BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Desist and Refrain Order Issued To: Robert L. Carver Brookstone Capital, Inc. Brookstone Biotech Ventures, L.P. Brookstone Biotech Ventures II, L.P. Respondents.	Case No. 6928 OAH No.: L2007070907

DECISION

The attached Proposed Decision of the Administrative Law Judge of the Office of Administrative Hearings, dated May 23, 2008, is hereby adopted by the Department of Corporations as its Decision in the above-entitled matter with the following minor typographical error pursuant to Government Code Section 11517(c)(2)(C).

On page 11, line 3 of paragraph item #10 of the LEGAL CONCLUSIONS: delete "§§ 203.501 and 203.502" and insert "§§ 230.501 and 230.502".

This Decision shall become effective on August 21, 2008.

IT IS SO ORDERED this 20th day of August 2008.

CALIFORNIA CORPORATIONS COMMISSIONER

Preston DuFauchard

BEFORE THE DEPARTMENT OF CORPORATIONS

OF THE STATE OF CALIFORNIA

In the Matter of the DESIST AND REFRAIN ORDER Issued To: **Robert L. Carver** **Brookstone Capital, Inc.** **Brookstone Biotech Ventures, L.P.** **Brookstone Biotech Ventures II, L.P.** **Respondents.**	**Case No. 6928** **OAH No. L2007070907**

PROPOSED DECISION

This matter came on regularly for hearing on February 25, 2008, in Los Angeles, California, before H. Stuart Waxman, Administrative Law Judge, Office of Administrative Hearings, State of California.

Preston DuFauchard, the Commissioner of the Department of Corporations of the State of California (Complainant or Commissioner) was represented by Edward Kelly Shinnick, Corporations Counsel.

Robert L. Carver (Carver), Brookstone Capital, Inc. (Brookstone Capital), Brookstone Biotech Ventures, L.P. (Biotech Ventures I), and Brookstone Biotech Ventures II, L.P. (Biotech Ventures II) (collectively Respondents) were represented by Brandon L. Blankenship, Attorney at Law.

Oral and documentary evidence was received. The record was left open for the parties to submit closing briefs pursuant to the following schedule:

Respondents' closing brief:	March 17, 2008
Complainant's closing brief:	April 7, 2008
Respondents' rebuttal brief:	April 21, 2008
Complainant's surrebuttal brief:	May 5, 2008

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Respondents' closing brief was not accompanied by a proof of service. It is dated March 17, 2008, and was received at the Office of Administrative Hearings on March 18, 2008. Although service may have been one day late, no objection was received. Respondents' brief is therefore deemed timely served. It was marked as Respondents' Exhibit "B" for identification.

Complainant's closing brief was timely received and was marked as Complainant's Exhibit "16" for identification.

No rebuttal brief was received from Respondents. Therefore, Complainant's surrebuttal brief was unnecessary.

On May 5, 2008, the record was closed, and the matter was deemed submitted for decision.

FACTUAL FINDINGS

The Administrative Law Judge makes the following factual findings:

1. On October 31, 2006, the Commissioner issued a Desist and Refrain Order against Respondents for violation of Corporations Code sections 25110 and 25401 (Desist and Refrain Order). In so doing, the Commissioner ordered Respondents (1) "to desist and refrain from offering or selling or buying or offering to buy securities in this state, including but not limited to investment contracts in the form of limited partnerships, by means of any written or oral 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 are made, not misleading" and (2) "to desist and refrain from further offers or sales of said securities by means of communications which include misrepresentations or omissions of material facts."

2. Complainant established the facts contained in paragraphs 2 through 6 of the Desist and Refrain Order. Those facts are set forth verbatim below and are incorporated as factual findings herein:

> 2. Beginning before February 2006, BBV [Brookstone Biotech Ventures, L.P.], BBVII [Brookstone Biotech Ventures II, L.P.], Brookstone Capital [Brookstone Capital, Inc.], and Robert L. Carver have offered to sell securities in the form of investment contracts involving interests in limited partnerships.
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> 3. The purported purpose of the solicitation has been to achieve long-term capital appreciation for its partners through investments in the biotechnology and life science industries.

