

- 1 JAMES CHARLES SIMMONS, JR.)
- 5045 N. 58th Ave. #23A)
- 2 Glendale, AZ 85301)
- 3)
- 3 MICHAEL E. CHO)
- 839 Faxon Avenue)
- 4 San Francisco, CA 94112)
- 5)
- 5 TO FAI CHENG)
- 1800 Van Ness, 2nd Fl.)
- 6 San Francisco, CA 94109)
- 7)
- 7 JEAN YUEN)
- 439 3rd Avenue)
- 8 San Francisco, CA 94118)
- 9)
- 9 Y & T INC. dba TOKYO)
- INTERNATIONAL INVESTMENT LTD.)
- 10 1800 Van Ness Ave., 2nd Fl.)
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- 11)
- 12 WING MING TAM)
- c/o Tokyo International Investment Ltd.)
- 13 1800 Van Ness Ave., 2nd Fl.)
- San Francisco, CA 94109)
- 14)
- 14 GUO QUAN ZHANG)
- c/o Tokyo International Investment Ltd.)
- 15 1800 Van Ness Ave., 2nd Fl.)
- San Francisco, CA 94109)
- 16)
- 17 **Respondents.**)
- 18)

19

20 The Securities Division ("Division") of the Arizona Corporation Commission

21 ("Commission") hereby submits the following Post Hearing Response Memorandum in the above-

22 captioned matter.

23 **I.**

24 **PRIMARY LIABILITY OF CERTAIN RESPONDENTS**

25 In their Post-Hearing Memorandum ("Respondents' PHM" or "RPHM"), all Respondents

1 except Simmons ("Respondents") fail to argue¹ or show that the Eastern Vanguard Forex Limited
2 ("EVFL") leveraged foreign currency trading accounts were not unregistered securities in the form
3 of commodity investment contracts; that Respondents Forex Investment Services Corporation
4 ("FISC"), Eastern Vanguard Forex Ltd. ("EVFL") and James Charles Simmons, Jr. ("Simmons") did
5 not offer and sell these securities within or from Arizona; or that FISC, EVFL and Simmons did not
6 act as dealers or salesmen while unregistered under the Securities Act of Arizona ("SAA").
7 Moreover, Respondents' PHM failed to assert any affirmative defense of exemption under the SAA.
8 Respondents' PHM does concede that:

9 FISC offered the "investment program" at issue; *RPHM*, p. 25;

10 Simmons was an FISC salesman and broker; *RPHM*, pp. 1, 41;

11 Simmons provided false information to several individuals, misrepresented and falsified his
12 credentials and induced them to invest in FISC; *RPHM*, pp. 1, 40;

13 Simmons minimized the risk involved in foreign currency trading; *RPHM*, p. 41;

14 Simmons made affirmative misstatements; *RPHM*, p. 3;

15 Simmons promised investors that seven out of ten trades would be profitable; *RPHM*, p. 41;

16 Simmons promised to limit investor's losses to \$300 a trade; *RPHM*, p. 41;

17 Simmons guaranteed a specific return to investors; *RPHM*, p. 41;

18 Simmons told investors they would double their money; *RPHM*, p. 41;

19 Simmons misrepresented his family's and his own investments in FISC; *RPHM*, pp. 40-41;

20 Simmons stated that EVFL was affiliated with the Vanguard Group of mutual funds; *RPHM*,
21 p. 40;

22 Simmons made a series of pre-investment misrepresentations to Alan Davis to induce him to
23 invest; *RPHM*, p p. 11, 12;

24 Simmons met with Alan Davis at FISC to induce him to invest: *RPHM*; p. 12;

25
26 ¹ Other than mere denials that Respondents have any primary or secondary liability for violations of the
Securities Act of Arizona. See *RPHM*, pp. 2, 43.

1 Simmons sold FISC investments to Alan Davis; *RPHM*, pp.11, 12-13;
2 Simmons sold the FISC investment to Melba and Dean Davis; *RPHM*, p. 13;
3 Simmons had several conversations with Michael Noriega about FISC, and Noriega decided
4 to open an FISC account based on Simmons' recommendations; *RPHM*, p. 14;
5 Simmons should be subject to a Commission Order; *RPHM*, p. 43;
6 Willis Scott and Julius Nagorny opened their accounts before Respondent Cho ("Cho") left
7 FISC; *RPHM*, p. 14;
8 FISC utilized Tokyo documents as forms; *RPHM*, p. 35.

