

ORIGINAL
OPEN MEETING ITEM 10/16



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WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

BRIAN C. McNEIL
EXECUTIVE SECRETARY



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ARIZONA CORPORATION COMMISSION

MEMORANDUM

TO: Marc Spitzer, Chairman
William A. Mundell
Jeff Hatch-Miller
Mike Gleason

Arizona Corporation Commission
DOCKETED

FROM: Matthew J. Neubert
Acting Director of Securities

OCT 02 2003

DATE: September 30, 2003

DOCKETED BY *CAF*

RE: *In the Matter of John R. Wallrich and Jennifer Wallrich, husband and wife,*
No. S-03506A-02-0000

CC: Brian C. McNeil, Executive Secretary

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AZ CORP COMMISSION

Attached is a proposed Order to Cease and Desist, Order of Restitution, Order for Administrative Penalties, and Consent to Same by: Respondents John R. Wallrich and Jennifer Wallrich ("Consent Order"). This order was negotiated to resolve claims regarding sales of pay telephone investment contracts involving phones offered by Alpha Telcom and related entities, generally through sales by licensed insurance professionals.

Salespersons for these pay phone contracts, including Wallrich, were recruited by various means. They were provided with legal opinions stating that the investment contracts in question were not securities; these opinions, however, did not address Arizona law regarding investment contracts. Moreover, during the period when most of the insurance salespersons were selling these contracts, a number of jurisdictions had already begun to take action against Alpha Telcom for illegal securities sales. As a result, had the salespersons checked further regarding the legality of the sales, they could have determined that there were questions regarding whether the investments should have been registered as securities.

The proposed Consent Order calls for Respondent John R. Wallrich to cease and desist from further violations of the Arizona Securities Act, and orders Respondents to disgorge all commissions Wallrich received from sales of Alpha Telcom pay telephones and pay an administrative penalty of \$10,000. The Securities Division recommends approval of this

Consent Order. The Order reflects full disgorgement of all commissions, and the penalty reflects an appropriate penalty for the activity.

Originated by: Kathleen Coughenour DeLaRosa

MJN/kcd

I.

FINDINGS OF FACT

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2
3 1. At all times material hereto, Alpha Telcom, Inc. ("Alpha") was an Oregon
4 corporation located at 2751 Highland Avenue, Grants Pass, Oregon 97526.

5 2. At all times material hereto, American Telecommunications Company, Inc.
6 ("ATC") was a Nevada corporation formed as a wholly owned subsidiary of Alpha on or about
7 September 17, 1998. Originally named ATC, Inc., the name was changed to American
8 Telecommunications Company, Inc., sometime in the first half of 2000. Its address was the same
9 as Alpha's, but was later changed to 620 S.W. 4th Street, Grants Pass, Oregon 97526, then to 2900
10 Vine Street, Suite J, Grants Pass, Oregon 97526, and then to 942 S.W. 6th Street, Suite G, Grants
11 Pass, Oregon 97526.

12 3. At all times material hereto, Paul S. Rubera ("Rubera") was the president and
13 control person of Alpha, and the control person of ATC.

14 4. ATC was organized by Rubera and operated in conjunction with and as an alter ego
15 of Alpha. The two companies were controlled by Rubera and his associates.

16 5. At all times material hereto, Alpha and ATC, and their affiliates, sold pay
17 telephones with telephone service agreements pursuant to which the investor would share in the
18 profits of the pay telephone. Investors would enter into two agreements, a purchase agreement, and
19 a service agreement with Alpha to manage the phone. The two agreements were presented and
20 promoted simultaneously. The telephones were presented to potential investors with four options
21 in the way of service contracts, each varying in the amount of service provided. The four options
22 varied from Level 1, which included a minimum of service, to Level 4, which provided full service
23 to the purchaser, including choosing a site and installing the telephone, collecting all revenue from
24 the telephone's operation, repairing the telephone when necessary, and even repurchasing or
25 buying back the telephone at the investor's option. Under Level 4, Alpha would split the net
26 proceeds with the investor on a 70/30 basis, with Alpha retaining 70% and the investor receiving

1 30%. The price of the pay telephones was the same regardless of the service option chosen,
2 \$5,000.00 per telephone. Although investors were given a choice of using a company other than
3 Alpha to manage the phone, no Arizona investor to whom WALLRICH sold the investment picked
4 a company other than Alpha to manage their phones. A "typical return" on each pay telephone was
5 touted as 14% per year. In practice, all purchasers received \$58.34 per month per pay telephone
6 purchased, which amounted to exactly 14% per annum.

7 6. ATC's primary role was marketing the contracts. Alpha's main focus was on
8 obtaining phone sites and installing, servicing, and managing the phones.