4. BBV, BBVII, Brookstone Capital, and Robert L. Carver have engaged in general solicitations to offer these securities for sale to the public by telephone and through the Internet on website www.brookstonebiotech.com.

5. These securities were offered in this state in issuer transactions. The Department of Corporations has not issued a permit or other form of qualification authorizing any person or entity to offer and sell these securities in this state.

6. In connection with these offers, BBV, BBVII, Brookstone Capital, and Robert L. Carver omitted to disclose material facts, specifically the following:

a.) On July 22, 1994 in the Los Angeles County Superior Court Robert L. Carver pled guilty to one felony count of making/passing fictitious checks, and on August 4, 1994 in the Riverside County Superior/Municipal Court Mr. Carver pled no lo *[sic]* contendere to two felony counts of grand theft. For the former conviction he was sentenced to 98 days in the county jail and five years probation and for the later conviction he was sentenced to 180 days in county jail and five years probation as well.

b.) On March 21, 1996 the State of California Department of Corporations issued to Robert L. Carver, among others, an Order to desist and refrain from the offer or sale of securities, including but not limited to specific stock, unless qualified or exempt.[1]

c.) On September 26, 2005, the State of California Department of Corporations issued an Order barring Robert L. Carver from any position of employment, management or control of any investment adviser, broker-dealer or commodity adviser in the State of California. The Order was based on Mr. Carver's two 1994 felony convictions and the failure to disclose the 1996 Desist and Refrain Order in an application for an Investment Adviser Certificate filed by Brookstone Capital, Inc.

[1] In their closing brief, Respondents claim that Carver was not served with the March 21, 1996 Desist and Refrain Order. Carver did not testify at the administrative hearing, and no evidence was offered to support that claim. Complainant's Exhibit 8 is a valid proof of service of the March 21, 1996 Desist and Refrain Order. Respondents bore the burden of proving that Carver was not served with that Order. (Evid. Code § 500.) They failed to sustain that burden.

d.) On September 26, 2005, the State of California Department of Corporations issued an Order denying [an] application for an investment adviser certificate filed by Brookstone Capital Inc. The denial Order was based on Robert L. Carver's two 1994 felony convictions and the failure to disclose the 1996 Desist and Refrain Order.

3. On April 27, 2005, Brookstone Capital, as the issuer, filed with the Department of Corporations (Department) a "Form D" Notice of Sale of Securities Pursuant to Regulation D, Section 4(6) and/or Uniform Limited Offering Exemption. The offering was listed as Brookstone Biotech Ventures, L.P.

4. On July 25, 2006, Brookstone Capital, as the issuer, filed with the Department a "Form D" Notice of Sale of Securities Pursuant to Regulation D, Section 4(6) and/or Uniform Limited Offering Exemption. The offering was listed as Brookstone Biotech Ventures II, L.P.

5. Late in 2005, Raymond Reiss (Reiss) decided to research the biotechnology industry via an Internet search using the search term "biotech." While reviewing a website, he found a link which would enable him to receive a brochure entitled "Investing in Biotech." In order to receive that brochure, Reiss provided his address and business cellular telephone number. The brochure was "Presented by Robert L. Carver President and CEO Brookstone Capital." It began with a disclaimer which read in part:

> This is not a solicitation to buy or sell securities nor does this purport to be a complete analysis of the Biotech Industry. This publication is not an endorsement of any company. Readers Caution: The publisher has relied on information provided by well-known, reputable sources and although believed to be true, cannot guarantee the accuracy of such information. All claims made by this advertisement should be verified by the reader. . . .

6. Reiss had no prior relationship with Respondents, and he took no further action in connection with the brochure he received.

