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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

2010 MAY 10 P 3:18

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

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

In the matter of:)
RADICAL BUNNY, L.L.C., an Arizona)
limited liability company,)
HORIZON PARTNERS, L.L.C., an Arizona)
limited liability company,)
TOM HIRSCH (aka THOMAS N. HIRSCH))
and DIANE ROSE HIRSCH, husband and)
wife,)
BERTA FRIEDMAN. WALDER (aka)
BUNNY WALDER), a married person,)
HOWARD EVAN WALDER, a married)
person,)
HARISH PANNALAL SHAH and)
MADHAVI H. SHAH, husband and wife,)
Respondents.)

DOCKET NO. S-20660A-09-0107

SECURITIES DIVISION'S RESPONSE TO
MOTION FOR SUMMARY JUDGMENT OR
TO DISMISS

Arizona Corporation Commission
DOCKETED

MAY 10 2010

DOCKETED BY [Signature]

The Securities Division ("Division") of the Arizona Corporation Commission ("Commission") hereby responds to the Motion for Summary Judgment or to Dismiss filed on behalf of Respondents Horizon Partners, L.L.C., an Arizona limited liability company, Tom Hirsch, Diane Rose Hirsch, Berta Friedman Walder, Howard Evan Walder, Harish Pannalal Shah, and Madhavi H. Shah ("Motion for Summary Disposition"), and requests that the Motion for Summary Disposition be denied. This Response is supported by the following Memorandum of Points and Authorities.

MEMORANDUM OF POINTS AND AUTHORITIES***I. Procedural Background***

On March 12, 2009, the Division filed a Notice of Opportunity for Hearing against Radical Bunny, L.L.C. (“Radical Bunny”),¹ Horizon Partners, L.L.C. (“Horizon Partners”), Tom Hirsch (aka Thomas N. Hirsch) (“Hirsch”), Diane Rose Hirsch,² Berta Friedman Walder (“B. Walder”), Howard Evan Walder (“H. Walder”), Harish Pannalal Shah (“Shah”), and Madhavi H. Shah (“Respondents”) alleging multiple violations of the Arizona Securities Act in connection with the offer and sale of securities in the form of investment contracts (“Notice”). On March 26, 2009, Respondents filed a request for hearing. On April 15, 2009, Respondents filed a verified answer to the Notice (“Verified Answer”). On July 16, 2009, the Division provided Respondents its Preliminary List of Witness and Exhibits (“Division Exhibits”). On August 25, 2009, Respondents provided the Division with Respondents’ Stipulations and Objections to the Securities Division’s Preliminary List of Witness and Exhibits (“Stipulations”). On April 30, 2010, Respondents filed the Motion for Summary Disposition and, in support thereof, Respondents filed the sworn Declaration of Tom Hirsch (“Hirsch Declaration”) and a Statement of Facts (“Statement of Facts”).

II. Argument

The Division brought an administrative action against Horizon Partners, Radical Bunny, Hirsch, B. Walder, H. Walder, and Shah for the fraudulent offer and a sale of unregistered securities in violation of the Arizona Securities Act (“Securities Act”). The Respondents have sought to challenge the validity of the Division’s Notice regarding fraud allegations on the theory that the Notice fails to state a claim for relief. Specifically, Respondents argue that the factual allegations included in the Notice could not possibly support a finding by the Commission that

¹ Radical Bunny, LLC entered into a Order to Cease and Desist, Order for Restitution and Consent to Same which was approved by the Commission on April 27, 2010 and docketed on April 28, 2010 as Decision No. 71682.

² Diane Rose Hirsch and Madhavi H. Shah were joined in the action pursuant to A.R.S. § 44-2031(C) solely for purposes of determining the liability of the marital communities of Hirsch and Diane Rose Hirsch, husband and wife, and Shah and Madhavi H. Shah, husband and wife.

1 Horizon Partners, Radical Bunny, Hirsch, B. Walder, H. Walder and Shah violated A.R.S. § 44-
2 1991 because they were not involved in the sale of securities.³ Respondents reach this conclusion
3 by (1) ignoring the legal standards for dismissing a matter for failure to state a claim or by
4 summary judgment; (2) patently disregarding well-established law applicable to the determination
5 of when an investment is a security under the Securities Act; and (3) failing to include in their
6 argument the correct legal precedent in Arizona for the determination of when a “note” is *not* a
7 security for purposes of the antifraud provisions of the Securities Act. In fact, an analysis of the
8 allegations set forth in the Notice against Radical Bunny and Respondents together with the
9 Respondents’ admissions contained in the Verified Answer, Stipulations, Hirsch Declaration, and
10 the Statement of Facts clearly establish a basis in fact and law for finding Horizon Partners,
11 Hirsch, B. Walder, H. Walder, and Shah liable for violations as proscribed under the Securities
12 Act.

