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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

2010 JAN 27 A 11:00

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

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

In re:
In the matter of:
SECURE RESOLUTIONS, INC., an Arizona Corporation;
DOUGLAS COTTLE and KYLA COTTLE, husband and wife,
Respondents.

DOCKET NO. S-20677A-09-0256
SECURITIES DIVISION'S RESPONSE TO RESPONDENTS' EXPEDITED MOTION FOR ORDER TO DISCLOSE INFORMATION BY SECURITIES DIVISION AND RE URGING OF ORIGINAL MOTION TO CONTINUE

The Securities Division of the Arizona Corporation Commission ("Division") hereby responds to Respondents' Expedited Motion for Order to Disclose Information by Securities Division ("Discovery Request") and Re-urging of Original Motion to Continue submitted in connection with the above-captioned matter. In short, this Discovery Request falls well outside acceptable discovery limits as permitted for administrative proceedings under both the Arizona Revised Statutes and Arizona Rules of Practice and Procedure before the Corporation Commission. Accordingly, the Division requests that this Commission deny the demands included in this Discovery Request. The Division has and will comply with appropriate discovery requests that comport with the prescribed discovery rules for administrative adjudications. This Response is supported by the following Memorandum of Points and Authorities.

Arizona Corporation Commission
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1 methodology employed to discover the figures disclosed. The purpose of making the underlying
2 information available for review upon request is that, in general, the documents are voluminous,
3 were obtained from Respondents, or are available to Respondents directly from their banking
4 institution.

5 B. Discovery for Administrative Proceedings within Arizona is available only within
6 the limits defined by statute and agency rule in administrative proceedings.

7 Respondents' Discovery Request does not fall within the limits defined by statute or agency
8 rule in administrative proceedings. Courts have often had occasion to consider the limits of
9 discovery in administrative proceedings. Through these deliberations, two salient points have
10 become evident. The first of these is the fact that, because they derive from an entirely distinct
11 process, the rules of civil procedure for discovery **do not** apply in administrative proceedings.¹
12 *See, e.g., Pacific Gas and Electric Company*, 746 F.2d 1383, 1387 (9th Cir. 1984); *Silverman v.*
13 *Commodity Futures Trading Commission*, 549 F.2d. 28, 33 (7th Cir. 1977); *National Labor*
14 *Relations Board v. Vapor Blast Mfg. Co.*, 287 F.2d 402, 407 (7th Cir. 1961); *In re City of Anaheim,*
15 *et al.* 1999 WL 955896, 70 S.E.C. Docket 1848 (the federal rules of civil procedure do not properly
16 play any role on the issue of discovery in an administrative proceeding).

17 The second of these points is that the authority to pursue discovery during the course of an
18 administrative proceeding is not conferred as a matter of right. In fact, courts have repeatedly
19 recognized that there simply is no basic constitutional right to pretrial discovery in administrative
20 proceedings. *Silverman v. Commodity Futures Trading Commission*, 549 F.2d. 28, 33 (7th Cir.
21 1977); *See also Starr v. Commissioner of Internal Revenue*, 226 F.2d. 721,722 (7th Cir. 1955), cert.

22 ¹ This principle is particularly important from a policy standpoint. Indeed, merging civil
23 discovery rules into the administrative arena would have many deleterious results, including: 1)
24 allowing respondents to access confidential investigative information far removed from the
25 witnesses and exhibits relevant to the active case against them; 2) allowing respondents to protract
26 the proceedings indefinitely; 3) allowing respondents to excessively consume scarce but vital
resources better expended on other matters necessary for the protection of the public; and 4)
allowing respondents to force the agency into the position of a civil litigant rather than into its
proper role as a governmental regulatory authority.

1 denied, 350 U.S. 993, 76 S.Ct. 542 (1955); *National Labor Relations Board v. Interboro*
 2 *Contractors, Inc.*, 432 F.2d 854, 857 (2nd Cir. 1970); *Miller v. Schwartz*; 528 N.E.2d 507 (N.Y.
 3 1988); *Pet v. Department of Health Services*, 542 A.2d 672 (Conn. 1988). The federal
 4 Administrative Procedures Act echoes this point by offering no provision for pretrial discovery
 5 during the administrative process. 1 Davis, *Administrative Law Treatise* (1958), § 8.15, p. 588.

