

IN THE DISTRICT COURT OF OKLAHOMA COUNTY
STATE OF OKLAHOMA

Oklahoma Department of Securities)
ex rel. Irving L. Faught,)
Administrator,)
)
Plaintiff,)
)
v.)
)
2001 Trinity Fund, L.L.C. and)
Robert Arrowood,)
)
Defendants.)

HEARING SET FOR
MARCH 6, 2015 @ 9:00 A.M.

Case No. CJ-2012-6164
Judge Roger Stuart

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OKLAHOMA COUNTY
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PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT
AND BRIEF IN SUPPORT

Respectfully Submitted,
OKLAHOMA DEPARTMENT OF SECURITIES

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The Oklahoma Department of Securities (Department) respectfully requests that the Court find that the notes at issue in this case are securities as defined by the Oklahoma Uniform Securities Act of 2004, Okla. Stat. tit. 71, § 1-101 through 1-701 (2011) (Act), and grant a partial summary judgment finding that the Defendants offered and sold unregistered securities in and from the state of Oklahoma in violation of Section 1-301 of the Act and that Defendant Robert Arrowood acted as an unregistered agent in this state in violation of Section 1-402 of the Act.

I. Introduction

Through the entity he controlled, 2001 Trinity Fund, L.L.C. (Trinity Fund), Defendant Robert Arrowood (Arrowood) raised money from individual investors to finance his oil and gas business (Investors). Investors were offered very high rates of return over a short term for the use of their money (the “Investments”). Most, but not all, of the Investments were evidenced by written promissory notes. Defendant offered and sold the Investments to friends-of-friends, acquaintances, and through word-of-mouth referrals, many of whom had no prior knowledge of or relationship with Arrowood prior to making their Investments. The Investors included retirees, physicians, drywall contractors, professional football players and others.

Defendants have twice requested that the Court grant summary judgment in their favor on the basis that the Investments are not securities. The Court denied both motions. At the hearing on Defendants’ second motion, the Court conducted an in-depth analysis of the *Reves* test, the established test for determining whether a note is a security, as set forth in *Reves v. Ernst & Young*, 494 U.S. 56, 66, 110 S.Ct. 9, 108 L.Ed.2d 47 (1990), and the many cases interpreting *Reves*. The Court determined that, of the four factors used in the *Reves* test, three of the factors weighed in favor of the Investments being securities. The Court was unsure how to apply the other factor and therefore ruled it neutral. The brief below should persuade the Court that this

factor weighs in favor of the notes being securities. Nevertheless, it is important to note that “[f]ailure to satisfy one of the factors is not dispositive; they are considered as a whole.” *S.E.C. v. Thompson*, 732 F.3d 1151, 1160 (10th Cir. 2013) citing *S.E.C. v. Wallenbrock*, 313 F.3d 532, 537 (9th Cir. 2002). The Investments are clearly securities when the *Reves* factors are considered as a whole.

Defendants have requested a jury trial. The Department does not dispute that they are entitled to a jury trial on the anti-fraud claim. However, it is clearly settled that the determination of whether a particular investment is a security is a question of law for the Court to decide. *Lambrecht v. Bartlett*, 1982 OK 158, 656 P.2d 269, 271; *Thompson* at 1160-1161. The Department’s claims that Defendants have violated the registration provisions of the Act are ripe for summary judgment. In resolving the registration issues on summary judgment, the Court will narrow the issues for trial thereby making the jury trial on the issue of anti-fraud liability more efficient.

II. Undisputed Facts

1. Arrowood is a resident of Norman, Oklahoma. *Admitted in First Amended Answer of Robert Arrowood, ¶ 5 (Filed 11/20/2012).*
2. The Trinity Fund is a limited liability company formed under the laws of the state of Oklahoma. *Admitted in First Amended Answer of Robert Arrowood, ¶ 4 (Filed 11/20/2012).*
3. At all times material hereto, Arrowood and the Trinity Fund maintained their principal place of business in Norman, Oklahoma. *Admitted in First Amended Answer of Robert Arrowood, ¶ 4 (Filed 11/20/2012).*

4. The Trinity Fund was controlled by Arrowood until he placed it in bankruptcy in October 2009. *Admitted in First Amended Answer of Robert Arrowood*, ¶ 5 (Filed 11/20/2012). See *Exhibit A*, *Arrowood Transc.* at 28:13 to 29:18.

5. Arrowood, directly and indirectly through others, let it be known that he and the Trinity Fund were willing to enter into the Investments. See *Exhibit A*, *Arrowood Transc.* at 87:21 to 88:3, 111:6 to 112:20, 118:13 to 121:16; *Exhibit B*, *Bankruptcy Transc.* at 101:20 to 103:1¹ and 178:14 to 182:24; *Exhibit C*, *Byrd Transc.* at 18:12 to 22:22 and 67:23 to 68:11; *Exhibit D*, *Hennersdorf Transc.* at 11:17 to 12:16 and 23:21 to 24:21; *Exhibit E*, *Martin Transc.* at 9:21 to 11:5; *Exhibit F*, *Rapp Transc.* at 10:23 to 11:11; *Exhibit G*, *Larry Sessions Transc.* at 6:21 to 8:20; *Exhibit H*, *Wade Sessions Transc.* at 7:25 to 9:22, 13:10 to 14:21; *Exhibit I*, *Rossell aff.* at ¶ 3; *Exhibit J*, *Dvoracek aff.* at ¶¶ 3 and 4.

