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**BEFORE THE DIVISION OF SECURITIES**
**OF THE DEPARTMENT OF COMMERCE**
**OF THE STATE OF UTAH**

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| **IN THE MATTER OF:**<br><br>**NORTHSTAR ENERGY, INC.,**<br>**LARRY M. KOONCE,**<br>**PAUL M. ESPOSITO,**<br><br>**Respondents.** | **SUPPLEMENTAL AUTHORITIES AND BRIEF**<br><br>**Docket No. SD 05-0041**<br>**Docket No. SD 05-0042**<br>**Docket No. SD 05-0043** |

Since submitting for decision Northstar's motion to dismiss and the Division's opposition and cross motion for judgment on the pleadings, both the Sixth Circuit and yet one more state court has decided the issue of complete preemption in favor of the Division: Brown v. Earthboard Sports USA, Inc., 481 F.3d 901 (6th Cir. 2007), and Papic v. Burke, No. HHBCV05008511S, slip op., 2007 WL 10019000 (Conn. Super. Mar. 22, 2007). The Sixth Circuit rejected Temple v. Gorman, the

Florida district court decision relied on by Northstar and the other district court decisions it spawned tersely with: "[w]e now agree with those courts that have held that offerings must actually qualify for a valid federal securities registration exemption in order to enjoy NSMIA preemption" and "a security has to actually be a 'covered security' before federal preemption applies." Brown, 481 F.3d at _____, headnotes 2, 3.[1] Brown also noted that several federal district courts had affirmed the reasoning in Buist and other cases. Id.

> The *Temple* court read language into the statute that does not appear there. A security is covered if it is exempt from registration. . . . Nowhere does the statute indicate that a security may satisfy the definition if it is sold pursuant to a putative exemption. If Congress had intended that an offeror's representation of exemption should suffice it could have said so, but did not. Such an intent seems unlikely, in any event; that a defendant could avoid liability under state law simply by declaiming its alleged compliance with Regulation D is an unsavory proposition and would eviscerate the statute. Nor is it necessary to look to the legislative history; the statute is unambiguous. *Grubka v. WebAccess Int'l,* 445 F.Supp.2d 1259, 1269-71 (D.Colo.2006)(citations and internal quotation marks omitted). *See also Myers v. OTR Media, Inc.,* No. 1:05CV-101-M, 2005 WL 2100996, at *5-6, 2005 U.S. Dist. LEXIS 18779, at * 15 (W.D.Ky. Aug.30, 2005)(denying plaintiff's motion for summary judgment where defendants claim NSMIA preemption because "Defendants have proffered evidence sufficient to create a question of fact as to whether they are exempt under Rule 506.").
>
> We likewise reject *Temple's* approach. Under the prevailing view of the Commerce Clause's grant of authority, *Gonzales v. Raich,* 545 U.S. 1, 125 S.Ct. 2195, 2205-09, 162 L.Ed.2d 1 (2005),

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[1]The version of Brown on Westlaw does not contain page numbering. Citations correspond to headnotes.

> Congress has clearly been authorized to regulate the trading of securities. This includes the power to preempt contravening state regulations. Congress could in fact decide to occupy the entire field of securities regulation and preempt all state laws as they pertain to securities. Appellees urge us to believe that Congress actually performed a feat only slightly narrower, for to hold that NSMIA preempts state regulation wherever offerings merely *purport* to be filed pursuant to a valid federal registration exemption, or where parties have filed for, but fail to qualify for, an SEC registration exemption, would effectively eviscerate state registration requirements. In such a world, state registration requirements could be avoided merely by adding spurious boilerplate language to subscription agreements suggesting that the offerings were "covered," or by filing bogus documents with the SEC. Congress indubitably possesses the power to accomplish that end.

Brown, 481 F.3d at ____, headnotes 2, 3.

Likewise, Papic quotes with approval Capital Research and Management Co. v. Brown, a California state court decision previously cited by the Division in its earlier reply.

