BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of: THE CALIFORNIA CORPORATIONS COMMISSIONER, Complainant, vs. IN-SYNC INTERACTIVE CORPORATION, d.b.a. ISIC; IN-SYNC INTERACTIVE MANAGEMENT COMPANY, d.b.a. ISIMC; and MICHAEL J. KILROY, Respondents.	OAH No.: L2007040489

DECISION

The attached Proposed Decision of the Administrative Law Judge of the Office of Administrative Hearings, dated February 24, 2010, is hereby adopted by the Department of Corporations as its Decision in the above-entitled matter.

This Decision shall become effective on July 9, 2010.

IT IS SO ORDERED this 9th day of June 2010.

CALIFORNIA CORPORATIONS COMMISSIONER

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Preston DuFauchard

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PROPOSED DECISION

This matter regularly came for hearing before Samuel D. Reyes, Administrative Law Judge, Office of Administrative Hearings, in Los Angeles, California, on May 27 and 28, and August 17 and 19, 2009.

Joan E. Kerst, Senior Corporations Counsel, appeared on behalf of complainant Preston DuFauchard, Commissioner of Corporations (Commissioner), Department of Corporations (Department), State of California.

Frank Sandelmann and William K. Swank, Attorneys at Law, appeared on behalf of In-Sync Interactive Corporation d.b.a. ISIC, In-Sync Interactive Management Company, d.b.a. ISMIC, and Michael J. Kilroy (Respondents In-Sync, ISIMC, and Kilroy, respectively, and Respondents, collectively).

Complainant's predecessor issued a Desist and Refrain Order (Order) on July 31, 2003, finding that respondents had violated the Corporate Securities Law of 1968 (Securities Law), Corporations Code[1] section 25000 *et seq.*, by offering and selling securities in issuer transactions without qualification or other authorization and by making material misrepresentations and omissions in connection with the offers or sales. Based on these findings, respondents were directed to cease their activities. Respondents thereafter requested a hearing.

[1] Unless otherwise stated, all further references are to the Corporations Code.

Oral and documentary evidence was received at the hearing. On the fourth day of hearing, respondents objected to rebuttal evidence proposed by Complainant. The parties briefed the issue regarding the additional testimony, and on October 26, 2009, an order issued sustaining respondents' objections and affording the parties the opportunity to object to the admissibility of any outstanding exhibits. No objections were received by the December 7, 2009 deadline, and Exhibits 5, 6. 8 through 17, D, H through N, P, and Q are received in evidence. Closing argument was received on January 11, 2010 (Respondent's Closing Brief), January 12, 2010 (Complainant's Closing Argument), January 25, 2010 (Respondents Reply Brief), and January 26, 2010 (Complainant's Reply Closing Argument), which documents have been marked for identification as Exhibits T, 20, U, and 21, respectively. The matter was submitted for decision on January 26, 2010.

FACTUAL FINDINGS

1. The Commissioner issued the Order in his official capacity.

2. Respondent In-Sync, a Delaware corporation, is a holding company with 29 wholly-owned subsidiaries. At all times material, Respondent ISMIC, a California corporation, managed the day-to-day operations of the other corporations. At all times material, Respondent Kilroy was the president and vice-president of Respondent In-Sync, and President and Chief Executive Officer of Respondent ISIMC.

3. In the mid-1990s, Respondent Kilroy invested in two limited partnerships formed to acquire air spectrum band licenses to be issued by the Federal Communications Commission (FCC). The band was first called Interactive Video and Data Services, based on its intended application, but later was simply referred to as the 218 to 219 megahertz (MHz) spectrum. Seven limited partnerships acquired rights to 19 licenses issued by the FCC. The partnerships paid a deposit and financed the remainder of the cost of the licenses through the FCC. In June 1995, the partnerships reorganized, through bankruptcy court, into 19 wholly-owned subsidiaries of Respondent In-Sync. The pre-existing partnerships exchanged their assets, the primary one being the FCC licenses, for stock in the new corporation. Liabilities of the partnerships were assumed by the successor corporations. The reorganization did not occur due to any distress or inability to pay existing obligations, but, rather, was devised as a strategic method to deploy available assets. Respondent In-Sync thereafter acquired an additional 10 licenses, representing a significant footprint in the 218-219 MHz spectrum.

4. After the reorganization, Respondents took steps to develop a network and applications for the spectrum. Starting in 2000, Respondents hired individuals with substantial technical expertise, and they developed hardware and software. Respondents also tested prototypes and contacted potential customers for the applications then in development.