6. Arrowood represented that he and the Trinity Fund were in the oil and gas business generally and, particularly, in the business of buying and selling leases for a profit. See *Exhibit B*, *Bankruptcy Transc.* at 6:25 to 10:15, 97:21 to 100:15; *Exhibit C*, *Byrd Transc.* at 18:12 to 20:2; *Exhibit D*, *Hennersdorf Transc.* at 11:17 to 12:16, 23:21 to 24:21; *Exhibit E*, *Martin Transc.* at 9:21 to 10:15; *Exhibit F*, *Rapp Transc.* at 24:2-10; *Exhibit G*, *Larry Sessions Transc.* at 6:21 to 8:20, 14:14-21; *Exhibit H*, *Wade Sessions Transc.* at 7:25 to 9:22; *Exhibit I*, *Rossell aff.* at ¶ 3; *Exhibit J*, *Dvoracek aff.* at ¶ 5.

7. Defendants sold the Investments to at least 18 Investors. See *Exhibit A*, *Arrowood Transc.* at 74:2-5 (*Machina*), 77:15-19 (*Byrd*), 87:7-10 (*Hennersdorf*), 99:5-7 (*C&P Properties*), 105:12 to 106:7 (*Gernsbacher*), 107:2-5 (*David Rapp*), 112:8-11 (*Barlow*), 116:12-21

¹ The page numbering referenced with regards to Exhibit B may create some confusion due to the condensed nature of the transcript. The references cited refer to the actual page numbers of the transcript that are found on the left side of the page between line numbers and not to the page numbers of the condensed transcript found at the bottom of each page.

(*Finstaad*), 118:7-10 (*Perkins*), 123:2-4 (*Jonathon Jackson*), 123:2 to 124:8 (*Larry and Ruby Jackson*), 126:25 to 127:12 (*Dvoracek*), 131:6-8 (*Harris*), 132:23 to 133:3 (*Semore*), 134:8-25 (*Brown*), 142:8-15 (*Pearlman*), 146:4-6 (*Wade Sessions*), 155:23 to 156:5 (*Rossell*), 163:12-14 (*Larry Sessions*), 168:17-22 (*Smith*), 174:1 to 176:10 (*Ingram*); **Exhibit B**, *Bankruptcy Transc.* at 101:20 to 102:20, 178:14 to 181:6, and 199:11 to 200:24; **Exhibit C**, *Byrd Transc.* at 28:16 to 32:23 and 36:14-18; **Exhibit D**, *Hennersdorf Transc.* at 16:17 to 18:14; **Exhibit E**, *Martin Transc.* at 13:3-6 and 17:4 to 18:13; **Exhibit F**, *Rapp Transc.* at 8:2 to 9:3 (for *Gernsbacher*), 9:4-18 (for *Rapp and his brother, Thomas "Todd" Rapp*) and 19:17 to 20:4 for (*Barlow*); **Exhibit G**, *Larry Sessions Transc.* at 9:12-25; **Exhibit H**, *Wade Sessions Transc.* at 13:14-16 and 21:9 to 22:12; **Exhibit I**, *Rossell aff.* at ¶ 5; **Exhibit J**, *Dvoracek aff.* at ¶ 6.

8. Most, though not all, of the Investments were evidenced by promissory notes. See **Exhibit A**, *Arrowood Transc.* at 75:18-21, 81:14-22, 93:2 to 94:20, 103:1-20, 107:1-5, 111:15-17, 115:1-5, 118:7-10, 123:17-23, 127:7-12, 131:5-10, 132:23 to 133:2, 134:23-25, 141:18 to 142:10, 147:3-11, 158:5 to 163:2, 164:19 to 166:11, 175:23 to 176:7, 168:17-22, and *Arrowood Transc. Exhibits 1, 2, 4, 5, 6, 7, 8, 9, 10, and 11*; **Exhibit C**, *Byrd Transc.* at 26:10 to 29:24 and 46:10 to 47:2; **Exhibit D**, *Hennersdorf Transc.* at 16:10 to 18:14; **Exhibit E**, *Martin Transc.* at 14:16 to 17:22; **Exhibit F**, *Rapp Transc.* at 22:4-14; **Exhibit G**, *Larry Sessions Transc.* at 9:10 to 12:16, 17:25 to 21:16 and 35:11 to 37:1; **Exhibit H**, *Wade Sessions Transc.* at 16:13-17; **Exhibit I**, *Rossell aff.* at ¶ 6; **Exhibit J**, *Dvoracek aff.* at ¶ 16.

9. The promissory notes, prepared by Arrowood and issued by the Trinity Fund under Arrowood's signature as President of the Trinity Fund, reflect that the Trinity Fund would pay a fixed interest rate ranging from 5% to 20% for the use of investor funds for terms ranging from

30 to 45 days. See *Exhibit A, Arrowood Transc. Exhibits 1, 2, 4, 5, 6, 7, 8, 9, 10, and 11*; *Exhibit J, Dvoracek aff. at ¶¶ 8 and 9 and Exhibit A*.

10. The interest rates were calculated for the term of the notes rather than on an annual basis. See *Exhibit A, Arrowood Transc. at 70:17 to 72:1, and Arrowood Transc. Exhibits 1, 2, 4, 5, 6, 7, 8, 9, 10, and 11*.

