

**BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF DELAWARE**

IN THE MATTER OF:

**DONALD MATTEI, and
HDN, INC.,**

Respondents.

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Case No. 00-25



OPINION AND ORDER

On September 4, 2002, the Delaware Division of Securities ("Division" or "State") filed an administrative complaint ("Complaint") with the Securities Commissioner for the State of Delaware ("Commissioner") against Donald Mattei and HDN, Inc. ("HDN"). The Division alleged in its Complaint that (1) from October 1997 to January 1998, Mattei and HDN offered and sold unregistered securities in Delaware in violation of 6 *Del. C.* § 7304; (2) from October 1997 to January 1998, Mattei transacted business in Delaware as an unregistered issuer agent in violation of 6 *Del. C.* § 7313(a); and (3) in November 1997, Mattei and HDN engaged in certain fraudulent conduct in connection with the offer and sale of the unregistered securities in violation of 6 *Del. C.* § 7303.

By an order dated September 4, 2002, the Securities Commissioner designated Deputy Attorney General Richard W. Hubbard to act as Hearing Officer in this matter.

On or about December 30, 2004, the Division filed a notice dismissing the fraud charges in the Complaint.

On June 13, 14, 20, 22, and 27, 2005, and July 7, 2005, the Hearing Officer conducted a hearing on the Division's Complaint. Deputy Attorney General Peter O.

Jamison, III, appeared as counsel for the Division, and James S. Green, Esquire, appeared as counsel for Mr. Mattei. No appearances were made on behalf of HDN.

This is the Hearing Officer's Opinion and Order in this matter.

APPLICABLE LAW

I. Offer and Sale of an Unregistered Security

A. State Statute Prohibiting the Offer and Sale of an Unregistered Security

Six *Del. C.* § 7304 prohibits the offer or sale of any security in Delaware unless (a) the security is registered under the Act, (b) the security or transaction is exempt from registration under § 7309 of the Act, or (c) the security is a federal covered security for which a notice filing under the Act has been made.

B. State Statute Defining the Word "Security"

Six *Del. C.* § 7302(a)(13) defines the word "security" as used in 6 *Del. C.* ch. 73 to include "any...stock...."

C. State Statute Defining "Offer" and "Offer to Sell"

Six *Del. C.* § 7302(a)(11)a. provides:

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

D. Federal Statute Preempting State Securities Registration Requirements

Section 18(a) of the federal Securities Act of 1933 (15 U.S.C. § 77r(a)) provides that no State registration requirement shall apply to a security that is a "covered security."

Under § 18(b) of the Act (15 U.S.C. § 77r(b)), a covered security includes (1) a security offered or sold to “qualified purchasers, as defined by the [SEC]” (15 U.S.C. § 77r(b)(3)) and (2) a security that is exempt from federal registration pursuant to SEC regulations issued under the federal private offering exemption at § 4(2) of the 1933 Act (15 U.S.C. § 77r(b)(4)(D)).

E. Federal Regulation Relating to Transactions Exempt From Registration Under § 4(2) of the Federal Securities Act of 1933

SEC Regulation D (17 C.F.R. §§ 230.501 - 230.508) creates three separate safe harbors for issuers seeking to rely upon the federal private offering exemption set forth at § 4(2) of the Securities Act of 1933. Those safe harbors are set forth at Rules 504, 505, and 506 of Regulation D. Rule 503 of Regulation D (17 C.F.R. § 230.503) provides that an issuer who seeks to rely upon either of those safe harbors must “file with the [SEC] five copies of a notice on Form D (17 C.F.R. 239.500) no later than 15 days after the first sale of securities.”

II. Transacting Business as an Unregistered Agent

A. State Statute Prohibiting a Person from Transacting Business as an Unregistered Agent

Six *Del. C.* § 7313(a) makes it unlawful for any person to transact business as an agent unless the person has first registered with the Securities Commissioner.

B. State Statute Defining “Agent”

Six *Del. C.* § 7302(a)(2) provides:

"Agent" means any individual, other than a broker-dealer, who represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Based on the evidence presented at the hearing and the applicable law, the Hearing Officer makes the following findings of fact and conclusions of law:

A. Findings of Fact

During the time period covered by the Complaint, October 1997 to January 1998 (the "Relevant Period"), HDN was a Delaware corporation. (State's Exhibit 55).