13 A. *Respondents fail to state a procedural basis for summary disposition of the Division's*
14 *fraud allegations contained in the Notice.*

15 The Motion for Summary Disposition does not state the legal basis for seeking summary
16 dismissal of the fraud counts in the Notice. The Division can only assume that Respondents intend
17 that the Administrative Law Judge (“ALJ”) follow the Arizona Rules of Civil Procedure in
18 considering their request.

19 The Arizona Administrative Code and the Arizona Rules of Practice and Procedure before
20 the Corporation Commission (“Rules of Practice and Procedure”) contain explicit provisions
21 addressing procedures in contested adjudicative proceedings before the Commission. *See* A.R.S. §
22 44-1601, *et seq.* and A.A.C. R14-3-101, *et seq.* Rule R14-3-101(A) states that the Rules of
23 Practice and Procedure govern in all cases before the Commission, including cases arising out of
24 Securities Act. A.A.C. R-14-3-101(A). This rule states that the Arizona Rules of Civil

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26 ³ Interestingly, Respondents *do not* address the Division’s allegations in the Notice that Horizon Partners, Radical
Bunny, Hirsch, B. Walder, H. Walder, and Shah violated the registration requirements of A.R.S. §§ 44-1841 and 44-
1842, except to the extent that they argue that the investments were not securities under the Securities Act.

1 Procedure apply *only if* procedures are not otherwise set forth by law, by the Rules of Practice
2 and Procedure, or by regulations or orders of the Commission. Thus, even if the Rules of Practice
3 and Procedure were silent about Division administrative proceedings, which they are not, the
4 Arizona Rules of Civil Procedure would still not apply. If another administrative law addresses
5 the procedure at issue, then, according to Rule R14-3-101(A), it must be followed before the
6 Arizona Rules of Civil Procedure. In other words, the Arizona Rules of Civil Procedure are rules
7 of last resort.

8 Motions are addressed in Rule R14-3-106(K) which states, “[m]otions shall conform insofar as
9 practicable with the Rules of Civil Procedure of the state of Arizona.” A.A.C. R14-3-106(K).
10 However, the Rules of Practice and Procedure are silent as to the legal standard for granting or
11 denying a motion for summary disposition in Division administrative proceedings.

12 Assuming, *arguendo*, that the legal standards applicable to motions for judgment on the
13 pleadings brought pursuant to the Arizona Rules of Civil Procedure apply to this case, motions to
14 dismiss are not favored by the courts and should be denied unless it appears that the plaintiff would
15 not be entitled to relief under any state of facts susceptible of proof under the claim presented.
16 *State ex rel. Corbin v. Pickrell*, 136 Ariz. 589, 594, 667 P.2d 1304, 1309 (1983). In deciding such
17 motions, courts must view the complaint as a whole, presume that all facts alleged therein are true,
18 and resolve all inferences in favor of the plaintiff. *Albers v. Edelson Tech. Partners L.P.*, 201
19 Ariz. 47, 51-52, 31 P.3d 821, 825-26 (App. 2001).

20 In considering a motion for summary judgment, the trial court is required to consider the
21 pleadings, interrogatories and answers thereto, admissions, depositions, and affidavits in the
22 record. *United Bank of Arizona v. Allyn*, 167 Ariz. 191, 195-197, 805 P.2d 1012, 1016-1018 (App.
23 1990). Statements made in a pleading are admissible against the party making them as proof of the
24 facts contained therein. *Schoonover Inv. v. Ram Constr., Inc.*, 129 Ariz. 204, 205, 630 P.2d 27, 28
25 (1981); *Henry v. Health Partners of Southern Arizona*, 203 Ariz. 393, 395-396, 55 P.3d 87, 89-91
26 (App. 2002), *review denied* (2003); *Brenton Wholesale, Inc. v. Arizona Pub. Serv., Inc.*, 166 Ariz.

1 519, 522, 803 P.2d 930, 933 (App. 1990). If the evidence would allow the trier of fact to resolve a
 2 material factual issue in favor of either party, summary judgment is improper. *United Bank of*
 3 *Ariz.*, 167 Ariz. at 195, 805 P.2d. at 1012. Questions of law may be determined by summary
 4 judgment. *Siporin v. Carrington*, 200 Ariz. 97, 100, 23 P.2d 92, 95 (App. 2001); *Daggert v.*
 5 *Jackie Fine Arts, Inc.*, 152 Ariz. 559, 564, 733 P.2d 1142, 1147 (App. 1986)(The question of
 6 whether a security exists is a question of law.).

