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Arizona Corporation Commission  
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BEFORE THE ARIZONA CORPORATION COMMISSION  
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**In the matter of** )  
)  
JOSEPH MICHAEL GUESS, SR. )  
2911 E. Calavar Road )  
Phoenix, Arizona 85032 )  
)  
PROGRESSIVE FINANCIAL MANAGEMENT )  
2911 E. Calavar Road )  
Phoenix, Arizona 85032 )  
)  
JAMES DOUGLAS SHERRIFFS )  
5544 East Helena Drive, )  
Scottsdale, Arizona 85254 )  
)  
RICHARD GORDON DAVIS )  
4330 North 30<sup>TH</sup> Street )  
Phoenix, Arizona 85016 )  
)  
RGD )  
4330 North 30<sup>TH</sup> Street )  
Phoenix, Arizona 85016 )  
)  
RGD ENTERPRISES, INC. )  
4330 North 30<sup>TH</sup> Street )  
Phoenix, Arizona 85016 )  
)  
IRA JOE PATTERSON )  
4330 North 30<sup>th</sup> Street )  
Phoenix, Arizona 85016 )  
)  
RANDALL WAYNE SMITH, JR. )  
1905 Springlake Court )  
Birmingham, Alabama 35215 )  
)  
BALLY OVERSEAS TRADING INC. )  
1905 Springlake Court )  
Birmingham, Alabama 35215, )  
)  
**Respondents.**

DOCKET NO. S-03280A-98-0000  
**POST HEARING MEMORANDUM  
BY SECURITIES DIVISION**

1 The Securities Division ("Division") of the Arizona Corporation Commission  
2 ("Commission") hereby submits the following Post Hearing Memorandum in the above-captioned  
3 matter.

4 **I.**  
5 **STANDARD OF PROOF**

6 In administrative adjudication by the Commission, the standard of proof for alleged  
7 violations of the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.* ("SAA"), and of the Arizona  
8 Investment Management Act, A.R.S. § 44-3101 *et seq.* ("IMA"), is merely the preponderance of  
9 the evidence. *See Steadman v. Securities and Exchange Commission*, 450 U. S. 91 (1981)  
10 (administrative adjudication of federal securities laws antifraud violations). *See also, Geer v.*  
11 *Ordway*, 156 Ariz. 588, 589, 754 P.2d 315, 316 (Ct. App. 1987) (administrative adjudication of  
12 state motor vehicle operator licensing law).

13 **II.**  
14 **OFFER OR SALE OF UNREGISTERED SECURITIES**

15 The Division alleged that from about February 1997 or thereafter, respondents Joseph  
16 Michael Guess, Sr. ("Guess"), Progressive Financial Management ("PFM"), James Douglas  
17 Sherriffs ("Sherriffs"), RGD, Ira Joe Patterson ("Patterson"), Randall Wayne Smith, Jr. ("Smith")  
18 and Bally Overseas Trading Inc. ("Bally") offered to sell or sold securities within or from Arizona  
19 in the form of investment contracts and certificates of participation in a profit-sharing agreement,  
20 all in violation of A.R.S. § 44-1841. The Division further alleged that during this time Guess,  
21 PFM, RGD and Patterson also offered or sold securities within or from Arizona in the form of  
22 notes, also in violation of A.R.S. § 44-1841.

23 Respondents PFM and RGD were duly served with the Notice of Opportunity for Hearing  
24 Regarding proposed Order for Relief ("Notice") issued by the Division in this matter on April 6,  
25 2000, *Hearing Exhibits ("Exhs.") S-1e, S-1f, S-1g, S-1h*, but failed to request a hearing to contest  
26 these and other factual allegations against them. Smith and Bally were also duly served with the

1 Notice, *Exhs. S-1k, S-1l*; but failed to request a hearing until long after the statutory deadline  
2 expired and were denied a hearing opportunity to contest these allegations. The Division docketed  
3 a Notice of Intent to Apply for Default Order ("Default Notice") against PFM, RGD, Bally and  
4 others on July 24, 2000 and will additionally seek a default order against Smith. Since the Notice  
5 allegations against PFM, RGD, Bally and Smith are uncontested, the evidence against them will  
6 only be cited in this memorandum in connection with the Division case against other respondents  
7 who requested the hearing held in this matter.

8 At the hearing in this matter, no respondent contested that the investment program interests  
9 at issue were securities in the form of investment contracts and certificates of participation in a  
10 profit-sharing agreement, or that interest-bearing loans from some investors were also securities in  
11 the form of notes.

12  
13 **A. Securities in the Form of an Investment Contract**

14 The SAA includes "investment contract" under its definition of a "Security." *A.R.S. § 44-*  
15 *1801(26)*. To define this particular category of security, our Court of Appeals has recognized a  
16 modified federal "Howey test" requiring: (1) an investment of money; (2) in a common enterprise; (3)  
17 with an expectation of profits; (4) to be derived substantially from the efforts of others. *See Nutek*  
18 *Information Systems, Inc. v. Arizona Corporation Commission*, 194 Ariz. 104, 108, 977 P.2d 826, 830  
19 (Ct. App. 1998), *review denied* (1999), *cert. denied*, 120 S.Ct. 332 (1999); *Vairo v. Clayden*, 153  
20 Ariz. 13, 17, 734 P.2d 110, 114 (Ct. App. 1987); *Sullivan v. Metro Productions, Inc.*, 150 Ariz. 573,  
21 576-77, 724 P. 2d 1242, 1245-46 (Ct. App. 1986), *cert. denied*, 470 U.S. 1102 (1987). This is an  
22 objective standard to characterize an offering or transaction when it is made. What actually or could  
23 have occurred afterward is immaterial to its application. *See Daggett v. Jackie Fine Arts, Inc.*, 152  
24 Ariz. 559, 565, 733 P.2d 1142, 1148 (Ct. App. 1986). It is the *representations* made by the promoters,  
25 not their actual conduct, that determine whether an interest is an investment contract. *S.E.C. v. Lauer*,  
26 52 F.3d 667, 670 (7<sup>th</sup> Cir. 1995). (Italics added for emphasis.) A writing is not required. Investment

1 contracts can be oral agreements. *Securities and Exchange Commission v. Addison*, 194 F. Supp.  
2 709, 722 (N. D. Tex. 1961).

