BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Statement of Issues of THE CALIFORNIA CORPORATIONS COMMISSIONER, Complainant, vs. SUPER ABSORBENT COMPANY, Respondent.	Department File No.: 309-4042

DECISION

The attached Proposed Decision of the Administrative Law Judge of the Office of Administrative Hearings, dated March 20, 2008, is hereby adopted by the Department of Corporations as its Decision in the above-entitled matter.

This Decision shall become effective on July 2, 2008.

IT IS SO ORDERED this 1st day of July 2008.

CALIFORNIA CORPORATIONS COMMISSIONER

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Preston DuFauchard

BEFORE THE DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Statement of Issues of THE CALIFORNIA CORPORATIONS COMMISSIONER, Complainant, vs. SUPER ABSORBENT COMPANY, Respondent.	Department File No.: 309-4042 OAH No. L2007050141

PROPOSED DECISION

This matter came on regularly for hearing before David B. Rosenman, Administrative Law Judge, Office of Administrative Hearings, State of California, on October 22 and 23, November 8 and 20, and December 19, 2007, at Los Angeles, California. Complainant Preston DuFauchard, California Corporations Commissioner (Commissioner), was represented by Michelle Lipton, Senior Corporations Counsel, and Jennifer Granat, Corporations Counsel. Respondent Super Absorbent Company (Respondent) appeared by its Chief Executive Officer (CEO), Phillip Berlin, and was represented by Brown & White LLP, by Thomas M. Brown and Steven A. Heath, Attorneys at Law.

Evidence was received. The record remained open for submission of briefs, as follows: Respondent's closing brief was received January 3, 2008, and marked for identification as Exhibit 201; Complainant's closing brief was received January 14, 2008, and marked for identification as Exhibit 12; and Respondent's reply brief was received January 18, 2008, and marked for identification as Exhibit 202. On January 18, 2008, Respondent also filed an appendix of case law relating to its closing brief, marked for identification as Exhibit 203, and its appendix of case law relating to its reply brief, marked for identification as Exhibit 204.

The record was closed and the matter was submitted for decision on January 18, 2008.

FACTUAL FINDINGS

The Administrative Law Judge makes the following factual findings:

1. Preston DuFauchard filed the Statement of Issues in his official capacity as Commissioner of the Department of Corporations of the State of California (Department).

2. On December 22, 2006, Respondent filed an application with the Department to offer and sell securities in California. The application was made under Corporations Code section 25113, and was verified by Phillip Berlin as the CEO.

3. By its application, Respondent proposes to qualify the offer and sale of securities in the form of common stock in Respondent totaling $3,000,000.

4. In the process of its review of the application, the Department's counsel, Theresa Leets, exchanged several communications with Respondent's counsel, Gary Wykidal. Often Ms. Leets asked for additional information in support of the application and/or for changes in the application. In response to one of the requests of Ms. Leets, Mr. Wykidal submitted a declaration signed under penalty of perjury by Mr. Berlin on March 15, 2007, stating that Respondent had not previously sold its common stock to investors residing in the state of California.

5. On April 24, 2007, the Commissioner issued a Notice of Intention to Refuse to Issue Permit Pursuant to Corporations Code Section 25140.[1] The refusal was based on the reasons set forth in the Statement of Issues.

6a. In summary, the Statement of Issues contends that Respondent and the application have not met the Commissioner's standards, quoting from section 25140, subdivision (b):

"The Commissioner may refuse to issue a permit under Section 25113 unless he or she finds that the proposed plan of business of the applicant and the proposed issuance of securities are fair, just and equitable, that the applicant intends to transact its business fairly and honestly, and that the securities which it proposes to issue and the methods used by it in issuing them are not such as, in his or her opinion, will work a fraud upon the purchaser thereof."

6b. The Statement of Issues alleges that the Commissioner cannot make such findings based on the following violations: (1) there are prior Desist and Refrain Orders issued against Mr. Berlin which include orders that Mr. Berlin not offer or sell securities in this state unless qualification has been made under the law or unless an exemption from qualification exists; (2) Respondent and Mr. Berlin had been offering and selling unqualified, non-exempt securities in Respondent in violation of the law and the prior Orders; and (3) Mr. Berlin willfully made an untrue statement of material fact in his declaration supporting the application, as Respondent had sold common stock to investors residing in California.

