

IN THE DISTRICT COURT OF OKLAHOMA COUNTY
STATE OF OKLAHOMA

FILED IN DISTRICT COURT
OKLAHOMA COUNTY

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

JUL - 8 2013

TIM RHODES
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Case No. CJ-2012-6164

**DEFENDANT ROBERT ARROWOOD'S REPLY TO PLAINTIFF'S RESPONSE TO
DEFENDANT'S MOTION FOR SUMMARY JUDGMENT**

Defendant Robert Arrowood hereby submits his Reply to Plaintiff's Response to Defendant's Motion for Summary Judgment against Plaintiff Oklahoma Department of Securities, *ex rel.* Irving L. Faught, Administrator ("ODS"). Defendant Arrowood asserts that nothing in the Plaintiff's Response changes the fact that the notes in this case are not securities, and are thus not subject to the jurisdiction of ODS.

It should be emphasized again that this case must analyzed in accordance with the United States Supreme Court's pronouncement in *Reves v. Ernst & Young*, 494 U.S. 56, 110 S.Ct. 945, 108 L.Ed.2d 47 (1990): "the phrase 'any note' should not be interpreted to mean literally 'any note,' but must be understood against the backdrop of what Congress was attempting to accomplish." *Id.* at 64. In his Motion, Arrowood argued that the notes at issue in this case are not securities under either of the tests articulated by the United States Supreme Court in *Reves*. First, the notes bear a family resemblance to short-term loans secured by a lien on a small business or some of its assets. Second, and more importantly in this case, the notes satisfy the

following factors which constitute the second prong of the *Reves* test: (1) the motivations of the seller; (2) the plan of distribution of the instrument; (3) the reasonable expectations of the investing public; and (4) the existence of some of factor which reduces the risk of the instrument and obviates the need for the protections of the securities laws. *Id.* at 66.

As discussed in the Defendant's Motion, while all of these criteria are satisfied in this case, the second and third are of particular significance. As to factor two, the evidence clearly and unequivocally establishes that Mr. Arrowood had no plan of distribution at all, as he never marketed or otherwise promoted the notes in any manner whatsoever. Mr. Arrowood also never engaged in any type of solicitation with regard to the notes, even by email. To the contrary, the purchasers contacted him in the first instance, and all discussions about the notes were on an individual basis with those purchasers.

The same can be said about the third factor. As ODS admits in its Response, *Reves* states that in order to "establish that there is common trading in an instrument, all that need be shown is that the instruments were offered and sold to *a broad segment of the public.*" The very opposite is true in this case - there simply is no investing public as that term is used in *Reves*. The fact is that there were only a select few individuals who purchased the notes sold by Defendant Arrowood and his company, and those few individuals were generally either business or personal friends. Moreover, none of the notes have been resold, nor is there any evidence that a resale was even contemplated. Absent these two very significant factors, the notes sold by Mr. Arrowood should not be considered securities as a matter of law.

Moreover, the cases cited by ODS in support of their Response are distinguishable, and actually support Defendant Arrowood's arguments on this issue. For example, in *SEC v. Mulholland*, 2013 WL 979432 (E.D. Mich.), the defendants were involved in the buying and

renting of real estate in Michigan, and financed their business by the sale of notes. The real estate business began to fail in 2009 and the company was dissolved, but the defendants continued to raise money through the dissolved company. The defendants eventually raised \$2 million through the sale of the notes to 75 investors, knowing all the while that they were losing money and would never be able to repay the notes. The court emphasized that “many of these investors were retirees, most with limited investment experience—a fact Defendants used to their advantage in persuading the individuals to invest.” *Id.* Importantly for purposes of this case, the court also stated that:

where the borrower places no limitations on who could purchase the notes, offering them to any member of the general public who would make the investment...the broad availability of the notes...tips this factor strongly in favor of classifying the note as a security.

Id. at *5.

The difference between these facts and those in the case at bar is striking. Defendant Arrowood has been selling notes such as those in this case for years, and virtually all of them have been fully repaid, with interest, according to their terms. Mr. Arrowood’s oil and gas business has been successful, and there is simply no evidence, other than the baseless and reckless allegations of ODS in this case, that he ever committed any kind of fraud with respect to the notes. Moreover, Mr. Arrowood has always been very selective and careful as to which individuals were allowed to purchase a note. Unlike in *Mulholland*, Defendant Arrowood has never made the notes available to any member of the general public who would make the investment. This is a very significant difference that should be recognized by this Court.