3 All elements of this standard are satisfied by the RGD, Bally and PFM investment program  
4 interests. To satisfy the first prong, an investor gives "a specific consideration in return for a separable  
5 financial interest with the characteristics of a security." *International Brotherhood of Teamsters v.*  
6 *Daniel*, 439 U.S. 551, 559, 99 S.Ct. 790, 796 (1979). This investment requires "only that the investor  
7 must commit his assets to the enterprise in such a manner as to subject himself to financial loss."  
8 *Hector v. Wiens*, 533 F.2d 429, 432 (9th Cir. 1976). *Accord, Ontario, Inc. v. Mays*, 14 Kan. App. 2d  
9 1, 2, 780 P.2d 1127-28 (1989) (applying *Hector* definition to Kansas Securities Act); *Activator Supply*  
10 *Co. v. Wurth*, 239 Kan. 610, 617, 722 P.2d 1081, 1087 (1986) (same). This prong is clearly satisfied  
11 by the "Procedure" subsection language in the RGD and PFM investor agreements that expressly  
12 provides for the investor to transfer a specified amount of funds to others for placement with a trading  
13 bank. *Exhs. S-4 (RGD/ Arnolds), S-10 (RGD/ Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber), S-*  
14 *43b (RGD/ Herrmann Plan), S-64 (PFM/ Clayton), S-72b and c (RGD/ Calta), S-74a and b (RGD/*  
15 *Calta), S-84 (RGD/ Far Horizon-Smiths), S-89 (RGD/ King)*<sup>1</sup>, *S-95 (PFM/ Jacobs), S-97 (PFM/*  
16 *Hammond), S-105b (PFM/Mader)*. See also *Exhs. S-112b and c (Bally/ Guess), S-113b (Bally/ RGD),*  
17 *S-114 (Bally/ Guess), S-115 (Bally/ RGD), S-116 (Bally/ Guess), S-117 (Bally/ Guess)*. This same  
18 subsection is also found in the \$40,000 RGD investor contract with Joseph Patterson<sup>2</sup> from which  
19 respondent Patterson offered and sold interests to certain RGD investors by means of his "Addendum  
20 to Contract." *Exhs. S-38b (Patterson/ Herrmann), S-68b (Patterson/ Calta), Exh. S-81a-c (Patterson/*  
21 *Hayes)*. Moreover, the later RGD "Agreement and Contract" under which the Smiths as "Heritage  
22 Trust" invested a total of \$150,000 with Sherriffs expressly provided for the "Assignment" of such  
23

24  
25 <sup>1</sup> This agreement provided by Guess to investor Glenn E. King as his investor contract is actually a  
specimen Bally contract that was never executed. Exh. S-89 is therefore cited herein as "RGD/ King."

26 <sup>2</sup> Division expert witness Mark Klamrzynski testified that Joseph Patterson was one of two signatories on a  
bank account used by respondent Patterson. The other signatory was Ira J. Patterson. Each had different signatures,  
home addresses and social security numbers. *Hearing Transcript ("H.T.")*, p. 652 lines 11-25.

1 “Cash assets” to RGD to be “entered into an established trading program provided by” RGD. *Exh. S-*  
2 *16a and b.*

3 A common enterprise requires the fortunes of the investor to be interwoven with and  
4 dependent upon the efforts and success of those seeking the investment of third parties. *Vairo*, 153  
5 Ariz. at 17, 734 P.2d at 114; *Sullivan*, 150 Ariz. at 576, 724 P.2d at 1245. This element is satisfied by  
6 either the vertical or horizontal tests. *Vairo*, 153 Ariz. at 17, 732 P.2d at 114; *Daggett*, 152 Ariz. at  
7 565, 733 P.2d at 1148. Both tests are satisfied here, although only one needs to be met.

8 The horizontal test requires the pooling of investor funds to be collectively managed by the  
9 promoter or a third party. *Vairo*, *id.* at 17, P.2d at 114; *Daggett*, 152 Ariz. at 565, 733 P.2d at 1148.  
10 This can include a pooling of interests, usually combined with a pro-rata sharing of profits. *Brodv v.*  
11 *Bache & Co., Inc.*, 595 F.2d 459, 460 (9th Cir. 1978). Many RGD and PFM investor agreements  
12 expressly stated in a “whereas” clause that investor funds would be accumulated by RGD until “the  
13 minimum amount” was gathered to transfer the pooled funds into a trading program. *Exhs. S-33a*  
14 *(PFM/ BVWI-Weber)*, *S-43b (RGD/ Herrmann Plan)*, *S-64 (PFM/ Clayton)*, *S-72b and c (RGD/*  
15 *Calta)*, *S-74a and b (RGD/ Calta)*, *S-89 (RGD/ King)*, *S-95 (PFM/ Jacobs)*, *S-97 (PFM/ Hammond)*.  
16 *See also Exhs. S-112b and c (Bally/ Guess)*, *S-113b (Bally/ RGD)*, *S-114 (Bally/ Guess)*, *S-115 (Bally/*  
17 *RGD)*, *S-116 (Bally/ Guess)*, *S-117 (Bally/ Guess)*. Investor witness Jill Arnold testified how she was  
18 told that RGD was “going to take our money and pool it with other investors.” *H.T.*, p. 66 lines 6—15,  
19 66 line 19-67 line 6, 71 lines 14-15, 74 line 23—75 line 5. Similarly, the later RGD “Agreement and  
20 Contract” under which the Smiths as “Heritage Trust” invested a total of \$150,000 with Sherriffs  
21 expressly provided under its “Assignment” and “Proceeds” subsections that these funds would “be  
22 combined with other investment dollars in order to meet the minimum investment” of one million  
23 dollars to enter the “established trading program provided by” RGD. *Exh. S-16a and b.*

24 The vertical test requires a positive correlation between investor success and the success of the  
25 promoter, *Vairo*, *id.*; *Daggett*; *id.*; or the seller or some third party. *S.E.C. v. R. G. Reynolds*  
26 *Enterprises, Inc.*, 952 F.2d 1125, 1130 (9th Cir. 1991); *Hocking v. Dubois*, 885 F.2d 1449, 1455 (9th