11. The interest rates equate to annualized returns of approximately 40%. *Exhibit K, Ulrey aff. at ¶¶ 10-12*.

12. According to Statistical Releases issued by the Federal Reserve, the bank prime loan rate from August 2008 to September 2009 ranged from 5% downward to 3.25% annualized interest. See *Exhibit K, Ulrey aff., ¶ 9*.

13. Defendants never sought a bank loan even though they were paying out approximately 40% in interest. See *Exhibit A, Arrowood Transc. at 35:14 to 38:10; Exhibit B, Bankruptcy Transc. at 153:23-154:10*.

14. Defendants made the Investments for the purported purpose of raising cash for the Trinity Fund's business operations. See *Exhibit L, Arrowood's aff. at ¶ 3; Exhibit A, Arrowood Transc. at 49:25 to 63:16*.

15. The Investors' primary motivation in making the Investments was the opportunity to make a profit, and many of the Investors were specifically motivated by the high interest rates and the short investment term. See *Exhibit A, Arrowood Transc. at 109:18 to 110:8, 113:14-22; Exhibit C, Byrd Transc. at 22:2-14 and 53:14 to 55:3; Exhibit D, Hennersdorf Transc. at 18:16-24; Exhibit E, Martin Transc. at 14:2-6; Exhibit F, Rapp Transc. at 14:4-8 and 17:16-23; Exhibit G, Larry Sessions Transc. at 12:22 to 14:2; Exhibit H, Wade Sessions Transc. at 16:4-12; Exhibit I, Rossell aff. at ¶ 6; Exhibit J, Dvoracek aff. at ¶ 7*.

16. At least 11 of the approximately 18 Investors did not know Arrowood personally prior to discussion of the Investments; most of the Investors were at best “friends of friends” of Arrowood. See **Exhibit A**, Arrowood Transc. at 60:2-10 (*friends of friends*), 77:20 to 78:17 (*Byrd*), 87:11 to 88:15 (*Hennersdorf*), 98:19 to 101:1 (*C&P Properties*), 105:12 to 106:7 (*Gernsbacher*), 107:6 to 109:11 (*David Rapp*); 110:21 to 111:5 (*Thomas Rapp*), 111:6 to 112:11 (*Barlow*), 124:9-14 (*Larry and Ruby Jackson*), 124:15-18 and 126:6-10 (*Perkins*), 128:10-18 (*Dvoracek*), 146:4-22 (*Wade Sessions*), 155:23-25 and 157:12-14 (*Rossell*), 163:6-11 (*Larry Sessions*); **Exhibit B**, Bankruptcy Transc. at 101:20-102:20, 178:14-181:6, and 199:11-200:24; **Exhibit C**, Byrd Transc. at 20:6 to 21:22, 79:19-21; **Exhibit D**, Hennersdorf Transc. at 13:19 to 14:24; **Exhibit E**, Martin Transc. at 13:21 to 14:1; **Exhibit F**, Rapp Transc. at 12:12-21 (*David Rapp*), 18:13-17 (*Thomas Rapp*); **Exhibit G**, Larry Sessions Transc. at 8:23 to 9:9; **Exhibit H**, Wade Sessions Transc. at 11:6 - 14; **Exhibit I**, Rossell aff. at ¶ 3; **Exhibit J**, Dvoracek aff. at ¶¶ 3 and 4.

17. The Investors were from at least 5 different states. See **Exhibit A**, Arrowood Transc. at 76:5-11 (*Machina/Texas*), 79:13-19 (*Byrd/Texas*), 88:21-25 (*Hennersdorf/Texas*), 107:6-24 (*David Rapp/Texas*); 112:21-24 (*Barlow*), 116:16-21 (*Finstaad/Texas*), 124:19-23 (*Larry and Ruby Jackson/Texas*), 132:9-11 (*Harris/Illinois*), 140:4-18 (*Pearlman/Illinois*), 154:20-23 (*Wade Sessions/Utah*), 164:21-25 (*Larry Sessions/Florida*); **Exhibit K**, (*Ulrey Aff.*), ¶ 6; **Exhibit B**, Bankruptcy Transc. at 200:9-17 (*Thomas Rapp/Missouri*); **Exhibit C**, Byrd Transc. at 9:11-22 (*Texas*); **Exhibit D**, Hennersdorf Transc. at 9:14-15 (*Texas*); **Exhibit F**, Rapp transc. Exhibit 2; **Exhibit G**, Larry Sessions Transc. at 6:2-6 (*Florida*); **Exhibit H**, Wade Sessions Transc. at 7:7-14, 32:2-10 (*Utah*); **Exhibit I**, Rossell aff. at ¶ 3 (*Alabama*); **Exhibit J**, Dvoracek aff. at ¶ 3 (*Illinois*).

18. Arrowood did not inquire about such information as the Investors' net worth or ability to suffer the loss of their funds. See **Exhibit A**, Arrowood Transc. at 80:12-19, 90:13-21, 113:3-8, 117:7-13, 155:5-13, 157:15-18; **Exhibit G**, Larry Sessions Transc. at 17:6-24; **Exhibit H**, Wade Sessions Transc. 16:18 to 17:5.