7 *B. The Notice alleges that Horizon Partners, Radical Bunny, Hirsch, B. Walder, H. Walder,*
 8 *and Shah were involved in the offer and sale of securities in the form of investment*
 9 *contracts, not notes.*

10 The Division does *not* allege in the Notice that Horizon Partners, Radical Bunny, Hirsch, B.
 11 Walder, H. Walder, and Shah sold securities in the form of notes. Respondents argue that the
 12 securities at issue in this case are either (1) the fractionalized interests in notes collateralized by
 13 deeds of trust which were sold by Mortgages Ltd. through Mortgages Ltd. Securities (“MLtd Pass
 14 Through Participation Program:”)⁴ or (2) the loans that were advanced by Radical Bunny directly to
 15 Mortgages Ltd. (“RB-MLtd Loan(s)”)⁵. The Division included in the Notice a discussion about
 16 these Mortgages Ltd investment programs for background information purpose only. These
 17 investments are *not* the securities at issue in this matter.

18 The Notice alleges that Radical Bunny, Horizon Partners, Hirsch, B. Walder, H. Walder, and
 19 Shah were involved in the offer and sale of securities in the form of *investment contracts*. The
 20 Notice includes three different investment opportunities offered and sold by Radical Bunny: (1)
 21 limited liability company membership interests in Horizon Partners from approximately 1998 until
 22 late 2005;⁶ (2) limited liability company membership interests in Radical Bunny from approximately
 23 1999 until late 2005;⁷ and (3) loans from investors to Radical Bunny, the proceeds of which were

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 25 ⁴ See, Notice, ¶¶16-21 for a detailed description of the Mortgages Ltd Pass Through Participation Program.

26 ⁵ See, Notice, ¶¶45-49 and 54 for a detailed description of the RB-MLtd Loans.

⁶ Notice, ¶¶27 and 30 and Verified Answer, ¶¶27 and 30; Hirsch Declaration, p. 2, lines 6-8, lines 18-22, and lines 25-28.

⁷ Notice, ¶¶ 35-39 and Verified Answer ¶¶35-39; Hirsch Declaration, p.2, lines 6-8 and lines 25-28.

1 first pooled, then used by Radical Bunny to fund the RB-MLtd Loans from approximately late 2005
2 until June 2008 (“RB-Participant Loan Program”).⁸

3 C. The limited liability company membership interests in Horizon Partners and Radical
4 Bunny are securities under the Securities Act.

5 Membership interests in limited liability companies or partnerships are not specifically
6 named as “securities” in either federal or state securities laws definitions. However, a
7 membership interest in a “member-managed” limited liability company becomes a security if it
8 falls within the statutory phrase “investment contract.” *Nutek Info. Sys., Inc. v. Arizona Corp.*
9 *Comm’n*, 194 Ariz. 104, 113, 977 P.2d 826, 835 (App.1998). A membership interest in a limited
10 liability company being operated as “manager-managed” (i.e., akin to a limited partnership) is an
11 investment contract and therefore a security.⁹ *SEC v. Murphy*, 626 F.2d 633, 640-641 (9th Cir.
12 1980), citing *McGreghar Land Co. v. Meguiar*, 521 F.2d 822, 824 (9th Cir. 1975).

13 An investment contract is included in the definition of “security” under the Securities Act.
14 A.R.S. § 44-1801(26). The core definition of an investment contract was set forth in *S.E.C. v.*
15 *W.J. Howey Co.*, 328 U.S. 293 (1946). Under the *Howey* test, an investment contract exists if it
16 involves (1) an investment of money or other consideration; (2) in a common enterprise; and (3)
17 with the expectation of profits earned solely from the efforts of the promoter or a third party.¹⁰
18 Although the test was designed to interpret federal law, Arizona courts have adopted the *Howey*
19 test and ordinarily apply it to determine whether an investment is a security.¹¹ *Rose v. Dobras*,
20 128 Ariz. 209, 211, 624 P.2d 887, 889 (App. 1981). Respondents argue that “one of the most
21 important elements in determining whether or not a particular instrument is a security is the
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⁸ Notice, ¶47 and Verified Answer, ¶47; Hirsch Declaration, p.3, lines 1-3.