1 Cir. 1989). Like Bally, RGD and PFM represented in investor agreements that they received a “fee”  
 2 in the form of a share of the overall trading program profit earned by the accumulated investor funds.  
 3 *Exhs. S-4 (RGD/ Arnolds)*<sup>3</sup>, *S-10 (RGD/ Heritage Trust-Smiths)*<sup>4</sup>, *S-33a (PFM/ BVWI-Weber)*<sup>5</sup>, *S-*  
 4 *43b (RGD/ Herrmann Plan)*<sup>6</sup>, *S-64 (PFM/ Clayton)*<sup>7</sup>, *S-72b and c (RGD/ Calta)*<sup>8</sup>, *S-74a and b (RGD/*  
 5 *Calta)*<sup>9</sup>, *S-84 (RGD/ Far Horizon-Smiths)*<sup>10</sup>, *S-89 (RGD/ King)*<sup>11</sup>, *S-95 (PFM/ Jacobs)*<sup>12</sup>, *S-97 (PFM/*  
 6 *Hammond)*<sup>13</sup>, *S-105b (PFM/Mader)*<sup>14</sup>. See also *Exhs. S-112b and c (Bally/ Guess)*<sup>15</sup>, *S-113b (Bally/*  
 7 *RGD)*<sup>16</sup>, *S-114 (Bally/ Guess)*<sup>17</sup>, *S-115 (Bally/ RGD)*<sup>18</sup>, *S-116 (Bally/ Guess)*<sup>19</sup>, *S-117 (Bally/*

8 <sup>3</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to RGD from profit exceeding the 5% monthly investor return  
 9 paid under §3.2.

10 <sup>4</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to RGD from profit exceeding the 4.5% monthly investor  
 11 return paid under §3.2.

12 <sup>5</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to PFM from profit exceeding the 15% investor return paid  
 13 under §3.2 in each of 10 disbursements per year.

14 <sup>6</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to RGD from profit exceeding the 5% monthly investor return  
 15 paid under §3.2. See also §1 “Profit Share” in the accompanying “Joint Venture Profit Share Agreement.”

16 <sup>7</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to PFM from profit exceeding the 5% investor return paid  
 17 under §3.2 in each of 12 disbursements per year. See also §1 “Profit Share” in the accompanying “Joint Venture  
 18 Profit Share Agreement.”

19 <sup>8</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to RGD from profit exceeding the 10% investor return paid  
 20 under §3.2 in each “cycle” for 12 months. See also §1 “Profit Share” in the accompanying “Joint Venture Profit  
 21 Share Agreement.”

22 <sup>9</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to RGD from profit exceeding the 10% investor return paid  
 23 under §3.2 in each “cycle” for 12 months. See also §1 “Profit Share” in the accompanying “Joint Venture Profit  
 24 Share Agreement.”

25 <sup>10</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to RGD from profit exceeding the 5% monthly investor  
 26 return paid under §3.2. See also §1 “Profit Share” in the accompanying “Joint Venture Profit Share Agreement.”

<sup>11</sup> In this specimen Bally contract provided by Guess to Glenn E. King as his investor contract, §3.2 pays a  
 12% investor return in each of 40 profit “payouts” per 52-week period, less a 10% “fee” or share deducted by Bally  
 under §3.3 from each such profit “payout.” The accompanying specimen “Joint Venture Profit Share Agreement”  
 further specifies under §1 “Profit Share” that the investor receives 90% of each profit “payout” and Smith receives  
 10%.

<sup>12</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to PFM from profit exceeding the 5% investor return paid  
 under §3.2 in each of 12 disbursements per year. See also §1 “Profit Share” in the accompanying “Joint Venture  
 Profit Share Agreement.”

<sup>13</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to PFM from profit exceeding the 5% monthly investor  
 return paid under §3.2. See also §1 “Profit Share” in the accompanying “Joint Venture Profit Share Agreement.”

<sup>14</sup> Under §3 “Profit Return,” §3.3 pays a “fee” to PFM from profit exceeding the 25% monthly investor  
 return paid under §3.2 for each “cycle.” See also §1 “Profit Share” in the accompanying “Joint Venture Profit Share  
 Agreement.”

<sup>15</sup> Under §3 “Profit Return,” §3.2 pays a 12% investor return in each of 40 profit “payouts” per 52-week  
 period, less a 10% “fee” or share deducted by Bally under §3.3 from each such profit “payout.” The “Joint Venture  
 Profit Share Agreement” accompanying Exh. S-112c further specifies under §1 “Profit Share” that the investor  
 receives 90% of each profit “payout” and Smith receives 10%.

<sup>16</sup> Under §3 “Profit Return,” §3.2 pays an 11.8% investor return in each of 40 profit “payouts” per 52-week  
 period, less a 10% “fee” or share deducted by Bally under §3.3 from each such profit “payout.” The accompanying

1 *Guess*)<sup>20</sup>. Investor witness Jill Arnold testified that she understood this RGD “fee” would not come  
 2 from the 5% profit return she would receive. *H.T.*, p. 73 lines 16--23. The same subsections 3.2 and  
 3 3.3 similarly provide for a 5% monthly investor return and overage profits fee in the investor  
 4 agreement between RGD and Joseph Patterson, from which respondent Patterson offered and sold  
 5 interests to certain RGD investors by means of his “Addendum to Contract.” *Exhs. S-38b (Patterson/  
 6 Herrmann), S-68b (Patterson/ Calta), Exh. S-81a-c (Patterson/ Hayes)*. Although the later RGD  
 7 “Agreement and Contract” under which the Smiths as “Heritage Trust” invested a total of \$150,000  
 8 with Sherriffs specified only a 5% monthly investor return, *Exh. S-16a and b*, hearing witness Jean  
 9 Smith testified that Sherriffs said it “was the same investment” with RGD as before, “the same  
 10 company and everything.” *Hearing Transcript (“H.T.”)*, p. 134 lines 15-16. The previous RGD  
 11 contract with the Heritage Trust/ Smiths specified a profit-sharing “fee” to RGD. *Exh. S-10*. These  
 12 representations of joint profit sharing positively correlate investor success with promoter success in  
 13 these trading program investments. The profit sharing between RGD and its investors was to be  
 14 generated by the spread between the profit return specified to RGD investors in their contracts and the  
 15 profit return to RGD and Guess specified in their contracts with Bally. Whereas the Bally contracts  
 16 provided a return ranging from 12% weekly to 12% or even 18% monthly, *Exhs. S-89 (Bally  
 17 specimen), S-112b and c (Bally/ Guess), S-113b (Bally/ RGD), S-114 (Bally/ Guess), S-115 (Bally/  
 18 RGD), S-116 (Bally/ Guess), S-117 (Bally/ Guess)*, the RGD investor contracts specified a return of

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19 “Joint Venture Profit Share Agreement” further specifies under §1 “Profit Share” that the investor receives 90% of  
 20 each profit “payout” and Smith receives 10%. From the 11.8% nominal “payout” return, therefore, the investor  
 receives 10% and Bally or Smith receives 1.8%.

