satisfy the conditions of CSL section 25102(n). (17 C.F.R. 230.1001.) In order to satisfy the conditions of section 25102(n), the issuer must file a specific exemption notice with the Commissioner concurrently with the initial offering of securities. (Corp. Code § 25102, subd. (n)(7).) No section 25102(n) exemption notice was filed with the Commissioner. Thus, the CE exemption is not met.

20. Defendants offered and sold securities, in the form of debentures, to at least one hundred and thirty (130) investors. Likewise, Defendants offered and sold securities, in the form of warrants, to at least one hundred and thirty (130) investors. Thus, Plaintiff proved two hundred and sixty (260) violations of section 25110 against Defendants.

21. Plaintiff proved an additional eighteen (18) violations of section 25110 against Robert Reed for the offer and sale of securities, in the form of debentures. Similarly, Plaintiff proved an additional eighteen (18) violations of section 25110 against Robert Reed for the offer and sale of securities, in the form of warrants. In total, Plaintiff proved an additional thirty-six (36) violations of section 25110 against Robert Reed.

Second Cause of Action:

Plaintiff Proved by a Preponderance of the Evidence that Defendants Made Material Misrepresentations and Omissions in Connection with the Offer and Sale of Securities in Violation of Section 25401.

22. Section 25401 provides:

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

23. Section 25401 differs from common law fraud in that no proof of reliance is required and the party accused of a violation need not be shown to have acted intentionally. (*Bowden v. Robinson* (1977) 67 Cal.App.3d 705, 714-715.) Similarly, knowledge and intent are not required to

establish a violation of section 25401 in a civil enforcement action brought by the Commissioner. (*People v. Simon* (1995) 9 Cal.4th 493, 515-16.) Rather, Plaintiff must only prove that in connection with the offer or sale of securities, Defendants misrepresented or omitted to disclose a material fact.

24. A fact is material if "there is a substantial likelihood that, under all the circumstances, a reasonable investor would consider it important in reaching an investment decision." (*Insurance Underwriters Clearing House, Inc. v. Natomas Co.* (1984) 184 Cal.App.3d 1520.) The legal standard is not what the investors here relied on, but what a "reasonable investor" would have found material. (*Lynch v. Cook* (1983) 148 Cal.App.3d 1072, 1081.)

25. As set forth in Finding of Fact Nos. 59-61 above, Defendants made a number of misrepresentations and/or failed to disclose facts to potential investors in the offer and sale of securities in SmartWear. These facts are material, since a reasonable investor would consider them important in reaching an investment decision.

26. Also, as set forth in Finding of Fact Nos. 62, 63 above, Robert Reed made a number of misrepresentations of facts to potential investors in the offer and sale of securities in SmartWear. These facts are material, since a reasonable investor would consider them important in reaching an investment decision.

27. Most notably, Defendants failed to disclose that Robert Reed, Walter Robert Reed and Sean Borzage Boyd, all officers of SmartWear, were issued cease and desist orders for previous violations of states securities laws. A reasonable investor would want to know if the officer of a company soliciting an investment has a history of violating securities laws. (See *SEC v. Merchant Capital, LLC* (11th Cir. 2007) 483 F.3d 747, 768 (The existence of a state cease and desist order is relevant to a reasonable investor, who is naturally interested in whether management is following the law in marketing the securities); *SEC v. Paro* (N.D.N.Y. 1979) 468 F. Supp. 635, 646.)

28. The misrepresentations made to potential investors about the nature and extent of SmartWear's business, including purported contracts with Disney and the Port of Los Angeles, are also material. (*SEC v. Empire Development Group* (2008) 2008 U.S. Dist. LEXIS 43509, at *31 [claims about the nature and extent of the defendant's business are material].)

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29. Claiming that SmartWear held patents when it had only filed patents applications is also a material misrepresentation. A patent application is clearly not the same thing as a patent. (*Flaxel v. Johnson* (S.D. Cal. 2008) 541 F. Supp. 2d 1127, 1137 [holding that defendants misrepresented that they held "patented" technology, when defendants had only filed patent applications].)

30. In the offer and sale of securities, Defendants misrepresented and/or omitted to disclose the material facts set forth in Finding of Fact No. 59, to one hundred and thirty (130) investors. Thus Plaintiff proved three hundred and ninety (390) violations of section 25401 against Defendants.

