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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

2009 SEP -2 A 8: 16

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

AZ CORP COMMISSION  
DOCKET CONTROL

In the matter of: )  
 STEVE JOHN ROGAN, a married man, )  
 CAROL ANN RICHEY, a married woman, )  
 DEM BONZ BARBECUE )  
 RESTAURANTS, L.L.C., an Arizona limited )  
 liability company, )  
 PIZAZZ, L.L.C., an Arizona limited liability )  
 company, )  
 Respondents.)

DOCKET NO. S-20654A-09-0068

SECURITIES DIVISION'S POST HEARING MEMORANDUM

Arizona Corporation Commission

DOCKETED

SEP -2 2009

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The Securities Division ("Division") of the Arizona Corporation Commission ("Commission") submits its post-hearing brief as follows:

I. PRELIMINARY ISSUES

A. Procedural History

On February 18, 2009, the Division filed a Temporary Order to Cease and Desist and Notice of Opportunity for Hearing ("TC&D"). The TC&D alleged that Respondents Steve John Rogan ("Rogan"), Carol Ann Richey ("Richey"), Dem Bonz Barbecue Restaurants, L.L.C. ("Dem Bonz") and Pizazz, L.L.C. ("Pizazz") engaged in acts, practices and transactions that constituted violations of the Securities Act of Arizona, A.R.S. §§ 44-1841, 44-1842, and 44-1991. The Division further alleged that Richey was a person controlling Dem Bonz through Pizazz within the meaning of A.R.S. § 44-1999, so that she is jointly and severally liable under A.R.S. § 44-1999 to the same extent as Dem Bonz and Pizazz for violations of the Securities Act. Rogan, Richey, Dem Bonz and Pizazz may be referred to collectively as "Respondents."

1 The Division served Respondent Rogan on February 19, 2009 and the remaining  
2 Respondents on February 23, 2009. On February 24, 2009, Respondents filed a joint Answer and  
3 Request for Hearing (“Answer”).

4 An administrative hearing was held on July 14, 2009. Respondents appeared for the  
5 hearing without counsel and stipulated to the admission of all of the Division’s exhibits, marked  
6 S-1 to S-14, inclusive of any subparts. (Hr’g Tr. p. 8:2-7). Respondents did not mark or offer  
7 admission of any exhibits. (Hr’g Tr. p. 7:21-25).

8 **B. Jurisdiction**

9 Pursuant to A.A.C. R14-4-303(D)(1), Respondents were personally served with the  
10 TC&D. (Affidavits of Service filed on 2/19/2009 & 2/23/2009). Respondents Richey and Rogan  
11 were at all times relevant, residents of Arizona. (Hr’g Ex. S-2 p. 7:9 to p. 8:10 and Hr’g Tr. p.  
12 99:4-5).

13 The Commission has jurisdiction to enforce the provisions of the Securities Act of  
14 Arizona (the “Act”), A.R.S. § 44-1801 *et. seq.* (See Article XV of the Arizona Constitution and  
15 § 44-1971 of the Act). The Act prohibits the sale or offer for sale of unregistered securities within  
16 or from Arizona, A.R.S. § 44-1841; transactions involving the sale, purchase or offer to sell or buy  
17 any securities by unregistered dealers or salesmen within or from Arizona, A.R.S. § 44-1842; and  
18 the use of fraud in the offer to sell or buy securities, within or from Arizona, A.R.S. § 44-1991.

19 **C. Facts**

20 1. Rogan and Richey are husband and wife and, at all times relevant, were acting for  
21 their own benefit and for the benefit or in furtherance of their marital community. (Hr’g Tr. p.  
22 108:3-4).

23 2. Dem Bonz is an Arizona limited liability company formed on or about June 27,  
24 2008. Until January 27, 2009, Rogan and Richey were the only members of Dem Bonz. Dem  
25 Bonz maintains a mailing address of 8912 E. Pinnacle Peak, Rd. #174, Scottsdale, Arizona 85255.  
26 (Hr’g Ex. S-8(a)-(b)).