⁹ The Commission has also found that a limited partnership interest is a security under the Securities Act. *See e.g., In the Matter of the Offering of Securities by Western Universal Fund Company, LLC, et al.*, Decision No. 60784.

¹⁰ The *Howey* case originally used the phrase “solely from the efforts of others,” however, this language was later modified to “substantially” in *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476, 482 (9th Cir. 1973).

¹¹ Respond

1 manner in which the interest is marketed.” This “element” is absent in *Howey*.^{12,13}

2 Arizona courts agree that the “investment contract” definition of a security embodies a
3 flexible principal, “that is capable of adaptation to meet the countless and variable schemes
4 devised by those who seek to use the money of others on the promise of profits.” *Nutek*, 194 Ariz.
5 at 108, 977 P.2d at 830. This flexible approach recognizes the investor’s economic reality and
6 maximizes the protection that the Arizona Securities Act provides to Arizona investors. *Rose*, 128
7 Ariz. at 212, 624 P.2d at 890. (“The supreme court has consistently construed the definition of
8 ‘security’ liberally.”).¹⁴

9 Two tests have been developed to determine the existence of the “common enterprise”
10 element: (1) horizontal commonality; and (2) vertical commonality. *Daggert*, 152 Ariz. at 565,
11 733 P.2d at 1148. The commonality element is satisfied if horizontal *or* vertical commonality is
12 demonstrated. *Id.*, 152 Ariz. at 566, 733 P.2d at 1149. Horizontal commonality requires a
13 pooling of investor funds collectively managed by the promoter. *Id.* at 565, 733 P.2d at 1148.
14 Vertical commonality is established if there is a correlation between the potential profits of the
15 investor and the promoter. *Id.*

16 The third and final prong of the *Howey* test has evolved since it was first handed down over
17 50 years ago. In order to satisfy the third *Howey* prong in Arizona, one must only establish that the

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19 ¹²Whether or not general solicitation is used in the offer and sale of a security is relevant only to the defense that the
security or security transaction was exempt from the registration provisions of the Securities Act. It is Respondents’
burden of proof to show that an exemption applies. A.R.S. § 44-2033.

20 ¹³ While the Respondents’ motion does not raise the defense of “advice of counsel” to the Division’s fraud allegations,
21 the Verified Answer, Hirsch Declaration and Statement of Facts seem to suggest that this defense is available to actions
for violations of the Securities Act. However, the registration and antifraud provisions of the Securities Act are strict
22 liability statutes. This means that the Respondents need not know that the conduct in which they are engaging in is
proscribed, or even know that the investment involved is a security. Therefore, “advice of counsel” is not an available
23 defense to a violation under the Securities Act. *See e.g., State v Tober*, 173 Ariz. 211, 213, 841 P.2d 206, 208 (1992),
citing *State v. Barrows*, 13 Ariz. App. 130, 464 P.2d 849 (1970); *Garvin v. Greenback*, 856 F.2d 1392, 1398 (9th Cir.
1988), as modified by A.R.S. § 44-1995.

24 ¹⁴ The Preamble to the Securities Act states:

25 The intent and purpose of this Act is for the protection of the public, the preservation of fair and equitable
26 business practices, the suppression of fraudulent or deceptive practices in the sale or purchase of
securities, and the prosecution of persons engaged in fraudulent or deceptive practices in the sale or
purchase of securities. This Act shall not be given a narrow or restricted interpretation or construction, but
shall be liberally construed as a remedial measure in order not to defeat the purpose thereof.

1 efforts made by those other than the investors were the undeniably significant ones, and were those
 2 essential managerial efforts that affected the failure or success of the enterprise. *Nutek*, 194 Ariz.
 3 at 108, 977 P.2d at 830.

4 Respondents argue that the investors (“Participants”)¹⁵ did not invest “with or in” either
 5 Horizon Partners or Radical Bunny for the time period beginning in at least 1999 through late 2005.
 6 Respondents contend that investors were participating in the MLtd Pass Through Participation
 7 Program. Respondents’ argument is disingenuous. In interpreting the term “security,” form should
 8 be disregarded for substance, and the emphasis should be on the economic reality. *Id.*; *Reves v.*
 9 *Ernst & Young*, 494 U.S. 56,61 (1990).