9 7. ATC was presented to the public as the sales organization for Alpha. In early 1999,
10 ATC engaged Strategic Partnership Alliance, L.L.C., a Nevada limited liability company, and/or
11 SPA Marketing, L.L.C., a Nevada limited liability corporation, (collectively "SPA") as its
12 independent marketing and sales firm(s). SPA thereafter was responsible for hiring, training, and
13 supervising sales agents who were selling the telephone contracts. After SPA came on board, ATC
14 remained as the processing center for the contracts, while Alpha continued to perform the service
15 and maintenance of the phones.

16 8. WALLRICH, directly or indirectly, entered into agreements with Alpha, ATC,
17 and/or SPA, pursuant to which WALLRICH sold investment contracts involving Alpha pay
18 telephones (the "Alpha investment contracts") within or from the state of Arizona. All Alpha
19 investment contracts WALLRICH sold were Level 4 contracts.

20 9. WALLRICH told prospective investors their investments were insured. The insurer
21 named varied. Mentioned most often was the Northern and Western Insurance Company of Grand
22 Turk, Turks and Caicos Islands, British West Indies ("N&W"). Also mentioned were Lloyd's of
23 London and four other insurance companies listed as re-insurers. N&W was a captive insurance
24 company wholly owned by Paul S. Rubera, the President and control person of Alpha, and Robert
25 S. Harrison of Richmond, Texas. N&W is not authorized to write insurance in Arizona.

26 10. WALLRICH presented Alpha to prospective customers as a stable, profitable, and

1 innovative company that had been in business since 1985. Alpha was said to be selling and
2 providing a "turn-key" operation.

3 11. All sales agents, including WALLRICH, were paid commissions on each telephone
4 sold.

5 12. WALLRICH participated in recruiting other licensed insurance salespersons to sell
6 Alpha investment contracts. During this activity, WALLRICH represented that the Alpha
7 investment contracts were not securities, and that salespersons did not need to be registered to sell
8 securities before selling the Alpha investment contracts. WALLRICH received commissions,
9 overrides, and/or other compensation as a result of referral of such salespersons to Alpha and/or
10 ATC and/or SPA.

11 13. WALLRICH sold Alpha investment contracts involving at least 138 telephones to at
12 least 28 individuals or entities within or from the state of Arizona from May, 2000 through May, 2001,
13 for a total sales amount of at least \$685,250.00.

14 14. WALLRICH received commissions and other compensation from Alpha and/or ATC
15 and/or SPA in the total amount of \$325,950.00. WALLRICH paid out shares of these commissions to
16 others in the total amount of \$197,230. An additional \$4,800 of WALLRICH's commissions
17 represented commissions on contracts purchased by WALLRICH himself. WALLRICH thus
18 received net commissions of \$123,920.00 on sales of Alpha investment contracts.

19 15. Alpha has a long regulatory history in which state securities regulators have found that
20 these purchases of pay telephones and accompanying service contracts were unregistered securities in
21 the form of investment contracts that were sold by unregistered persons and/or entities, and ordered
22 Alpha and those working with it to cease and desist. WALLRICH did not reveal these orders to most
23 Arizona investors to whom he sold the Alpha investment contracts. The orders that WALLRICH
24 could have revealed include:

- 25 a. February 2, 1999, Cease and Desist Order issued by Pennsylvania Securities
26 Commission, *In the Matter of Alpha Telecom, Inc., et al.*, No. 9812-06.

- b. November 17, 1999, Cease and Desist Order issued by North Carolina Secretary of State, *In the Matter of the North Carolina Securities Division v. ATC, Inc., Paul Rubera, et al.*, No. 99-038-CC.
- c. June 30, 1999, Temporary Order of Prohibition issued by Illinois Secretary of State, *In the Matter of Alpha Telecom, Inc.*, No. 9900201.
- d. January 14, 2000, Consent Order of Prohibition issued by Illinois Secretary of State, *In the Matter of Alpha Telecom, Inc.*, No. 9900201, in which Alpha agreed to offer rescission to all Illinois purchasers.
- e. November 24, 1999, Cease and Desist Order issued by Wisconsin Department of Financial Institutions, *In the Matter of Alpha Telecom, Inc. and Paul S. Rubera, et al.*, No. S-99225(EX).
- f. March 7, 2000, Temporary Cease and Desist Ordered issued by Rhode Island Department of Business Regulation, *In the Matter of Alpha Telecom, Inc. and ATC, Inc.*
- g. July 18, 2000, Florida Department of Banking and Finance filed administrative action against Alpha and others, seeking a Cease and Desist Order.
- h. October 24, 2000, Desist and Refrain Order issued by California Department of Corporations.