7. On April 27, 2007, Respondent submitted its Notice of Defense, resulting in this hearing.

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

8. Respondent contends that, in those instances wherein it sold stock, different exemptions apply; that there has been no violation of state securities laws; that Mr. Berlin's declaration contains no information which is untrue; and that it should be permitted by the Department to offer and sell its securities.

9. Under section 25110, companies that want to sell their own securities must either have qualified the offer and sale with the Commissioner or must operate under a recognized exemption from the qualification requirement.

Prior Orders of the Commissioner

10. On August 21, 2002, the Commissioner issued a Desist and Refrain Order pursuant to section 25532 including the determination that Mr. Berlin and Mark Sinkinson had violated section 25110 by selling unqualified, non-exempt securities in the form of stock in MyOnlyCatalogue.com, Inc., later known as Commerce Syndication Network, Inc. (collectively referred to as MyOnlyCatalogue.com, Inc.). The Order states that, pursuant to section 25532, Mr. Berlin, Mr. Sinkinson and MyOnlyCatalogue.com, Inc., "are hereby ordered to desist and refrain from the further offer or sale in the State of California of securities it the form of stock, unless and until qualification has been made under the [applicable] law or unless exempt."

11. On November 15, 1994, the Commissioner issued a Desist and Refrain Order pursuant to section 25532 to 29 people, including Mr. Berlin that they were to stop selling securities described as "investment contracts in the form of general partnership interests in, but not limited to, Capitol Peak Partners ...." For reasons not explained in the record, all parties referred to this Order as relating to Diamond Communications, and it is so designated in the Statement of Issues.

12. .On August 21, 2002, the Commissioner issued a Desist and Refrain Order pursuant to section 25532 to Mr. Berlin, Mr. Sinkinson and S.K.B. Trading Group, Inc., including the determination that Mr. Berlin and Mr. Sinkinson had violated section 25110 by selling unqualified, non-exempt securities in the form of joint venture participation interests.

13a. The Complainant did not establish that any activities of Respondent violated any of the three Desist and Refrain Orders noted above. First, none of those Orders is directed to Respondent. There is some inconsistency in the manner in which the Statement of Issues refers to entities and persons as respondents.[2] However, the only entity identified in the caption is Respondent, as the company on whose behalf the application was submitted. Under Government Code section 11500, the respondent is the person against whom a

[2] Serveral references are made to "respondents" in the plural and, in one instance (page 3, line 10), reference is made to "Respondent BERLIN." However, the majority of the references are to respondent in the singular, referring to the applicant corporation.

statement of issues is filed. The Statement of Issues is against the company only. If Complainant wanted to include Mr. Berlin as a named respondent, he could have clearly done so, but did not.

13b. In each of the three Orders noted above, Mr. Berlin and others are directed to desist and refrain from certain specified offers and sales activities. That is, the matter involving MyOnlyCatalogue.com, Inc., related to securities in the form of stock; the Diamond Communications matter related to securities in the form of "investment contracts in the form of general partnership interests in, but not limited to, Capital Peak Partners . . . . ."; and the S.K.B. Trading Group, Inc., matter related to securities in the form of joint venture participation interests. The Complainant appears to contend that, as the present matter; Super Absorbent Company, relates to sales of securities, somehow the prior Desist and Refrain Orders world be violated, because offers and sales of securities were also the subject of those matters. To the contrary, each prior Desist and Refrain Order is limited to its own particular facts, including not only the particular form of security involved but also the name of the entity in which the security was issued. Further, the authority under which each Desist and Refrain Order was issued, section 25532, permits an order directed to "the security." This reference relates to the security in issue in the particular matter, and not all securities in the future. Therefore, Respondent has not violated the Desist and Refrain-Orders referred to in the Statement of Issues.

13c. By virtue of these prior Orders, Mr. Berlin was aware that certain offer and sale activities were subject to oversight by the Department. The Respondent corporation can only operate through its control persons, of which Mr. Berlin is one. Mr. Berlin and Respondent were aware that it was necessary for them to comply with applicable securities laws concerning offers and sales activities of securities.