9 **A. Respondents Apply the Wrong Law to Primary Liability**

10 Respondents' PHM asserts and argues a legal theory of primary liability defense based
11 almost exclusively on the statutory language of A.R.S. § 44-2003 and the judicial gloss thereon in
12 *Standard Chartered PLC v. Price Waterhouse*, 190 Ariz. 6, 17-23, 945 P.2d 317, 328-34 (Ct. App.
13 1996). *RPHM*, pp. 8-10, 40. Respondents err by invoking the wrong statute and decisional law test
14 for liability to defend this public enforcement matter.

15 First, Respondents tilt against a statutory liability that has not been alleged or raised against
16 them. At no time in this matter has the Division ever pleaded, asserted or argued A.R.S. § 44-2003
17 as the basis for the liability of any Respondent. Primary liability is alleged by the Division solely on
18 the basis of violations of A.R.S. §§ 44-1841, 44-1842 and 44-1991. In its Post Hearing
19 Memorandum ("SDPHM"), the Division argued the primary liability of Respondents FISC, EVFL,
20 Simmons and CHO for their offer and sale of unregistered securities under the statutory language of
21 A.R.S. § 44-1841 and the gloss thereon provided by the doctrine of participant liability² recognized

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24 ² The Commission "adopted a two-prong test for administrative enforcement actions, requiring a
25 defendant's participation to be a 'but for' cause of the unlawful sale and the participation to be more than 'de
26 minimis.'" Weinroth, *Liability of Attorneys in Securities Transactions: A Reevaluation in light of Central Bank*, 31
Arizona Attorney 1, 21-22 (August/September 1994). This doctrine originated as a judicial gloss on Section 5 of the
federal Securities Act of 1933. See *S.E.C. v. Rogers*, 790 F.2d 1450, 1456 (9th Cir. 1986). The SAA was derived
from and based on this federal law. *Butler v. American Asphalt & Contracting Co.*, 25 Ariz. App. 26, 29, 540 P. 2d
757, 760 (1975).

1 and applied by the Commission since 1992. *SDPHM*, pp. 5-13. Under this doctrine, no showing of
2 direct contact between the participant and the offerees is required to impose liability for the offer or
3 sale of unregistered securities. *SDPHM*, p. 6. Liability arises from participation that is a "but for"
4 cause of such offer or sale, and more than *de minimis*. *SDPHM*, p. 6. Moreover, liability under
5 A.R.S. § 44-1842 is co-extensive with liability arising under A.R.S. § 44-1841 where, as in this
6 matter,³ the sellers acted as securities dealers or salesmen while unregistered under the SAA. The
7 Division also argued the primary liability of FISC, EVFL, K. David Sharma ("Sharma"), Simmons,
8 Cho, To Fai Cheng ("Cheng"), Jean Yuen ("Yuen"), Y & T Inc. dba Tokyo International Investment
9 Ltd. ("Tokyo") and Wing Ming Tam ("Tam") (collectively the "primary Respondents") under the
10 statutory language of A.R.S. § 44-1991 and case law directly thereunder, such as *Barnes v. Vozack*,
11 113 Ariz. 269, 550 P.2d 1070 (1976) (In Banc). *SDPHM*, pp. 13-38. Since no liability under Sec.
12 44-2003 was alleged by the Division in this matter, Respondents defensive arguments against such
13 liability are misplaced and simply inapplicable to a determination of the Division's allegations.