10 In this case, the following facts are *uncontested* relative to the time period beginning in at
 11 least 1999 through late 2005: (1) Horizon Partners and Radical Bunny were both manager-operated
 12 entities in which their non-manager members were unable to actively participate in the business
 13 operations of the entities (i.e., “passive”);¹⁶ (2) Horizon Partners and Radical Bunny conducted
 14 business pursuant to the terms of their respective Operating Agreements;¹⁷ (3) Participants
 15 provided their funds to Horizon Partners and/or Radical Bunny;¹⁸ (4) in exchange for their
 16 investment funds, Participants became members of either Horizon Partners or Radical Bunny and
 17 at least some Participants endorsed the respective entity’s Operating Agreement member signature
 18 page;¹⁹ (5) Horizon Partners and Radical Bunny participated in the MLtd Pass through
 19 Participation Program with the use of the entities’ members’ pooled capital accounts;²⁰ (6) all
 20 interests in the MLtd Pass Through Participation Program were issued by Mortgages Ltd. to
 21 Horizon Partners and Radical Bunny in the name of the respective entity;²¹ (7) Participants were
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23 ¹⁵ Respondents refer to the investors as “Participants.” That term may be used interchangeably with “investors” in this
 24 Response strictly for purposes of uniformity and convenience.

24 ¹⁶ Notice ¶3 and Verified Answer ¶3; Notice ¶5 and Verified Answer ¶5.

25 ¹⁷ Division Exhibit S-9(a) and Stipulations, p. 3, line 11. The Division issued a subpoena to the Custodian of Records
 of Horizon Partners, however, its Operating Agreement was not provided.

25 ¹⁸ Hirsch Declaration, p. 1, line 28 – p. 2, line 2 and p. 2, lines 18-22 and 25-28;

26 ¹⁹ Division Exhibits S-9(b), S-10, and S-26 and Stipulations, p. 3, lines 9-10 and p.4, line 14.

26 ²⁰ Hirsch Declaration, p.2, lines 18-22; Answer ¶9, lines 8-9; Hirsch Declaration, p.2, lines 6-8.

26 ²¹ Notice ¶27 and Verified Answer ¶27.

1 each issued an IRS form 1065 Schedule K-1 (“Schedule K-1”) from Horizon Partners and/or
2 Radical Bunny;^{22,23} (8) Horizon Partners and Radical Bunny, by and through their managers, did
3 all due diligence with regard to the MLtd Pass Through Participation Program (including the
4 decision as to which interests in the Mortgages Ltd loans to its borrowers that would be acquired)
5 on behalf of the Participants, made all distributions of interest and principal to the Participants,
6 maintained accounts for Participants, provided regular account statements for each of the
7 Participants, and communicated directly with the Participants with regard to their investments;²⁴
8 and (9) Participants were promised a guaranteed rate of return on their principal investments (i.e.,
9 capital accounts) by Horizon Partners and Radical Bunny which would result substantially from the
10 investment and managerial activities of Horizon Partners and Radical Bunny, by and through their
11 managers, and/or Mortgages Ltd. and/or its borrowers on behalf of the Participants.²⁵

12 The first prong of the *Howey* test is satisfied because the Participants gave their money to
13 Radical Horizon Partners and/or Radical Bunny. The second prong of the *Howey* test, horizontal
14 commonality, is satisfied because the Participants’ funds were pooled in a common account, and
15 then used by Radical Bunny and/or Horizon Partners to invest in the MLtd Pass Through
16 Participation Program. The third prong of the *Howey* test is satisfied because it was the investment
17 and managerial efforts of Horizon Partners and Radical Bunny, by and through their managers,
18 Mortgage Ltd, and/or its borrowers, not the investors, which affected the failure or success of the
19 enterprise. Participants had no managerial role whatsoever. The Participants simply surrendered
20 their money to one or both limited liability companies and upon receipt of a return on their
21 investment (either interest or principal), Horizon Partners and/or Radical Bunny would pay the
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23 ²² Notice ¶33 and Verified Answer ¶33; Notice ¶41 and Verified Answer ¶41; Hirsch Declaration p.2, line 22 and line
28; Division’s Exhibits S-27 and S-28 and Stipulations, p.5, lines 15-16.

24 ²³ Hirsch, a certified public accountant since October 19, 1979, and Shah, a certified public accountant since January
25 11, 1993, surely know that U.S. income tax law requires a pass-through entity (e.g., partnership, limited liability
company, S corporation, or income trust) to issue at year-end a Schedule K-1 to each unit holder (i.e., investor)
outlining that investor’s share of the pass-through entity’s income, deductions, and credits.

26 ²⁴ Hirsch Declaration, p. 2, lines 18-22 and lines 25-18; Notice ¶33 and Verified Answer ¶33; Notice ¶41 and Verified
Answer ¶41.

²⁵ *Id.*

1 Participants a guaranteed rate of return. Therefore, the limited liability company membership
2 interests in Horizon Partners and Radical Bunny constitute investment contracts and therefore
3 securities under the Securities Act.