Application for sale of stock and exemptions

14. The pending application is for Respondent to obtain permission under section 25113 to sell its common stock. To evaluate Complainant's contention that Respondent and Mr. Berlin have previously sold Respondent's stock in violation of the law requires an examination of various circumstances under which a sale or offer of stock is exempt from qualification with the Commissioner.

Exemptions under State and Federal law

15. Respondent has offered and sold its common stock and its preferred convertible stock, and claims exemptions for such sales.

16. Under sections 25102, subdivision (f) , as it. applies to this case, an exemption exists if the offer or sale meets certain criteria, including that there be no more than 35 such sales and that all purchasers either had a preexisting personal or business relationship with the offeror (including its controlling persons) or, "by reason of their business or financial experience ... could be reasonably assumed to have the capacity to protect their own

interests in connection with the transaction." Under subdivision (f)(4), the offer and sale cannot be accomplished by the publication of any advertisement. As further clarified in California Code of Regulations, title 10, section 260.102.12, subdivision (j)(2), "neither the issuer nor any person acting on its behalf shall offer or sell securities by any form of general solicitation or general advertising."

17. Under section 25102, subdivision (n), as it applies to this case, an exemption exists if the offer or sale is to a "qualified purchaser," defined as an individual with either a minimum net worth, excluding the home value, of $500,000 or a net worth of $250,000 in conjunction with a spouse and gross income in excess of $100,000. The issuer must file a notice of transaction with the Department when the offering is first published or otherwise made available, and the issuer may then offer or sell the securities for no more than 210 days, at which time the issuer must file a second notice of transaction. Under subdivision (n)(6), telephone solicitation is permitted only after the issuer "has determined that the prospective purchaser to be solicited is a qualified purchaser."

18. As relevant here, an exemption under federal securities law found in 17 Code of Federal Regulations, section 230.506 (part of what is commonly referred to as Regulation D), allows sales of securities to an "accredited investor," defined as an individual with a net worth in excess of $1 million and individual income of at least $200,000, or joint spousal income of $300,000 in each of the last two years, and who has a reasonable expectation of achieving the same level of income in the current year. Regulation D allows sales to no more than 35 non-accredited investors. Further, sales must also comply with Rule 502, subdivision (c), which precludes the offer and sale of securities "by any form of general solicitation or general advertisement …."

19. Thus, each exemption noted above includes some delineation of those who are capable of bearing the risk of investing in a security. The subdivision (f) exemption is limited by the number of non-excluded purchasers and either the existence of a business relationship or the reasonable belief that the buyer could financially shoulder the risk of the investment. Similarly, the subdivision (n) exemption is limited to those who can bear such a risk and to sales within a certain time frame. The Regulation D exemption allows sales to 35 non-accredited purchasers and, if more, those extra sales can only be to accredited purchasers, i.e., people capable of handling the financial risk based on net worth and other factors that are more stringent than those under subdivision (f).

20. As relevant here, section 25104, subdivision (a), provides an exemption for the sale of a security by an owner of that security for his own account. Under this exemption, someone who has purchased a security from the issuer can, under specified circumstances, sell that security without qualification by the Commissioner.

Respondent s sales of securities in reliance on the exemptions

21. Respondent offered and sold its securities by using lists it had purchased of potential investors who would meet the financial risk capabilities of the exemptions noted

above. Telephone calls were made to people on the lists. If people expressed interest in purchasing a security, Respondent sent them, among other things, a Private Placement Memorandum including a Subscription Agreement. These documents asked the potential investors to certify their status as meeting the listed criteria for accredited investors under Regulation D, and to represent that the certification may be relied upon by Respondent in determining the investor's qualifications as a purchaser. Mr. Berlin reviewed each completed Subscription Agreement to ascertain that the investor had certified himself as accredited before Mr. Berlin approved any sale of stock.

22. Complainant proved that, in two instances, investors who were residents of California were contacted by telephone by salesmen of Respondent and were sold stock in Respondent. However, the stock had previously been issued to Mr. Berlin or Mr. Sinkinson.