14 Secondly, the *Standard Chartered* gloss on A.R.S § 44-2003 does not reach the statutory
15 violations alleged against some Respondents in this matter. *Standard Chartered* expressly confined
16 its statutory analysis to interpreting the terms "participated in" and "induced" within the meaning of
17 Sec. 44-2003 only.⁴ *See id.*, 190 Ariz. at 18, 21-22, 945 P.2d at 329, 332-33.⁵ As Respondents
18 concede, the *Standard Chartered* gloss addressed the former version of A.R.S § 44-2003,⁶ *RPHM*,

20 ³ Respondents stipulated that FISC, EVFL, Simmons and Cho were never registered under A.R.S. § 44-
21 1842. *Exh. S-161, para. 20; SDPHM, p. 13.*

22 ⁴ "There is no equivalent provision under federal securities laws." Weinroth *et al.*, *Reformation of the*
23 *Arizona Securities Act: A Brief Summary*, 33 Arizona Attorney 25, 50 n. 34 (August/September 1996) (hereafter
24 cited as "*Weinroth et al., supra*"). Therefore, the court acknowledged that "the federal statutes do not guide us here."
25 *Id.*, 190 Ariz. at 18, 945 P.2d at 329. This is the reason, unmentioned in Respondents' PHM, why the court "declined
26 to apply caselaw construing the federal securities statutes." *RPHM, p. 9 n. 3.*

⁵ The court was "obliged to determine the meaning of participation or inducement *within A.R.S. § 44-2003*,"
24 *Standard Chartered PLC v. Price Waterhouse*, 190 Ariz. 6, 21, 945 P.2d 317, 332 (Ct. App. 1996); "PW did not
25 'participate in' the sale *within the meaning of A.R.S. § 44-2003*," *id.*; "... we believe *it better fits A.R.S. § 44-2003* to
26 give 'induce' the narrower and more active construction ...," *id.*; "... capture the meaning of 'induce' that best fits *its*
usage in A.R.S. § 44-2003," *id.* at 22, at 333; "... PW neither 'participated in' nor 'induced' a securities transaction
within the meaning of A.R.S. § 44-2003," *id.* (Italics added.)

⁶ The former version of A.R.S § 44-2003 considered in *Standard Chartered* was part of Article 14, the

1 p. 9 n. 3, which served *only* to make certain persons jointly and severally liable in *private* lawsuits
2 brought under A.R.S. §§ 44-2001 and 44-2002⁷ for rescission or damages related to securities
3 transactions in violation of specified SAA provisions. The Sec. 44-2003 liability issue before the
4 court arose from a private claim for rescissory damages under Sec. 44-2001 that was predicated on
5 untrue statements and misleading omissions pursuant to A.R.S. § 44-1991. *See Standard Chartered*,
6 190 Ariz. at 18, 945 P.2d at 329. But the opinion carefully cabined its "participation-or-inducement
7 standard",⁸ *id.* at 18, at 329, to Sec. 44-2003 alone, avoiding any language stating or implying this
8 "standard" reached beyond that statute to predicate violations of the SAA. Nor has any Arizona case
9 law subsequently held otherwise.

10 Thirdly, the *Standard Chartered* language addressing the former A.R.S. § 44-2003 expressly
11 removed itself from any application to a public enforcement administrative matter. In reasoning
12 through its "participation-or-inducement standard," the court sharply distinguished the "range of
13 persons" liable under Sec. 44-2003 from those liable under Sec. 44-1991. Declaring that Secs. 44-
14 2001 and 44-2003 "do not provide a *private* civil remedy against *anyone* who makes a material

15
16 "Civil Remedies and Liabilities" portion of the SAA confined in scope to private litigation. *See A.R.S. §§ 44-2001--*
17 *44-2005 (1994)*. Sec. 44-2003 was extensively amended by *Laws 1996*, Ch. 197 § 6, effective July 20, 1996. "No
18 area of the Arizona Act contains more technical revisions than revised Section 44-2003." Weinroth *et al.*, *supra*, p.
19 26. Subsection (A) of the amended version retained the former language addressed in *Standard Chartered*, though
20 modified in part by the addition of Sec. 44-2032 to Secs. 44-2001 and 44-2002. *See A.R.S. § 44-2003 (1994)*; *A.R.S.*
21 *§ 44-2003(A) (1996)*. New subsections (B) through (P) relate only to private litigation.

