

1 STATE OF WASHINGTON
2 DEPARTMENT OF FINANCIAL INSTITUTIONS
3 SECURITIES DIVISION

4 IN THE MATTER OF DETERMINING) Order Number S-04-244-05-SC01
5 Whether there has been a violation of the)
6 Securities Act of Washington by:) STATEMENT OF CHARGES AND NOTICE
7 AminoPath Labs, LLC;) OF INTENT TO IMPOSE FINES AND
8 Respondent) COSTS
9)
10)

11 THE STATE OF WASHINGTON TO: AminoPath Labs, LLC

12 **STATEMENT OF CHARGES**

13 Please take notice that the Securities Administrator of the State of Washington has reason
14 to believe Respondent, AminoPath Labs, LLC, has violated the Securities Act of Washington
15 and that the violations justify the entry of an order of the Securities Administrator under RCW
16 21.20.390 against it to cease and desist from such violations, imposing fines, and collecting
17 costs. The Securities Administrator finds as follows:

18 **TENTATIVE FINDINGS OF FACT**

19 *Respondent*

20 1. AminoPath Labs, LLC (“AminoPath”) is an Oregon limited liability corporation with its
21 principal place of business in Portland, Oregon. AminoPath describes itself as a science-based,
22

1 nutraceutical company. The Washington Secretary of State has no record that AminoPath has
2 applied for a certificate of authority to do business in Washington as a foreign entity.

3
4 *Description of the Conduct*

5 2. Stephen J. Klos (CRD# 1049423) (“Klos”), is a King County resident. In 1992, Klos was
6 subject to an action in which the Securities and Exchange Commission alleged that Klos made
7 material misrepresentations in the offer and sale of unregistered promissory notes and
8 unregistered bonds. As a result of that action, Klos was enjoined from violating the antifraud
9 provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, enjoined from
10 violating the registration provisions of the Securities Act of 1933, and enjoined from violating
11 the broker-dealer provisions of the Securities Exchange Act of 1934. The Securities and
12 Exchange Commission also barred Klos from association with any broker, dealer, municipal
13 securities dealer, investment adviser or investment company.

14 3. Beginning in April 2004, Klos offered and sold at least \$331,000 of 14% convertible
15 promissory notes issued by AminoPath (“Notes”) to seven Washington investors. At least six of
16 the investors were residents of King County, Washington.

17 4. Klos solicited potential investors principally at his health club and at his church. Klos
18 obtained signed documentation from potential investors and sent it to AminoPath for review.
19 Klos also maintained communication with potential investors on behalf of AminoPath. For his
20 efforts, AminoPath paid Klos a finder’s fee of 10% of the funds invested through him.

21 5. The investors were told that the Notes had a one year term. At the end of the year,
22 investors purportedly had the option of redeeming the Notes for the amount invested plus 14%

1 interest. Alternatively, investors could keep their money in the company by rolling the Notes
2 into membership units, which investors could purchase at a nominal price. Membership units are
3 to a limited liability corporation what stock is to a corporation.

4 6. Most of the potential investors had not heard of AminoPath nor were familiar with the
5 nutraceutical market until Klos approached them to invest in the company.

6 7. The investors trusted Klos because he was a Christian and/or a member of their church.

7 8. Klos provided Investors with AminoPath's business plan dated August 2003 ("Business
8 Plan"). The Business Plan identifies AminoPath as a science-based, nutraceutical company
9 focused primarily on developing an amino acid called L-Tryptophan ("LT").

10 9. The Business Plan states that AminoPath has secured comprehensive, international
11 patents to broadly protect its process for extraction of natural amino acids. The Business Plan
12 also states that AminoPath has successfully built comprehensive, blocking patent protection for
13 its amino acid extraction process.

14 10. The Business Plan states that LT serves many roles, but most importantly is useful in
15 controlling mood, sensory perception, sleep, and appetite. The Business Plan further states that
16 studies have established that dietary supplementation with LT is highly effective in alleviating
17 depression, chronic pain, sleep disorders, and obesity and that AminoPath holds four patented
18 formulas that increase the availability and efficacy of LT for these conditions.

19 11. The Business Plan states that AminoPath owns four patents.