1           3. On January 27, 2009, articles of amendment executed by Richey were filed with the  
2 Arizona Corporation Commission for Dem Bonz. According to the articles of amendment,  
3 effective January 21, 2009, Rogan and Richey were replaced as limited liability members of Dem  
4 Bonz with Pizazz. **(Hr'g Ex. S-8(b)).**

5           4. Pizazz is an Arizona limited liability company formed on or about December 4,  
6 2008. Richey is identified as the statutory agent and sole member of Pizazz with a mailing address  
7 of 8912 E. Pinnacle Peak Rd. #174, Scottsdale, Arizona 85255. **(Hr'g Ex. S-7).**

8           5. At all times relevant, Rogan conducted business through Dem Bonz and represented  
9 himself to be a co-owner and co-founder of Dem Bonz. **(Hr'g Ex. S-3, S-5, S-6, S-8(a), S-10, S-  
10 12(c), S-13 and S-14).**

11           6. Rogan was registered as a securities salesperson with PFS Investment, Inc. in  
12 California beginning February 10, 1986; in Colorado beginning December 6, 1993; in Illinois  
13 beginning November 29, 1989; and in Ohio beginning February 21, 1986. The Illinois registration  
14 terminated on December 31, 1990. All other registrations terminated on June 4, 1999. **(Hr'g Ex. S-9).**

15           7. Beginning as early as January 22, 2009, Respondents offered an unregistered  
16 security within or from Arizona in the form of a promissory note and investment contract to at least  
17 one potential Arizona resident investor ("PAI") in the amount of \$85,000. **(Hr'g Ex. S-1(c)-(d), S-  
18 4, S-6(a)-(d) and S-10(a)-(k)).**

19           8. Respondents solicited potential Arizona investors through advertisements placed on  
20 an internet website, known as Craig's List/Phoenix ("Craig's List"). **(Hr'g Ex. S-10(a)-(k)).**

21           9. The advertisements set forth that Respondents were looking for an investor to  
22 provide \$85,000 in initial operating capital and reserves for a restaurant, Dem Bonz, to be located  
23 in Scottsdale. In return, prospective investors were promised a 48% ROI. The ads further  
24 represented that, "We have invested over \$150,000 to get to this point." **(Hr'g Ex. S-10(a)-(k)).**

25

26

1           10. The advertisements directed prospective investors to respond to an e-mail address at  
2 [dembonzbbq@gmail.com](mailto:dembonzbbq@gmail.com) or go to a website at [www.dembonzbbq.com](http://www.dembonzbbq.com) where prospective investors  
3 could request a copy of the business plan for Dem Bonz. **(Hr'g Ex. S-10(a)-(k), S-11).**

4           11. After seeing an advertisement, at least one PAI responded by sending an e-mail  
5 from Arizona to the address provided. Shortly thereafter, the PAI received an e-mail reply from  
6 Rogan that attached a copy of the business plan. **(Hr'g Ex. S-6(a) and S-3).**

7           12. Rogan continued to correspond with the PAI via e-mail through February 19, 2009.  
8 One of Rogan's e-mail replies to the PAI stated that the "buildout" was already complete and an  
9 "angel" investor was needed to participate for a 48% return and that Rogan's experience and  
10 commitment would be the "security" in the investment. **(Hr'g Ex. S-6(a)-(d)).**

11           13. The business plan provided by Rogan to the PAI set forth that the founders, Rogan  
12 and Richey, had invested over \$150,000 to date in the venture. The amount alleged to have been  
13 expended was itemized in the business plan under a category titled "Initial Capitalization." The  
14 amount included under the initial capitalization category was itemized as: \$116,500 for "buildout"  
15 expenditures related to such things as framing, drywall, electric, plumbing, grease trap, flooring,  
16 painting, counters, cabinets and gas piping; \$18,300 for equipment and fixtures expenditures; and  
17 \$19,500 for administrative and technical expenditures. Rogan confirmed to the PAI that funds had  
18 been expended to build out the location proposed for the restaurant. **(Hr'g Ex. S-3 p. 9 and S-  
19 6(a), Hr'g Tr. p. 33:13-17, p. 36:5-14).**