22 ⁷ Sec. 44-2001 creates a private cause of action and monetary remedy for the purchaser of securities sold in
23 violation of Secs. 44-1841, 44-1842 or Article 13 of the SAA. *See A.R.S. § 44-2001(A) (1994 & 1996)*. Sec. 44-2002
24 does the same for a seller of securities where a purchase violates Secs. 44-1842, 44-1991 or 44-1994 of the SAA. *See*
25 *A.R.S. § 44-2002(A) (1994 & 1996)*. Both Secs. 44-2001 and 44-2002 are express liability statutes with identical
26 subsections (B), added by *Laws 1993*, Ch. 257, §§ 4 & 5, that provide an affirmative defense of lack of actual or
constructive knowledge of an untrue statement or misleading omission predicated as a violation of Sec. 44-1991. No
such statutory defense is available in public civil actions to impose equitable liability for violations of Sec. 44-
1991(A)(2), where violators remain strictly liable under *State v. Gunnison*, 127 Ariz. 110, 113, 618 P. 2d 604, 607
(1980) (In Banc). *See Rose v. Dobras*, 128 Ariz. 209, 214, 624 P.2d 887, 892 (Ct. App. 1981); *Rosier v. First*
Financial Capital Corp., 181 Ariz. 218, 222, 889 P.2d 11, 15 (Ct. App. 1994) (an innocent misrepresentation can
violate Sec. 44-1991).

⁸ Indeed, this standard merely reflected the last sentence added in the new Sec. 44-2003(A) which had
already become law over three months before *Standard Chartered* was issued as a slip opinion on November 7, 1996
(corrected on denial of reconsideration, January 13, 1997). This sentence provided that: "No person shall be deemed
to have participated in any sale or purchase solely by reason of having acted in the ordinary course of that person's
professional capacity in connection with that sale or purchase."

1 misstatement in connection with a securities transaction," the court opined that "[h]ad the legislature
2 intended so extensive a *private* remedy, it could simply have done so against *any* person who
3 violated section 44-1991. Instead, the legislature provided a *private* civil remedy *only* against the
4 *narrower range of persons* 'who made, participated in or induced the unlawful sale' " under Sec. 44-
5 2003. *Id.* at 22, at 333. (Italics added.) The court then noted that "in contrast" with such private
6 lawsuits under Sec. 44-2003, "the Securities Act arms the Attorney General and *Corporation*
7 *Commission* with a range of *public enforcement* measures against '*any person*' engaging in a
8 violation of the Act," citing A.R.S. §§ 44-2032, 44-2036 and 44-2037. *Id.* at 48 n. 6, at 359 n. 6.
9 (Italics added.)

10 Thus, the *Standard Chartered* court construed the Sec. 44-2003 terms under a double
11 standard theory of legislative intent to reduce the class of persons liable in Article 14 private
12 litigation from the larger pool of persons liable in public enforcement actions under the SAA.⁹ As
13 reflected in its own language quoted above, the court in no way intended or contemplated that its
14 Sec. 44-2003 reducer standard was applicable to public enforcement actions. Indeed, such a
15 misapplication would contradict the theory of legislative intent adopted by the court as a rationale
16 and underpinning for its standard. Insofar as the *Standard Chartered* gloss on Sec. 44-2003 survived
17 the wholesale legislative remake of that statute in 1996,¹⁰ it remains confined to private lawsuits
18 brought under Secs. 44-2001 and 44-2002 only, not public enforcement cases arising under Sec. 44-
19 2032.

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22 ⁹ Sec. 44-2032 authorizes the Commission "in its discretion" to, *inter alia*, undertake administrative or
23 judicial actions for equitable relief against "*any person*" who "has engaged in, is engaging in, or is about to engage in
24 any act, practice or transaction which constitutes a violation" of the SAA "or any rule or order of the Commission
thereunder... ." (Italics added.) The 1996 enactment that included Sec. 44-2032 in new Sec. 44-2003(A) also
specified a legislative intent that: "Nothing in this act limits or abridges the power or *authority* of the Arizona
corporation commission or the Arizona attorney general." *Laws 1996*, Ch. 197 § 11(D). (Italics added.)

