

OPEN MEETING ITEM

8/19/09

COMMISSIONERS
KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR



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ARIZONA CORPORATION COMMISSION

DOCKETED

JUL 28 2009

MEMORANDUM

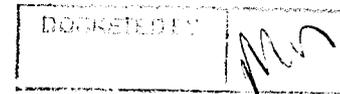
TO: Kristin K. Mayes, Chairman
Gary Pierce, Commissioner
Paul Newman, Commissioner
Sandra D. Kennedy, Commissioner
Bob Stump, Commissioner

FROM: Matthew J. Neubert, Director of Securities 

DATE: July 28, 2009

RE: Deutsche Bank Securities Inc.
Docket No. S-03578A-09-0314

cc: Ernest G. Johnson, Executive Director



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AZ CORP COMMISSION
DOCKET CONTROL

The Securities Division recommends that the Corporation Commission enter the attached Order for Administrative Penalties and Consent to Same by Respondent Deutsche Bank Securities Inc. ("Consent Order"). The Consent Order relates to activities of Deutsche Bank Securities Inc. ("DBSI") regarding the offer and sale of auction rate securities. The proposed Consent Order imposes administrative penalties in the amount of \$115,823.35.

As you are aware, as a result of the February 2008 wide spread auction failures in the auction rate securities market, in March 2008 the North American Securities Administrators Association (NASAA) formed a multistate task force, with which the Securities Division participated, to investigate the auction rate securities market. The investigations focused on the sales practices of securities salesmen and the supervision of those salesmen by their broker-dealers. Last Fall, DBSI agreed in principle to a national settlement. In order to provide for uniformity among the states, the NASAA task force created a model consent order. The findings of fact and conclusions of law contained in the attached proposed Consent Order were negotiated between DBSI and the lead task force state.

The principal components of the settlement are:

- Payment of administrative penalties in the amount of \$15 million dollars, apportioned among the states.
- An offer to purchase from eligible customers at par auction rate securities that were purchased from DBSI on or before February 13, 2008.

- Payment of the difference between par and the price at which an individual investor sold the auction rate securities to each individual investor who sold auction rate securities below par between February 13, 2008, and August 31, 2008.
- A refund of refinancing fees to municipal auction rate issuers that issued through respondent in the initial primary market between August 1, 2007, and February 13, 2008, and refinanced those securities through respondent after February 13, 2008.
- A refund of interest associated with auction rate securities-based loans to individual investors who took out loans from DBSI between February 13, 2008, and June 30, 2009.
- Respondent's efforts to expeditiously provide liquidity solutions for institutional investors.

In light of the significant effort undertaken by the NASAA task force members in investigating DBSI and the relief DBSI has provided to investors in auction rate securities, the Securities Division believes that entry of the proposed Consent Order is in the public interest.

Originator: Matthew J. Neubert

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

In the matter of
DEUTSCHE BANK SECURITIES INC.,
Respondent.

DOCKET NO. S-03578A-09-0314

DECISION NO. _____

ORDER FOR ADMINISTRATIVE
PENALTIES AND CONSENT TO SAME
BY: RESPONDENT DEUTSCHE BANK
SECURITIES INC.

WHEREAS, Deutsche Bank Securities Inc. ("DBSI") is a dealer registered in the state of Arizona; and

WHEREAS, coordinated investigations into DBSI's activities in connection with DBSI's marketing and sale of auction rate securities ("ARS") have been conducted by a multistate task force; and

WHEREAS, DBSI has provided documentary evidence and other materials, and provided regulators with access to information relevant to their investigations; and

WHEREAS, Deutsche Bank AG (as parent entity of DBSI) has entered into a Settlement Term Sheet dated August 31, 2008 (the "Settlement") with the North American Securities Administrator's Association ("NASAA"), which recommends to NASAA members the settlement terms intended to resolve the investigation into the marketing and sale of auction rate securities by DBSI; and

1 WHEREAS, DBSI and the Arizona Corporation Commission (“Commission”) wish to
2 resolve these issues in accordance with the terms of the Settlement and without the expense and
3 delay that formal administrative proceedings would involve; and