16. Actions against Alpha after WALLRICH ceased his sales of the Alpha investment contracts include:

- a. July 26, 2001, Cease and Desist Order issued by Ohio Commissioner of Securities;
- b. August 27, 2001, Temporary Restraining Order issued by United States District Court, District of Oregon, *SEC v. Alpha Telecom, Inc., et al.*, No. CV 01-1283 PA
- c. September 5, 2001, Cease and Desist Order issued by Arkansas Securities Department, *In the Matter of Alpha Telecom, Inc., et al.*, No. 01-36-S.
- d. September 6, 2001, Preliminary Injunction issued by United States District Court, District of Oregon, *SEC v. Alpha Telecom, Inc., et al.*, No. CV 01-1283 PA.
- e. February 7, 2002, Final Judgment of Permanent Injunction issued by United States District Court, District of Oregon, *SEC v. Alpha Telecom, Inc., et al.*, No. CV 01-1283 PA.
- f. March 13, 2002, Final Order to Cease and Desist issued by Washington Department of Financial Institutions, *In the Matter of Alpha Telecom, Inc., et al.*, No. SDO-21-02.

1 The SEC's Complaint in the United States District Court, District of Oregon, alleged that Alpha
2 and its affiliates engaged in a Ponzi-like scheme that never generated enough income to pay
3 expenses, and that the money paid to existing investors always came from sales to new investors.
4 Several days before the Temporary Restraining Order was issued on August 27, 2001, Alpha
5 sought bankruptcy protection in Florida pursuant to chapter 11 of the Bankruptcy Code. A court-
6 appointed receiver subsequently took over the remaining operations of Alpha. Alpha consented
7 on October 19, 2001 to entry of the Final Judgment of Permanent Injunction against it, but did
8 not admit the allegations of the Complaint.

9 17. On February 7, 2002, the United States District Court for the District of Oregon
10 issued its final opinion in connection with the trial of Paul Rubera. That opinion is reported at
11 *SEC v. Alpha Telecom*, 187 F. Supp. 2d 1250 (D. Or. 2002). In its opinion, the court confirmed
12 that the Alpha investment contracts are securities and thus subject to regulation as securities. The
13 court also confirmed that Alpha operated what was essentially a Ponzi scheme in connection with
14 the sale of the Alpha investment contracts.

15 18. Monthly payments to investors ceased prior to August, 2001.

16 II.

17 CONCLUSIONS OF LAW

18 1. The Commission has jurisdiction over this matter pursuant to Article XV of the
19 Arizona Constitution and the Securities Act.

20 2. The Commission has jurisdiction to enter an order that may be collected from
21 property attributable to the marital community of RESPONDENTS, pursuant to A.R.S.
22 § 44-2031(C).

23 3. WALLRICH offered or sold securities within or from Arizona, within the meaning
24 of A.R.S. §§ 44-1801(15), 44-1801(21), and 44-1801(26).

25 4. WALLRICH violated A.R.S. § 44-1841 by offering or selling securities that were
26 neither registered nor exempt from registration.

1 amounts payable to each investor shall be reduced by the amounts of any recoveries of principal,
2 interest, or other distributions received by the investors from any source, including, but not limited
3 to, any amounts recovered by the investors pursuant to legal actions or claims made by or on
4 behalf of the investors against the insurers or receivers of Alpha, ATC, or their related companies
5 or affiliates, or pursuant to proceedings brought by or on behalf of the U.S. Securities and
6 Exchange Commission or the receivers or bankruptcy estate of Alpha, ATC, or their related
7 companies or affiliates. If all investors are paid in full, any excess funds paid by Respondents
8 pursuant to this Order which have not been distributed to investors shall be refunded to
9 Respondents. If restitution is not made in accordance with this Order, any outstanding balance
10 shall be deemed in default and shall be immediately due and payable.

11 IT IS FURTHER ORDERED, pursuant to A.R.S. § 44-2036, that RESPONDENTS,
12 including the marital community of WALLRICH and JENNIFER WALLRICH, shall pay an
13 administrative penalty in the amount of \$10,000, payable to the "State of Arizona." Payment shall
14 be made in full by cashier's check or money order on the date of this Order. If RESPONDENTS

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1 do not comply with this order for administrative penalties, any outstanding balance shall be
2 deemed in default and shall be immediately due and payable.

3 IT IS FURTHER ORDERED that this Order shall become effective immediately.

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION

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7 CHAIRMAN

COMMISSIONER

COMMISSIONER

8 COMMISSIONER

COMMISSIONER

9 IN WITNESS WHEREOF, I, BRIAN C. McNEIL,
10 Executive Secretary of the Arizona Corporation
11 Commission, have hereunto set my hand and caused the
12 official seal of the Commission to be affixed at the
13 Capitol, in the City of Phoenix, this _____ day of
14 _____, 2003.