25 ¹⁰ During the legislative deliberations that amended the SAA in 1996, "[m]embers of the legislature
26 continually emphasized that they did not intend to protect fraud-feasors, and in particular, persons such as Charles
Keating *and the professionals who represented him.*" Weinroth *et al., supra*, p. 49 n. 10. (Italics added.) It can be
officially noticed that Weinroth was general counsel for the Division during those deliberations and represented the
Commission before the legislature in regard to senate bill 1383 that was enacted as Chapter 197 of *Laws 1996*.

1 Respondents' PHM mixes apples with oranges by mistargeting the *Standard Chartered* gloss
2 against the violations of Secs. 44-1841, 44-1842 and 44-1991 alleged by the Division against certain
3 Respondents in this matter. The dispositive statutory and decisional law applicable to their primary
4 violations was detailed in the Division's Post Hearing Memo, *see SDPHM, pp. 5-6, 13-17, 33-34,*
5 and that law provides the appropriate standards for the determination of Respondents' liability.

6 **B. Respondent Cho's Exculpatory Testimony is not Credible**

7 Respondents' PHM relies heavily--as it must--on exculpatory statements by Cho during his
8 hearing testimony. Cho was the *only* Respondent to testify at hearing. The testimony of rebuttal
9 witness Benson, *Hearing Transcript, pp. 3071-3129,* directly contradicts and impeaches the
10 credibility of Cho's exculpatory statements pertaining to his tenure as marketing manager of FISC.
11 In weighing Cho's exculpatory statements, the Hearing Officer should consider their impeachment
12 of their credibility by Benson's testimony.

13 **II.**

14 **VICARIOUS LIABILITY OF CERTAIN RESPONDENTS UNDER SECTION 44-1999**

15 Respondents' PHM contests the Division's allegations of control liability against certain
16 Respondents and asserts the good faith defense under Sec. 44-1999. *RPHM, pp. 23-38.*

17 **A. Control Liability**

18 Respondents' PHM asserts that the allegations of control liability against certain
19 Respondents in this matter must be dismissed under the federal Ninth Circuit test for control as
20 applied in *Paracor Finance, Inc. v. General Elec. Capital Corp., 79 F.3d 878 (9th Cir. 1996).*
21 *RPHM, pp. 23-25, 33-34.* This is a variation of the "third test" described in the Division's Post
22 Hearing Memorandum, *SDPHM, p. 43,* and its application by *Paracor* and in Respondents' PHM
23 particularly underscore why it should not be a standard for Sec. 44-1999 control liability under the
24 SAA.

25 In its most widely-recognized form among federal circuits, this test requires proof of the
26 *actual exercise* of control over the *general affairs* of the primary violator and the *possession* of

1 power (whether or not exercised) to control the *specific violative activity*. *SDPHM*, p. 43. However,
2 the Ninth Circuit variant has evolved a second prong requiring *actual participation* in the specific
3 violative activity. This variant first emerged in *Kaplan v. Rose*, 49 F.3d 1363 (9th Cir. 1994), which
4 reviewed a summary judgment for the defendant with "scrutiny" of his "power to control corporate
5 actions" and "participation in the day-to-day affairs of the corporation."¹¹ *Id.*, 49 F.3d at 1382.
6 Although *Kaplan* provided little discussion on the "participation" prong, it did note without
7 comment that the lower court granted summary judgment because the plaintiff failed to show the
8 defendant "was a *culpable participant* in the violations allegedly perpetrated by the other
9 defendants." *Kaplan*, 49 f.3d at 1382. (Italics added).