4 WHEREAS, DBSI consents to the form and entry on this Consent Order without admitting
5 or denying the allegations set forth herein. Accordingly, DBSI waives the following rights:

6 a. To be afforded an opportunity for hearing on the Commission’s findings and
7 conclusions of law in this Consent Order after reasonable notice within the meaning of
8 Article 11 of the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.* (“Securities Act”); and

9 b. To seek judicial review of, or otherwise challenge or contend, the validity of
10 this Consent Order; and

11 WHEREAS, DBSI agrees that for purposes of this matter, or any future proceedings to
12 enforce this Consent Order by the Commission, this Consent Order shall have the same effect as if
13 proven and ordered after a full hearing held pursuant to the Securities Act; and

14 WHEREAS, the provisions set forth in this Consent Order constitute the entire agreement
15 between the Commission and DBSI, and shall supersede any conflicting provisions contained in
16 the Settlement;

17 NOW, THEREFORE, the Commission, as administrator of the Securities Act, hereby
18 enters this Consent Order:

19
20 **I.**

21 **FINDINGS OF FACT**

22 1. DBSI admits the jurisdiction of the Commission, neither admits nor denies the
23 findings of fact and conclusions of law contained in this Consent Order, and consents to the entry
24 of this Consent Order by the Commission.
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1 **Auction Rate Securities**

2 2. Auction rate securities (“ARS”) as a general term refers to long-term debt or equity
3 instruments tied to short-term interest rates that are reset periodically through an auction process.

4 3. An ARS auction is regarded as a “fail” or “failed auction” if there is not a buyer
5 available for every ARS being offered for sale at the auction. In the event of a failed auction, the
6 investors that wished to sell their ARS were unable to do so and would continue to hold the ARS
7 and wait until the next successful auction to liquidate their positions.

8 4. Beginning in February 2008, the ARS market experienced widespread failed
9 auctions (the “2008 Auction Failures”).

10 5. Common categories of ARS instruments include: auction preferred shares of closed-
11 end funds (“Preferreds”); municipal auction rate certificates (“Municipal ARS”); and student loan-
12 backed auction rate certificates (“Student Loan ARS”). The interest rates paid to ARS holders are
13 intended to be set through a Dutch auction process.

14 6. The interest rate set at an ARS auction is commonly referred to as the “clearing
15 rate.”

16 7. In order to determine the clearing rate, the buy bids are arranged from lowest to
17 highest interest rate (subject to any applicable minimum interest rate). The clearing rate is the
18 lowest interest rate at which all ARS available for sale at the auction can be sold at par value.

19 **DBSI’s Marketing and Sale of Auction Rate Securities**

20 8. DBSI (CRD #2525) is a Delaware corporation with a primary place of business
21 located at 60 Wall Street, New York, New York.

22 9. Deutsche Bank Alex. Brown (“DBAB”), a division of DBSI, provides wealth
23 planning and brokerage services to private, institutional, and corporate clients.

24 10. The Corporate and Investment Bank (“CIB”), another division of DBSI, provides
25 capital market financial services to institutions and corporate clients.

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- 11. DBSI engaged in the marketing and sale of ARS in the state of Arizona.
- 12. Certain DBSI agents solicited sales of ARS to clients; however, certain DBSI agents did not fully comprehend the product, auction process, or the risks.
- 13. DBSI did not provide its agents with adequate training concerning the complex characteristics of ARS and risks inherent with this type of investment.
- 14. DBSI did not create and maintain adequate written supervisory procedures to ensure its agents provided their clients with adequate disclosure of the complex characteristics of ARS and risks inherent with this type of investment.
- 15. Certain DBAB agents misrepresented the characteristics of ARS to clients. Certain DBAB agents told clients that ARS were “safe and liquid,” “cash equivalents,” and “just like money markets.”
- 16. Third-party marketing materials about ARS, which were available to DBAB agents, described certain ARS issues as an “AAA-rated source of short-term income” and a “Cash alternative.”
- 17. Certain DBAB clients maintained investment policies and objectives designed to place their money in safe and liquid investments.
- 18. Certain DBAB agents sold ARS to these DBAB clients, despite their investment policies and objectives which sought safe and liquid investments.
- 19. From approximately September 2003 until February 2008, DBAB categorized ARS under the heading “Other – Money Market Instruments” on clients’ monthly account statements.
- 20. ARS, unlike money market instruments, are not short-term investments. In fact, ARS bonds may have maturities as long as 30 years and Preferreds have unlimited maturity.
- 21. Beginning in 2003, CIB began to underwrite certain Student Loan ARS issues (“CIB SL ARS”). Because CIB had not developed a sales network for those CIB SL ARS, there were instances in which several CIB SL ARS issues were not successfully sold to institutions