20           14. The business plan set forth key personnel as Rogan, who was represented to be a  
21 founder and chef who would primarily be responsible for the management of the restaurant.  
22 According to the business plan, Richey was a co-founder and director of marketing who would be  
23 responsible for "developing and implementing marketing and promotional campaigns as well as  
24 attending to customer relations in the restaurant itself." **(Hr'g Ex. S-2 p. 24:25 to p. 25:4 and S-3  
25 p. 8).**

26

1           15. Richey, a founding limited liability member of Dem Bonz, was responsible for  
2 opening a bank account in the name of Dem Bonz and was an authorized signor on the account.  
3 Richey also signed the Transaction Privilege (Sales) Tax or Business, Occupational and  
4 Professional License Application for Dem Bonz and was identified as a co-owner on the  
5 application. **(Hr'g Ex. S-8, S-2 p. 20:11-13, S-12(c)-(f) and S-13).**

6           16. The proposed location for Dem Bonz was 14144 N. 100<sup>th</sup> St., Building B, Suite B-  
7 130, Scottsdale, AZ 85260. **(Hr'g Ex. S-14).**

8           17. Upon driving by the proposed location for the Dem Bonz restaurant, the PAI found  
9 the suite to be vacant. **(Hr'g Tr. p. 21:14-19).**

10           18. Contrary to the assertion made by Respondents to the PAI, Respondents never  
11 leased or performed any work to "buildout" the location at 14144 N. 100<sup>th</sup> St., Building B, Suite B-  
12 130, Scottsdale, AZ 85260. **(Hr'g Tr. p. 26:4-22, p. 90: 17-20).**

13           19. On February 2, 2009, in an attempt to gather additional information about the  
14 investment, the PAI placed a call to the telephone number provided by Rogan in the e-mail sent by  
15 Rogan to the PAI. The person answering the call confirmed that he was Rogan. **(Hr'g Ex. S-6(a)**  
16 **at bate stamp ACC000011, Hr'g Tr. p. 35:3 to p. 36:19).**

17           20. Rogan informed the PAI that he expected to be able to open the Scottsdale location  
18 within 2-4 weeks of receiving the \$85,000. **(Hr'g Tr. p. 35:3-15).**

19           21. Rogan further informed the PAI that he could expect to begin receiving a payout  
20 within one month after opening and should receive a 100% return on the investment within four  
21 years of making the \$85,000 initial investment. **(Hr'g Tr. p. 84:21 to p. 85:12)**

22           22. Rogan explained to the PAI that the PAI's role would be that of a passive investor.  
23 **(Hr'g Tr. p. 17:25 to p. 18:9).**

24           23. On February 9, 2009, the PAI received via e-mail a promissory note setting forth  
25 some of the terms and conditions for the proposed investment. According to the terms of the  
26 promissory note, the PAI would be paid interest on the amount invested at the rate of 15% per

1 annum. As additional consideration for the investment, Dem Bonz, through its managing member  
2 identified in the promissory note as Richey, agreed to pay the investor 15% percent of the after tax  
3 net profits from the operation of Dem Bonz. Richey and Rogan were identified as guarantors of  
4 the promissory note. **(Hr'g Ex. S-4 and S-6(b))**.

5 24. Rogan failed to disclose to the PAI that as of January 21, 2009, Rogan was no  
6 longer a limited liability member of Dem Bonz and that Richey was no longer the managing  
7 member of Dem Bonz. **(Hr'g Tr. p. 47:15-19 and Hr'g Ex. S-8(b))**.

8 25. At all times material hereto, Respondents were not registered as dealers or salesmen.  
9 **(Hr'g Ex. S-1)**.