19. Prior to the Investments, Arrowood did not advise Investors of risk factors associated with the Investments. See **Exhibit A**, Arrowood Transc. at 81:23 to 82:4, 102:11-20, 113:23 to 114:2; **Exhibit G**, Larry Sessions Transc. at 26:4-10; **Exhibit H**, Wade Sessions Transc. at 32:1 to 33:18; **Exhibit J**, Dvoracek aff. at ¶ 17.

20. Most of the Investors were not in the oil and gas business. See **Exhibit C**, Byrd Transc. at 10:19 to 11:13; 16:10-22 (restaurant entrepreneur); **Exhibit D**, Hennersdorf Transc. at 9:16 to 11:6 (drywall contractor); **Exhibit E**, Martin Transc. at 8:13 to 9:2, 18:10-11, 29:11-22, 30:21 to 31:18 (drywall contractor); **Exhibit F**, Rapp Transc. at 19:20 to 21:25, 26:1 to 27-10 (lawyer); **Exhibit G**, Larry Sessions Transc. at 6:13-20 (retired engineer); **Exhibit H**, Wade Sessions Transc. at 19:19-24 (physician); **Exhibit I**, Rossell aff. at ¶ 1; **Exhibit J**, Dvoracek aff. at ¶ 2 (professional football player).

21. Most of the Investors were not in the business of making loans to others. See **Exhibit C**, Byrd Transc. at 71:20-25; **Exhibit D**, Hennersdorf Transc. at 27:7-21, 42:3-7; **Exhibit E**, Martin Transc. at 22:22 to 23:30, 38:11 to 39:19; **Exhibit F**, Rapp Transc. at 14:9 to 16:24; **Exhibit G**, Larry Sessions Transc. at 25:19 to 26:30, 55:17-20; **Exhibit H**, Wade Sessions Transc. at 19:25 to 20:17; **Exhibit I**, Rossell aff. at ¶ 10; **Exhibit J**, Dvoracek aff. at ¶ 18.

22. The Investors did not have any involvement in the business activities of Arrowood or the Trinity Fund. See **Exhibit A**, Arrowood Transc. at 92:2-7, 183:7 to 185:23; **Exhibit B**, Bankruptcy Transc. at 101:1 to 103:1, 195:14-198:20.

23. The Investors believed that their investment funds were being used for 2001 Trinity Fund's oil and gas business, particularly, to purchase oil and gas leases that would be sold for a profit. See **Exhibit C**, *Byrd Transc.* at 18:12 to 20:2; **Exhibit D**, *Hennersdorf Transc.* at 11:17 to 12:16, 23:21 to 24:21; **Exhibit E**, *Martin Transc.* at 9:21 to 10:15, 49:1-12; **Exhibit G**, *Larry Sessions Transc.* at 7:23 to 8:8, 14:15-21; **Exhibit H**, *Wade Sessions Transc.* at 7:25 to 9:22, 13:14 to 15:20; **Exhibit I**, *Rossell aff.* at ¶ 3; **Exhibit J**, *Dvoracek aff.* at ¶ 5.

24. Arrowood purposefully avoided giving Investors information about his activities because he did not want Investors to have a claim to any specific lease and he did not want to risk that they would use his business information to compete against him. See **Exhibit A**, *Arrowood Transc.* at 53:12-13, 62:10 to 63:16; **Exhibit B**, *Bankruptcy Transc.* at 101:1-103:1, 195:14-198:20.

25. The Investors referred to their funds given to Arrowood as "investments." See **Exhibit C**, *Byrd Transc.* at 22:2-11, 30:24 to 31:2, 49:10-14, 50:8 to 52:1; **Exhibit D**, *Hennersdorf Transc.* at 11:24-25, 12:12-16, 23:21 to 24:3; **Exhibit E**, *Martin Transc.* at 9:23 to 10:15, 26:24 to 27:4, 27:15 to 28:8, 29:5-8; **Exhibit F**, *Rapp Transc.* at 8:2 to 9:7, 12:24 to 13:2; **Exhibit G**, *Larry Sessions Transc.* at 11:2-7, 13:12-23, 14:14-21, **Exhibit H**, *Wade Sessions Transc.* at 15:21 to 16:3; **Exhibit I**, *Rossell aff.* at ¶¶ 5 and 6; **Exhibit J**, *Dvoracek aff.* at ¶ 13.

26. Several of the investors wrote the word "investment" on their checks, or in their check register, contemporaneously with giving their funds. See **Exhibit C**, *Byrd Transc.* at 47:14 to 52:1 and *Byrd Transc. Exhibits 6 and 7*; **Exhibit F**, *Rapp Transc.* at 8:2 to 9:30, 10:2-22, and *Rapp Transc. Exhibits 1 and 2*.