7. In February 2006, Reiss received a telephone call from John Dade (Dade), Vice-President of Public Relations for Brookstone Capital. Dade stated he was following up on Reiss's request for the brochure, and that he wanted to know if Reiss was interested in investing in the biotech field. Reiss indicated a possible interest, and Dade stated that someone would contact him.

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8. In late February 2006, Reiss was contacted by James DeMers (DeMers) who informed Reiss he was following up on the call from Dade. DeMers stated that Biotech Ventures I had recently been closed and that investments in Biotech Ventures II were being accepted. Investments would be pooled and invested in various biotech companies.

9. Shortly after that conversation, Reiss received a follow-up call from DeMers and Karl Mazzeo (Mazzeo), Vice-President of Investor Relations for Brookstone Capital. DeMers asked if Reiss had a net worth of at least $1,500,000. Reiss answered affirmatively. DeMers asked if he could send a prospectus to Reiss. Reiss stated that he would be happy to read it. On March 7, 2006, Reiss received a prospectus for Biotech Ventures I, a prospectus for Biotech Ventures II, approximately three "exhibits" (Reiss's term), an agreement, a questionnaire regarding Reiss's qualifications to be an investor, and a subscription agreement on which Reiss was asked to answer certain questions. Reiss understood from the prospectuses that Carver was the company's CEO and general partner.

10. Reiss noted that the prospectus for Biotech Ventures II indicated that "the securities [had] not been registered with the Securities and Exchange Commission under the Securities Act of 1933." In a subsequent conversation, he asked DeMers and Mazzeo about that statement and others, including one indicating that the company was not registered as an investment company and another stating that the general partner would not be registered as an investment advisor. DeMers and Mazzeo stated that it was unnecessary to be registered because they were exempt from those requirements.

11. Reiss then decided to research Brookstone Capital. He read Brookstone's two "fairly extensive" (Reiss's term) websites and believed Brookstone was doing a good job looking into various investments and that it had a good advisory board. However, upon checking with the states of California and Ohio, he found two Orders that had been issued by the California Department of Corporations. He contacted Complainant's counsel who provided him with copies of those Orders. The Orders indicated that Carver had been convicted of two felonies, one for making or passing a "bad" check and the other for grand theft. Reiss considered those convictions to be related to his potential investment in that he wanted to invest with someone he could trust with his investment. He considered Carver's two felony convictions contrary to that interest, regardless of their age. Had it not been for the nature of the two felony convictions, Reiss believes he would have invested with Respondents. He was in the process of arranging funding for the investment when he learned of the convictions.

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12. A disclosure on the website www.brookstonebiotech.com reads in part:

> The material contained within the Brookstone Biotech Ventures, L.P. website does not constitute an offer or solicitation by anyone in any jurisdiction in which such offer is not authorized or to any person to whom it is unlawful to make such offer or solicitation.
>
> No representations or warranties of any kind are intended or should be inferred with respect to the economic return or tax consequences from an investment in Brookstone Biotech Ventures, L.P.
>
> Offerings of limited partnership interests [in] Brookstone Biotech Ventures, L.P. are only made by delivery of Brookstone Biotech Ventures, L.P. confidential offering memorandum and subscription materials. Limited partnership interests require a minimum investment of $100,000 and are offered only to those investors who are accredited and qualified investors pursuant to Regulation D under the Securities Act of 1933 and Rule 506 thereunder and the Investment Advisors Act of 1940 and whose net worth at the time of investment exceeds $1,500,000. . . .

13. The information contained on www.brookstonebiotech.com relates to various issues regarding investments in Biotech Ventures I and Biotech Ventures II. None of the information contained on the website is password protected. On the website, despite the language of the disclosure, investments are offered to an unlimited number of investors, whose net worth is unknown, and with whom Respondents share no prior substantive relationship.