## 10 **II. SECURITIES & UNREGISTERED ACTIVITIES**

### 11 **A. Offer of an unregistered security by an unregistered securities salesperson**

12 The Securities Act defines a security as "any note . . ." A.R.S. § 44-1801(26). While a  
13 promissory note is presumed to be a security, the Supreme Court has identified certain types of  
14 notes that are excluded from the definition of a security. *See Reves v. Ernst & Young*, 494 U.S.  
15 56, 65 (1990). In *Reves*, the Supreme Court held that every promissory notes is a security unless  
16 it bears a strong "family resemblance" to a judicially crafted list of non-securities such as: 1) a  
17 note delivered in consumer financing, 2) a note secured by a mortgage on a home, 3) a note  
18 secured by a lien on a small business or some of its assets, 4) a note relating to a "character" loan  
19 to a bank customer, 5) a note which formalizes an open account indebtedness incurred in the  
20 ordinary course of business, 6) short-term notes secured by an assignment of accounts receivable,  
21 7) notes given in connection with loans by a commercial bank to a business for current  
22 operations. *Reves*, 494 U.S. at 65 citing *Exch. Nat'l Bank of Chicago v. Touche Ross & Co.*, 544  
23 F.2d 1126, 1138 (2d Cir 1976). In this case, the promissory note was unsecured and called for  
24 repayment over forty eight (48) months. **(Hr'g Ex. S-4)**. Clearly, the promissory note at issue in  
25 this case does not resemble the type of note that could be classified within one of the categories  
26 set forth above. Respondents have not provided any evidence to rebut the presumption that the

1 promissory note offered to the PAI is a security. As a result, the promissory note in this case is  
2 presumed to be a security.

3 The investment opportunity offered by Respondents in this case also constitutes an  
4 investment contract. Investment contracts are included in the definition of securities. A.R.S. §  
5 44-1801(26). The definition of an investment contract was set forth in *S.E.C. v. W.J. Howey*  
6 *Co.*, 328 U.S. 293 (1946). Under the *Howey* test, an investment contract exists if : (1) an  
7 individual is led to invest money, 2) in a common enterprise, 3) with the expectation that they  
8 will earn a profit solely from the efforts of others. In Arizona, the *Howey* test remains the basis  
9 for investment contract analysis.

10 The first prong of the *Howey* test, the investment of money, is satisfied by the investors  
11 tendering funds to Respondents. With respect to the second element of *Howey*, “[t]wo tests have  
12 been developed to determine the existence of a common enterprise in order to satisfy the second  
13 prong of the *Howey* test: 1) the horizontal commonality test and 2) the vertical commonality  
14 test.” *Daggert v. Jackie Fine Arts, Inc.*, 152 Ariz. 559, 565 (Ariz. Ct. App. 1986). Arizona  
15 courts have held that commonality will be satisfied if either horizontal or vertical commonality  
16 can be shown. *Id.* at 566. Horizontal commonality is not applicable here since there is no  
17 evidence that Respondents pooled investor funds. For the vertical form of commonality to be  
18 established, a positive correlation between the success of the investor and the success of the  
19 promoter need only be demonstrated. *Id.* at 565. In this case, vertical commonality is established  
20 by the terms of the promissory note provided to the PAI by Rogan that required Respondents to  
21 share with the PAI fifteen percent of the after tax net profits from the operation of Dem Bonz.  
22 **(Hr’g Ex. S-4)**. The amount was in addition to the interest to be paid on the promissory note by  
23 Respondents. As a result, there was a positive correlation between the success of the investor  
24 and the success of the Respondents’ business venture.

25 In order to satisfy the third prong of the *Howey* test in Arizona, one must only establish  
26 that the efforts made by those other than the investors were the undeniably significant ones, and

1 were those essential managerial efforts that affected the failure or success of the enterprise.  
2 *Nutek Information Systems, Inc. v. Arizona Corporation Commission*, 194 Ariz. 104, 108 (Ariz.  
3 Ct. App. 1998). This third prong is easily met in this case by Rogan's own statements.  
4 According to Rogan, the investor's role would be passive. (Hr'g Tr. p. 17:25 to p. 18:9).  
5 Rogan further informed the PAI that, "I have done this before so my experience and commitment  
6 is the security." (Hr'g Ex. S-6(a) at bate stamp ACC000011). Respondents touted not only  
7 their extensive experience in the business, but clearly informed the PAI that he would have no  
8 active role in the business. The investment opportunity in this case satisfies all three elements of  
9 the test set forth in *Howey*.