1 during the initial offering. As a consequence, CIB purchased and maintained on its books 100
2 percent of the outstanding ARS for several CIB SL ARS issues, which ultimately allowed the
3 initial offerings for these issues to succeed. Despite this, CIB continued to market those CIB SL
4 ARS to investors. Some of those CIB SL ARS remained on CIB's books as of the 2008 Auction
5 Failures.

6 22. Because certain DBSI agents misrepresented the characteristics of ARS to clients
7 and purchased ARS for clients based upon those misrepresentations, DBSI engaged in dishonest
8 and unethical conduct in the securities business with respect to the marketing and sale of auction
9 rate securities.

10 23. By failing to: (i) provide adequate training to agents concerning ARS, (ii) create and
11 maintain adequate written supervisory procedures concerning ARS, and (iii) ensure accurate
12 disclosure of ARS characteristics to clients by its agents, DBSI failed to reasonably supervise its
13 agents with respect to the marketing and sale of auction rate securities.

14 **Conflict of Interest**

15 24. DBAB failed to adequately disclose to clients who purchased ARS that the firm's
16 roles as underwriter and broker-dealer in certain ARS issues were a conflict of interest, and this
17 conflict may affect the auction clearing rate. As the underwriter and lead manager on four
18 Preferred issues since 1992¹ (the "DBAB Managed Preferred"), it was in the interest of the firm to
19 keep the clearing rates low for issuers of the DBAB Managed Preferred. As broker-dealer, the firm
20 had a duty to provide the highest available ARS clearing rates to its clients.

21 25. DBAB issued a "price talk" document prior to each ARS auction in which it acted
22 as a broker-dealer. This document detailed the interest rate at which DBAB believed the ARS
23 would clear at auction. DBAB determined this rate by utilizing different factors, including the
24 competing interests of both investors and issuers.

25 _____
26 ¹ These Preferred issues were Nuveen Maryland Premium Income Municipal Fund 2 (CUSIP No. W67061Q305), and
Van Kampen Invest Grade (CUSIP Nos. E920929601, F920929700, and G920929809).

1 26. By failing to fully inform clients about the effect of DBAB's conflicting roles, as
2 underwriter and broker-dealer of ARS issues, on auction clearing rates, DBSI engaged in dishonest
3 and unethical conduct in the securities business with respect to the marketing and sale of auction
4 rate securities.

5 27. By failing to ensure adequate disclosure of conflicts of interest concerning ARS to
6 clients by its agents, DBSI failed to reasonably supervise its agents with respect to the marketing
7 and sale of auction rate securities.

8 **Supporting Bids**

9 28. In every auction for the DBAB Managed Preferred, the firm submitted "supporting
10 bids" for its own account that were sufficient to cover the entire allotment of each DBAB Managed
11 Preferred issue. These supporting bids were customary among lead managers to prevent failed
12 auctions and to maintain liquidity for investors. In certain instances, the supporting bids prevented
13 failed auctions, and in others, the supporting bids were unnecessary. However, regardless of the
14 auction outcome, these supporting bids were consistently placed by DBAB, ensuring that
15 successful auctions occurred and liquidity was maintained.

16 29. DBAB failed to disclose to clients that, in each auction of auction rate preferred
17 issues for which DBAB acted as lead manager, the firm placed supporting bids for the entire
18 allotment of auction rate preferred to ensure a successful auction.