LEGAL **CONCLUSIONS**

Pursuant to the foregoing Factual Findings, the Administrative Law Judge makes the following Legal Conclusions:

1. Cause exists to affirm the Desist and Refrain Order of October 31, 2006, against Respondents, pursuant to Corporations Code sections 25110 and 25401, as set forth in Findings 1 through 13.

2. Corporations Code section 25017, subdivision (b) states:

> "Offer" or "offer to sell" includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.

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3. Corporations Code section 25110 states:

It is unlawful for any person to offer or sell in this state any security in an issuer transaction (other than in a transaction subject to Section 25120), whether or not by or through underwriters, unless such sale has been qualified under Section 25111, 25112 or 25113 (and no order under Section 25140 or subdivision (a) of Section 25143 is in effect with respect to such qualification) or unless such security or transaction is exempted or not subject to qualification under Chapter 1 (commencing with Section 25100) of this part. The offer or sale of such a security in a manner that varies or differs from, exceeds the scope of, or fails to conform with either a material term or material condition of qualification of the offering as set forth in the permit or qualification order, or a material representation as to the manner of offering which is set forth in the application for qualification, shall he an unqualified offer or sale.

4. Corporations Code section 25102.1 states in relevant part:

The following transactions are not subject to Sections 25110, 25120, and 25130:

[¶] . . . [¶]

(d) Any offer or sale of a security with respect to a transaction that is exempt from registration under the Securities Act of 1933 pursuant to Section 18(b)(4)(D) of that act, if all of the following requirements are met:

(1) A notice in the form of a copy of the completed Form D (17 C.F.R. 239.500) filed with the Securities and Exchange Commission is filed with the commissioner within 15 days of the first sale in this state, along with documents filed with the Securities and Exchange Commission in annual or periodic reports that the commissioner by rule or order deems appropriate. The commissioner may allow for a notice in the form of the electronic transmission of the information in Form D.

(2) A consent to service of process under Section 25165 is filed with the notice as required by paragraph (1).

(3) Payment of the notice filing fee provided for in subdivision (c) of Section 25608.1 is made.[2]

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[2] The filing fee is $300.

5. In 1996, the Securities Act of 1933 (Securities Act) was amended by the National Securities Markets Improvement Act of 1996 (NSMIA). That Act was codified in 15 United States Code 77r which reads in relevant part:

> (a) Scope of exemption. Except as otherwise provided in this section, no law, rule, regulation, or order, or other administrative action of any State or any political subdivision thereof —
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> (1) requiring, or with respect to registration or qualification of securities, or registration or qualification of securities transactions, shall directly or indirectly apply to a security that —
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> (A) is a covered security; or
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> (B) will be a covered security upon completion of the transaction;
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> (b) Covered securities. For purposes of this section, the following are covered securities:
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> [¶] . . . [¶]
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> (4) Exemption in connection with certain exempt offerings. A security is a covered security with respect to a transaction that is exempt from registration under this subchapter pursuant to —
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> [¶] . . . [¶]
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> (D) Commission rules or regulations issued under 77d(2) of this title . . .

6. Section 18(b)(4)(D) of the Securities Act, as it relates to section 4(2),[3] exempts "transactions by an issuer not involving any public offering." This exemption is commonly known as the "private offering exemption." Its purpose is to enable sophisticated investors, i.e., those not in need of the securities laws' protection, to purchase unqualified securities while protecting other investors who are in need of such protection (*S E C v. Ralston Purina* (1953) 346 U.S. 119, 124-25; *S E C v. Murphy* (9th Cir. 1980) 626 F.2d 633, 644.) An issuer making a private offering pursuant to those provisions is not subject to Corporations Code section 25110 if specific requirements are met. Those requirements are set forth in "Regulation D," a commonly used designation for the provisions of 17 Code of Federal Regulations sections 230.501-230.506.

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[3] 15 United State Code § 77d(2).