6 In accordance with these findings, discovery within the confines of an administrative
 7 proceeding is only authorized to the extent that it is explicitly provided for in a separate statute or
 8 rule. *See, e.g.*, 73A C.J.S. *Public Administrative Law and Procedure*, § 124 (1983) (“Insofar as the
 9 proceedings of a state administrative body are concerned, only the methods of discovery set forth
 10 by the pertinent statute are available, and the methods not set forth therein are excluded”); *See also*
 11 2 Am.Jur.2d. *Administrative Law* § 327 (2d. ed. 1994)(In the context of administrative law, any
 12 right to discovery is grounded in the procedural rules of the particular administrative agency).

13 Following these precepts, the state of Arizona has enacted both statutes and agency rules to
 14 address the issue of discovery in the context of administrative proceedings. Indeed, both the
 15 Arizona Revised Statutes and the Arizona Rules of Practice and Procedure before the Corporation
 16 Commission (“Rules of Practice and Procedure”) contain explicit provisions addressing discovery
 17 procedures in contested administrative adjudications. Only by observing these controlling provisions
 18 can a party effectively pursue discovery in an administrative matter before the Arizona Corporation
 19 Commission.

20 The statute setting forth the parameters of discovery in administrative proceedings is, not
 21 surprisingly, found in the chapter on Administrative Procedure, A.R.S. § 41-1001, *et seq.* Under
 22 Article 6 of this chapter, covering “Adjudicative Proceedings,” Arizona law provides as follows:

23 *A.R.S. § 41-1062: Hearings; evidence; official notice; power to require testimony*
and records; Rehearing

24 A. Unless otherwise provided by law, in contested cases the following shall apply:

25 [...]
 26

- 1 4. The officer presiding at the hearing may cause to be issued
2 subpoenas for the attendance of witnesses and for the production of
3 books, records, documents and other evidence and shall have the
4 power to administer oaths. [...]. *Prehearing depositions and*
5 *subpoenas for the production of documents may be ordered by the*
6 *officer presiding at the hearing, provided that the party seeking*
7 *such discovery demonstrates that the party has reasonable need of*
8 *the deposition testimony or materials being sought. [...].*
9 *Notwithstanding the provisions of section 12-2212, no subpoenas,*
10 *depositions or other discovery shall be permitted in contested*
11 *cases except as provided by agency rule or this paragraph.*

12 (Emphasis added). The plain import of this provision is that, in Arizona, the only forms of pre-trial
13 discovery permitted in administrative proceedings are 1) subpoenas, based on a showing of need
14 and authorized by the administrative hearing officer; 2) depositions, based on a showing of need
15 and authorized by the hearing officer; and 3) any other discovery provision specifically authorized
16 under the individual agency's rules of practice and procedure.

17 The Rules of Practice and Procedure, *R14-3-101, et seq.*, thus serve to augment the available
18 means of pre-trial discovery within the Corporation Commission. Under these rules, the presiding
19 administrative law judge may also direct a pre-hearing conference wherein an arrangement is made
20 for the exchange of proposed exhibits, witness lists, or prepared expert testimony. *See Arizona*
21 *Administrative Code, Title 14, R-14-3-108(A)*. These rules also provide that a party may gain access
22 to additional pre-hearing materials by way of a discretionary ALJ order requiring that the parties
23 interchange copies of exhibits prior to hearing. *See Arizona Administrative Code, Title 14, R-14-3-*
24 *109(L)*. Indeed, Corporation Commission administrative law judges often call upon these rules in
25 ordering parties to file a list of witnesses and exhibits at a time and date in advance of the hearing,
26 thereby facilitating the hearing preparation process. On September 25, 2009, by fourth procedural
order, Administrative Law Judge Marc E. Stern ("ALJ Stern") ordered the Division and Respondents
to exchange their LWE on January 8, 2010, and set the matter for final contested hearing on February
8, 2010 with the parties further ordered to set aside February 9, 10, 11, 16, 17, and 18, 2010 as
additional hearing dates. The Division complied and disclosed its LWE on January 8, 2010. By

1 agreement, the Respondents were provided an extension to disclose their LWE on January 19, 2010.
2 Now Respondents' Counsel states that this timeframe makes it difficult to adequately defend one's
3 self from the Division's allegations; however, the Division's allegations have never changed since the
4 filing of the Notice of Opportunity for a Hearing Regarding Proposed Order to Cease and Desist,
5 Order for Restitution, for Administrative Penalties, and for Other Affirmative Action ("Notice") on
6 May 21, 2009. Notwithstanding the fact that Respondents have been apprised since May 21, 2009 of
7 the allegations against them, the Respondents have their own duty of due diligence if they plan on
8 refuting any or all allegations listed in the Notice, upon their request for a hearing. Respondents had
9 ample time to begin obtaining any and all relevant documents to defend against the Division's
10 allegations. In addition, from September 25, 2009 through January 8, 2010, neither Respondents nor
11 their prior or current counsel objected to a disclosure of the LWE thirty (30) days prior to hearing as
12 inadequate. Rather, they contort the timeline as a means to request discovery by an improper method
13 and not in compliance with discovery methods authorized in administrative proceedings before the
14 Commission.