19 30. DBAB agents were not aware that DBAB placed supporting bids in the auction rate
20 preferred auctions for which DBAB was the lead manager; nor were they aware of the effect of
21 DBAB's supporting bids on those auctions.

22 31. In or around August 2007, CIB declined to place supporting bids for certain ARS
23 issued by three special purpose vehicles previously created by Deutsche Bank (the "SPVs") (called
24 Pivots, Capstans, and Cambers). CIB's decision to stop submitting supporting bids resulted in
25 failed auctions for these ARS issues.

1 ensure accurate disclosure of ARS characteristics to clients by its agents, and (iv) ensure adequate
2 disclosure of conflicts of interest concerning ARS to clients by its agents, DBSI failed to
3 reasonably supervise, and establish and enforce procedures necessary to detect and prevent such
4 conduct, within the meaning of A.R.S. § 44-1961(A)(12).

5 3. The activities set forth herein are grounds, pursuant to A.R.S. § 44-1961, for the
6 initiation of administrative proceedings; and further, pursuant to A.R.S. § 44-1961(B), to impose
7 such other appropriate remedial measures as may be necessary in the public interest.

8
9 **III.**

10 **ORDER**

11 On the basis of the Findings of Fact, Conclusions of Law, and DBSI's consent to the entry of this
12 Consent Order,

13 **IT IS HEREBY ORDERED:**

14 1. Pursuant to A.R.S. § 44-1961(B)(1), DBSI is assessed and shall pay a civil
15 monetary penalty in the amount of One Hundred Fifteen Thousand Eight Hundred Twenty-three
16 and 35/100 Dollars (\$115,823.35) (Arizona's pro rata share of the \$15,000,000 total penalty that
17 DBSI agreed to pay pursuant to the Settlement), due and payable within ten (10) days of the entry
18 of this Consent Order to the Commission. The payment to the state of Arizona shall be in the form
19 of a certified or bank check made out to the "State of Arizona."

20 2. DBSI shall take (and, to the extent the enumerated measures described herein
21 required action to be taken prior to the date of this order, has already complied or is complying
22 with) certain measures, enumerated below, with respect to all current and former clients of DBSI
23 that purchased "Eligible ARS", defined below, from DBSI on or before February 13, 2008 (the
24 "Relevant Class"). For purposes of this Consent Order, "Eligible ARS" shall be defined as ARS
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1 purchased from DBSI that were subject to auctions that were not continuously succeeding between
2 February 13, 2008, and August 31, 2008.

3 3. DBSI shall offer or has offered to purchase at par Eligible ARS, that were purchased
4 from DBSI prior to February 13, 2008, held by: (i) all individuals; (ii) legal entities forming an
5 investment vehicle for family members including but not limited to IRA accounts, Trusts, Family
6 Limited Partnerships and other legal entities performing a similar function; (iii) all charities and
7 non-profits; and (iv) small to medium sized businesses with assets of \$10 million dollars or less
8 with Deutsche Bank (collectively, "Individual Investors").

9 a. DBSI shall complete all purchases from Individual Investors who accept the
10 offer (i) prior to November 19, 2008, by November 19, 2008, and (ii) prior to December 31,
11 2008, by December 31, 2008. For any Individual Investor who accepts the offer between
12 December 31, 2008, and June 30, 2009, DBSI will complete the purchase within seven
13 business days of DBSI's receipt of his or her acceptance. However, Individual Investors
14 may request that DBSI purchase the Eligible ARS on the next scheduled auction date after
15 DBSI's receipt of its acceptance, in which event DBSI will complete the purchase within
16 seven business days of that auction;

17 b. DBSI shall provide notice to customers of the settlement terms and DBSI
18 shall establish a dedicated telephone assistance line, with appropriate staff, to respond to
19 questions from customers concerning the terms of this Consent Order;