> The plain language of the savings clause and its legislative history persuade us that Congress intended to preserve the states' antifraud authority to control the conduct of brokers and dealers, notwithstanding that the exercise of such controls might prospectively influence the disclosure made by a covered security. Put another way, the Attorney General's action has all the attributes necessary to bring it squarely within the ambit of the savings clause. It is (1) an enforcement action (2) brought by a state officer performing the functions of a securities commission, (3) under California law (4) with regard to fraud and deceit (5) in connection with covered securities transactions.

*Papic, 2007 WL 10019000 at 5 (quoting Capital Research, 147 Cal. App. 4th 58, 66-67, 53 Cal.Rptr.3d 770 (2007); see also Id. at 68-70; Papic, 2007 WL 10019000 at 4 ("The State is not*

*precluded from exercising its enforcement authority where 'covered securities" are involved.").*

Under Brown, Papic, Capital Research, Zuri-Invest, Patterman, Buist, and Blue Flame, states may properly regulate covered securities under the antifraud provisions of various state security laws. If all the conditions are met for them to be federal covered under Rules 502 through 506, NSMIA prohibits states from regulating covered securities except under state law antifraud provisions. *See 17 CFR 230.501-508.* However, if all the conditions are not met, they are not covered securities. If they are not federal covered, states are not limited to their antifraud provisions and may regulate them under state blue sky laws.

The Division's regulation of Northstar is proper in this case because the limited offer on the Northstar Las Raices Multiwell Joint Venture (Las Raices) is not a covered security. The limited offer is not federal covered because Northstar posted the offering on a public website. Posting an offering on a general website constitutes general solicitation. *In re Blue Flame Energy Corp., 2006 WL 3775856, ¶¶ 50-52 (posting offer on unrestricted and therefore public Internet site constitutes general solicitation).* Posting the offering on a website meant the offering was not limited to accredited investors. Because the offering was not limited to accredited investors and was offered or sold through general solicitation, state regulation is proper under NSMIA. The only other issue for determination is whether it was registered. The answer to that question is no.

Northstar admitted selling to an unaccredited investor through its website in its Answer. *See Respondents' Answer at ¶¶ 7 ("Respondents agree that a joint venture interest was sold to*

*an investor in Utah who was not accredited as that term is defined in Rule 501(a)"); ¶ 17 ("At all times the interests in the Las Raices project that were sold to Utah investors were subject to the regulatory requirements of the Securities and Exchange Commission ('SEC')").* Northstar does not deny posting the offer on its website or failure to register. Northstar's only defense to posting and failure to register is the argument that posting the offer on a website does not constitute general solicitation and registration was not required because NSMIA completely preempts state law. *Respondents' Motion to Dismiss at 1, 5-6; see also Respondents' Response at 1, 4, ¶¶ 1, 17-20.* Papic, Capital Research, Zuri-Invest, Patterman, Buist, and Blue Flame hold just the opposite.

But even if NSMIA completely preempted all state regulation contrary, as Northstar claims, this tribunal cannot reach the merits of that issue because preemption is a challenge to the constitutionality of a statute. *Celebrity Custom Builders v. Industrial Claim Appeals, 916 P.2d 539, 541 (Colo. App. 1995)(citations omitted).* Agencies have no authority to rule on the constitutionality of statutes, and the Division Director cannot reach the merits of Northstar's constitutional challenge. *Clayton v. Bennett, 5 Utah 2d 152, 154-55, 298 P.2d 531, 533 (1956).* Because statutes are presumed to be constitutional, *West Jordan City v. Goodman, 2006 UT 27, ¶ 37, 135 P.3d 874, 883;* and agencies have no authority to rule on the constitutionality of a statute, the Division Director should presume the constitutionality of the statute, grant the Division's motion for judgment on the pleadings, and deny the motion to dismiss so Northstar can pursue its constitutional claim through the district court.