21 <sup>17</sup> Under §3 “Profit Return,” §3.2 pays an 18% monthly investor return in each thirty international banking  
 22 day period, less a 10% “fee” or share deducted by Bally under §3.3 from each such profit “payout.” The  
 23 accompanying “Joint Venture Profit Share Agreement” further specifies under §1 “Profit Share” that the investor  
 receives 90% of each profit “payout” and Smith receives 10%. From the 18% nominal “payout” return, therefore, the  
 investor receives 16.2% and Bally or Smith receives 1.8%.

24 <sup>18</sup> Under §3 “Profit Return,” §3.2 pays an 12% monthly investor, less a 10% “fee” or share deducted by  
 25 Bally under §3.3 from each such profit “payout.” The accompanying “Joint Venture Profit Share Agreement”  
 further specifies under §1 “Profit Share” that the investor receives 90% of each profit “payout” and Smith receives  
 10%.

26 <sup>19</sup> Under §3 “Profit Return,” §3.2 pays an 12% monthly investor return, less a 10% “fee” or share deducted  
 by Bally under §3.3 from each such profit “payout.”

<sup>20</sup> Under §3 “Profit Return,” §3.2 pays an 12% investor return in each thirty day period, less a 10% “fee” or  
 share deducted by Bally under §3.3 from each such profit “payout.”

1 4.5% to 5% monthly, with only one later investor receiving 10%. *Exhs. S-4 (RGD/ Arnolds), S-10*  
2 *(RGD/ Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber), S-43b (RGD/ Herrmann Plan), S-64*  
3 *(PFM/ Clayton), S-72b and c (RGD/ Calta), S-74a and b (RGD/ Calta), S-84 (RGD/ Far Horizon-*  
4 *Smiths), S-95 (PFM/ Jacobs), S-97 (PFM/ Hammond), S-105b (PFM/Mader).*

5 The expectation of profits element requires the investor to be attracted solely by the prospects  
6 of a return on the investment, whether from income yielded by the investment or from capital  
7 appreciation. *See United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975). This  
8 element is satisfied in the Bally, RGD and PFM investor agreements by their “whereas” clauses  
9 representations that investor funds “can be deployed to maximize” their return toward which Bally,  
10 RGD or PFM “will use its best efforts to maximize and improve upon the return” from invested  
11 funds. *Exhs. S-4 (RGD/ Arnolds), S-10 (RGD/ Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber),*  
12 *S-43b (RGD/ Herrmann Plan), S-64 (PFM/ Clayton), S-72b and c (RGD/ Calta), S-74a and b (RGD/*  
13 *Calta), S-84 (RGD/ Far Horizon-Smiths), S-89 (RGD/ King), S-95 (PFM/ Jacobs), S-97 (PFM/*  
14 *Hammond), S-105b (PFM/Mader). See also Exhs. S-112b and c (Bally/ Guess), S-113b (Bally/ RGD),*  
15 *S-114 (Bally/ Guess), S-115 (Bally/ RGD), S-116 (Bally/ Guess), S-117 (Bally/ Guess).* These same  
16 clauses are also found in the RGD investor contract with Joseph Patterson from which respondent  
17 Patterson offered and sold interests to certain RGD investors by means of his “Addendum to  
18 Contract.” *Exhs. S-38b (Patterson/ Herrmann), S-68b (Patterson/ Calta), Exh. S-81a-c (Patterson/*  
19 *Hayes).* Moreover, the later RGD “Agreement and Contract” under which the Smiths as “Heritage  
20 Trust” invested a total of \$150,000 with Sherriffs expressly provided for the “assignment” of such  
21 “Cash assets” to RGD (§1 “Assignment”) to be “entered into an established trading program” (§2  
22 “Proceeds”) in order to earn a 5% monthly return (§4 “Profits”). *Exh. S-16a and b.*

23 The last element requires that the efforts made by those other than the investor be the  
24 undeniably significant ones, those essential managerial efforts which affect the failure or success of  
25 the enterprise. *Nutek*, 194 Ariz. at 108, 977 P.2d at 830; *Sullivan*, 150 Ariz. at 577, 724 P.2d at 1246.  
26 Such efforts need not be by the promoter. *Vairo*, 153 Ariz. at 17, 734 P.2d at 114; *Daggett*, 152 Ariz.

1 at 566, 733 P.2d at 1149. Nor must they preclude the investor from some powers of control. *Rose v.*  
2 *Dobras*, 128 Ariz. 209, 212, 624 P.2d 887, 890 (Ct. App. 1981). In this case, the Bally, RGD and  
3 PFM investment documents expressly repose exclusive control over the management of investor  
4 funds in those promoters and collateral third persons. The “whereas” clauses in the investor  
5 agreements specify that the investor provides funds to the promoter who “has certain knowledge,  
6 association, ability and relationships to facilitate introduction to certain organizations that can  
7 coordinate the investment of the aforementioned funds in trading programs” and “will use its best  
8 efforts basis to maximize and improve” the return on this investment. Subsection 3.3 of these  
9 agreements pays a profit-sharing fee to the promoter “for the administration and compliance of all  
10 contractual obligations and overseeing of accurate entrance and disbursement of funds to the  
11 individual clients respectfully[sic].” Moreover, the investor’s “Specific Power of Attorney”  
12 accompanying the agreement granted to a promoter “full power and authority” to “manage my  
13 investment account in an investment trading program” including “such incidental acts as are  
14 reasonably required to carry out and perform the specific authorities granted herein.” *Exhs. S-4 (RGD/*  
15 *Arnolds)*, *S-10 (RGD/ Heritage Trust-Smiths)*, *S-33a (PFM/ BVWI-Weber)*, *S-43b (RGD/ Herrmann*  
16 *Plan)*, *S-64 (PFM/ Clayton)*, *S-72b and c (RGD/ Calta)*, *S-74a and b (RGD/ Calta)*, *S-84 (RGD/ Far*  
17 *Horizon-Smiths)*, *S-89 (RGD/ King)*, *S-95 (PFM/ Jacobs)*, *S-97 (PFM/ Hammond)*, *S-105b*  
18 *(PFM/Mader)*. See also *Exhs. S-112b and c (Bally/ Guess)*, *S-113b (Bally/ RGD)*, *S-114 (Bally/*  
19 *Guess)*, *S-115 (Bally/ RGD)* (no “Specific Power of Attorney”), *S-116 (Bally/ Guess)* (no “Specific  
20 *Power of Attorney*”), *S-117 (Bally/ Guess)* (no “Specific Power of Attorney”). These same provisions  
21 are also found in the RGD investor contract and “Specific Power of Attorney” for Joseph Patterson  
22 from which respondent Patterson offered and sold interests to certain RGD investors by means of his  
23 “Addendum to Contract.” *Exhs. S-38b (Patterson/ Herrmann)*, *S-68b (Patterson/ Calta)*, *Exh. S-81a-*  
24 *c (Patterson/ Hayes)*. The later RGD “Agreement and Contract” under which the Smiths as “Heritage  
25 Trust” invested a total of \$150,000 with Sherriffs as RGD “President” expressly provided for the  
26 investor assignment of their “Cash assets” to RGD to be “entered into an established trading program