20 12. The Business plan explained that for every one unit of LT extracted from a protein source
21 59 units of Complementary Amino Isolates are extracted. According to the Business Plan, the
22
23

1 development of economically viable products from Complementary Amino Isolates is important
2 to AminoPath.

3 13. The Business Plan contains a diagram, labeled figure 2, showing a refined protein source
4 produces LT as well as Complementary Amino Isolates. The diagram shows three products that
5 may be produced from LT: AP Depression Relief, AP Pain Management, and AP Gentle Sleep.
6 No products are listed as being produced from Complementary Amino Isolates.

7 14. The Business Plan states that AminoPath plans to market and sell its products through
8 multi-level marketing and other nutraceutical distributors.

9 15. The Business Plan further states that AminoPath is singularly positioned for rapid,
10 profitable growth and to provide superior returns for its investors. It included a Summary Profit
11 and Loss Statement that projected a 22.1% operating profit in 2005 and a 30.5% operating profit
12 in 2006.

13 16. Investors were also given a document titled Risk Factors. However, neither Klos nor
14 AminoPath spoke about the risks with many of the investors.

15 17. Based on Klos's representations and the documents Klos provided to investors, seven
16 Washington residents purchased Notes from AminoPath. Most of the investors had not heard of
17 AminoPath or its products prior to being approached by Klos to invest; however the investors
18 trusted Klos.

Filing of a Claim of Exemption under Rule 506

18. Investors were asked to sign a subscription agreement that stated that the offer and sale of the Note and the issuance of securities in the form of memberships units upon conversion was intended to be exempt from registration under Rule 506 of Regulation D.

19. AminoPath filed a Form D notice pursuant to Rule 506 with the State of Washington for an offering of \$500,000 of convertible promissory notes in April 2004. In June 2004, AminoPath filed an amendment to such notice. The amendment increased the offering amount from \$500,000 to \$1,250,000.

20. Form D section B Item 4 requests, in part, for information for each person “who has been or will be paid or given, directly or indirectly, any commission or similar remunerations for solicitation of purchasers in connection with the offer or sale of securities in the offering.”

21. AminoPath failed to disclose that Stephen Klos, or any other person, was either a promoter or a person that would receive a commission, fee or other remuneration for sales in Washington.

22. However, in a March 2004 email, one month prior to AminoPath’s original filing, AminoPath and Klos agreed that AminoPath would pay Klos a finder’s fee of 10% of the funds placed with AminoPath. Further, Klos had been paid a finder’s fee on two Notes purchased by Washington investors before AminoPath’s original filing and was paid a finder’s fee on a third Note purchased by a Washington investor before the amendment was filed.

23. Then on June 6, 2005, after AminoPath received notification that this investigation had begun, AminoPath again amended its Form D filing. The June 6, 2005, amended filing identified Stephen Klos as a person that had been or will be paid a commission or similar

1 remunerations for solicitation of purchasers in connection with the offer or sale of securities in
2 the offering.

4 **MISREPRESENTATIONS AND OMISSIONS**

5 24. Respondent's statements that AminoPath had comprehensive patent protection were
6 misleading because AminoPath failed to disclose to investors that only two patent assignments
7 are recorded at the United States Patent and Trademark Office and the risks associated with
8 unrecorded patent assignments. In addition, AminoPath failed to disclose material information
9 regarding the risks associated with the expiration of the four patents covering the products that
10 increase the availability and efficacy of LT.

11 25. AminoPath's Summary Profit and Loss Statement projecting a 22.1% operating profit in
12 2005 and a 30.5% operating profit in 2006 was misleading. AminoPath failed to provide a
13 reasonable basis for its projections and failed to disclose the limitations of the projections.
14 AminoPath failed to provide the risks of not meeting the revenue projections. AminoPath failed
15 to disclose how the patent expiration would affect the revenues. In addition, AminoPath failed to
16 provide material information regarding the general and specific risks involved with AminoPath
17 and the investment including, but not limited to, the following:

- 18 • the likelihood of market acceptance of AminoPath's product, the risk that the market
19 would not accept the product, and the risk of public concern over LT;
- 20 • the risk that AminoPath's products would not be as effective as expected in treating
21 depression, chronic pain, sleep disorders, and obesity;