27. Arrowood referred to the funds received from Investors as "investments." See *Exhibit A, Arrowood Transc. at 166:14 to 167:1 and Arrowood Transc. Exhibit 12; Exhibit H, Wade Sessions Transc. at 15:21 to 16:3; Exhibit I, Rossell aff. at ¶ 4; Exhibit J, Dvoracek aff. at ¶ 13.*

28. The Investments were not secured by an interest in property or other collateral. See *Exhibit A, Arrowood Transc. at 65:2-9, 84:16-19, 92:12-14, 102:21-23, 110:16-20, 155:20-22, 158:25 to 159:2; Exhibit G, Larry Sessions Transc. at 41:17 to 42:25; Exhibit H, Wade Sessions Transc. at 15:4-20, 26:3-6, 26:1 to 27:5; Exhibit I, Rossell aff. at ¶ 9; Exhibit J, Dvoracek aff. at ¶ 15.*

29. The Investments were not registered under the Act. *Exhibit M, Maillard aff.*

30. Arrowood was not registered as an agent under the Act. *Exhibit N, Gruis aff.*

III. The Investments are securities as defined by the Act.

Section 1-102 of the Act provides in relevant part:

32. "Security" means a *note*; stock; treasury stock; security future; bond; debenture; evidence of indebtedness; certificate of interest or participation in a profit-sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable share; **investment contract**; voting trust certificate; certificate of deposit for a security; fractional undivided interest in oil, gas, or other mineral rights; put, call, straddle, option, or privilege on a security, certificate of deposit, or group or index of securities, including an interest therein or based on the value thereof; put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; or, in general, an interest or instrument commonly known as a "security," or a certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. [Emphasis added.]

Of the types of securities set forth in Section 1-102, the Investments qualify as both notes and investment contracts. The legal tests for determining when a note is a security and explaining what constitutes an investment contract are set forth below.

Please note that when interpreting the definition of “security” the Act embodies a flexible principle that is “capable of adaptation to meet the countless and variable schemes devised by those who seek to use the money of others on the promise of profits.” *State v. Hoephner*, 1978 OK CR 18, ¶ 7, 574 P.2d 1079, 1081, citing *S.E.C. v. Howey*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946). The United States Supreme Court has ruled that remedial legislation such as the securities laws should be broadly construed to effectuate its purpose. *Tcherepnin v. Knight*, 389 U.S. 332, 336, 88 S.Ct. 548, 553 (1967). Therefore, in analyzing an investment, “form is to be disregarded over substance and the emphasis should be on (the) economic reality” of the transaction. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 848, 95 S.Ct. 2051, 2058 (1975).

A. The Investments, as notes, are securities.

Most of the Investments are evidenced by promissory notes and Arrowood has characterized most of the Investors as note holders even where we do not have a copy of an actual promissory note. The Oklahoma Supreme Court has stated that in interpreting the provisions of the Act, the interpretive history of the federal securities laws should be considered. *Day v. Southwest Mineral Energy, Inc.*, 1980 OK 118, ¶ 30-31, 617 P.2d 1334, 1339 (citing Section 406 of the predecessor act). Federal law interpreting the definition of the term “note” was settled by the United States Supreme Court in *Reves* and further developed in subsequent case law. *Reves* at 65-66. The Court should find the reasoning of *Reves* and its progeny persuasive in considering the Department’s motion.

The *Reves* court unequivocally stated that *all notes are presumed to be securities*. *Reves* at 65 (*emphasis added*). The presumption that the Investments herein are securities is rebuttable

only if the notes 1) fall within certain enumerated exceptions or 2) have a strong “family resemblance” to one of those exceptions. *Id.*

1. The Investments do not fall within any of the enumerated *Reves* exceptions.

The presumption that a note is a security may be rebutted if the note is one of the following:

1. a note delivered in consumer financing;
2. a note secured by a mortgage on a home;
3. a short-term note secured by a lien on a small business or some of its assets;
4. a note evidencing a character loan to a bank customer;
5. short-term notes secured by an assignment of accounts receivable;
6. a note formalizing an open-account debt incurred in the ordinary course of business; and,
7. notes evidencing loans by commercial banks for current operations.

Id.

The Investments in this case clearly do not fall within any of these categories as being excluded from the definition of a security. The Investments were not delivered by an individual in connection with a consumer loan or for a home mortgage; the Investments were not secured by a lien on any collateral; the Investments were not issued to a bank as part of a customer loan; the Investments were not secured by an assignment of accounts or to formalize an open-account debt; and the Investments were not to evidence loans by a commercial bank for current operations.

2. The Investments do not bear a “strong resemblance” to any of the *Reves* exceptions.

The presumption that a note is a security can also be rebutted if the note bears a “strong resemblance” to one of the seven enumerated exceptions described above. *Id.* at 66-67. The burden is on a person claiming a note is not a security to prove a “strong resemblance” to one of the exceptions, and, “[w]here the question is a close one, the presumption that the note is a security holds.” *Fox v. Dream Trust*, 743 F.Supp. 2d 389, 401 (D.N.J. 2010).

To determine whether a note bears a strong resemblance to the non-security type notes listed above, the *Reves* court adopted a four-part test commonly referred to as the “family resemblance test.” *Reves*, at 66-67. The four factors of the “family resemblance” test are:

1. the motivations of the parties;
2. the offeror’s plan of distribution;
3. the reasonable expectations of the public; and
4. whether an alternative regulatory scheme renders application of the securities laws unnecessary.

Reves at 66-67. It is important to recognize that these four factors are not elements to be met, but rather points of comparison for the ultimate determination of whether the notes bear a “strong resemblance” to the seven types of commercial notes identified in *Reves*. *Robyn Meredith v. Levy*, 440 F.Supp.2d 378, 384 (D.J.J. 2006).

a. The motivations of the parties

The first *Reves* factor directs the Court to consider the motivations of both the seller and the buyers of the notes. *Reves at 66.* “If the seller’s purpose is to raise money for the general use of a business enterprise...and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a security.” *Id.*

Defendants’ motivations are very clear. Their purpose in selling the Investments was to raise money for the general use of their business. In Arrowood’s own words, the purpose of taking the Investors’ money was “... to raise cash for its [the Trinity Fund’s] business operations.” *See supra* ¶ 14.