31. In the offer and sale of securities, Defendants misrepresented a material fact set forth in Finding of Fact No. 60 to five (5) investors. Thus Plaintiff proved five (5) additional violations of section 25401 against Defendants.

32. In the offer and sale of securities, Defendants misrepresented a material fact set forth in Finding of Fact No. 61 to three (3) investors. Thus Plaintiff proved three (3) additional violations of section 25401 against Defendants.

33. In the offer and sale of securities, Robert Reed misrepresented and/or omitted to disclose the materials facts set forth in Finding of Fact No. 62, to eighteen (18) additional investors. Thus Plaintiff proved fifty-four (54) additional violations of section 25401 against Robert Reed.

34. In the offer and sale of securities, Robert Reed misrepresented the material facts set forth in Finding of Fact No. 63, to one hundred and eighty-four (184) investors. Thus Plaintiff proved four hundred and forty-four (444) additional violations of section 25401 against Robert Reed.

Joint and Several Liability as to All Defendants:

Plaintiff Proved by a Preponderance of the Evidence that Defendants are Liable for the Entire Scheme as Control People.

35 Section 25403, subdivision (a), provides, "Every person who with knowledge directly or indirectly controls and induces any person to violate any provision of this division [commencing with § 25000] . . . shall be deemed to be in violation of that provision . . . to the same extent as the controlled and induced person."

36. Control person liability statutes are intended to prevent evasion of the law "by organizing dummies who will undertake the actual things forbidden." (*Hollinger v. Titan Capital Corp.* (9th Cir. 1990) 914 F.2d 1564, 1577; see also *Eastern Vanguard Forex Ltd. v. Arizona Corp. Commission* (Ariz.App. 2003) 206 Ariz. 399, 410-412 [rejecting a requirement that a control person "actually participated" in the specific action upon which the securities violation is based].) Actual participation by a control person is unnecessary. (*People v. Miller* (1987) 192 Cal.App.3d 1505, 1509-511, fn. 10.)

37. The "failure of the controlling person to maintain and diligently enforce a proper system of internal supervision and control constitutes participation in the misconduct and the violation will be deemed to have been committed, not only by the controlled person, but also by the controlling person who did not perform the duty to prevent it." (*SEC v. First Securities Company of Chicago* (7th Cir. 1972) 463 F.2d 981, 987, citing *Hecht v. Harris Upham & Co.* (N.D. Cal. 1968) 283 F. Supp. 417, 438.)

38. As set forth in Findings of Fact Nos. 8-10, Defendants were officers of SmartWear. Defendants were "control" people of SmartWear and thus are liable for violations of the CSL to the same extent as SmartWear and its agents.

39. The Court finds the Defendants jointly and severally liable with SmarWear and its agents under section 25403, subdivision (a).

Joint and Several Liability as to Robert Reed:

Plaintiff Proved by a Preponderance of the Evidence that Robert Reed is Liable For the Entire Scheme For Providing Substantial Assistance.

40. Further, Robert Reed substantially assisted SmartWear and its agents in the entire securities scheme. Under section 25403, subdivision (b), any person who provides "substantial assistance" to another person in violation of the CSL "shall be deemed in violation of [the CSL] to the same extent as the person to whom the assistance was provided." As detailed above in Findings of Fact Nos. 6, 11-13, 18, 24, Robert Reed was not a disinterested officer, but rather, provided substantial assistance to SmartWear and its agents in the fraudulent investment scheme.

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41. The Court finds Robert Reed jointly and severally liable with SmartWear and its agents under section 25403, subdivision (b).

Alter Ego:

Plaintiff Proved by a Preponderance of the Evidence that Robert Reed is liable for the Entire Scheme Under the Alter Ego Doctrine.

42. Under the alter ego doctrine a court may disregard the corporate entity and treat the acts as if individual perpetrators did them. (*Kohn v. Kohn* (1950) 95 Cal.App.2d 708, 718.) Courts, in general, have followed a liberal policy of applying the alter-ego doctrine where the equities of the situation appear to call for the doctrine's application. (*First W. Bank and Trust Co. v. Bookasta* (1968) 267 Cal.App.2d 910, 915 [it is not essential that the alter ego doctrine be specifically pleaded in the complaint in order for it to be applied].)