23. More specifically, Margaret Hodgson Margulies purchased 2,500 shares of common stock for $5,000 in July 2005, while residing in California. Respondent communicated with Ms. Margulies by telephone and mail. There was no indication to Ms. Margulies that she was buying stock from an individual or entity other than from Respondent as the issuer. When Ms. Margulies mailed her check for the purchase price, payable to Respondent, it was returned to her and she was instructed to make the check payable to Synchronized Funding. She was never informed that Synchronized Funding was an entity selling stock in Respondent that had previously been issued to Mr. Berlin and Mr. Sinkinson. Ms. Margulies was under the impression that Synchronized Funding was a department or office of Respondent that handled investment transactions.

24. James Caldwell purchased 1,677 shares of Respondent's common stock for $5,000 in December 2006, while residing in California. When he received his stock certificate, it was sent with a cover letter on the letterhead of Respondent, signed by Mr. Wilkinson as president. Mr. Caldwell was never informed that Synchronized Funding was an entity selling stock in Respondent that had previously been issued to Mr. Berlin and Mr. Sinkinson. Mr. Caldwell was led to believe that the person calling him was an agent for Respondent, that he was purchasing stock from Respondent, and that Synchronized Funding was some sort of holding company necessary to the transaction.

25. Complainant proved that, in one instance, an investor was advised by Respondent's salesman to complete the Subscription Agreement with incorrect financial information. David Donley resided in Illinois and made two purchases of stock from Respondent. In December 2003, on behalf of a family trust, Mr. Donley purchased 5,000 shares of common stock for $5,000. The salesman told him how to fill in the financial information on the Subscription Agreement, particularly the portion that indicated that Mr. Donley was an accredited investor. Although Mr. Donley did not meet the requirements, he was told that this portion of the document did not apply to him. Mr. Donley followed the salesman's instructions. In January 2006, Mr. Donley purchased an additional 1,000 shares of Respondent's common stock for $1,000. He filled in the Subscription Agreement for the second purchase relying on the same advice he had received for the first purchase. Only later did Mr. Donley realize that, by following those instructions, the financial information he had

written was incorrect. According to his testimony, Mr. Donley did not meet the criteria of an accredited investor.

26. With respect to the exemption under section 25102, subdivision (n), Respondent filed a first notice of transaction, dated October 30, 2001, applicable to sales of convertible preferred stock. (The application was filed in the name of Biodegradable Environmental Solutions, Inc., which later changed its name to Super Absorbent Company.) The second notice of transaction was dated May 29, 2002. (Exhibits 8A and 120.)

27. With respect to the exemption under section 25102, subdivision (n), Respondent filed a first notice of transaction, dated March 24, 2007, applicable to sales of common stock. There was no evidence of the filing of any second notice of transaction. (Exhibit 3K.)

28. According to information included in its application, Respondent sold its first shares of convertible preferred stock in August 2001, and also sold shares of convertible preferred stock in August 2003. Respondent also sold shares of convertible preferred stock to James Irwin in October 2002.

29. Names Irwin lives in Redondo Beach, California. He is an accredited investor and had previously invested in MyOnlyCatalogue.com. The same contact person who sold him that investment called him to promote the sale of Respondent's convertible preferred stock. Mr. Irwin paid $25,000 for that purchase.

30. For purposes of identifying potential investors, Respondent purchased lists of potential investors, known as leads, from a company that represented that all of the leads listed would meet the definition of an accredited investor, had indicated the types of investments they would he interested in and were open to receiving calls from companies with those types of investments. Mr. Berlin testified that, because these were high quality leads, the lead lists were expensive to purchase. Telephone salesmen for Respondent would call people listed as leads and, using a script, would determine if they were interested in investing in Respondent and if they met the requirements of an accredited investor.

31. With regard to sales of his own stock in Respondent, Mr. Berlin stated that the same salesmen were used; however, if the investor was in a state wherein Respondent was not able to sell its stock, the salesmen would offer to sell stock that was previously issued to Mr. Berlin or Mr. Sinkinson. Mr. Berlin testified that, in those instances where he was directly involved in the sale, he notified investors that the stock had been previously issued or was owned by an individual, not by Respondent.