15 _____
16 BRIAN C. McNEIL
17 Executive Secretary

18 _____
19 DISSENT

20 This document is available in alternative formats by contacting Yvonne McFarlin, Executive
21 Assistant to the Executive Secretary, voice phone number 602-542-3931, E-mail
22 ymcfarlin@cc.state.az.us.

23 KCD
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CONSENT TO ENTRY OF ORDER

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2 1. RESPONDENTS JOHN R. WALLRICH ("WALLRICH"), an individual, and
3 JENNIFER WALLRICH, his wife, admit the jurisdiction of the Commission over the subject
4 matter of this proceeding. RESPONDENTS acknowledges that they have been fully advised of
5 their right to a hearing to present evidence and call witnesses and RESPONDENTS knowingly and
6 voluntarily waive any and all rights to a hearing before the Commission and all other rights
7 otherwise available under Article 11 of the Securities Act and Title 14 of the Arizona
8 Administrative Code. RESPONDENTS acknowledge that this Order To Cease And Desist, Order
9 of Restitution, Order for Administrative Penalties and Consent to Same by: Respondents John R.
10 Wallrich and Jennifer Wallrich ("Order") constitutes a valid final order of the Commission.

11 2. RESPONDENTS knowingly and voluntarily waive any right they may have under
12 Article 12 of the Securities Act to judicial review by any court by way of suit, appeal, or
13 extraordinary relief resulting from the entry of this Order.

14 3. RESPONDENTS acknowledge and agree that this Order is entered into freely and
15 voluntarily and that no promise was made or coercion used to induce such entry.

16 4. RESPONDENTS acknowledge that they have been represented by counsel in this
17 matter, they have reviewed this Order with their attorney and understand all terms it contains.

18 5. RESPONDENTS do not contest the Findings of Fact and Conclusions of Law
19 contained in the Order for the purposes of this proceeding or any other administrative proceeding
20 before an agency of the state of Arizona.

21 6. By consenting to the entry of this Order, RESPONDENTS agree not to take any
22 action or to make, or permit to be made, any public statement denying, directly or indirectly, any
23 Finding of Fact or Conclusion of Law in this Order or creating the impression that this Order is
24 without factual basis. This provision does not, however, prevent RESPONDENTS from taking
25 any action necessary to defend themselves against any claims made in connection with any legal or
26 administrative action filed against them by any person or entity not associated or affiliated with the

1 Arizona Corporation Commission or any other agency of the state of Arizona who is acting in their
2 official capacity as a representative of such agency. RESPONDENTS will undertake steps
3 necessary to assure that all of their agents and employees, if any, understand and comply with this
4 agreement.

5 7. While this Order settles this administrative matter between RESPONDENTS and
6 the Commission, RESPONDENTS understand that this Order does not preclude the Commission
7 from instituting other administrative proceedings based on violations that are not addressed by this
8 Order.

9 8. RESPONDENTS understand that this Order does not preclude the Commission
10 from referring this matter to any governmental agency for administrative, civil, or criminal
11 proceedings that may be related to the matters addressed by this Order.

12 9. RESPONDENTS understand that this Order does not preclude any other agency or
13 officer of the state of Arizona or its subdivisions from instituting administrative, civil or criminal
14 proceedings that may be related to matters addressed by this Order.

15 10. RESPONDENTS agree that they will not apply to the state of Arizona for
16 registration as a securities dealer or salesman or for licensure as an investment adviser or
17 investment adviser representative at any time in the future.

18 11. RESPONDENTS agree that they will not exercise any control over any entity that
19 offers or sells securities or provides investment advisory services, within or from Arizona.

20 12. RESPONDENTS agree that until restitution and penalties are paid in full,
21 RESPONDENTS will notify the Director of the Securities Division within 30 days of any change
22 in home address or any change in RESPONDENTS' ability to pay amounts due under this Order.

23 13. RESPONDENTS understand that default shall render them liable to the
24 Commission for its costs of collection and interest at the maximum legal rate.

25 14. RESPONDENTS acknowledge that any restitution, rescission or penalties imposed
26 by this Order are obligations of WALLRICH as well as the marital community of

1 RESPONDENTS. RESPONDENTS consent to the entry of this Order and agree to be fully bound
2 by its terms and conditions. If RESPONDENTS breach any provision of this Order, the
3 Commission may vacate this Order and restore this case to its active docket.

4
5 *John R. Wallrich*
6 JOHN R. WALLRICH

7
8 *Jennifer Wallrich 9-22-03*
9 JENNIFER WALLRICH

10 SUBSCRIBED AND SWORN TO BEFORE me this 22nd day of September, 2003.

11
12 *Peter J. Kim*
13 NOTARY PUBLIC

14 My Commission Expires:

June 21, 2006



16 2003-09-17 Wallrich Final Consent Order.doc