Even in *Stoiber v. SEC*, 161 F.3d 745, 751 (D.C. Cir. 1998), involving a stockbroker and member of the National Association of Securities Dealers (“NASD”) who solicited money from his customers in return for promissory notes, the court noted and found it significant that

“[w]hile the terms of the notes do not preclude trading in a secondary market, none have been resold and there is no indication that anyone has considered reselling them. Nor do we think thirteen customers with whom Stoiber had a personal relationship constitute ‘a broad segment of the public.’” *Id.* at 751. While the D.C. Circuit did ultimately affirm the sanctions imposed by the NASD, the Defendant submits that a significant reason for that determination was that the NASD is a self-regulatory organization with very high standards of conduct for its members, requiring that each member, in the conduct of his business, hold himself to “high standards of commercial honor and just and equitable principles of trade.” *Id.* at 747. The court was thus more likely to defer to the decisions of the NASD, despite factual circumstances in which the opposite result could have been reached.

Defendant Arrowood asserts that the facts of this case are directly analogous to those in *LeBrun v. Kuswa*, 24 F.Supp.2d 641 (E.D. La. 1998), referenced by the court in *Mulholland*. In *LeBrun*, the defendant sold six promissory notes to friends and family of the plaintiff to finance the capital operations of his business. The notes were memorialized by loan agreements providing for repayment within 12 months, and interest based on certain sales, but to be no less than 100% of the loan amount. When the defendant defaulted on the notes, the plaintiffs sued in federal court, asserting jurisdiction under the securities laws. The defendant moved to dismiss, arguing that the court lacked jurisdiction because the promissory notes did not constitute securities.

The district court agreed and dismissed the case. In so holding, the court determined that the fourth *Reves* factor – an additional risk reducing factor such as another regulatory scheme – was inapplicable, and thus proceeded to balance the remaining three criteria. While the court found that the first *Reves* factor was met because the seller’s purpose was to raise money for his

general business enterprise, the court did not find that to be the case with regard to factors two and three. In finding that there was no broad trading as required by *Reves*, the court stated as follows:

In the case at hand, the facts indicate that there was no common trading for speculation or investment in the notes, including no offering or sale to a "broad segment of the public." While this factor is not dispositive of the issue, it does weigh against finding the transactions in this matter to be securities.

Id. at 648. The court also found that application of the third part of the *Reves* test weighed against finding the notes to be securities because of the manner of repayment.

But assuming that the plaintiffs could be characterized as "investing public," their reasonable expectations were nothing more than the payment of the notes, plus the specified high interest. The Loan Agreements were unusual transactions not designed to be publicly traded. Moreover, there was no advertising or marketing of these notes to the general public, but only a specific inquiry into a select group of individuals.

Id. The court thus determined that the combination of factors two and three outweighed the applicability of the first factor.

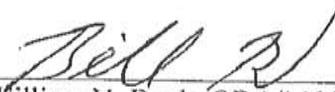
Although it is possible to find that a note is a security even if one of the factors is not met, certain findings against application of the securities laws must be heavily weighed. *The plan of distribution is perhaps the most essential factor.* This Court, having gone through the above analysis, and considering the facts and the appropriate standards of review, holds that these transactions are not "securities" under the *Reves* test for notes.

Id. at 649 (emphasis added).

The parallels between *LeBrun* and the case at bar are obvious, and Defendant Arrowood submits that the same result should be reached. Just as in *LeBrun*, Arrowood had no investing public and no plan of distribution, and those important factors mandate that the notes in this case be considered to be outside the scope of the securities laws and the jurisdiction of ODS.

Accordingly, in light of the foregoing, Defendant Robert Arrowood respectfully requests that his Motion for Summary Judgment be granted by this Court.

Respectfully Submitted,

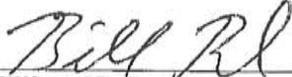


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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on July 8, 2013, a true and correct copy of the foregoing Defendant Robert Arrowood's Reply to Plaintiff's Response to Defendant's Motion for Summary Judgment was mailed by first-class mail, postage prepaid, to:

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