1 provided by” RGD, which “has the ability to participate as ‘principal’ in established trading  
2 programs.” *Exh. S-16a and b*. Moreover, hearing witness Jean Smith testified that Sherriffs said it  
3 “was the same investment” with RGD as before, “the same company and everything.” *H.T., p. 134*  
4 *lines 15-16*. The previous RGD contract with the Heritage Trust/ Smiths had the same “whereas”  
5 clause and subsection 3.3 provisions noted above, together with an accompanying “Specific Power of  
6 Attorney” with the described language. *Exh. S-10*. This evidence clearly establishes that the essential  
7 managerial efforts of the promoters and collateral third persons are undeniably significant and clearly  
8 affect the failure or success of the trading program investment.

9 The evidence cited above to prove the elements of the *Howey* standard was not contested at  
10 the hearing by any respondent. The Bally, RGD and PFM investment programs were investment  
11 contracts within the meaning of the SAA.

12 **B. Securities in the Form of a Certificate of Participation in a Profit-Sharing Agreement**

13 The definition of “Security” in the SAA includes “any ...certificate of interest or  
14 participation in any profit-sharing agreement.” A.R.S. § 44-1801(26). No Arizona case law has  
15 glossed this statutory language. However, identical categories in the definition of security in the  
16 Securities Act of 1933 and the Securities Exchange Act of 1934 (“1934 Act”) have come within  
17 federal judicial scrutiny. The Supreme Court opined that the “withdrawable capital shares” of an  
18 Illinois savings association fell within this category in the 1934 Act because they were evidenced  
19 by a certificate and dividends were paid from apportioned profits. *Tcherepnin v. Knight*, 389 U.S.  
20 332, 339, 88 S.Ct. 548, 555 (1967). “Instruments may be included within any of [the Act’s]  
21 definitions, as matter of law, if *on their face* they answer to the name or description.” *Tcherepnin*,  
22 389 U.S. at 339, 88 S.Ct. at 555. (Italics added.) *See also Securities and Exchange Commission v.*  
23 *Addison*, 194 F. Supp. 709 (N. D. Tex. 1961) (written agreement to execute contract conveying  
24 percentage interest in income and profits from mining operations); *Diaz Vicente v. Obenauer*, 736  
25 F.Supp. 679 (E. D. Va. 1990) (participation agreement for *pro rata* distribution of profits from real  
26 estate development).

1           The foregoing investment contract analysis of respondents' programs clearly establishes  
2 the profit-sharing element for a certificate of interest or participation in a profit-sharing agreement.  
3 The "certificate" requirement for a writing memorializing the investment agreement is satisfied by  
4 the Bally, RGD and PFM practice of providing contracts and collateral transactional documents to  
5 investors in their trading programs. *Exhs. S-4 (RGD/ Arnolds), S-10 (RGD/ Heritage Trust-Smiths),*  
6 *S-16a and b (RGD/Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber), S-38b (Patterson/*  
7 *Herrmann), S-43b (RGD/ Herrmann Plan), S-64 (PFM/ Clayton), S-68b (Patterson/ Calta), S-72b*  
8 *and c (RGD/ Calta), S-74a and b (RGD/ Calta), S-81a-c (Patterson/ Hayes), S-84 (RGD/ Far*  
9 *Horizon-Smiths), S-89 (RGD/ King), S-95 (PFM/ Jacobs), S-97 (PFM/ Hammond), S-105b*  
10 *(PFM/Mader). See also Exhs. S-112b and c (Bally/ Guess), S-113b (Bally/ RGD), S-114 (Bally/*  
11 *Guess), S-115 (Bally/ RGD), S-116 (Bally/ Guess), S-117 (Bally/ Guess).* These writings provided to  
12 investors were securities in the form of certificates of interest or participation in a profit sharing  
13 agreement within the meaning of the SAA.

#### 14       **C.     Securities in the Form of Notes**

15           The definition of "Security" in the SAA includes "any note." *A.R.S. § 44-1801(26)*. For  
16 purposes of *A.R.S. §§ 44-1841 and 44-1842*, no judicial gloss further defines "note" by any  
17 standard or test. *See State v. Tober*, 173 Ariz. 211, 213, 841 P.2d 206, 208 (1992) (En Banc);  
18 *MacCollum v. Perkinson*, 185 Ariz. 179, 185, 913 P.2d 1097, 1103 (Ct. App. 1996). Those  
19 registration statutes are violated by the offer or sale of any note that is neither registered nor  
20 specifically exempt from registration under the SAA. *Tober*, 173 Ariz. at 213, 841 P.2d at 208;  
21 *MacCollum*, 185 Ariz. at 185, 913 P.2d at 1103. Evidence admitted at the hearing in this matter  
22 showed the sale of notes by Guess for himself and both RGD and PFM as well as by Patterson on  
23 behalf of RGD. Investor witness Susan Herrmann testified that on August 22, 1997, in response to  
24 an offer from Patterson, she "wrote" a \$10,000 check to RGD "for a short investment" of one  
25 week to earn a \$500 return on this principal. *H.T., pp. 299 line 25—302 line 3; Exh. S-47.*  
26 Although no other writing memorialized the terms of this loan, *H.T., pp. 301 line 24—302 line 1,*

1 the check to RGD with accompanying terms comports with a note. Investor witness Lyle Mader  
2 testified that on August 25, 1997 he invested \$25,000 with Guess for a \$50,000 "Promissory Note"  
3 issued by Pacific Beach Mortgage Company, Inc. with a maturity date of September 21, 1997.  
4 *H.T.*, pp. 447 line 5--450 line 4; *Exh. S-104a-d*. These Mader funds were deposited in a Guess  
5 personal bank account. *Exh. S-104a-c*. Division investigator David Adams testified that investor  
6 Salvatore Calta paid \$25,000 to Guess on August 27, 1997 for another \$50,000 "Promissory Note"  
7 from the same issuer with an identical maturity date. *H.T.*, pp. 482 line 23—485 line 25; *Exhs. S-*  
8 *70, S-71*. These Calta funds were deposited by Sherriffs into an RGD bank account. *Exh. S-71*.  
9 Adams also testified that investor Calta paid \$50,000 to PFM on February 21, 1998 under an  
10 "Agreement" note of that date executed for PFM by Guess to repay \$75,000 to Calta by May 21,  
11 1998. *H.T.*, pp. 496 line 21—497 line 25; *Exhs. S-76, S-77*. These Calta funds were deposited into  
12 a PFM bank account. *Exh. S-77*.