During the Relevant Period, Respondent Donald Mattci was the president of HDN. (Hearing transcript at 453).

During the Relevant Period, the legal and financial affairs of HDN as they related to the sale and issuance of securities were primarily controlled by Hector Hernandez, Esquire ("Hernandez").

During the Relevant Period, the day to day business affairs of HDN were primarily controlled by its Chief Operating Officer, Edward Cole ("Cole").

During the Relevant Period, HDN issued preferred stock ("HDN Securities") pursuant to a Private Placement Memorandum ("PPM") dated July 14, 1997. (State's Ex. 1).

The following persons purchased the HDN Securities in the dollar amounts indicated:

Name of Investor(s)	Approximate Number of Shares Offered and Sold	Approximate Amount Invested
	2,000	\$20,000.00
	350	\$3,500.00
	5,000	\$50,000.00
	10,200	\$102,000.00
	250	\$2,500.00
	250	\$2,500.00
	200	\$2,000.00
	750	\$7,500.00
	500	\$5,000.00
	500	\$5,000.00
	3,000	\$30,000.00
	10,000	\$100,000.00
	500	\$5,000.00
	1,000	\$10,000.00

Collectively, the above persons are referred to as the "Purchasers."

Most of or all the Purchasers executed an Investor Questionnaire and a Confidential Subscription Agreement in connection with their purchase of HDN Securitics. *See, e.g.,* State's Ex. 2.

According to their testimony, few if any of the Purchasers learned about the HDN Securities from or were induced to purchase by Mr. Mattei.

learned about HDN from .. (Hearing transcript at 12).

learned about HDN from .. (77).

learned about HDN from .. (115).

learned about HDN from .. (179).

learned about HDN from her husband who, in turn, learned about it from .. (201).

learned about HDN from .. (240).

learned about HDN from .. (253).

learned about HDN from (282).

learned about HDN from who, in turn, learned about it from .. (300).

learned about HDN from Cullian. (336, 353).

learned about HDN from his son-in-law, .. (469).

learned about HDN from .. (496).

never testified.

purchased HDN Securities after attending a meeting in Delaware. Mattei was at the meeting, but does not recall anything Mattei said. (19).

testified that she attended a meeting at HDN, but Mattei did not speak at the meeting. (84, 105).

could not remember who spoke or what was said at the meeting she attended regarding HDN. (121, 149, 150). shares were purchased jointly with , but he did not testify. (State's Ex. 10).

did not recognize Mattei at the hearing. (171). invested in HDN based upon advice. (188).

attended a meeting in Delaware regarding HDN. Mattei gave the concept of what the idea (of HDN) was, but he was not the numbers person. Another person did the presentation. (204). incorrectly identified another person in a photograph from the Relevant Period as the person she thought was Mattei. (205). shares were purchased jointly with her husband, but he did not testify. (State's Ex. 21)

recalls nothing of what was said at a meeting she attended at HDN. (241, 249, 250). Her primary reason in investing was recommendation. (248).

has a finance degree from Villanova and has been employed as a tax accountant and in investment accounting. (268, 269). He attended a meeting at HDN. Mr. Cole and Mr. Mattei both spoke. He thinks they just gave an overview of the company. (276, 277).

attended a meeting at HDN. He had no recollection of who was there representing HDN. (283). His investment depended largely on advice. (296). Mr. shares were purchased jointly with his wife, but she did not testify. (State's Ex. 33).

attended a meeting at HDN. He remembered Mr. Cole speaking at the meeting, but did not remember a man he recalled as "Matteio" speaking. (303, 321).

shares were purchased jointly with his wife, but she did not testify. (State's Ex. 29).

attended a meeting at HDN. recalled Mr. Cole and Mr. Mattei being at the meeting and that Mr. Cole took over the meeting. (370). Discussions regarding SEC and registration were with Mr. Cole. (372). In 2002, when shown a photograph of Mr. Mattei, could not recall Mattei's name. (375, 376).

shares were purchased jointly with his wife, but she did not testify. (State's Ex. 36).

never attended a meeting in Delaware. (473, 482). He invested based upon what his son-in-law told him about HDN. (483). He invested jointly with his wife, but she did not testify.

attended a meeting at HDN. Mr. Mattei gave a brief introduction and turned the meeting over to Mr. Cole, and Cole did most of the talking. (501, 518). Ms. invested jointly with her husband, but he did not testify.

did not attend any meeting in Delaware and did not recall speaking with anyone at HDN regarding his purchase. (418, 429).