The remainder of Northstar's objections can be dismissed without merit. For example, Northstar contends the action should be dismissed on grounds that the Division failed to join an indispensable party. Although Northstar did not raise this issue in its earlier motion to dismiss, the company did raise it during oral argument on March 8, 2007. The company had previously advanced two interrelated arguments that tied into its current failure to join argument, first, that Las Raices is the issuer, not Respondents; and second, that Las Raices is a general partnership. The failure to join argument was not briefed. Nevertheless, the argument has no legal substance, and no legal significance in determining the issues in this case.

Partners are personally liable for the debt or obligation of a general partnership under both Texas and Utah law. *UTAH CODE ANN. § 48-1-12 (general partners jointly and severally liable for debts and obligations of partnership);* see also TEX. CODE ANN. TEX. REV. CIV. STAT. ANN. *Vernons § 152.304.*[2] Because partners are personally liable, whether Las Raices

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[2]Because general partners are personally liable under both Utah and Texas law, the presiding officer does not need to reach the question of what law analyze a conflict of law question.

> § 152.304. NATURE OF PARTNER'S LIABILITY. (a) Except as provided by Subsection (b) or Section 152.801(b), all partners are liable jointly and severally for a debt or obligation of the partnership unless otherwise: (1) agreed by the claimant; or (2) provided by law. (b) A person who is admitted as a partner into an existing partnership does not have personal liability under Subsection (a) for an obligation of the partnership that: (1) arises before the partner's admission to the partnership; (2) relates to an action taken or omission occurring before the partner's admission to the partnership; or (3) arises before or after the partner's admission to the partnership under a contract or commitment

should have been named in the Order to Show Cause has no legal significance, especially in this case, when Northstar and the partnership are one the same.

Respondents' website says: "Northstar Energy, Inc., is a private corporation that was formed by two experienced oilmen, Larry M. Koonce (President) and Paul M. Esposito (Chief Executive Officer), who each own 50% of the stock in the company. Northstar Energy is an independent producer of oil and gas. Northstar an oil and gas operator in the states of Texas and Louisiana and is the managing entity for all of our programs." *Exhibit A (emphasis added).* Although the name "Las Raices" appears on the face of the Form D, Esposito signed the form as "CEO, Northstar Energy, Inc., Managing Venturer." *(Exhibit B at 5).*

Whether the Division should have named Las Raices as well makes no difference. A joint venture is a form of partnership. Partners are personally liable and Las Raices does not have a separate legal existence from Northstar. Northstar provided no proof to the contrary. But even if it did, if Northstar really wanted to prove that Las Raices had separate legal existence from Northstar, it would have produced a copy of the joint venture agreement, rather than just citing the name on a form or a statute. Any name could appear on the face of a form. The statute is not dispositive of formation of an entity, and Northstar presented no evidence. Indeed, Northstar contends evidence is not required and defends its supposed right to do so.

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entered into before the partner's admission.
TEX. CODE ANN. TEX. REV. CIV. STAT. ANN. *Vernons § 152.304.*

Likewise, who the issuer is makes no difference. Liability is premised on whether a person offered or sold unregistered securities, not who an issuer is. Section 61-1-7 of the Utah Uniform Securities Act makes it unlawful for "any person to offer or sell" unregistered securities.

> It is unlawful for any person to offer or sell any security in this state unless it is registered under this chapter, the security or transaction is exempted under Section 61-14, or the security is a federal covered security for which a notice filing has been made pursuant to the provisions of Section 61-1-15.5.

*UTAH CODE ANN. § 61-1-7 (quoted in ¶ 14 of OSC); compare UTAH CODE ANN. § 61-1-13(1)(q)(defining "issuer").*[3]

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[3]The Act defines "issuer" as