15 C. Respondents have not met the requirements to require the Division to disclose
16 five boxes of documents, if it exists, regarding transactions between Secure
17 Resolutions, Inc. and Houlihan Lokey Howard & Zukin.

18 It is clear that Arizona statute and the Rules of Practice and Procedure establish that only
19 certain, specified methods of discovery are sanctioned in administrative proceedings before the
20 Commission, and that such methods of discovery are often both limited and discretionary. As
21 discussed below, the confidentiality statute would also apply to all documents or information
22 obtained during the course of investigation regarding transactions between Secure Resolutions,
23 Inc. ("SRI") and Houlihan Lokey Howard & Zukin ("HLHZ"), a firm hired by SRI. Though
24 Respondents have been unable to point out why the confidentiality provision does not apply,
25 assuming arguendo that it was not in issue, the Respondents still have not made a requisite
26 showing of "reasonable need" as required by A.R.S. § 41-1062(A)(4). The discovery Request filed

1 by Respondents' Counsel in this instance utterly fails to acknowledge or operate within the
2 discovery framework of administrative proceedings.

3 As Respondents have admitted, HLHZ was a firm hired by SRI. Respondent Douglas
4 Cottle is president, chief executive officer and a director of SRI. Kyla Cottle is a director of SRI².
5 In addition, as part of Respondents' January 19, 2010 LWE disclosure, they included an email and
6 document attachment of communications between Respondent Douglas Cottle and HLHZ.
7 Respondent Kyla Cottle has even stated to the Division's counsel that she has physically viewed
8 the boxes of documentation at one point and thus had access to them at some point. The fact that
9 SRI filed bankruptcy has not established a showing of need. Respondents' Counsel also argues
10 that because Douglas Cottle and Kyla Cottle are no longer controlling members of SRI, they are
11 not privy to any of the information in those boxes of documents and thus can not request it. But
12 Respondents' Counsel forgets a key fact, that he also represents SRI. Nowhere in the motion have
13 Respondents detailed any attempts to obtain the requested documents directly from HLHZ or the
14 reasons why HLHZ would or has refused such a request. The fact that the Division may be in
15 possession of certain documents and thus it would be more convenient for the Respondents to
16 obtain them from the Division is not a sufficient basis in which to request and grant such
17 discovery. Since the motion is devoid of any showing of need and fails to establish that
18 Respondents are unable to obtain the documents directly from their source, the request should be
19 denied. Also, the disclosure of such documents would be governed by the confidentiality statute.

20 D. The Division is bound by Arizona statute that explicitly prohibits the Division's
21 disclosure of certain information unless an applicable exception applies, which
22 Respondents' have failed to show.

23 The Respondents again fail to cite any Arizona statute or Rules of Practice and Procedure
24 that would require the Division to disclose all information and documents, including investor
25

26 ² SRI's authority to transact business and conduct affairs in Arizona was revoked on October 29,
2009 for failure to file the annual report.

1 complaints, the Division may have obtained from testifying witnesses. Arizona law provides as
2 follows:

3 *A.R.S. § 44-2042: Confidentiality*

4 **The names of complainants and all information or documents obtained by any officer,**
5 **employee or agent of the commission,** including the shorthand reporter or stenographer
6 transcribing the reporter's notes, in the course of any examination or investigation are
7 confidential unless the names, information or documents are made a matter of public record.
8 **An officer, employee or agent of the commission shall not make the confidential names,**
9 **information or documents available to anyone** other than a member of the commission,
10 another officer or employee of the commission, an agent who is designated by the commission
11 or director, the attorney general or law enforcement or regulatory officials, **except pursuant to**
12 **any rule of the commission or unless the commission or the director authorizes the**
13 **disclosure of the names, information or documents as not contrary to the public interest.**
14 *(emphasis added).*

15 Respondents fail to realize that compliance with the confidentiality statute is not discretionary but
16 mandatory under the law. There has been no rule of the Commission cited by Respondents that
17 would obviate the Division's required compliance with the confidentiality statute nor an
18 authorization by the Commission or director authorizing disclosure of names, information or
19 documents as not contrary to public interest. Instead, Respondents argue that by disclosing merely
20 the names³ of the Division's witnesses in the LWE and as required by the Commission's
21 procedural order, all documents, information, and if applicable, complaints obtained in the course
22 of investigation are now public. That clearly is erroneous. Unless and until those documents and
23 information are made public, the confidentiality provision still applies.