43. To establish an alter-ego nexus between a corporation and a particular individual, it must be shown, first, that the corporation is not only influenced and governed by that person, but that there is such a unity of interest and ownership that the individuality, or separateness, of the said person and corporation has ceased, and, second, that the facts are such that an adherence to the fiction of the separate existence of the corporation would, under the particular circumstances, sanction a fraud or promote injustice. (*First W. Bank and Trust Co., supra*, 267 Cal.App.2d at 914-915; see also, *Automortiz Del Golfo De California v. Resnick* (1957) 47 Cal.2d 792, 796.)

44. Factors pertinent to determining whether there is a unity of interest between the individual perpetrator and the corporation, include: commingling of funds and other assets, unauthorized diversion of corporate funds or assets to other than corporate uses, the failure to obtain authority to issue stock, the use of a corporation as a mere shell, the disregard of legal formalities, failure to adequately capitalize a corporation, and undercapitalization of the corporation. (*Associated Vendors, Inc. v. Oakland Meat Co.* (1962) 210 Cal.App.2d 825, 838-40; see also, *Troyk v. Farmers Group, Inc.* (2009) 171 Cal.App.4th 1305, 1341.)

45. As set forth in Finding of Fact No. 49 above, investor funds deposited in SmartWear's corporate bank account were commingled with funds from other businesses.

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46. As set forth in Findings of Fact Nos. 50-55 above, Robert Reed made use of SmartWear funds for non-corporate purposes. Investor funds were used to pay for the personal affairs of Bob Reed and his family.

47. As set forth in Findings of Fact No. 58 above, Robert Reed disregarded legal formalities in the operation of SmartWear. SmartWear maintained no corporate minute books documenting such transactions as the issuance of millions of shares of stock to Robert Reed and the dissolution of SmartWear itself.

48. As set forth in Findings of Fact Nos. 50, 57 above, SmartWear was undercapitialized and was merely a shell, a vehicle for Robert Reed's personal gain.

49. In weighing the second part of the alter-ego test, it must be determined that treating the entity and individual separately will result in fraud or inequity. Both aspects are not required. (*First W. Bank Trust Co., supra,* 267 Cal.App.2d at 914-15; *Automortiz Del Golfo, supra,* 47 Cal.2d at 796.)

50. As set forth in Findings of Fact Nos. 59-63 above, unsuspecting members of the public were convinced to invest in SmartWear as a result of misrepresentations. A main objective of the CSL is to protect against fraudulent investment schemes (*People v. Syde*, *supra*, 37 Cal.2d at p. 768), and to promote disclosure of all information necessary to make informed investment decisions. (*People v. Park, supra,* 87 Cal.App.3d at 565.) Had SmartWear's business made a legitimate profit, Robert Reed could have issued dividends to shareholders and used his portion of the profits to pay for luxury automobiles, mortgage payments, and dentist bills for his mother, etc. Yet, investor funds which were supposed to be used to grow SmartWear were instead used to pay for the personal affairs of Bob Reed and his family. This is not an equitable result. This is exactly the kind of situation that the alter-ego doctrine was created to protect against. (*Associated Vendors, Inc. v. Oakland Meat Co.*, 210 Cal.App.2d at p. 842 [the doctrine affords protection, "where some conduct amounting to bad faith makes it inequitable [for] a corporate owner to hide behind its corporate veil"].) Robert Reed's personal use of investor funds, rather than for corporate obligations, caused harm to not only SmartWear investors, but the investing public at large.

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51. Robert Reed disregarded securities qualification requirements in order to raise millions of dollars. Another objective of the securities laws is to make violations unprofitable in order to deter future would-be violators. (*SEC v. Manor Nursing Centers, Inc.* (2nd Cir. 1972) 458 F.2d 1082, 1104.) If Robert Reed is not held personally liable, this would, in effect, allow an individual to form a corporation, coax investors into handing over millions, divert those funds for personal use, dissolve the corporation, and the perpetrator would have no liability. Such a result is not equitable.