The State's witness, Edward Cole ("Cole"), was Chief Operating Officer of HDN during the Relevant Period. (386).

Cole attended the information meetings at HDN. (387, 388).

The purpose of the meetings was to explain the HDN business concept. (388).

There were no mailings or written invitations to the meetings, but people came through friends and family by word of mouth. (389).

Mr. Cole did most of the speaking at the meetings. (390, 558).

Hanover Mercantile Corporation ("Hanover Mercantile") was to handle "the legal aspects of SEC stock registration, Blue Sky Laws, etc.," according to Cole's testimony. (393).

The PPM was prepared by Hanover Mercantile. (549).

Mr. Mattei testified it was not his job to draft the PPM or any Federal or State registration documents. (551-553).

Hanover Mercantile was paid approximately \$300,000 by HDN for its services, according to Mattei. (553).

Mattei attended HDN informational meetings. (557).

Mattei's role at the meetings was to introduce himself and give a brief synopsis of the HDN business concept. (558).

Securities-related matters were primarily the job of Cole and Hernandez. (558).

Mattei did not review Investor Questionnaires or Subscription Agreements or qualify prospective investors in HDN. (559-561).

Mattei never transferred any HDN securities that he owned to any third-party. (561).

Mattei believed that HDN had taken all necessary steps to comply with all securities registrations or exemptions. (581, 590, 591).

None of the Purchasers testified that they purchased the HDN Securities in reliance on the belief that they were registered securities.

Most of or all the Purchasers certified that he or she was qualified to purchase the securities and understood the speculative and risky nature of the investment.

Mattei never received any commissions based upon the sale or issuance of HDN securities.

Mattei was not registered in Delaware as a broker-dealer, agent, or issuer agent during the Relevant Period, (437-38), and HDN Securities were not registered in Delaware during the Relevant Period. (431-33).

B. Conclusions of Law

1. Sale of unregistered securities

This case presents thorny issues of federal preemption, what constitutes a solicitation of a securities purchase, and the intent, if any, required to establish a violation of 6 *Del. C.* §§ 7304 and 7313. I will address the preemption issue first, for if the State is preempted by federal law from requiring registration of the securities at issue, then the Respondents must prevail regardless of the other issues.

The State alleges that Mattei offered and sold shares of HDN's preferred stock to the Purchasers in violation of 6 *Del. C.* § 7304. Section 7304 of the Delaware Securities Act (the "Act") provides that it is unlawful to offer or sell a security in Delaware unless: (a) the security is registered under the Act; (b) the security is exempt from registration under § 7309 of the Act; or (c) the security is a federally covered security for which a notice filing under the Act has been made.

The HDN Securities were offered “in reliance upon the availability of an exemption from registration provisions of the Securities Act of 1933, as amended, by virtue of the intended compliance with the provisions of Regulation D and/or Section 4(6) of such Act.” State's Exhibit 1 (PPM) at 3. The quoted language appeared in capital letters on page three of HDN's Private Placement Memorandum.

The Respondent argues that because the HDN Securities were offered under an exemption from registration in the Securities Act of 1933, they are “covered securities” and the State is preempted from regulating their transfer. *See* 15 U.S.C. §77(a). Mr. Mattei relies upon *Temple v. Gorman*, 201 F. Supp.2d 1238 (S.D. Fl 2002), and *Lillard v. Stockton*, 267 F.Supp.2d 1081 (N.D. Ok. 2003). He argues that these cases stand for the proposition that States are preempted from regulating federally “covered securities” where the securities were offered pursuant to a federal exemption, such as Regulation D or Rule 506.

The Securities Division argues that Mr. Mattei reads too much into these authorities, which are not binding in the Third Circuit. The Division argues that *Temple v. Gorman* does not purport to find preemption in a Rule 506 context unless the issuer has at least filed a Form D to claim the exemption, which did not occur in the instant case. Moreover, the Securities Division argues, *Temple v. Gorman* was poorly decided, has been rejected by the Alabama Supreme Court in *Buist v. Time Domain Corporation*, 2005 WL 1793342 (Ala.), and has been criticized by securities law commentators. *See* T. Hazen, *Law of Securities Regulation* § 8.1[3], n. 67 (5th ed. July 2005 Pocket Part).