> (I) . . . any person who issues or proposes to issue any security or has outstanding a security that it has issued.
> (ii) With respect to a preorganization certificate or subscription, "issuer" means the promoter or promoters of the person to be organized.
> (iii) "Issuer" means the person or persons performing the acts and assuming duties of a depositor or manager under the provisions of the trust or other agreement or instrument under which the security is issued with respect to:
>
> > (A) interests in trusts, including collateral trust certificates, voting trust certificates, and certificates of deposit for securities; or
> > (B) shares in an in investment company without a board of directors.
>
> (iv) With respect to an equipment trust certificate, a conditional sales contract, or similar securities serving the same purpose, "issuer" means the person by whom the equipment or property is to be used.
> (v) With respect to interests in partnerships, general or limited,

The term "person" means an "individual, a corporation, a partnership, a limited liability company, an association, a joint-stock company, a joint venture, a trust where the interests of the beneficiaries are evidenced by a security, an unincorporated organization, a government, or a political subdivision of a government." UTAH CODE ANN. § 61-1-13(1)(s)(emphasis added). Because "person" includes partnerships, and partners are personally liable, it makes no difference whether Las Raices Project is an issuer. The Division conceded that Las Raices was named as the issuer on the Form D. The Division even acknowledged or alluded to that fact in ¶¶ 4, 8 and of the OSC.

> 4. On July 14, 2005, the Division received a Form D from Respondents' attorney, Suzanne W. Falcon, in Dallas, Texas, in connection with Northstar's limited offering of equity for the Northstar Las Raices Multiwell Prospect Joint Venture (Las Raices offering).
>
> . . .
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> 8. Gary Bowen, Securities Examiner at the Division, reviewed the contents of Northstar's website, and found the following information regarding Northstar's Las Raices offering:
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> a. "If you are interested in our most current offering, or future offerings, and would like to know if you qualify, you can either go to our guestbook and fill in your information or you can fill out our questionnaire and fax (972) 769-0880

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> "issuer" means the partnership itself and not the general partner or partners.
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> (vi) With respect to certificates of interest or participation in oil, gas, or mining titles or leases or in payment of production under the titles or leases, "issuer" means the owner of the title or lease or right of production, whether whole or fractional, who creates fractional interests therein for the purpose of sale.

*UTAH CODE ANN. § 61-1-13(1)(q).*

or mail it to us at the address on the bottom of this page"; and

b. "**The Northstar Las Raices Prospect**
Located in Webb County, Texas, this oil and gas drilling program includes four wells to be drilled inside of a currently producing field, each of the four wells will be drilled to a depth of 7,300 feet during the months of June and July 2005. Contact a Northstar associate for more info."

*OSC, ¶¶ 4, 8.*

As stated above, any name can appear on a form, and Northstar presented no evidence that Las Raices has a separate legal identity from Northstar. Even if it were a joint venture, it makes no difference to whether Las Raices should have been named. Joint ventures are persons. Joint ventures are a form of partnership. Partners are personally liable. Northstar, Esposito and Koonce are the partners.

Finally, the request of dismissal on these grounds is untimely. *Utah R. Civ. P. 12(b)(dismissal for failure to join an indispensable party "shall be made" before further pleading), -(h)(Party waives all defenses and objections not presented by motion); see also Utah Code Ann. § 63-46b-1(4)(motions to dismiss under Rule 12 allowed if requirements are met).* Dismissal is brought before filing a responsive pleading. Northstar filed its response and then waited year and a half to move for dismissal. It is untimely.

## CONCLUSION

For these reasons, the Division's Cross Motion for Judgment on the Pleadings should be granted, and Northstar's motion to dismiss should be denied.

Respectfully submitted this May 22, 2007.

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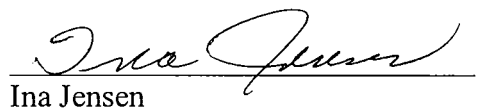
## CERTIFICATE OF MAILING

I, Ina Jensen, hereby certify that I have this day served a copy of the foregoing **Supplemental Authorities and Brief** to Respondents by mailing a copy, with postage prepaid, to:

Craig G. Ongley
Vial, Hamilton, Koch & Knox, LLP
1700 Pacific Avenue, Suite 2800
Dallas, TX 75201

Dated this 22nd day of May 2007.



Ina Jensen