20 4. No later than November 19, 2008, any DBSI Individual Investor that DBSI can
21 reasonably identify who sold auction rate securities below par between February 13, 2008, and
22 August 31, 2008, will be paid the difference between par and the price at which the investor sold
23 the auction rate securities;

24 5. DBSI shall consent to participate, at the Eligible Customer's election, in the special
25 arbitration procedures as briefly described below. Under these procedures, the Special Arbitration
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1 Process that applies to firms that have entered into settlements with state regulators (the "State
2 SAP"), under the auspices of Financial Industry Regulatory Authority ("FINRA"), will be available
3 for the exclusive purpose of arbitrating any Individual Investor's consequential damages claim:

4 a. No later than November 19, 2008, DBSI shall notify those DBSI Individual
5 Investors who own auction rate securities, pursuant to the terms of the Settlement, that a
6 public arbitrator (as defined by section 12100(u) of the NASD Code of Arbitration
7 Procedures for Customer Disputes, eff. April 16, 2007), under the auspices of FINRA, will
8 be available for the exclusive purpose of arbitrating any DBSI Individual Investor's
9 consequential-damages claim;

10 b. Arbitration shall be conducted by public arbitrators and DBSI will pay all
11 applicable forum and filing fees;

12 c. Any DBSI Individual Investors who choose to pursue such claims shall bear
13 the burden of proving that they suffered consequential damages and that such damages
14 were caused by investors' inability to access funds consisting of investors' auction rate
15 securities holdings at DBSI;

16 d. DBSI shall be able to defend itself against such claims; provided, however,
17 that DBSI shall not contest in these arbitrations liability related to the sale of auction rate
18 securities; and provided further that DBSI shall not be able to use as part of its defense a
19 DBSI Individual Investor's decision not to borrow money from DBSI;

20 e. Individual Investors who elect to use the State SAP provided for in this
21 Order shall not be eligible for punitive damages, or any other type of damages other than
22 consequential damages. The State SAP will govern the availability of attorneys' fees.

23 f. All customers, including but not limited to Individual Investors who avail
24 themselves of the relief provided pursuant to this Consent Order, may pursue any remedies
25 against DBSI available under the law. However, Individual Investors, that elect to utilize
26

1 the special arbitration process set forth above are limited to the remedies available in that
2 process and may not bring or pursue a claim relating to Eligible ARS in another forum.

3 6. DBSI shall endeavor to work with issuers and other interested parties, including
4 regulatory and governmental entities, to expeditiously provide liquidity solutions for institutional
5 investors not covered by paragraph 3 immediately above. Beginning November 19, 2008, and then
6 quarterly after that, DBSI shall submit a written report to the representative specified by NASAA
7 (“NASAA Representative”) outlining the efforts in which DBSI has engaged and the results of
8 those efforts with respect to DBSI institutional investors’ holdings in auction rate securities. DBSI
9 shall confer with the NASAA Representative no less frequently than quarterly to discuss DBSI’s
10 progress to date. Such quarterly reports shall continue until no later than December 31, 2009.
11 Following every quarterly report, the NASAA Representative shall advise DBSI of any concerns
12 and, in response, DBSI shall discuss how DBSI plans to address such concerns;

13 7. DBSI shall refund refinancing fees DBSI has received from municipal auction rate
14 issuers that issued such securities through DBSI in the initial primary market between August 1,
15 2007, and February 13, 2008, and refinanced those securities after February 13, 2008; and

16 8. DBSI shall make its best efforts to identify Individual Investors who took out loans
17 from DBSI, between February 13, 2008, and June 30, 2009, that were secured by Eligible ARS that
18 were not successfully auctioning at the time the loan was taken out from DBSI. DBSI shall refund
19 to those Individual Investors any interest associated with the auction rate securities-based portion
20 of those loans in excess of the total interest and dividends received on the auction rate securities
21 during the duration of the loan. Such refunds shall occur no later than July 31, 2009.

22 **GENERAL PROVISIONS**

23 9. This Consent Order concludes the investigation by the Commission and any other
24 action that the Commission could commence under applicable Arizona law on behalf of Arizona as it
25 relates to DBSI’s marketing and sale of ARS to DBSI’s “Individual Investors,” as defined above.
26

1 10. The Commission shall refrain from taking legal action, if necessary, against DBSI
2 with respect to its institutional investors until November 19, 2008.