Arrowood represented to the Investors that he and the Trinity Fund were in the oil and gas business, specifically, the business of buying and selling leases for a profit. *See supra* ¶¶ 6 and 23. The Investors believed that their money would be used for the oil and gas business. *See supra* ¶ 23. Of particular significance, Arrowood issued the promissory notes in the name of the

Trinity Fund, not his own personal name. *See supra* ¶ 9. That in itself would lead any Investor to believe that they were investing in the Trinity Fund's oil and gas operations, rather than merely making a personal loan to Robert C. Arrowood individually.

The Investors were primarily interested in making a profit, many of them specifically noting the high interest rates and the short investment term. *See supra* ¶ 15. The interest rates on the Investments ranged from 5% to 20% for the use of the Investors' funds over a term of 30 to 45 days. *See supra* ¶ 9. The interest rate was calculated for the term of the note rather than on an annual basis so that equates to an annualized rate of return of approximately 40%. *See supra* ¶¶ 10 and 11. In comparison, the bank prime loan rate in 2008 and 2009 ranged from 5% downward to 3.25% annualized interest. *See supra* ¶ 12. Tellingly, Defendants never sought a traditional bank loan even though the Trinity Fund was paying out 40% in interest to the Investors. *See supra* ¶ 13.

The interest rates on the face of the notes support a finding of investment intent on the part of the Investors. According to the United State Supreme Court, "a favorable interest rate indicates that profit was the primary goal of the lender." *Reves* at 67-68. The Investments carry rates of interest far in excess of normal commercial loan rates. *See supra* ¶¶ 9-13. This fact alone indicates the transactions involved securities, not commercial loans. *Stoiber v. S.E.C.*, 161 F.3d 745, 750 (D.C. Cir. 1998), citing, *Reves*, 494 U.S. at 67-68.

Because Defendants' motivation was to raise money for the business operations of the Trinity Fund and the Investors' primary motivation was their profits, this *Reves* factor clearly indicates that the Investments are securities.

b. The plan of distribution

The second *Reves* factor directs the Court to consider the seller's overall plan of distribution to determine whether "there is common trading for speculation or investment" in the notes. *Reves* at 66. Although common trading may easily be established where the instrument is "offered and sold to a broad segment of the public," the number of investors is not dispositive to determining whether this factor is met. *S.E.C. v. Global Telecom Services, L.L.C.*, 325 F.Supp.2d 94, 114-115 (D. Conn. 2004). The Court should evaluate this factor with a particular emphasis on "the purchasing individual's need for the protection of the securities laws." *Id.* at 115; *S.E.C. v. Mulholland*, 2013 WL 979423 (E.D. Mich., 2013).

Where even one investor has need of the protection of the securities laws, the investor is unsophisticated and has been given very little information about the use of his money, a security may be found. *Global Telecom Services* at 114-115. The *Global Telecom Services* court found that the plan of distribution factor was met even though there were only 5 note holders. *Id.* See also *National Bank of Yugoslavia v. Drexel Burnham Lambert, Inc.* 768 F. Supp 1010, 1015-16 (S.D.N.Y. 1991) ("A debt instrument may be distributed to but one investor, yet be a 'security'"). The court in *Fox v. Dream Trust*, 743 F.Supp. 2d. 389, 400, found the plan of distribution factor neutral where a single note was sold to a family member who nevertheless was "exactly the kind of individual investor that securities laws seek to protect." The *Fox* court found the note to be a security. *Id.* at 401. The court in *Stoiber v. S.E.C.*, 161 F.3d 745, 750-751 (D.D.C. 1998) said that although thirteen note holders did not constitute "a broad segment of the public," the situation suggested "common trading" where the solicited individuals were not "sophisticated institutions" and the seller gave the note holders little detail about how their money would be used. See also *Global Telecom Services* at 115.

Arrowood has previously argued that he sold only a few promissory notes to people who were his family and friends. However, the evidence proves otherwise. The Department has identified 18 Investors so far. *See supra* ¶ 7. In Arrowood’s own words, most of those Investors were at best “friends of friends.” *See supra* ¶ 16. When questioned about the Investors individually, Arrowood admitted that he did not know most of them prior to the Investments and that the Investors came to him primarily through several individuals that were telling other people the Trinity Fund was willing to enter into these high-interest, short-term transactions. *See supra* ¶¶ 5 and 16. The Investors themselves confirm that they did not know Arrowood prior to their Investments. *See supra* ¶ 16. The Investors were from at least five different states. *See supra* ¶ 18. Even after issuing the promissory notes, Arrowood could not remember the names of many of the Investors or explain how he knew them other than to say they were friends of someone else. *See supra* ¶ 16. None of the Investors have claimed a familial relationship with Arrowood, nor has Arrowood asserted such a relationship with any of the Investors. Most of the individuals were at best, acquaintances, friends-of-friends, and word-of-mouth referrals from other investors. As the testimony of Arrowood and the Investors reflect, the vast majority knew nothing of the Trinity Fund or Arrowood prior to the Investments.