52. The Court finds that SmartWear is the alter ego of Robert Reed. There is such a unity of interest and ownership that the individuality of Robert Reed and SmartWear ceased. Adherence to the fiction of the separate existence of SmartWear would sanction a fraud and promote injustice. The Court finds that Robert Reed is liable for the acts of SmartWear and its agents under the alter ego doctrine.

ORDER FOR RELIEF

The Court hereby finds in favor of Plaintiff on its claims for violations of California Corporations Code sections 25110 and 25401 against defendant SmartWear Technologies, Inc., Robert Reed, Walter Robert Reed and Sean Borzage Boyd. The Court finds that the Defendants are jointly and severally liable for the above detailed violations of sections 25110 and 25401.

Further, the Court finds that defendant Robert Reed is liable for the entire scheme under two additional grounds. First, under section 25403, subdivision (b), Robert Reed is liable for the entire scheme because he provided substantial assistance to others in violation of the CSL. Second, Robert Reed is liable for the entire scheme under the alter ego doctrine.

PURSUANT TO THE FOREGOING FINDINGS OF FACT AND CONCLUSIONS OF LAW, IT IS HEREBY ORDER THAT:

1. Pursuant to California Corporations Code section 25530, subdivision (a), SmartWear Technologies, Inc., Robert Reed, Walter Robert Reed and Sean Borzage Boyd are permanently enjoined from, directly or indirectly:

a. Violating California Corporations Code section 25110 by offering to sell, selling, arranging for the sale of, issuing, engaging in the business of selling, or negotiating for the sale of any security of any kind unless such security or transaction is qualified; and

b. Violating California Corporations Code section 25401 by offering to sell or selling any security of any kind by means of any written or oral communication which includes any untrue statement of material fact or omits to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

2. Pursuant to California Corporations Code section 25530, subdivision (b), SmartWear Technologies, Inc. Robert Reed, Walter Robert Reed and Sean Borzage Boyd, jointly and severally, are ordered to pay full restitution to each of the one hundred and thirty (130) investors as set forth on Exhibit A hereto, in the amount of $ 4,970,639.93 (where an investor was paid in full, no restitution is due). Each time a payment is made pursuant to this order, Defendants shall file a notice with the Commissioner by U.S. Mail, attention Alex M. Calero, at Plaintiff's address of record in this action, which shall identify: the name of the investor, amount of payment, date of payment, method of payment and remaining amount of restitution due and owing to the investor.

3. Pursuant to California Corporations Code section 25530, subdivision (b), Robert Reed is ordered to pay full restitution to each of the one hundred and thirty (130) investors, who invested additional funds, and is order to pay full restitution to each of the additional eighteen (18) investors as set forth on Exhibit A hereto, in the amount of $ 4,040,404.60 (where an investor was paid in full, no restitution is due). Each time a payment is made pursuant to this order, Defendants shall file a notice with the Commissioner by U.S. Mail, attention Alex M. Calero, at Plaintiff's address of record in this action, which shall identify: the name of the investor, amount of payment, date of payment, method of payment and remaining amount of restitution due and owing to the investor.

4. Pursuant to California Corporations Code section 25535, SmartWear Technologies, Inc., Robert Reed, Walter Reed and Sean Borzage Boyd, jointly and severally, are ordered to pay the Commissioner civil penalties, as follows:

a. $ 6,500,000.00 for the two hundred and sixty (260) violations of section 25110; and

b. $ 9,950,000.00 for the three hundred and ninety-eight (398) violations of section 25401.

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5. Pursuant to California Corporations Code section 25535, Robert Reed is ordered to pay the Commissioner additional civil penalties, as follows:

a. $ 900,000.00 for the thirty-six (36) additional violations of section 25110; and

b. $ 11,100,000.00 for the four hundred and ninety-eight (498) additional violations of section 25401.

6. This Court will retain jurisdiction of this action in order to implement and carry out the terms of all orders and decrees that may be entered herein or to entertain any suitable application or motion by Plaintiff for additional relief within the jurisdiction of this Court.

IT IS SO ORDERED.

Dated: MAY 04 2012

RONALD S. PRAGER

HON. RONALD S. PRAGER, JUDGE OF THE SUPERIOR COURT OF THE STATE OF CALIFORNIA FOR THE COUNTY OF SAN DIEGO

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