7. 17 Code of Federal Regulations § 230.502, subdivision (c) states in pertinent part:

> Limitation on manner of offering. Except as provided in section 230.504(b)(1), neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, the following:
>
> (1) Any advertisement, article, notice or other communication, published in any newspaper, magazine, or similar media broadcast over television or radio; and
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> (2) Any seminar or meeting whose attendees have been invited by any general solicitation or general advertising. . . .

8. Pursuant to 17 Code of Federal Regulations § 230.501(e)(1)(iv), a private offering may be sold to an unlimited number of "accredited investors." Generally, an "accredited investor" is an institutional investor, an individual investor with a net worth exceeding $1,000,000, or an individual investor whose individual income exceeded $200,000 for each of the two most recent years, or whose joint income with his/her spouse exceeded $300,000 for each of those years, and who holds a reasonable expectation of reaching the same income level in the current year. (17 C.F.R. § 230.501.)

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9. In his closing brief, Complainant correctly made the following argument:

> Over the past 20 years the SEC [Securities and Exchange Commission] has issued No-action letters emphasizing that, to avoid a general solicitation that will vitiate a claimed private offering exemption under Regulation D, there must be a pre-existing "substantive" relationship between the offeror and the offeree before an offer is made. (1982 SEC No. Act. LEXIS 2662 [aka Woodtrails No-Action Letter]; see also 1985 SEC No-Act. LEXIS 2917, [aka Hutton No-Action Letter].) While not entitled to the same deference as a rule, the SEC no-action letters may be treated as persuasive on the proper interpretation of the prohibition against general solicitations See New York City Employees' Retirement System v. SEC 45 F.3d 7, 13 (2nd Cir. 1994).
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> A "substantive" relationship is one that allows the offeror to determine that "each of the proposed offerees currently has such knowledge and experience in financial and business matters that he or she is capable of evaluating the merits and risks of the prospective investment." (Woodtrails No-Action Letter at p. 2.) Although a substantive relationship is usually established by a past business relationship, it may also be established by "questionnaires that provide Hutton (the offeror) with sufficient information to evaluate the prospective offerees' sophistication and financial circumstances"; however, the relationship is not pre-existing if the questionnaire and offer are distributed at the same time. Hutton No-Action Letter at *2.
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> [¶] . . . [¶]
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> A pre-existing substantive relationship must be present even where the offeror has reason to believe that the offerees are persons of financial means and experienced in business affairs. In the Matter of Kenman Corporation, 1985 SEC LEXIS 1717 at * 9 … .

(Exhibit I6, pages 7-8.)

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10. 17 Code of Federal Regulations § 230.506 provides that, once the general conditions under
§§ 203.501 and 203.502 are satisfied, two additional "specific conditions" must be met:

> (i) *Limitation on number of purchasers.* There are no more than or the issuer reasonably believes that there are no more than 35 purchasers of securities from the issuer in any offering under this section.
>
> (ii) *Nature of purchasers.* Each purchaser who is not an accredited investor either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description.

11. Respondents argue that, pursuant to *Lillard v. Stockton* (N.D. Okla. 2003) 267 F.Supp.2d 1081 and *Temple v. Gorman* (S.D. Fla. 2002) 201 F.Supp.2d 1238, the mere filing of a Form D "qualifies a sale of the securities involved as one sold pursuant to Rule 506, thus preempting state law." (Exhibit B, page 6.) Respondents are incorrect. In *Brown v. Earthboard Sports U.S.A.* (6th Cir. 2007) 481 F.3d 901, the Court rejected that position stating it "would effectively eviscerate state registration requirements. In such a world, state registration requirements could be avoided by adding spurious boilerplate language to subscription agreements suggesting that the offerings were 'covered', or by filing bogus documents with the SEC." (*Id.* at 911.) The *Brown* Court continued:

> Far from defining "covered securities" in a manner that generally incorporates all securities, the SEC has promulgated specific requirements that must be met in order for a security to be "covered". Therefore, we hold that NSMIA preempts state registration laws with respect only to those offerings that actually qualify as "covered" securities according to the regulations that the SEC has promulgated. (*Id.* at 9I2.)