Furthermore, Arrowood was willing to take the money of any one who approached him. He did not inquire about the Investors’ financial situation such as their net worth or their ability to suffer the loss of their funds. *See supra* ¶ 18. He conveniently did not discuss any risk factors with the Investors. *See supra* ¶ 19. These behaviors indicate that Arrowood was willing to enter into these transactions with anyone with available cash and was not concerned with limiting Investors in any way. Where no limitations are placed on who can purchase the notes, the second *Reves* factor tips in favor of classifying the note as a security. *Wallenbrock*, at 539.

Given more time before he became unable to make his promised payments, Arrowood likely would have accepted money from many more investors.

The Tenth Circuit noted in *Thompson*, that the non-securities lending arrangements contemplated in *Reves* usually involve one lender who, in the ordinary course of its business as a professional lender, infuses cash in multiple borrowers, but that the situation where one borrower receives money from multiple lenders more closely resembles a securities transaction. *Thompson* at 1167. That is exactly the scenario we have here: one borrower receiving money from multiple individuals, who do not make loans in their ordinary course of business.

Whether or not this Court considers 18 Investors to be a broad segment of the public, there can be no dispute that at least some of the Investors need the protection of the securities laws. The Investors were not in the business of making loans nor were they sophisticated institutions like banks and mortgage companies; neither were most of the investors in the oil and gas business. *See supra* ¶¶ 20 and 21. Further, Arrowood purposefully gave the Investors very little detail about how their money would be spent. *See supra* ¶ 24. The Investors did not have any involvement in the business of 2001 Trinity Fund except to passively hand over their money. *See supra* ¶ 22. These are exactly the type of people that the securities laws are meant to protect.

Because Defendants' plan of distribution involved accepting money without any limitations from multiple unaffiliated individuals who clearly needed the protection of the securities laws, this *Reves* factor strongly indicates that the Investments are securities.

c. Reasonable expectations of the public

The third *Reves* factor directs the Court to consider whether the public would perceive the note to be a security. *Reves* at 66. In analyzing this factor, the Court does not need to guess at what some hypothetical member of the investing public might think about the note, but instead,

may consider whether the notes were “reasonably viewed *by purchasers* as investments.” *Stoiber* at 751 (emphasis added). Specifically, it is important for the Court to consider whether the “public who invested” had a reasonable expectation that they would “make money through investing.” *S.E.C. v. Mulholland*, 2013 WL 979423, *6-7 (E.D. Mich. 2013).

Courts, therefore, evaluate similar elements to those considered in the first *Reves* factor. *Wallenbrock* at 539. For instance, a high rate of return and the opportunity for the transaction to be renewed or rolled over every few months looks more like an investment than a loan. *Id.* An “attractive rate of return” as well as the funds being used for the business’s growth and expansion suggests the transaction would be viewed as an investment. *In the Matter of the Application of Frank Thomas Devine*, S.E.C. Release 46746, 2002 WL 31426279, *5 (Admin. Proceeding File No. 3-10518, October 30, 2002). A transaction appears to be an investment where the investors expect to get more in return for their money and the sellers indicate the returns would be generated by the profits of the business. *Mulholland* at *7.

An instrument may be deemed a security simply because the seller referred to it as an investment. *Reves* at 68-69. Of course, Arrowood has argued that he was very careful to refer to the Investments as loans and that the Investors sometimes referred to the Investments as loans. That is immaterial. “Congress’ purpose in enacting the securities laws was to regulate *investments*, in whatever form they are made and by whatever name they are called.” *Reves* at 61. “No amount of evidence that anyone called the transactions ‘loans’ would prove that the notes were not securities.” *In the Matter of District Court Business Conduct Committee for District No. 5 Complainant v. Goldsworthy*, 2000 WL 1585691 (N.A.S.D.R. 2000). The third *Reves* factor is a “one way ratchet”:

It allows notes that would not be deemed securities under a balancing of the other three factors nonetheless to be treated as securities if the public has been led to

believe they are. It does not, however, allow notes which under the other factors would be deemed securities to escape the reach of regulatory laws.

Stoiber at 751.

First and foremost, the investing public would consider the Investments to be investments, and therefore securities, because Arrowood himself used the words “invest” or “investment” to describe the transactions. *See supra* ¶ 78. It would be reasonable for a prospective Investor to take Arrowood at his word. *Reves at 69.*

The investing public would also consider the Investments to be investments, and therefore securities, because Defendants offered such a high rate of interest that potential Investors could not help but be attracted to the Investments. *See supra* ¶¶ 9, 10, 11, 12, and 15. These were not commercial loans by professional lenders at commercial loan rates. They were investments that attracted ordinary individuals by offering very high rates of interest.

Further, the Investments were for the oil and gas business of the Trinity Fund. *See supra* ¶¶ 5, 6, 14, and 23. The Investors were led to believe that their Investments would be used for business purposes of the Trinity Fund. *See supra* ¶ 23. And the Investors themselves thought of these transactions as investments, using words such as “investment” and “invest” in reference to the transactions, some even writing those words on their checks or in their check registers contemporaneously with their Investments. *See supra* ¶¶ 25 and 26.