10 Ariz. Rev. Stat. § 44-2033 requires that Respondents carry the burden of proving the  
11 existence of any claimed exemption. Respondents did not set forth or argue that any exemption  
12 was applicable. Instead, Respondents have attempted to characterize the offer to the PAI as an  
13 attempt at obtaining a loan. This attempted characterization by Respondents is simply not  
14 relevant and does not influence the analysis necessary to determine whether the promissory note  
15 is a security. Certificates of Non-Registration establish that the investment offered was not  
16 registered and that Respondents were not registered as dealers or salesmen. (Hr'g Ex. S-1). As  
17 a result, Respondents have violated A.R.S. §§ 44-1841 and 44-1842.

18 **B. Fraud in the offer or sale of securities**

19 Fraud, including untrue statements of material fact and material omissions, in the offer or sale  
20 of securities violates A.R.S. § 44-1991. As it relates to fraud, the standard of materiality of omitted  
21 facts is whether a reasonable investor would have wanted to know. *Rose v. Dobras*, 128 Ariz. 209,  
22 214 (1981). Further, unlike common law fraud, reliance upon a misrepresentation is not an element in  
23 fraud involving the purchase or sale of securities. *Id.*

24 The evidence presented in this matter sets forth clearly the following frauds committed by  
25 Respondents:  
26

1           1. Respondents misrepresented to the PAI that the founders, Rogan and Richey, had invested  
2 over \$150,000 to build out a business location.

3           2. Respondents misrepresented to the PAI that they had leased a business location for Dem  
4 Bonz.

5           3. Respondents failed to disclose to the PAI that as of January 21, 2009, Rogan and Richey  
6 were no longer limited liability members of Dem Bonz.

7           4. Respondents misrepresented to the PAI that the restaurant could be open within 2-4 weeks  
8 of receiving from the \$85,000.

9           As set forth above, Richey directly or indirectly controlled Dem Bonz through Pizazz, within  
10 the meaning of A.R.S. § 44-1999. Respondents presented no evidence to establish that Richey was  
11 not a control person pursuant to A.R.S. § 44-1999. Therefore, Richey is liable to the same extent as  
12 Dem Bonz and Pizazz for its violations of A.R.S. § 44-1991.

13 **C. Conclusion**

14           The evidence presented at the hearing establishes that Respondents, while not being registered  
15 as securities salespersons, offered for sale at least one unregistered security, within or from Arizona, to  
16 at least one prospective Arizona investor beginning from at least January 22, 2009. Pursuant to A.R.S.  
17 § 44-2036(A), Respondents can be ordered to pay an administrative penalty of up to five thousand  
18 dollars (\$5,000) for each violation of the Act. The violations include Respondents' offer of an  
19 unregistered security, as an unregistered securities salesperson, and the four material frauds set forth  
20 above. Based upon the nature of Respondents' material misrepresentations and omissions, the  
21 maximum administrative penalty amount of five thousand dollars (\$5,000) per violation is justified.

22           Based upon the evidence presented, the Division respectfully requests this tribunal to:

23           A. Order Respondents to cease and desist from further violations of the Act pursuant to A.R.S.

24 § 44-2032;

25 ...

26 ...

1 B. Order Respondents, pursuant to A.R.S. § 44-2036(A), to pay an administrative penalty of  
2 not less than \$30,000;

3 C. Order any other relief this tribunal deems appropriate or just.  
4

5 Dated this 2nd day of September, 2009.

6  
7   
8 William W. Black, Esq.  
9 For the Securities Division

10 ORIGINAL AND THIRTEEN (13) COPIES  
11 of the foregoing filed this second day of  
12 September, 2009, with:

13 Docket Control  
14 Arizona Corporation Commission  
15 1200 West Washington  
16 Phoenix, AZ 85007

17 COPY of the foregoing hand-delivered this  
18 second day of September, 2009 to:

19 Administrative Law Judge Marc Stern  
20 Arizona Corporation Commission/Hearing Division  
21 1200 West Washington  
22 Phoenix, AZ 85007

23 COPY of the foregoing mailed this  
24 second day of September, 2009 to:

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