12. The holding in *Brown v. Earthboard Sports U.S.A., supra,* makes it clear that the 2005 filing of a Form D for Biotech Ventures I, and the 2006 filing of a Form D for Biotech Ventures II, do not, by themselves, qualify those securities for a private offering exemption. The offering must actually and completely meet the requirements of Regulation D. They failed to do so.

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13. With respect to the Reiss matter, Respondents solicited an investment based on Reiss's request for a brochure about the biotechnical industry. Reiss and Respondents did not share a prior substantive relationship, and Reiss's net worth was not questioned until the approximate time the solicitation was made. No inquiry was attempted, before the solicitation was made, as to whether Reiss had "such knowledge and experience in financial and business matters that he or she [was] capable of evaluating the merits and risks of the prospective investment" as referenced in the Woodtrails No-Action letter. Nothing in the evidence indicated that the offering was limited to 35 unaccredited purchasers.

14. An issuer or b r o k e r dealer is permitted to post a notice of a private offering on its website if the prospective purchasers have been previously determined to be "accredited" or "sophisticated" pursuant to Regulation D, and if the notice of private offering is posted on a password-protected page. (1996 SEC No-Act. LEXIS 642.) However, a questionnaire posted on a website must be generic and contain no reference to any specific fund. In addition, the subscriber must not be permitted to purchase privately offered securities until 30 days after his/her prequalification. (1997 SEC No-Act. LEXIS 688.)

15. Respondents failed to satisfy the above requirements on their website www.brookstonebiotech.com. Despite the language of the disclosure, sufficient information was offered on the website to constitute a general solicitation. Nothing on the website was password protected, and no attempt was made on the website to determine if a prospective purchaser was "accredited" or "sophisticated."

16. Respondents argue that it was unnecessary to disclose Carver's two felony convictions because they were temporally remote. Complainant strongly disagrees. Neither party convincingly established the correct statute or regulation under which a determination can be made as to the time during which a criminal conviction must be disclosed in an offering. In the absence of a specific controlling statute or regulation, Corporations Code section 25401 governs the issue. It provides:

> It is unlawful for any person to offer or sell a security in this state or buy or offer to buy a security in this state by means of any written or oral 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 the light of the circumstances under which they were made, not misleading.

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17. In 1994, Carver was convicted of making/passing fictitious checks and two counts of grand theft. All of the crimes were felonies. There is little more materially related to the investment of one's money than convictions for crimes involving fraud and/or dishonesty. Such convictions would be of concern to any reasonable investor. Carver was the President and CEO of Brookstone Capital, the general partner for Biotech Ventures I and Biotech Ventures II. By virtue of his position and the nature of his crimes, his felony convictions for fraud/dishonesty should have been disclosed despite their age.

18. However, even if disclosure of Carver's convictions was deemed unnecessary, no one disputes that, if federal preemption did not apply, Corporations Code section 25401 required Respondents to disclose the September 26, 2005 Order barring Carver from any position of employment, management or control of any investment adviser, broker-dealer or commodity adviser in the State of California, and the September 26, 2005 Order denying Brookstone Capital's application for an investment adviser certificate. Since both Orders were based on Carver's two felony convictions, disclosure of either or both Orders would have placed diligent prospective purchasers on notice of those convictions.

ORDER

WHEREFORE, THE FOLLOWING ORDER is hereby made:

The Desist and Refrain Order of October 31, 2006, against Robert L. Carver, Brookstone Capital, Inc., Brookstone Biotech Ventures, L.P., and Brookstone Biotech Ventures II, L.P., is affirmed.

DATED: May 23, 2008

H. STUART WAXMAN
Administrative Law Judge
Office of Administrative Hearings