24 Respondents Counsel further requests an alleged recorded interview of Dawn Kern, SRI's
25 bookkeeper. First, the confidentiality provision equally applies to any information or documents
26 obtained from Dawn Kern by the Division. Second, Dawn Kern is not even listed as a potential
witness by the Division. Respondents' Counsel listed a "Darn Kern, x-employee" as a potential
witness. It is the Division's belief that "Darn Kern, x-employee" is the same Dawn Kern that was

³ It should also be noted that the Division's proposed witness list was not docketed as a public filing but instead included as part of the LWE disclosure submitted to Respondents' Counsel.

1 allegedly interviewed by the Division. As such, Respondents Counsel has the opportunity to
2 depose and interview Ms. Kern and get her first hand knowledge and testimony regarding the
3 alleged interview that took place and thereby again fails to show "reasonable need."

4 E. Notes and information created by a Division's Special Investigator is protected by
5 the work-product doctrine and listing the Special Investigator as a witness does not
6 waive that protection.

7 Documents, reports, memos, investigatory records and other information prepared by a
8 special investigator in anticipation of an administrative action are work product material and are
9 protected from discovery by the work-product doctrine. The work-product doctrine originated in
10 *Hickman v. Taylor*, 329 U.S. 495, 67 S. Ct. 385 (1947). The *Hickman* court stated that the general
11 policy against invading the privacy of an attorney's preparation is essential to an orderly working of
12 the system of legal procedure. *Id.* at 512. Material such as witness statements taken during the
13 course of litigation preparation and materials that reflect the attorney's mental impressions or
14 opinions about a case receive protection from disclosure. *Longs Drug Stores v. Howe*, 134 Ariz.
15 424, 428, 657 P.2d 412, 416 (1983) citing *Hickman*, 329 U.S. at 511. Arizona practice conforms
16 to *Hickman*. *Longs Drug Stores v. Howe*, 134 Ariz. 424, 428, 657 P.2d 412, 416 (1983). The
17 doctrine extends to trial preparation material prepared by a party's representatives, including
18 investigators. *Id.* at 430, 657 P.2d at 418. The doctrine also applies during an investigative stage if
19 the parties may well become adversaries in litigation. *State v. Weaver*, 140 Ariz. 123, 129, 680 P.2d
20 833, 839 (Ct. App. 1984). The fact that a special investigator files an affidavit in support of a State of
21 Arizona motion to dismiss does not thereby waive the protections of work product relating to the
22 conversation noted, let alone waiving protections for all work product created during the investigative
23 stage. The harm to the state's ability to prepare an enforcement action as a result of disclosure of work
24 product outweighs any public interest in disclosure of the work product.

25 Finally, in the context of an administrative discovery, even if confidentiality protections
26 and privacy interests are not at issue, disclosure should be restricted to matters that are relevant and
to instances where there is a requisite showing of "reasonable need." A.R.S. § 41-1062(A)(4). If

1 and when the special investigator is called as a witness, the Respondents and their counsel have the
2 opportunity to examine him under oath. The investigative interview memos are confidential under
3 the law, and Respondent has demonstrated no reasonable need for the memos.

4 **II. CONCLUSION**

5 The discovery rules for contested administrative proceedings in Arizona are expressly
6 provided by statute and agency rule, and in the context of an administrative discovery, even if
7 confidentiality protections and privacy interests are not at issue, disclosure should be restricted to
8 matters that are relevant and to instances where there is a requisite showing of "reasonable need."
9 A.R.S. § 41-1062(A)(4). Therefore, the Commission should deny Respondents Discovery Request
10 and request for a continuance.

11 RESPECTFULLY SUBMITTED this 27th day of January, 2010.

12
13 By _____


Phong (Paul) Huynh
Attorney for the Securities Division of the
Arizona Corporation Commission

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15
16 ORIGINAL AND THIRTEEN (13) COPIES of the foregoing
17 filed this 27th day of January, 2010, with

18 Docket Control
19 Arizona Corporation Commission
20 1200 West Washington
Phoenix, AZ 85007

21 COPY of the foregoing hand-delivered this
22 27th day of January, 2010, to:

23 Mr. Marc Stern
24 Hearing Officer
25 Arizona Corporation Commission/Hearing Division
26 1200 West Washington
Phoenix, AZ 85007

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COPY of the foregoing mailed
this 27th day of January, 2010, to:

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By: Paul Huynh