4 *D. Interests in the RB-Participant Loan Program are securities under the Securities Act.*

5 Respondents argue that the investors did not invest “with or in” Radical Bunny for the time
6 period beginning in late 2005 though June 2008. Again, Respondents’ argument is disingenuous.
7 Respondents state that beginning in the fall of 2005, “Mortgages Ltd. wanted to institute a new
8 opportunity program, by which million dollar notes would be issued by Mortgages Ltd.”²⁶ Radical
9 Bunny did, in fact, participate in this new program and loaned Mortgages Ltd. approximately
10 \$197,232,000 as of June 2008.²⁷ This obligation is memorialized by the notes evidencing the RB-
11 MLtd Loans.²⁸ In order for Radical Bunny to fund the RB-MLtd Loans, it needed to raise money
12 and, in response, instituted the RB-Participant Loan Program in which to do so.²⁹

13 In this matter, the following facts are *uncontested* relative to the RB-Participant Loan
14 Program: (1) this investment opportunity is one in which the Participants became lenders to
15 Radical Bunny;³⁰ (2) Participants provided their funds to Radical Bunny; (3) Radical Bunny funded
16 the RB-MLtd Loans from the use of the Participants’ pooled investment funds;³¹ (4) all notes
17 evidencing the RB-MLtd Loans were issued by Mortgages Ltd directly to Radical Bunny;³² (5)
18 Participants were each issued an IRS form 1099-INT from Radical Bunny;³³ (6) Radical Bunny
19 invested the Participants’ funds in the RB-MLtd Loans, made all distributions of interest and
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21 ²⁶ Declaration of Hirsch, p. 3, lines 1-3.

22 ²⁷ Notice ¶78 and Verified Answer ¶78; Division Exhibit S-33 and Stipulations, p. 5, line 33.

23 ²⁸ The Proof of Claim filed by Radical Bunny for the balance due under the RB-MLtd Loans can be found in the claims
register as Claim #33-1 (amended as Claim #33-2) in official court docket for *In re Mortgages Ltd.*, case no. 2:08-bk-
07465-RJH in United States Bankruptcy Court for the District of Arizona (Phoenix).

24 ²⁹ Declaration of Hirsch, p. 3, lines 4-6. See Notice ¶¶43-49 for a detailed explanation.

25 ³⁰ Exhibit 2 to the Declaration of Hirsch. Exhibits 1 and 2, taken together, are misleading because the “Re: Investment
in B080223 MORTGAGES LTD.” in Exhibit 1 refers to one of the RB-MLtd Loans. However, Exhibit 2 is an
authorization from the Participant to Radical Bunny to use the investor’s funds as part of the pool of money used by
Radical Bunny to fund that particular RB-MLtd Loan.

26 ³¹ Declaration of Hirsch, p.2, lines 25-28 and p.3, lines 10-11.

³² Declaration of Hirsch, p.3, lines 10-11.

³³ Division Exhibit S-29 and Stipulations p.5, line 17.

1 principal to the Participants, maintained accounts for Participants, provided regular account
2 statements for each of the Participants, and communicated directly with the Participants with
3 regard to their investments;³⁴ (7) Participants had no managerial role whatsoever;³⁵ and (8)
4 Participants were promised a guaranteed rate of return on their principal investments (i.e., capital
5 accounts) by Respondents which would result substantially from the investment and management
6 activities of Radical Bunny, by and through their managers, and/or Mortgages Ltd. and/or its
7 borrowers on behalf of the Participants.³⁶

8 The Participants entered into an agreement with Radical Bunny under which they would
9 passively invest funds in an enterprise with profits to come from the substantial efforts of Radical
10 Bunny, by and through its managers, and/or Mortgages Ltd. The Participants' bought a package,
11 an investment contract, pursuant to which Radical Bunny took the purchase money and invested it
12 and agreed to perform a number of services for the Participants. That *entire* package, all of the
13 components of the agreement with Radical Bunny constituting the RB-Participant Loan Program,
14 constitutes an investment contract and, therefore, a security under the Securities Act.

15 The Respondents also state that Mortgages Ltd. was obligated to repay the Participants
16 directly.³⁷ This statement is false.