10 The "culpable participation" requirement has undergone an uneven history in the Ninth
11 Circuit. A circuit panel declared in 1978 that control liability required "some kind of participation by
12 the controlling person in the activities of the controlled person which are claimed to be violative of
13 the securities laws," although it declined to address whether this participation must be "culpable."
14 *Christoffel v. E.F. Hutton & Co., Inc.*, 588 F.2d 665, 668-69 (9th Cir. 1978). In *Kersh v. General*
15 *Council of Assemblies of God*, 804 F. 2d 546 (9th Cir. 1986), another circuit panel required a
16 showing of "actual power or influence" and "culpable participation". *Kersh*, 804 F.2d at 549. The
17 following year, a circuit panel defined "culpable participation" as "actual participation in activities
18 which are claimed to violate the securities laws." *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433,
19 1442 (9th Cir. 1987). *See also Orloff v. Allman*, 819 F.2d 904 (9th Cir. 1987) (participation or
20 inaction culpable if knowing). However, in 1990 the Ninth Circuit *en banc* held that no "culpable
21 participation" was required to show control liability for a securities broker-dealer.¹² *Hollinger v.*
22 *Titan Capital Corp.*, 914 F.2d 1564, 1575 (9th Cir. 1990). *Culpability* at least was to be disproved by
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25 ¹¹ Although *Kaplan* cites to *Arthur Children's Trust v. Keim*, 994 F.2d 1390 (9th Cir. 1993), no such
26 formulation was expressed in *Keim*. *Kaplan*, 49 F.3d at 1382; *Keim*, 994 F.2d at 1396-97. The *Kaplan* court
apparently derived its test by induction from the factual discussion of control in *Keim*. *See Keim, id.*

¹² This holding was "reached in the context of the broker-dealer/registered representative relationship
exclusively." *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1582 n. 24 (9th Cir. 1990).

1 the good faith defense, not under the control test. *See Hollinger, id.* Three years later, a circuit panel
2 apparently extended this holding to non-broker dealer cases in *Arthur Children's Trust v. Keim*, 994
3 F.2d 1390, 1398 (9th Cir. 1993). Probably for this reason the *Kaplan* court thereafter substituted
4 "participation in the *day-to-day affairs of the corporation*" for "*culpable participation.*" This *Kaplan*
5 prong was a refinement of the former *Christoffel* requirement for "some kind of participation."

6 Although *Kaplan's* formulation of this prong was acknowledged in *Paracor*, 79 F.3d at 890,
7 the *Paracor* court's application of this prong effectively recast it into a requirement for a defendant's
8 *actual participation in the specific violative activity of the primary violator.* Where a defendant in
9 *Paracor* was both CEO and Chairman of the corporate issuer, was consulted on every major
10 company decision, knew about its allegedly fraudulent debenture offering, saw (but did not read) the
11 offering disclosure document, and helped develop projections that were later used in the disclosure
12 document, the court strictly limited its inquiry to the details of his *personal involvement in preparing*
13 *the offering and its disclosure document.* *Paracor*, 79 F.3d at 890-91. Noting he was the only officer
14 not authorized to act on behalf on his company in this offering, he "was not involved in the
15 preparation of any of the offering materials," and he never discussed the offering with any investor,
16 the court concluded that he "exercised" no control "*over the debenture offering in any way.*" *Id.* at
17 891. (Italics added.)¹³ This was an altogether different focus than "scrutiny of the defendant's
18 participation in the *day-to-day affairs of the corporation.*" *Kaplan*, 79 F.3d at 890.

19 This application in *Paracor* vividly illustrates the inherent defect of requiring "culpable" or
20 any actual participation in the violation, as well as the inapplicability of this Ninth Circuit test to the
21 SAA control liability statute. Any actual participation in specific violative activity would create
22 *primary liability* and render meaningless the concept of vicarious liability. *See Binder v. Gordian*
23 *Securities, Inc.*, 742 F. Supp, 663, 668 (N.D. Ga. 1990). Moreover, the plain meaning of the
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25 _____
26 ¹³ Yet another circuit panel had previously opined in *Keim* that control liability was alleged against the
defendant "not because he controlled those marketing the investment contracts but cause he was one of the persons
controlling the issuer of the investment contracts." *Keim*, 994 F.2d at 1398.

1 statutory language does not require participation in violative activity. *See Metge v. Baehler*, 762
2 F.2d 621, 631 (8th Cir. 1985), *cert. denied sub nom. Metge v. Bankers Trust Co.*, 474 U.S. 1057
3 (1986). Finally, such a test would operate as in *Paracor* to defeat the remedial and investor
4 protection purpose of the SAA. *See SDPHM*, pp. 40-41, 43-44.

5 The decisional law tests for Sec. 44-1999 control liability that provide the best fit for the
6 SAA are identified and discussed in the Division's Post Hearing Memorandum. *See SDPHM*, pp.
7 41-44. The determination of control liability in this matter should be guided by the first and second
8 tests reviewed therein.