3 11. The Commission will not seek additional monetary penalties from Deutsche Bank
4 relating to DBSI's marketing and sale of auction rate securities.

5 12. If payment is not made by DBSI, or if DBSI defaults in any of its obligations set
6 forth in this Consent Order, the Commission may vacate this Consent Order, at its sole discretion,
7 upon ten (10) days notice to DBSI and without opportunity for administrative hearing.

8 13. This Consent Order is not intended to indicate that Deutsche Bank or any of its
9 affiliates or current or former employees shall be subject to any disqualifications contained in the
10 federal securities law, the rules and regulations thereunder, the rules and regulations of self
11 regulatory organizations, or various states' securities laws including any disqualifications from
12 relying upon the registration exemptions or safe harbor provisions. In addition, this Consent Order
13 is not intended to form the basis for any such disqualifications.

14 14. For any person or entity not a party to this Consent Order, this Consent Order does not
15 limit or create any private rights or remedies against Deutsche Bank, limit or create liability of
16 Deutsche Bank, or limit or create defenses of Deutsche Bank to any claims.

17 15. Nothing herein shall preclude Arizona, its departments, agencies, boards,
18 commissions, authorities, political subdivisions and corporations (collectively, "State Entities"), other
19 than the Commission and only to the extent set forth in paragraph 1 immediately above, and the
20 officers, agents or employees of State Entities from asserting any claims, causes of action, or
21 applications for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or
22 injunctive relief against Deutsche Bank in connection with the marketing and sale of ARS at DBSI.

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16. This Consent Order shall not disqualify Deutsche Bank or any of its affiliates or current or former employees from any business that they otherwise are qualified or licensed to perform under applicable state law and this Consent Order is not intended to form the basis for any disqualification.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2009.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT

DISSENT

This document is available in alternative formats by contacting Shaylin A. Bernal, ADA Coordinator, voice phone number 602-542-3931, e-mail sabernal@azcc.gov.

(mn)

1 **CONSENT TO ENTRY OF CONSENT ORDER BY DBSI**

2 DBSI hereby acknowledges that it has been served with a copy of this Consent Order, has read
3 the foregoing Consent Order, is aware of its right to a hearing and appeal in this matter, and has
4 waived the same.

5 DBSI admits the jurisdiction of the Commission, neither admits nor denies the Findings of
6 Fact and Conclusions of Law contained in this Consent Order; and consents to entry of this Consent
7 Order by the Commission as settlement of the issues contained in this Consent Order.
8

9 DBSI states that no promise of any kind or nature whatsoever was made to it to induce it to
10 enter into this Consent Order and that it has entered into this Consent Order voluntarily.

11 Robert Rice ^{Managing Director} represents that he/she is _____ of DBSI and
12 that, as such, has been authorized by DBSI to enter into this Consent Order for and on behalf of DBSI.

13 DBSI agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with
14 regard to any state, federal, or local tax for any administrative monetary penalty that DBSI shall
15 pay pursuant to this Consent Order.

16 Dated this 23rd day of July, 2009.

17 DEUTSCHE BANK SECURITIES INC.

18 By: [Signature]
19 Title: Managing Director

20 STATE OF New York)
21) ss.
22 County of New York)

23 SUBSCRIBED AND SWORN TO before me this 23rd day of July, 2009.

24 [Signature]
25 Notary Public

26 My commission expires: 3/31/2011

YUN SUH
Notary Public, State of New York
No. 01SU5075403
Qualified in Nassau County
Certificate Filed in New York County
Commission Expires March 31, 2011

Decision No. _____

1 SERVICE LIST FOR: DEUTSCHE BANK SECURITIES INC.

2 DOCKET NO.: S-03578A-09-0314

3 Matthew J. Neubert, Director
4 Securities Division
5 ARIZONA CORPORATION COMMISSION
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