32. The sales of Respondent's stock to Ms. Margulies and Mr. Caldwell were improper in that the sales bore all indicia of being from Respondent, and not from individual owners. Those sales occurred based upon misrepresentations made by Respondent's salesmen. Whether Mr. Berlin and Respondent are able to rely upon the exemption under section 25104 for the sale of an individual's shares is separate from the conclusion that Respondent made these misrepresentations.

33. The sales of Respondent's stock to Mr. Donley were improper in that Respondent's salesman advised Mr. Donley to improperly answer certain questions regarding his financial suitability and risk acceptability. Those sales occurred based upon misrepresentations made by Respondent's salesmen.

The declaration of Mr. Berlin

34a. As noted in Finding 4, above, Mr. Berlin, as CEO of Respondent, submitted a declaration in support of the application. The evidence established that there had been an exchange of communications between Ms. Leets, on behalf of the Department, and Mr. Wykidal, on behalf of Respondent, concerning many aspects of the application. Ms. Leets would often ask for clarifications and additional information, and Mr. Wykidal would submit responses.

34b. In one instance, Ms. Leets asked for the applicant to submit a statement under of penalty of perjury that common stock was only offered and sold outside of the state of California. (Exhibit 3F.) The first declaration signed by Mr. Berlin and submitted by Mr. Wykidal (Exhibit 3G, page 211) indicated "that to the best of the Company's knowledge," the company had made no sales of common stock in California. In a follow up e-mail, Ms. Leets asked for the qualifying language to be deleted, and stated further: "Provide me a new statement under penalty of perjury that no shares of Super Absorbent Company have been sold to a California investor. If the applicant is uncertain then they should investigate before signing. If applicant discovers that shares have been issued in California, we'll cross that bridge when we come to it." (Exhibit 3H.) In response, Mr. Berlin submitted his declaration, under penalty of perjury, indicating that "the Company has not previously sold its common stock to investors residing in the State of California." (Exhibit 31, page 264.)

34c. Complainant contends that Respondent should have notified Ms. Leets of sales in California of stock owned by Mr. Berlin. Respondent contends that it submitted the information requested by Ms. Leets, which focused on sales of stock made by the company.

35. The determination of the issue of alleged untrue statements in the declaration depends on whether Mr. Berlin was obliged to consider if the sales of his personal stock to people in California, such as Ms. Margulies and Mr. Crawford, were to be included in his declaration. In Ms. Leets' e-mail, she directed the applicant to delete a phrase and, if necessary, investigate. Her next instruction is very general, asking for a statement "that no shares of Super Absorbent Company have been sold to a California investor." If the inquiry were left there, it is possible that shares sold by Mr. Berlin would be implicated. However, Ms. Leets goes on to reference shares that have been "issued in California." This narrows the inquiry to shares that would have come from the Respondent alone, as only a company can issue its shares.

36. The totality of the evidence did not establish a clear obligation of Respondent to submit a statement under penalty of perjury concerning sales of stock owned by any of its principals such as Mr. Berlin. If the Department wanted such information, it was under the duty to make such a request using clear and unequivocal language. This it did not do. Mr. Berlin's declaration does not amount to an untrue statement under these circumstances.

CONCLUSIONS OF LAW AND DISCUSSION

Based on the foregoing factual findings, the Administrative Law Judge makes the following conclusions of law:

1. The burden of establishing that the sale or offer of a security meets an exemption is upon the party making the sale or offering; here, the Respondent. *(Johnston v, Bumba* (N.D. Ill. 1991) 764 F. Supp. 1263, 1277.)

2. Similarly, the burden of establishing the entitlement to issuance of a license rests with the person/entity applying for that license. (Evidence Code sections 115 and 500; *Southern Cal. Jockey Club, Inc. v. California Horse Racing Bd.* (1950) 36 Cal.2d 167; *Breakzone Billiards v. City of Torrance* (2000) 81 Cal.App.4th 1205.)