5. In or about September 2000, Terry Brown (Brown), an investor in Respondent In-Sync, met Mahnaz Judson Westerberg (Westerberg) and suggested that she meet Respondent Kilroy to discuss a business opportunity. Bernard Magara (Magara), another investor in Respondent In-Sync and a mutual friend of Brown and Westerberg, had recommended Westerberg's introduction to Brown and to Respondent Kilroy. Based on the information provided by Brown, Respondent Kilroy believed Westerberg to be a wealthy individual. His understanding was confirmed by the oral and written representations made by Westerberg.

6. On September 20, 2000, Brown hosted a meeting in his house between Respondent Kilroy and Westerberg. Magara and Brown's wife were also present. Westerberg stated that she wanted to learn about the business opportunity. Before discussing any business details, Respondent Kilroy required Westerberg to sign a confidentiality agreement, whereby, among other things, Westerberg agreed to maintain the confidentiality of any information obtained about the business opportunity, including forthcoming evaluation material. Respondent Kilroy provided information about Respondent In-Sync, about the potential for the 218-219 MHz spectrum, and about potential risks and benefits of the venture. He told Westerberg that they wanted to keep the number of individual investors small, as they were attempting to procure institutional investors, and that she would have to invest a significant amount, about $50,000.[2]

7. After the meeting, Respondent Kilroy instructed his staff to send Westerberg a set of documents entitled "10/1/99 Offering (Second Set)." The packet contained a cover letter, an Executive Summary, a company brochure, a Business Overview, investor representation letters, and investor offering term sheets, which document described Respondents' business and potential risks and benefits of the business.

8. A log of documents sent, entitled "10/1/99 Private Placement Initial Set – Package Issuance Registry," shows that the packet was sent to Westerberg via United States Postal Service delivery. The log of recipients of the private placement materials, redacted for the hearing, contains more than 300 names.

9. Respondent Kilroy met with Westerberg about two or three weeks after the first meeting. Westerberg brought a friend, Bob McKenzie (McKenzie), who also wanted to invest. Respondent Kilroy determined that McKenzie was not qualified to invest, and so informed him. Respondent Kilroy answered some additional questions from Westerberg about the investment.

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[2] This finding and factual finding numbers 7, 9, and 10, are primarily based on the testimony of Respondent Kilroy. When in conflict, I have credited his testimony over that of Westerberg. He presented better demeanor and had better recollection. More importantly, he presented internally consistent testimony, unlike Westerberg's testimony, which was often self-contradictory and inconsistent with facts more likely to be true or with more credible testimony. Magara also testified, but his recollection was vague, and it was unclear if his testimony was based on his personal recollection or that of others, including Brown and Westerberg.

10. Either at the meeting or shortly thereafter, on October 5, 2000, Westerberg issued two checks for a total of $55,000 to invest in Respondent In-Sync. At that time, Westerberg signed a letter,[3] which was addressed to Respondent In-Sync and which states, in pertinent part:

"The undersigned is providing you with this letter in connection with the purchase by the undersigned of 1,000 shares of Class A Common Stock (the 'Securities') of IN-SYNC INTERACTIVE CORPORATION, a Delaware corporation (the 'Company'). In particular, this letter is being provided so that the Company may avail itself of the exemption from registration under applicable federal and/or California state laws, including, without limitation, the exemption from registration contained in Section 25102(f) of the California Corporate Securities Law of 1968, as amended.

"The undersigned acknowledges that the offer and sale of the Securities has not been registered pursuant to either federal or California securities laws and understands that the Company is relying upon exemptions from such registration requirements predicated upon the following representations:

"1. The undersigned is purchasing the Securities for the undersigned's own account for investment purposes only and not with a view to or for sale in connection with any distribution of the Securities.

"2. The undersigned acknowledges the fact that the undersigned has a pre-existing business or personal relationship with the Company or its officers, directors or controlling persons, such that the undersigned is able properly to evaluate an investment in the Securities and to have access to all relevant information attendant thereto.

"3. The undersigned realizes and acknowledges that the Securities cannot be readily sold, there being no public market for them, and that the Certificates representing the Securities will bear a legend restricting their transfer unless registered under the Securities Act of 1933, or transferred pursuant to an exemption thereunder.

"4. By reason of the undersigned's knowledge and experience in financial and business matters in general, and investments in particular, the undersigned is able to evaluate the merits and risks of an investment in the Securities.

"5. The undersigned is able to bear the economic risks of an investment in the Securities, including, without limitation, the risk of losing part or all of the undersigned's investment in the Securities.