9 **B. Affirmative Defense to Control Liability**

10 Respondents assert the two-prong "good faith" defense to control liability under Sec. 44-
11 1999, *RPHM*, p. 38, but fail to specifically identify *any* evidence from the record to establish the
12 requisite *affirmative* showing that:

13 Respondents To Fai Cheng ("Cheng"), Jean Yuen ("Yuen"), Y & T Inc. ("Tokyo"), Wing
14 Ming Tam ("Tam") and Guo Quan Zhang ("Guo") "acted in good faith" *and* "did not directly or
15 indirectly induce" FISC's primary violations of Secs. 44-1841, 44-1842 and 44-1991;

16 Respondents K. (David) Sharma ("Sharma"), Eastern Vanguard Group Limited ("EVGL"),
17 Sammy Lee Chun Wing ("Wing") and Peter Suen Suk Tak ("Tak") "acted in good faith" *and* "did
18 not directly or indirectly induce" EVFL's primary violations of Secs. 44-1841, 44-1842 and 44-
19 1991.

20 The first "good faith" prong requires some affirmative showing that each such Respondent
21 acted without scienter or negligence and established supervisory procedures or other precautionary
22 measures appropriate to the circumstances. *SDPHM*, pp. 45-46. The second prong requires some
23 affirmative showing that each such Respondent did not directly or indirectly induce the violations,
24 either by action or inaction. *SDPHM*, p. 46. Failing to provide any specific affirmative evidence
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1 under these prongs,¹⁴ Respondents' PHM instead claims the "evidence set forth above establishes
2 conclusively" this defense, citing *Paracor* and *Kaplan*¹⁵ for the proposition that evidence
3 establishing no control liability *may* also prove the good faith defense. *RPHM*, p. 38. The only
4 affirmative evidence "set forth above" in Respondents' PHM to contest control liability is that "there
5 have *never* been any transfers of funds, direct or indirect, between EVG and EVFL."¹⁶ *RPHM*, p. 35
6 (*citing Exh. S-183, "Affidavit of Alwin Yam"*). Moreover, Respondents raised this evidentiary item in
7 opposition to the control liability of EVGL only for the primary liability of EVFL. *RPHM*, pp. 35-
8 36. Respondents PHM raised no affirmative evidence in opposition to the control liability of any
9 Respondent other than EVGL.

10 As opposed to affirmative evidence, Respondents' PHM does contest control liability with
11 both generalized and specific complaints that the Division's evidence of control is insufficient or
12 nonexistent. *RPHM*, pp. 23, 25-26, 30, 33, 34, 35. Respondents PHM even claims support for such
13 lack of evidence in selective testimony from hearing witnesses. *RPHM*, pp. 26-30 (*Smedinghoff*),¹⁷
14 30-31 (*Cho*)¹⁸, 31 (*Saxon, Scott, Nagorny*),¹⁹ 31-33 (*Goss*)²⁰, 34 (*Scott, Nagorny*).²¹ However, none
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16 ¹⁴ Without citing to the record, Respondents do assert that "FISC created a training program specifically
17 designed to ensure that investors received full disclosure." *RPHM*, p. 38. However, they fail to assert or show how
18 any alleged control person in this matter can claim individual benefit under the "good faith" defense from FISC's
19 action. Indeed, Respondents' PHM elsewhere declared that the "Division offered no evidence" that these
20 Respondents "created FISC's training program." *RPHM*, p. 26. Without an admission of control or showing of
21 individual linkage, no Respondent alleged to be a control person can claim this as affirmative evidence in their favor.

22 ¹⁵ Although cited by Respondents, *Kaplan* did not involve evidence serving both roles. Instead, an affidavit
23 by defendant Rose served only to establish his *prima facie* good faith defense. *See Kaplan v. Rose*, 49 F.3d 1363,
24 1383 (9th Cir. 1994), *cert. denied*, 116 S.Ct. 58 (1995). Because this uncontradicted evidence was not rebutted, the
25 defense prevailed. *See id.*

26 ¹⁶ Respondents claim that "this evidence, and the complete lack of evidence that EVG was involved in the
day-to-day operations of FISC, is not enough to establish a control relationship." *RPHM*, p. 35.