#### 13 **D. Non-registration of the Securities**

14 At the hearing in this matter it was uncontested that the securities at issue were not  
15 registered under the SAA. Certificates of non-registration of these securities were admitted into  
16 evidence pursuant to A.R.S. § 44-2034. *Exhs. S-3f, S-3g, S-3h, S-3i, S-3j, S-3k, S-3l, S-3m, S-3n*. It  
17 is unlawful to offer or sell within or from Arizona any securities not registered or not exempt  
18 therefrom under the SAA. *A.R.S. § 44-1841*. See generally *State v. Burrow*, 133 Ariz. App. 130,  
19 132, 474 P.2d 849, 851 (1970). The burden of proving the existence of any exemption from  
20 registration under the SAA is upon the party raising such a defense in a civil action. *State v.*  
21 *Barber*, 133 Ariz. 572, 578, 653 P.2d 29, 35 (Ct. App. 1982), *approved*, 133 Ariz. 549, 653 P.2d 6  
22 (1982). No respondent at the hearing raised any affirmative defense of exemption or preemption  
23 from the requirement of registration under the SAA.

#### 24 **E. Respondent Offerors and/or Sellers**

25 The unlawful offer or sale of unregistered securities within or from Arizona  
26 encompasses more than just face-to-face solicitation or sale by a seller. Under the recognized

1 doctrine of participant liability, a person violates A.R.S. § 44-1841(A) who is directly responsible  
 2 for the distribution of unregistered securities by conduct that is both necessary to and a substantial  
 3 factor in the unlawful transaction. *See S.E.C. v. Rogers*, 790 F.2d 1450, 1456 (9th Cir. 1986); *In the*  
 4 *Matter of the Offering of Securities by: Lost Dutchman Investments, Inc. et al.*, Arizona Corporation  
 5 Commission Decision No. 58259 (April 8, 1993), pp. 13-14; *In the Matter of the Offering of*  
 6 *Securities by: Terry L. Barrett et al.*, Arizona Corporation Commission Decision No. 58187  
 7 (February 4, 1993), pp. 10-11; *In the Matter of the Offering of Securities By: The Woodington*  
 8 *Group, Inc. et al.*, Arizona Corporation Commission Decision No. 58113 (December 10, 1992), pp.  
 9 8-9; *In the Matter of the Offering of Securities by: American Microtel, Inc. et al.*, Arizona  
 10 Corporation Commission Decision No. 58088 (December 9, 1992), p. 17. Conduct necessary to the  
 11 unlawful transaction requires participation that is a "but for" cause of such transactions. *Rogers*, 790  
 12 F.2d at 1456; *Haberman v. Public Power Supply System*, 109 Wash. 2d 107, 130, 744 P.2d 1032,  
 13 1051 (1987), *appeal dismissed sub nom. American Express Travel Related Services Co. v.*  
 14 *Washington Public Power System*, 488 U.S. 805 (1988); *Lost Dutchman Investments*, pp. 13-14. To  
 15 be a substantial factor in the transaction requires participation that is more than *de minimis*. *Rogers*,  
 16 790 F.2d at 1456; *Lost Dutchman Investments*, pp. 13-14. No showing of direct contact between the  
 17 participant and the offerees is required to impose liability. *S.E.C. v. Holschuh*, 694 F.2d 130, 140 (7<sup>th</sup>  
 18 Cir. 1982); *Lost Dutchman Investments*, p. 14.

### 19 1. Guess

20 The evidence admitted at the hearing in this matter clearly showed Guess offered and sold  
 21 the securities at issue. He was both the organizer and a principal in the RGD offering as well as the  
 22 organizer and only principal in the PFM offering. Guess admitted at his examination under oath  
 23 ("EUO") that he was the "administrator" of "RGD Enterprises,"<sup>21</sup> *Exh. S-109, p. 10 lines 4—6*, as  
 24 well as owner and sole proprietor of PFM. *Exh. S-109, p. 11 lines 2—20*. Respondent Richard  
 25 Gordon Davis ("Davis") testified at his EUO that Guess originated the RGD program. *Exh. S-125*,

26 <sup>21</sup> When asked at his EUO what form of business organization was RGD Enterprises, Guess responded:  
 "Private placement investments." *Exh. S-109, p. 10 lines 7—9*.