"6. The undersigned's net worth (together with that of the undersigned's spouse) is no

[3] At the hearing, Westerberg testified that she only signed one document, about confidentiality, and that she did not read it. However, the document, as does the September 20, 2000, confidentiality agreement, contains her signature, and Respondent Kilroy recalls seeing her sign the documents.

less than $1,000,000, and/or, the undersigned's income was in excess of $200,000 in each of the two most recent years (or together with the undersigned's spouse was in excess of $300,000) and that the undersigned expects to have income in excess of such amount in the current year.

"7. The undersigned hereby represents and warrants that the undersigned has heretofore discussed the Company and its plans, operations and financial condition with its officers and that it has heretofore received all such information as the undersigned deems necessary or appropriate to enable it to evaluate the financial risks inherent in making an investment in the Securities and further represents and warrants that it has received satisfactory and complete information concerning the business and financial condition of the Company on response to all inquiries in respect thereof, and has received copies of the following from the company:" (Exhibit A.)[4]

11. The letter did not set forth any specific documents received, but respondent Kilroy's testimony and the log establish that Westerberg received the documents set forth in factual finding number 7.[5]

12. By letter dated October 11, 2000, Westerberg received a certificate for 11,000 shares of In-Sync common stock.

13. A document entitled "Summary of ISIC Securities Offering 1995-2002," contains summary data about the private placement that involved the stock sold to Westerberg. It lists "60" as the approximate number of total purchasers. It also lists in a separate column, entitled

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[4] At the hearing, Westerberg denied that she was sophisticated in business affairs. However, facts presented at the hearing are inconsistent with said assertion. Until her divorce in 1998, Westerberg had been an officer in Judson Enterprises d.b.a. K Designers, a company that in 1999 had about 600 employees and annual revenue of about $40,000,000. In November 2000, she and others bought real property worth $104,000 for re-sale, and she purchased a residence for $435,000. She was an officer, and had a 50 percent interest in Advanced Airporter, a licensed public utility. She was a director and had registered a non-profit company called Planet Light. She was studying to become a real estate agent –she received her license on April 5, 2001.

[5] Westerberg variously testified that she had not received documents or that if she had, they had not been received before she invested. Westerberg initially testified that the only documents she had received were the stock certificate and the document pertaining to "confidentiality." When presented with additional documents, she acknowledged receiving some of them, namely, a November 28, 2000 letter to stockholders. In a letter sent to the Securities and Exchange Commission in February 2003, several pages from the 1999 Business Overview were attached, indicating that she had received the documents associated with the October 1, 1999 offering. Westerberg further stated that she no longer had any documents because she either sent them to the Department or they were packed, misplaced, or lost during one of her moves.

"Approximate [number] of [California] Purchasers," totals of "28 (accredited)" and "18 (not accredited)." Although the purported applicable "[California] Permit/Exemption," "25102(f)," is listed in the document, there is no explanation or details regarding the number of purchasers and their relationship to the exemption. (Exhibit O.) Respondents did not explain these numbers and did not provide testimony regarding the number of persons to whom the securities were sold or whether they were covered by an exemption.

14. Respondents had not qualified the common stock sold to Westerberg before it was sold to her.

15. It was not established that Respondents told Westerberg or any other potential investor that "Respondent In-Sync is poised to become the leading wholesale provider of inexpensive, high-speed data services to mobile Internet Protocol computing devices" or that "Respondent In-Sync's wireless radio modem miniaturization would be the surface area of a postage stamp," as alleged in the Order. On the contrary, testimony presented at the hearing established that Respondent In-Sync had a substantial footprint in the 218-219 MHz spectrum and that it was miniaturizing its modem.

16. Respondent Kilroy did not tell Westerberg or any other potential investor that "he had formed several other corporations which were suspended corporations or not in good standing with the California Secretary of State's Office," as alleged in the Order. However, the identity of any of these alleged corporations was not established at the hearing. Respondent Kilroy credibly testified that he learned about some companies with "in sync" in their names, but these were unrelated to Respondents.

17. Respondent Kilroy did not tell Westerberg or any other potential investor that he "had been a defendant in numerous lawsuits," as alleged in the Order. However, no evidence was presented that he had been involved in any lawsuits that were material to Westerberg's investment decision.

18. It was not established that respondent Kilroy failed to inform Westerberg or any other potential investor that he "failed to comply with the qualification requirements of the California Corporate Securities Law," as alleged in the Order. The document set forth in finding number 10, which Westerberg signed, stated that the subject securities "had not been registered pursuant to either federal or California securities laws."

LEGAL CONCLUSIONS

1. Section 25110 makes it "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 the 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." In any proceeding under the Securities Law, "the burden of proving an exemption or an exception from a definition is upon the person claiming it." (§ 25163).