3. Also relevant is the statement, under section 25140, subdivision (b), that the Commissioner may refuse to issue a permit unless it is found "that the proposed plan of business of the applicant and the proposed issuance of securities are fair, just and equitable, that the applicant intends to transact its business fairly and honestly, and that the securities which it proposes to issue and the methods used by it in issuing them are not such as, in [the Commissioner's] opinion, will work a fraud upon the purchaser thereof." See Finding 6a. In the context of the present proceedings, based upon a Statement of Issues and Respondent's burden to establish the existence of exemptions from the application of certain securities laws, this wording would also make it Respondent's burden to submit evidence to support the finding that this code section requires the Commissioner to make about Respondent's business activities and sales of securities. Stated in the alternative, if the Commissioner has made determinations under this section that are against Respondent, it is up to Respondent to marshal the evidence to contradict those determinations.

4. Complainant contends that Respondent cannot meet its burden because the offers and sales under the various exemptions claimed by Respondent were accomplished by use of a general solicitation of investors, which is not permitted under the exemptions. See Findings 16 17 and 18.

5. The arguments made by Complainant, supported by case law and "no action" letters by the Securities and Exchange Commission (SEC), focus on certain details of the offerings, such as the number of people to whom calls were made or the number of names on a leads list. The evidentiary record herein does not disclose any such details - we do not know how many names were listed or how many calls relied upon the lists. However, some of those authorities examine the circumstances under which the sales calls might be considered general solicitation.

6. The SEC no action letter in In the Matter of Kenman Corp., 1985 SEC LEXIS 1717, examines relevant concepts. There was no preexisting relationship between Kenman and persons to whom investment information was mailed. "These person were selected only because their names were on lists that were purchased or created by Kenman .... [including] an unknown number of persons with whom Kenman had no prior contact or relationships." (Page 10, footnote 6.) The SEC concluded that, under such circumstances, the utilization of lists with thousands of names did not comply with the requirements under Regulation D that there be no general solicitation.

7. In *Johnston v. Burma, supra,* 764 F.Supp. at pages 1274-12755, the court commented that the failure to submit evidence of the size of the offering and the number of units sold "cuts against a finding in plaintiffs favor." (Plaintiff therein was attempting to establish that there was no general solicitation and that an exemption applied.) The court emphasize) that the key facts go to the nature of the control exercised by the offeror over the release of information relating to the investment, and that the more control by the issuer, the more likely that no general solicitation will be found. The *Johnston* court also commented unfavorably on claims by the principals, not supported by any other evidence, that their salesmen were not following established policies.

8. In this matter, there was very little evidence of the criteria used by the company that develcped the leads for Respondent, other than the fairly general testimony of Mr. Berlin. (See Findings 21 and 30.) In the absence of stronger evidence that the California residents who actually invested in Respondent, such as Ms. Margulies and Mr. Caldwell, were first contacted by the company that developed the leads list for Respondent, it is concluded that Respondent engaged in general solicitation with respect to those sales.

9. Further, in those two sales, Respondent did not establish that the salesmen made it clear that they were selling shares owned by Mr. Berlin and not actually being issued by Respondent.

10. Under such circumstances and based on the evidence herein, it was proper for the Commissioner to form the opinions that: Respondent's proposed plan of business and issuance of securities are not fair, just and equitable; Respondent does not intend to transact its business; fairly and honestly; and the securities which Respondent proposes to issue and the methods to be used in issuing the proposed securities will work a fraud upon purchasers thereof.

11. Cause exists to deny the application of Respondent for qualification to issue securities, for failure to satisfy section 25140, subdivision (b), for the reasons set forth in Findings 2 through 5, 9, and 14 through 33 and Legal Conclusions 1 through 10.

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12. Cause does not exist to deny the application of Respondent for qualification to issue securities, for violation of prior Desist and Refrain Orders or for making an untrue statement in connection with the application, for the reasons set forth in Findings 2 through 4, 10 through 13, and 34 through 36.

ORDER

WH RI FORE, THE kOLLOWiNG ORDER is hereby issued:

The application of Respondent Super Absorbent Company to offer and sell securities in California is denied.

DATED: March 20, 2008.

DAVID B. ROSENMAN
Administrative Law Judge
Office of Administrative Hearings