There are at least three precedents by federal district courts holding that securities sold “pursuant to” Regulation D or Rule 506 are “covered securities” regardless of whether they were sold in compliance with those regulations: *Temple v. Gorman*, 201 F. Supp.2d 1238 (S.D. Fl 2002), *Lillard v. Stockton*, 267 F.Supp.2d 1081 (N.D. Ok. 2003), and *Pinnacle Communications International, Inc., v. American Family Mortgage Corporation*, 2006 WL 468759 (D.Minn.). I am not aware of any federal precedent to the contrary. I think it is fair to characterize these decisions as an emerging consensus of opinion on this issue by the federal judiciary.

The State argues that *Temple v. Gorman*’s holding is limited to the circumstance where a federal Form D has been filed. In my view, the *Temple* opinion is ambiguous on this point. In one place in the opinion, the court states: “Regardless of whether the private placement actually complied with the substantive requirements of Regulation D or Rule 506, the securities sold to Plaintiffs are federal ‘covered securities’ because they were sold pursuant to those rules.” 201 F.Supp.2d at 1244. In the following paragraph, the court states: “Where a Form D was filed with the SEC for a transaction that purported to merit an exemption from federal registration pursuant to Regulation D, Florida law could not require duplicative registration or a transactional exemption from registration.” *Id.* These two statements may be interpreted to have different meanings—one that requires the filing of a Form D before the transaction attains “covered” status, and one that does not. It is not clear, however, that the court intended its observation that a Form D had been filed in that case to be a prerequisite to federal preemption.

It is clear that the district courts in *Lillard v. Stockton*, 267 F.Supp.2d 1081 (N.D. Ok. 2003), and *Pinnacle Communications International, Inc., v. American Family Mortgage Corporation*, 2006 WL 468759 (D.Minn.), viewed the holding of *Temple* as the first statement: “Regardless of whether the private placement actually complied with the substantive requirements of Regulation D or Rule 506, the securities sold to Plaintiffs are federal ‘covered securities’ because they were sold pursuant to those rules.” *Lillard, supra*, 267 F.Supp.2d at 1116; *Pinnacle, supra*, 2006 WL 468759 at *12-*13. Neither the *Lillard* court nor the *Pinnacle* court focused on the filing of a Form D as essential to a party’s selling the securities “pursuant to” the federal rules. Therefore, I do not interpret the filing of a Form D as a prerequisite to federal preemption.

Although the Alabama Supreme Court has rejected the holdings of these federal district courts, in *Buist v. Time Domain Corporation, supra*, the Delaware Supreme Court has indicated its preference for following federal precedents where applicable. See *Hubbard v. Hibbard Brown & Co.*, 633 A.2d 345, 352-53 (Del. 1993) (applying federal precedents under Rule 10b-5 to interpret 6 *Del.C.* § 7303(2)). I have little doubt that if the Delaware courts were to determine the scope of federal preemption of covered securities, they would follow the general rule articulated in *Temple*, *Lillard*, and *Pinnacle*. I think they would be especially likely to find federal preemption on the facts of this case, where few if any of the investors were induced to invest by statements of the Respondent, Mr. Mattei. The HDN Private Placement Memorandum, which was given to or at least available to the Purchasers in this case, stated clearly that the HDN Securities were being sold pursuant to Regulation D. (State’s Ex. 1 at 3).

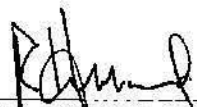
Therefore, I find that the HDN Securities were covered securities, and the registration and exemption requirements under the Delaware Securities Act and regulations are preempted by federal law.

2. Sale of securities by an unregistered issuer agent

The State's Complaint alleges that 6 *Del. C.* § 7313(a) makes it unlawful for a person to transact business as an issuer agent unless the person has first registered with the Securities Commissioner. It further alleges that Mattei sold securities to the Purchasers and that he was not registered as an issuer agent. Complaint ¶¶15-17.

"Agent" does not include an individual who represents an issuer of a covered security under the Securities Act of 1933. *See* 6 *Del. C.* § 7302(a)(2)(A)(iii). As I have found that the HDN Securities were covered securities under federal law, Mr. Mattei was not required to register as an issuer agent in Delaware.

WHEREFORE, for the foregoing reasons, IT IS ORDERED that the charges against the Respondents are hereby dismissed.



Richard W. Hubbard
Hearing Officer

Dated: March 23, 2006