1 pp. 55 line 21—56 line 2. Guess executed the RGD and PFM trading program contracts with  
2 investors, including collateral documents such as the “Joint Venture Profit Share Agreement.”  
3 *Exhs. S-4 (RGD/ Arnolds), S-10 (RGD/ Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber), S-43b*  
4 *(RGD/ Herrmann Plan), S-64 (PFM/ Clayton), S-72b and c (RGD/ Calta), S-74a and b (RGD/ Calta),*  
5 *S-84 (RGD/ Far Horizon-Smiths), S-95 (PFM/ Jacobs), S-97 (PFM/ Hammond), S-105b*  
6 *(PFM/Mader).* He executed the RGD investor contract with Joseph Patterson from which respondent  
7 Patterson offered and sold interests to certain RGD investors by means of his “Addendum to  
8 Contract.” *Exhs. S-38b (Patterson/ Herrmann), S-68b (Patterson/ Calta), Exh. S-81a-c (Patterson/*  
9 *Hayes).* Moreover, subsection 3.4 of the RGD and PFM contracts identified Guess as the  
10 “Administrator” for the “Joint Venture Management Program.”<sup>22</sup> The collateral “Specific Power of  
11 Attorney” executed by investors with their contract contained standardized language that the  
12 “investment trading program” was “introduced” to the investor by Guess. *Exhs. S-4 (RGD/ Arnolds),*  
13 *S-10 (RGD/ Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber), S-38b (Patterson/ Herrmann), S-*  
14 *43b (RGD/ Herrmann Plan), S-64 (PFM/ Clayton), S-68b (Patterson/ Calta), S-72b and c (RGD/*  
15 *Calta), S-74a and b (RGD/ Calta), Exh. S-81a-c (Patterson/ Hayes), S-84 (RGD/ Far Horizon-*  
16 *Smiths), S-95 (PFM/ Jacobs), S-97 (PFM/ Hammond), S-105b (PFM/Mader).* Guess also executed  
17 the PFM “Agreement” note for which Calta invested \$50,000 on February 21, 1998. *Exh. S-76.* As  
18 the middleman link between RGD and Bally, he executed Bally investment contracts on behalf of  
19 RGD and in his own name. *Exhs. S-112b and c (Bally/ Guess), S-113b (Bally/ RGD), S-114 (Bally/*  
20 *Guess), S-115 (Bally/ RGD), S-116 (Bally/ Guess), S-117 (Bally/ Guess).* Of the \$492,755 received by  
21 the RGD bank account from investors, \$230,000 was transferred to respondent Smith who sent \$124,  
22 402 back to the RGD account. *H.T., p. 612 lines 10—22; Exhs. S-120, 127.* Guess was a signatory on  
23 the RGD bank account from which he received net payments totaling \$39,488 in 1997. *H.T., pp. 601*  
24 *line 20—602 line 1, pp. 611 line 18—612 line 13; Exh. S-127.* The 1099 form issued to Guess from  
25 RGD for 1997 shows he was paid \$23,000 in “interest income,” *Exh. S-118,* while his 1099 form for

26 <sup>22</sup> Witness investor Jill Arnold testified that Guess told her he was handling all of the arrangements for the RGD investment program. *H.T., p 74 lines 4--6.*

1 that year from “Oasis Communications”<sup>23</sup> shows he was paid \$38,000 in “misc. income” by  
 2 respondent Smith. *Exh. S-121*. As the architect and a principal of both the RGD and PFM offerings,  
 3 Guess was directly responsible for the distribution of unregistered securities by conduct that is both  
 4 necessary to and a substantial factor in the unlawful transactions.

5 Uncontested witness testimony at the hearing also established that Guess offered and sold the  
 6 securities at issue in face-to face contact with offerees. He directly communicated with the following  
 7 investors to induce their investment: Arnolds (in RGD), *H.T.*, pp. 63 line 24—78 line 20; Heritage  
 8 Trust/ Smiths (in RGD), *H.T.*, pp. 117 line 19—122 line 14; Aitkins (in RGD), *H.T.*, pp. 189 line 19—  
 9 194 line 1; BVW/ Weber (in PFM), *H.T.*, pp. 225 line 14—252 line 7; Mader, *H.T.*, pp. 446 line  
 10 12—450 line 6 (in promissory note), pp. 450 line 7—456 line 15 (in PFM); Calta, *H.T.*, pp. 482 line  
 11 23—487 line 16 (in promissory note), 487 line 20—496 line 3 (in RGD); King, *H.T.*, pp. 515 line 3—  
 12 517 line 7 (in RGD). Indeed, respondent Davis himself testified at his EUO that he invested \$30,000  
 13 with Bally based on information from Guess. *Exh. S-125*, pp. 19 line 20-21 line 23 (EUO).

14 Finally, Guess repeatedly invoked his constitutional right against self-incrimination at his  
 15 EUO in response to specific questions from the Division about RGD and his receipt of funds from  
 16 certain RGD and PFM investors. *Exh. S-109*, pp. 40 line 9—44 line 7. In a civil proceeding such as  
 17 this matter before the Commission, Guess’ Fifth Amendment invocations allow an adverse inference  
 18 against him by the trier of fact as to those questions he declined to answer. *See Baxter v. Palmigiano*,  
 19 425 U.S. 308, 318, 96 S.Ct. 1551, 1557 (1975). An adverse inference by the Commission is warranted  
 20 and comports with the hearing evidence admitted against Guess showing he offered and sold  
 21 securities within the meaning of A.R.S. § 44-1841.

## 22 2. Sherriffs

23 Like Guess, Sherriffs offered and sold the securities at issue both face-to-face with offerees  
 24 and as a principal in the RGD offering. The initial RGD investor contracts specified under § 2.2  
 25 that investors forward their funds “to R.G.D./ Jim Sherriffs, Public Accountant, 1015 N. 1<sup>st</sup> Street

26 <sup>23</sup> The “Oasis Communications” address shown on this form was that of respondents Smith and Bally. *H.T.*,  
 p. 541, lines 13—18. Smith also used “Oasis Cellular” as a DBA. *H.T.*, pp. 613 line 23, 614 lines 6--7.

1 Phoenix, Arizona 85004., for safekeeping until he receives instructions to transfer moneys into  
2 trading bank.” *Exhs. S-4 (RGD/ Arnolds), S-10 (RGD/ Heritage Trust-Smiths)*. See also *S-84 (RGD/  
3 Far Horizon-Smiths)(different address for Sherriffs)*. That N. 1<sup>st</sup> Street address is also identified in the  
4 first paragraph of *Exhs. S-4 and S-10* as the RGD “communication offices,” and by respondent Davis  
5 as his business address. *H.T., p. 545 line 14—17; Exh. S-125, p. 10 lines 18--20*. He was a signatory  
6 on the RGD bank account that received investor funds and signed most the checks disbursing  
7 funds from that account. *H.T., pp. 601 line 20—602 line 16, 656 lines 12--19*. Respondent Davis  
8 testified at his EUO that Sherriffs was among “the initial group” or “working group to pull it all  
9 together and make it work,” *Exh. S-125, p. 38 line 2--10*, and “was supposed to have been doing all  
10 the accounting; set up the accounts, the funds in accounts, the—received the distributions, and then  
11 issued the proceeds to investors.” *Exh. S-125, p. 26 lines 8-18*. Guess testified at his EUO that  
12 Sherriffs was the accountant for RGD. “He was part of RGD. That was his portion of RGD.” *Exh. S-  
13 109 lines 17--20*. Sherriffs told investor Jean Smith that he was getting paid for being the RGD  
14 accountant. *H.T., pp. 126 lines 21—25, 127 lines 1--6*. Investor funds totaling \$492, 255 were  
15 received into and disbursed from this RGD account from early April 1997 until November 1997.  
16 *H.T., p. 605 lines 14-19; Exh. S-127*. Of this amount, a net total of \$233,299 was disbursed to  
17 Sherriffs. *H.T., p. 611 line 18—612 line 4, pp. 656 line 12—657 line 8; Exh. S-127*. Sherriffs  
18 received at least \$20,000 of the \$124,400 transferred by respondent Smith into the RGD account from  
19 April through July 1997, none of which was from trading profits. *H.T., pp. 619 line 14—621 line 17*.  
20 Davis testified that Sherriffs got those payments because “he had a function to perform as a part of the  
21 group and from the accounting standpoint,” even though Davis knew of no initial investment by  
22 Sherriffs in the program. *Exh. S-125, p. 48 lines 4--21*. Guess and Davis also received at least \$20,000  
23 each from the Smith payments. *H.T., p. 621 lines 12—17*. These \$31,000 monthly transfers from  
24 Smith were nothing more than his incentive payments to the RGD principals to encourage their  
25 recruitment of investors whose funds would flow from RGD to Smith. As a principal of the RGD  
26 offering, Sherriffs was directly responsible for the distribution of unregistered securities by conduct