2. The Commissioner issued the Order pursuant to the authority found in section 25532, which provides, in pertinent part, as follows:

"(a) If, in the opinion of the commissioner, (1) the sale of a security is subject to qualification under this law and it is being offered or sold without first being qualified, the commissioner may order the issuer or offeror of the security to desist and refrain from the further offer or sale of the security until the qualification has been made under this law or (2) the sale of a security is subject to the requirements of Section 25100.1, 25101.1, or 25102.1 and the security is being or has been offered or sold without first meeting the requirements of those sections, the commissioner may order the issuer or offeror of that security to desist and refrain from the further sale of the security until those requirements have been met.

[¶] . . . [¶]

"(d) If, after an order has been served under subdivision (a), (b), or (c), a request for hearing is filed in writing within 30 days of the date of service of the order by the person to whom the order was directed, a hearing shall be held in accordance with the provisions of the Administrative Procedure Act . . . .

"If that person fails to file a written request for a hearing within one year from the date of service of the order, the order shall be deemed a final order of the commissioner and is not subject to review by any court or agency, notwithstanding Section 25609."

3. Under Evidence Code section 500, "a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting." The standard of proof is preponderance of the evidence, as no statute or case law requires a higher burden. (Ev. Code, § 115.) Pursuant to Evidence Code section 500 and sections 25163 and 25532, the Commissioner has the burden to establish the facts that warranted issuance of the Order, and respondents bear the burden with respect to any claimed exemption or exception.

4. The common stock purchased by Westerberg from Respondents is a "security" within the meaning of section 25019.

5. Qualification means that the Commissioner has found the offering to be "fair, just and equitable." (§ 25140, subd. (b).) The security sold to Westerberg had not been qualified prior to its sale to her.

6. Complainant has established, prima facie, a violation of section 25110, in that a

security was sold to Westerberg without first having been qualified, by reason of factual finding numbers 6 through 14, and legal conclusion numbers 1 through 5.

7. Respondents rely on the exemption contained in section 25102, subdivision (f). The statute in effect at the time of the transaction provides, in pertinent part, an exemption for:

"Any offer or sale of any security in a transaction (other than an offer or sale to a pension or profit-sharing trust of the issuer) that meets each of the following criteria:

"(1) Sales of the security are not made to more than 35 persons, including persons not in this state.

"(2) All purchasers either have a preexisting personal or business relationship with the offeror or any of its partners, officers, directors or controlling persons, or managers (as appointed or elected by the members) if the offeror is a limited liability company, 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.

"(3) Each purchaser represents that the purchaser is purchasing for the purchaser's own account . . . and not with a view to or for sale in connection with any distribution of the security.

"(4) The offer and sale of the security is not accomplished by the publication of an advertisement. . . ."

8. Respondents have failed to establish an exemption pursuant to section 25102, subdivision (f), in that they have not met each of the statutory requirements for the exemption. Respondents did not affirmatively establish any of the four requirements for an exemption with respect to all purchasers. Significantly, Respondents did not show that "sales of the security [were] not made to more than 35 persons, including persons not in this state," as required by section 25102, subdivision (f)(1). On the contrary, the evidence received at the hearing tends to indicate that there are more than 35 persons to whom sales of the security were made. Offering materials were sent to more than 300 potential purchasers and Exhibit O states that there are 60 purchasers, and no evidence was presented to establish that these numbers include purchasers to whom the exemption does not apply.

9. Section 25401 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."

The Order alleges the following, in paragraph 7, that: "In connection with the offers or

sales of securities, ISIC, ISMIC, or Kilroy made, or caused to be made, misrepresentations and omissions of material facts in connection with the offers or sales of the securities to the public: [¶] a. The misrepresentations of material facts include: [¶] (1) ISIC is poised to become the leading wholesale provider of inexpensive, high-speed data services to mobile Internet Protocol computing devices; and [¶] (2) ISIC's wireless radio modem miniaturization would be the surface area of a postage stamp. [¶] The omissions of material facts include: [¶] (1) Kilroy had formed several other corporations which were suspended corporations or not in good standing with the California Secretary of State's Office; [¶] Kilroy had been a defendant in numerous lawsuits; and [¶] ISIC, ISMIC and Kilroy failed to comply with the qualification requirements of the California Corporate Securities Law."

As set forth in factual finding numbers 15 through 18, it was not established that Respondents made misrepresentations or failed to disclose material facts as set forth in the Order.

ORDER

Respondent's appeal is denied in part and sustained in part. The Order was properly issued and shall remain in effect, except with respect to the alleged misrepresentations.

Dated:_____

Samuel D. Reyes
Administrative Law Judge
Office of Administrative Hearings