17 On October 8, 2008 an involuntary petition for relief was filed against Respondent under
18 title 11 of the United States Code in the United States Bankruptcy Court for the District of Arizona
19 (Phoenix) ("Bankruptcy Court") under case no. 2:08-bk-13884-CGC (the "RB Bankruptcy"). On
20 October 20, 2008, the Bankruptcy Court entered an order converting the case to a voluntary
21 petition under Chapter 11 of the Bankruptcy Code. On November 11, 2008, Hirsch, on behalf of
22 Radical Bunny, executed and filed Schedule F-Creditors Holding Unsecured Nonpriority Claims in
23
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25 ³⁴ Notice ¶¶46-47 and Verified Answer ¶¶46-47; Hirsch Declaration, p. 2, lines 25-28, p.4, lines 12-19, and p.4, lines
26-28.

26 ³⁵ *Id.*

³⁶ *Id.*

³⁷ Declaration of Hirsch, p. 4, lines 1-3; Statement of Facts, p.5, lines 4-5.

1 the RB Bankruptcy (“Schedule F”).³⁸ Schedule F is a sworn declaration containing the list of
2 individuals and entities to whom *Radical Bunny* owed money. Schedule F contains the same
3 names as those listed on the Radical Bunny “Lender Name & Address Listing.”³⁹ The return of the
4 Participants’ purchase money and promised interest, if any, will be governed by the Amended Plan
5 of Reorganization dated March 9, 2010 and approved by the Bankruptcy Court on April 28, 2010.⁴⁰

6 *E. Respondents patently disregard Arizona law it relates to when a note is not a security under*
7 *the Securities Act.*

8 Again, the Notice alleges that Horizon Partners, Radical Bunny, Hirsch, B. Walder, H.
9 Walder, and Shah were involved in the offer and sale of securities in the form of investment contracts,
10 not notes. Even if the Notice did allege that they offered and sold notes, Respondents’ legal analysis is
11 still wrong.

12 When looking to interpretations of federal law for guidance, Arizona courts do not defer to
13 federal case law when, by doing so, Arizona courts would be taking a position inconsistent with the
14 Arizona policy of protecting the public from unscrupulous investment promoters. *Siporin*, 200 Ariz. at
15 103, 23 P.3d at 98. Respondents argue that *Amfac Mortgage Corp. v. Arizona Mall of Tempe*, 583
16 F.2d 426 (9th Cir. 1978) is controlling law in Arizona. Respondents’ argument is meritless. Arizona
17 courts have adopted *two* approaches to distinguish between security and nonsecurity notes. The
18 analysis used depends upon whether a violation of the registration *or* the antifraud provisions of the
19 Securities Act is at issue.

20 For purposes of the registration provisions, the Arizona Supreme Court held that the Securities
21 Act provided a clear meaning for the words “any note,” and, therefore, the court had no reason to use
22 any of the tests fashioned by the federal courts for determining whether a particular note was a
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24 ³⁸ Division Exhibit S-35 and Stipulations, p. 5, line 24: In the Stipulations, Respondents state that Schedule F was
25 prepared by the attorney for the Trustee. However, G. Grant Lyon was not appointed by the Bankruptcy Court as the
26 Chapter 11 Trustee in the RB Bankruptcy until December 29, 2008. See Division Exhibit S-36 and Stipulations, p. 5,
line 36.

³⁹ Division Exhibit S-34 and Stipulations p.5, line 23.

⁴⁰ A copy of the order confirming the Amended Plan of Reorganization dated March 9, 2010 is available as document
no. 728 in the Bankruptcy Court’s official docket for the RB Bankruptcy.

1 security. *State v. Tober*, 173 Ariz. 211, 213 841 P.2d 206, 208 (1992). Specifically, the Arizona
2 Supreme Court looked to the Arizona statutory definition of security and held that all notes are
3 securities that must be registered unless an exemption applies. *Id.* In rejecting *Amfac*, the court stated:

4 We disagree. In our view, neither the “risk capital” test of *Amfac*, the “family
5 resemblance” test of *Reves v. Ernst & Young*, *** nor any variant applies to the
6 charges under A.R.S. § 44-1841 and § 44-1842. These two sections are part of a
7 comprehensive statutory scheme that defines the universe of securities, exempt
8 securities, and exempt transactions. The statutory scheme leaves no room for judicial
9 gloss, and thus there is no uncertainty in its application.

8 *Id.* (Citation omitted).