Arrowood will argue that the Investments were not contingent on the Trinity Fund’s business because the Trinity Fund owed a return on the Investments under the terms of the promissory notes regardless of its business success. That argument, however, does not give consideration to the economic reality of the situation. Arrowood has consistently stated that he believed he could afford to pay the high interest rates because he always had an oil and gas deal about to close indicating that the repayment of the Investments and the profits thereon were

contingent on the Trinity Fund's oil and gas business. *See supra* ¶ 14. Simply put, if Trinity Fund did not close one of those oil and gas deals or sell off an asset of the business, there would be nothing to pay the Investors. And that is exactly what eventually happened, thereby resulting in the Trinity Fund's bankruptcy.

Because the public would reasonably perceive these transactions to be investments rather than commercial loans, this factor strongly indicates that the Investments are securities.

d. The existence of another regulatory structure

Finally, the fourth *Reves* factor directs the Court to consider whether "some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the securities laws unnecessary." *Reves at 66-67*. The securities laws are designed to provide investors with all of the necessary information they need about a company and its principals to make an informed investment decision. The securities laws also help investors recover where they have been harmed from violations of the securities laws. No other regulatory structure exists to protect these Investors. This *Reves* factor strongly weighs in favor of the Investments being securities.

The purpose of the "family resemblance" test is to determine whether the notes bear a "strong resemblance" to the 7 types of commercial notes identified in *Reves*. As shown herein, the Investments bear no resemblance to the type of commercial lending transactions contemplated in *Reves*, much less a "strong resemblance." The Investments are securities in the nature of notes, and as such, should be registered under the Act or qualify for an exemption from registration.

B. The Investments, as investment contracts, are securities.

Section 1-102(32) of the Act identifies an “investment contract” as a security and in subsection (d) explains that the phrase includes

an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor and a “common enterprise” means an enterprise in which the fortunes of the investor are interwoven with those of either the person offering the investment, a third party, or other investors.

Section 1-102(32)(d) of the Act is a slightly amended codification of the test set forth in *S.E.C. v. Howey*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946). The elements of the *Howey* test are 1) an investment of money, 2) in a common enterprise, 3) with the expectation of profits, 4) to be derived primarily² from the efforts of others.

It is clear that the Investors made investments of money thereby meeting the first element of the definition. *See supra* ¶¶ 7, 9, and 15; see also, *Probst v. State*, 807 P.2d 279, 1991 OK CR 30 ¶ 16 (investor providing a check to the promoter for the investment satisfies this element of the definitional test). It is also clear that they had an expectation of profits. *See supra* ¶¶ 7, 9, and 15. Furthermore, the Investors did not have any involvement in the business of the Trinity Fund. *See supra* ¶ 22. Arrowood himself has asserted that the Investors had nothing to do with the Trinity Fund business other than providing money and that he purposefully avoided giving them any information about the business. *See supra* ¶ 24. Therefore, it is clear that the Investors were relying primarily, if not solely, on Arrowood and the Trinity Fund for their profits.

The remaining element of the *Howey* test is whether the transaction involved a “common enterprise.” As defined in Section 1-102(32)(d) of the Act, a common enterprise exists where

² The *Howey* court used the word “solely” instead of “primarily” to describe the extent of the “efforts of others,” but “solely” was modified to “substantially” by many courts including the Oklahoma Court of Criminal Appeals in *Probst v. State*, 807 P.2d 279, 1991 OK CR 30 and ultimately codified in the Act as “primarily.”

the “fortunes of the investor are interwoven with...the person offering the investment... .” Clearly, the fortunes of the Investors were tied to Arrowood’s ability to make a profit on the buying and selling of oil and gas leases. The notes were signed by Arrowood as president of the 2001 Trinity Fund, L.L.C. *See supra* ¶ 9. Furthermore, Investors made their checks payable to the Trinity Fund and those checks were deposited into an account of the Trinity Fund along with deposits from other Investors. *See Exhibit K, ¶¶ 3 and 4.* The notes are also listed as obligations of the Fund in its bankruptcy proceeding. The fortunes of the Investors and the Fund could not have been more interwoven.

The Investments are securities in the nature of investment contracts and as such should either be registered or qualify for an exemption from registration under the Act.

IV. The Investments were not registered under the Act.

The Investments were not registered under the Act. *See supra* ¶ 29. Defendants have claimed no exemption from registration under the Act and none are available to them. As such, the Investments were sold in violation of Section 1-301 of the Act.

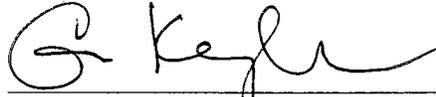
V. Arrowood was not registered under the Act.

Arrowood was not registered under the Act as an agent. *See supra* ¶ 30. By offering and selling the Investments in and/or from the state of Oklahoma, Arrowood transacted business as an agent in violation of Section 1-402 of the Act.

VI. Conclusion

For the reasons stated above, the Department requests that the Court grant partial summary judgment finding 1) that the Investments are securities, 2) that the securities were not properly registered under the Act, and 3) that Arrowood offered and sold the securities without benefit of registration under the Act.

Respectfully Submitted,
OKLAHOMA DEPARTMENT OF SECURITIES



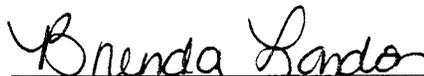
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CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of January, 2015, the foregoing document was sent by first-class mail to the following:

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