- 1 • the risk that AminoPath would not be able to develop or sell an economically viable
- 2 product from its Complementary Amino Isolates;
- 3 • the risks of not meeting the projected revenues in 2005 and 2006;
- 4 • the percentage of the market AminoPath expected to capture, the risk of not being
- 5 able to capture the percentage of the market AminoPath expected to capture, the risk
- 6 of new competitors entering the market, and the competitive barriers AminoPath
- 7 would face;
- 8 • the risk of relationships, such as with the manufactures and other the partners, never
- 9 being finalized or terminating;
- 10 • the risk that AminoPath would not be able to find or secure wholesale distributors, a
- 11 warehouse facility, a labeler, or transportation for the product;
- 12 • the risks of transporting the product from the projected manufacturing location in
- 13 North Carolina to the warehouse in Oregon;
- 14 • the risk of the ability of finding quality, cost effective, outsourced employees;
- 15 • the risk of the product quality not being as high as expected, of the Food and Drug
- 16 Administration changing the restrictions placed on LT, and of potential allergic
- 17 reactions or other side effects to AminoPath's products;
- 18 • the risk of lawsuits; and
- 19 • the risk of carrying debt, of not being able to raise the money from investors as
- 20 expected, and of not being able to cash out the notes upon maturity.
- 21
- 22
- 23

1 **REGISTRATION STATUS**

2 26. AminoPath Labs’ 14% convertible promissory notes are not registered as securities in the
3 State of Washington and have not previously been so registered.

4
5 Based upon the Tentative Findings of Fact, the following Conclusions of Law are made:

6 **CONCLUSIONS OF LAW**

7 27. The 14% convertible promissory notes described above are securities as defined in RCW
8 21.20.005(12).

9 28. The offer or sale of 14% convertible promissory notes described above constitutes the
10 offer or sale of a security as defined in RCW 21.20.005(10).

11 29. The offer and/or sale of said securities was made in violation of RCW 21.20.010 because,
12 as set forth above, Respondent, AminoPath Labs, LLC, in connection with the offer and sale of a
13 security, made untrue statements of material fact or omitted to state material facts necessary in
14 order to make the statements made, in light of the circumstances under which they were made,
15 not misleading.

16 30. Respondent, AminoPath Labs, LLC, has violated RCW 21.20.350 by making a material
17 misrepresentation when it failed to disclose Klos would receive a commission, fee or other
18 remuneration for solicitation of investments in Washington in its Form D filing.

19
20 **NOTICE OF INTENT TO IMPOSE FINES AND COSTS**

21 Based on the above Tentative Findings of Fact and Conclusions of Law, the Securities
22 Administrator, pursuant to RCW 21.20.390, intends to order that Respondent, AminoPath Labs,
23

1 LLC, shall be liable for and pay to the Securities Division (1) a fine of \$15,000 and (2) the costs,
2 fees, and other expenses incurred in the conduct of investigating this matter in an amount not less
3 than \$5,000.

4
5 **AUTHORITY AND PROCEDURE**

6 This Statement of Charges and Notice of Intent to Deny Registration and Impose Fines
7 and Costs is entered pursuant to the provisions of RCW 21.20.390 and is subject to the
8 provisions of RCW 34.05 and RCW 21.20.395. The Respondent, AminoPath Labs, LLC, may
9 make a written request for a hearing as set forth in the NOTICE OF OPPORTUNITY TO
10 DEFEND AND OPPORTUNITY FOR HEARING accompanying this order.

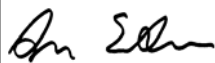
11 If the respondent does not request a hearing, the Securities Administrator intends to adopt
12 the above Tentative Findings of Fact and Conclusions of Law as final and enter an order to cease
13 and desist permanent as to that respondent and impose the fines and the costs sought in this
14 order.

15 Dated and Entered this 15th day of March, 2006

16 

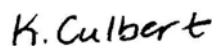
17 MICHAEL E. STEVENSON
18 Securities Administrator

19 Approved by:

20 

21 Suzanne Sarason
22 Chief of Compliance

Presented by:

23 

24 Kristen Culbert
Financial Legal Examiner