9 While in *Tober* the Arizona Supreme Court left open the issue of whether the definition of a
10 security was the same for antifraud as for registration purposes, the appellate court in *MacCollum v.*
11 *Perkinson*, 185 Ariz. 179, 185, 913 P.2d 1097, 1103 (App. 1996) concluded that the definition of
12 security was not the same for purposes of antifraud, and adopted the analysis articulated in *Reves v.*
13 *Ernst & Young*, 494 U.S. 56 (1990). The *Reves* court started with the presumption that notes are
14 securities and established a two part test with which the presumption may be rebutted. First, any note
15 is a security unless the note “bears a strong resemblance” to an instrument listed in an enumerated
16 category of exceptions.⁴¹ *Id.* at 63. Second, the presumption can be rebutted with a showing a note
17 resembles one or more of the categories of instruments that are *not* securities, applying a four factor
18 test: (1) motivations of seller and buyer; (2) plan of distribution; (3) reasonable expectations of the
19 investing public; and (4) the existence of another risk reducing regulatory scheme. *Id.* at 66-69. With
20 the adoption of the “family resemblance” test developed in *Reves*, the “risk capital” test used in *Amfac*
21 was expressly rejected by the Arizona Supreme Court.⁴²

22
23 ⁴¹ According to *Reves*, notes that are not securities include notes delivered in consumer financing, notes secured by a
24 mortgage on a home, short-term notes secured by a lien on a small business or some of its assets, notes evidencing a
25 “character” loan to a bank customer, short-term notes secured by an assignment of accounts receivable, notes which
26 formalize an open-account of indebtedness incurred in the ordinary course of business or notes evidencing loans by
commercial banks for current operations. *Reves*, at 63.

⁴² In developing the “family resemblance” test in *Reves*, the Second Circuit Court of Appeals rejected the tests used by
other federal courts in determining whether a note is a security under federal law. In addition to *Amfac*, Respondents
rely on other federal cases that pre-date Arizona’s adoption of the *Reves* test, thus rendering their argument void of any
supporting legal authority.

1 Respondents argue that since the RB-MLtd Loans were purportedly used to “finance
2 construction,” the notes evidencing the loans are not “notes” for fraud purposes under the Securities
3 Act. However, Respondents fail to apply the *Reves* test to the RB-MLtd Loan transactions.
4 Furthermore, assuming that it is relevant, Respondents fail to provide any evidence that Mortgages
5 Ltd. used any of the RB-MLtd Loan proceeds to finance construction. At best, Respondents can only
6 allege that the funds were used by Mortgages Ltd. for general operating expenses.⁴³ This factual
7 allegation alone, however, does not rebut the presumption that the notes evidencing the RB-MLtd
8 Loans are not securities under the *Reves* test.

9 *F. Radical Bunny, Hirsch, B. Walder, H. Walder, and Shah are subject to liability under the*
10 *antifraud provisions of the Securities Act even if they are not the issuer of the RB- ML Loan*
11 *notes.*

12 Respondents’ argument that only the issuer of securities can violate the antifraud
13 provisions of the Securities Act is also meritless. Under the Securities Act, it is a fraudulent
14 practice for *any person in connection with* a transaction *involving an offer or sale of securities*
15 do any of the following: (1) employ any device, scheme or artifice to defraud; (2) make untrue
16 statements of material fact, or omit to state any material fact necessary in order to make the
17 statements made, in the light of the circumstances in which they were made, not misleading; or
18 (3) engage in any transaction, practice or course of business which operates or would operate as a
19 fraud or deceit. A.R.S. § 44-1991(A). Securities fraud may be proven by any one of these acts.
20 *Hernandez v. Superior Court*, 179 Ariz. 515, 880 P.2d 735 (App. 1994). Accordingly, even if
21 the ALJ found that the RB-MLtd Loan notes were the securities at issue in this matter, the fact
22 that Mortgages Ltd. issued those notes is not relevant. What *is* relevant, however, is a factual
23 finding by the ALJ that, in the sale of the notes, Radical Bunny and its managers misrepresented
24 to Participants that their interests in the RB-MLtd Loans were properly collateralized, which
25 finding would render Radical Bunny and its managers liable for fraud under the Securities Act.⁴⁴

26 ⁴³ In their Verified Answer, the Respondents deny that the RB-MLtd Loans were not properly collateralized as represented by Radical Bunny and its managers.

⁴⁴ See Notice ¶¶70-72, 86(b) and 86(c). Respondents deny these allegations. Verified Answer ¶¶70-72, 87(b) and 87(c).

1 **III. Conclusion**

2 For the reasons set forth above, the Division requests the Respondents' Motion for
3 Summary Judgment or to Dismiss be denied.

4 RESPECTFULLY SUBMITTED this 10th day of May, 2010.

5 

6 Julie Coleman
7 Chief Counsel of Enforcement for the Securities
8 Division of the Arizona Corporation Commission

9 ORIGINAL and 13 copies of the foregoing
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