¹⁷ All of this extract consists of witness Smedinghoff's cross-examination by Respondents' counsel, in
which this witness consistently answered that he simply had no personal knowledge of the events or facts he was
queried about. His *lack of personal* knowledge certainly is not proof, as Respondents' PHM asserts, of the *positive*
facts that certain Respondents "did not select the location of FISC's offices; they did not set up the office; they were
not at the office for the day-to-day business; they did not participate in hiring or firing employees; they did not
participate in or direct the training; they did not give directions to any of FISC's employees; they did not talk to any
of FISC's clients." *RPHM*, p. 30. At best, this testimony can be used as evidence that the Division *failed to adduce*
evidence to prove those facts. The burden of proof is on the Division.

¹⁸ This summary extracted from testimony by Respondent Cho is also cited by Respondents to support their
argument about what facts Smedinghoff's testimony proved. *RPHM*, p. 30. As with Smedinghoff, nothing in this

1 of this cited testimony is affirmatively probative of either prong of the good faith defense. Although
2 affirmative evidence against control liability might also serve to establish the good faith defense,²²
3 not *all* evidence can serve both roles. Evidence recited to show its mere insufficiency for proving
4 control liability certainly does not rise to affirmatively establish a *prima facie* good faith defense.

5 The Yam affidavit declaration of no direct or indirect transfers of funds between EVGL and
6 EVFL also illustrates that not all evidence can serve both roles. Although this statement may be used
7 to defend against EVGL control liability for EVFL's primary violations, it has not been shown to be
8 probative of either prong of the good faith defense. How can it contribute to a *prima facie* showing
9 that EVGL "acted in good faith" in relation to the offers and sales of securities by EVFL in violation
10 of Secs. 44-1841, 44-1842 and 44-1991 of the SAA? How does it show that EVGL did not directly
11 or indirectly induce EVFL to make such offers or sales? This declaration alone fails to make even a
12 *prima facie* showing of the good faith defense by EVGL.

13 III. 14 CONCLUSION

15 For the foregoing reasons, the arguments in Respondents' PHM against their primary and

16 summary proves the positive facts asserted by Respondents. At best, it can be used to show the Division failed to
17 adduce enough evidence to prove those facts and meet its burden.

18 ¹⁹ This summary extracted from testimony by witnesses Saxon, Scott and Nagorny is also apparently cited
19 by Respondents either as support for their argument about what facts Smedinghoff's testimony proved or to show the
20 Division failed to present sufficient evidence to prove control liability. *See RPHM, p. 33.* As regards the former, it
21 does not prove the positive facts claimed by Respondents, and at best is evidence of the Division's insufficient
22 showing to meet its burden of proof.

20 ²⁰ Respondents' PHM claims this extract from cross-examination testimony by witness Goss "established
21 that none of the Respondents from Hong Kong can be classified as controlling persons." *RPHM, p. 31.* As with the
22 Smedinghoff testimony, Goss consistently answered that she simply had no personal knowledge of the events or
23 facts she was queried about. At best, this extract can be used to show the Division failed to present sufficient
24 evidence to meet its burden of proof, and not as evidence of positive facts.

23 ²¹ Respondents' PHM claims these extracts from testimony by witnesses Scott and Nagorny "helped
24 establish that Mr. Tam was not a controlling person." *RPHM, p. 34.* At best they go to the insufficiency of the
25 Division's burden to prove control, not to any positive fact.

24 ²² In the *Paracor* case relied on by Respondents, the opinion recited the same affirmative "facts" both
25 against control liability and for the good faith defense. The defendant Burton was not authorized by the issuer to act
26 on its behalf in regard to the securities offering at issue; he was not involved in the preparation of the offering
materials; and he did not read the offering document. The court decided the plaintiffs failed to rebut this showing
with other evidence and the defense prevailed. *See Paracor Finance, Inc. v. General Elec. Capital Corp., 79 F.3d*
878, 891 (9th Cir. 1996).

1 vicarious liability, as well as for their good faith defense to control liability, should be rejected.

2
3 RESPECTFULLY SUBMITTED this 1ST day of June , 1999.

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