1 that is both necessary to and a substantial factor in the unlawful transactions.

2 Beside his role as a principal in the RGD offering, Sherriffs also offered and sold its securities  
3 directly by steering his tax-preparation clients into making such investments. Investor witness Jill  
4 Arnold testified that Sherriffs was their trusted tax preparer when her husband inherited \$75,000 in  
5 April 1997. When they asked him for investment advice, Sherriffs recommended Guess as “squeaky  
6 clean.” *H.T.*, p. 60 lines 9—63 line 23. At the beginning of May, Sherriffs brought Guess to the  
7 Arnold residence where they presented the RGD investment program. *H.T.*, pp. 63 line 24—65 line 6.  
8 Referring to § 2.2 of their RGD investor contract admitted as Exh. S-4, Arnold recalled that “Jim  
9 Sherriffs, we asked him what his part was in this and he was—his title was the disbursement officer.”

10 And that was another reason we felt really comfortable with this.

11 We didn’t know Michael. We didn’t have any history with Michael, but based  
12 upon our history and professionalism with Jim Sherriffs, and he had handled our taxes in such  
13 a professional manner, we felt that since Jim was a disbursement officer we at least had some  
14 sort of recourse there.

15 Q. It says under provision 2.2 that the money will be forwarded to Mr. Sherriffs  
16 for safekeeping until he receives instructions to transfer moneys into a trading bank.

17 Was that your understanding also?

18 A. Yes. We were—we understood it that Jim was going to be handling the  
19 transferring of the funds at all times.

20 Q. So is it fair to say that you understood this to be a safekeeping escrow with  
21 Mr. Sherriffs until the money went into the trading program?

22 A. Yes, it would be.

23 *H.T.*, pp. 69 line 23—70 line 19.

24 Investor witness Jean Smith testified about a similar experience. Sherriffs was a trusted family  
25 tax preparer when the Smiths received the proceeds from the sale of a residence. When they asked  
26 him for advice, Sherriffs recommended the “squeaky clean” RGD investment program. Sherriffs  
brought Guess to the Smith residence in April 1997, where they presented the program. *H.T.*, pp 114  
line 5-115 line 3. Smith testified that “we trusted Jim.”

He was our accountant and he showed us several pieces of papers of where it  
was on the up-and-up and was guaranteed through banks. And it just it sounded—you know, I  
told him, you know, we would never get into oil or gas or silver mines or anything like that,  
but if that’s banks, why, it sounded good to us.

Q. So is it fair to say that Mr. Sherriffs was fully familiar with your financial  
situation?

A. Absolutely. He knew everything we had.

*H.T.*, p. 115 lines 6--15.

1           Their presentation indicated to Smith that both Sherriffs and Guess were involved in the  
2 program. *H.T.*, p. 118 line 6. She recounted how “both of them seem to be involved. And they were  
3 telling me that the program that we would receive high percent a month on our moneys and that it was  
4 bank guaranteed. And we questioned him about losing any of the money, and they assured us that we  
5 never would because it was guaranteed through a bank.” *H.T.*, p. 118 lines 7--12. Both Sherriffs and  
6 Guess said the program could generate high profits with no risk. *H.T.*, p. 119 lines 1--6. Smith  
7 delivered to Sherriffs a \$50,000 cashier’s check payable to RGD, *H.T.*, p. 122 lines 2--23; *Exh. S-11*,  
8 for which Sherriffs gave her a receipt. *H.T.*, pp. 123 line 8--124 line 5; *Exh. S-12*.

9           Jean Smith further testified that in October 1997 Sherriffs urged them to sell a land contract he  
10 was aware of as their tax preparer and to invest the proceeds in another RGD trading program. *H.T.*,  
11 pp. 130 line 15—138 line 22; *Exhs. S-13, S-15*. They sold their contract and invested \$150,000 of the  
12 proceeds by signing two RGD contracts with Sherriffs and delivering to him a \$150,000 check. *H.T.*,  
13 pp. 138 line 24—140 line 23; *Exhs. S-16 a and b, S-19*. Sherriffs later disclosed that he instead  
14 intended to place their funds in the World Trading Alliance (“WTA”) trading program operated by  
15 Lora Kidd in Utah. *H.T.*, pp. 142 line 9—151 line 16. Sherriffs told Jean Smith that he would hold  
16 their \$150,000 in an escrow account until transferred to the WTA program and pay the Smiths \$5000  
17 monthly interest while the funds remained in escrow. *H.T.*, p. 149 line 9—151 line 16.

18           Finally, Sherriffs repeatedly invoked his constitutional right against self-incrimination at his  
19 EUO in response to specific questions from the Division about RGD and his role in the offer and sale  
20 of RGD securities to investors. *Exh. S-110*, pp. 19 line 2—27 line 7. In a civil proceeding such as this  
21 matter before the Commission, Sherriffs’ Fifth Amendment invocations allow an adverse inference  
22 against him by the trier of fact as to those questions he declined to answer. *See Baxter v. Palmigiano*,  
23 425 U.S. 308, 318, 96 S.Ct. 1551, 1557 (1975). An adverse inference by the Commission is warranted  
24 and comports with the hearing evidence admitted against Sherriffs showing he offered and sold  
25 securities within the meaning of A.R.S. § 44-1841.

26

1           **3. Patterson**

2           Evidence admitted at the hearing showed Patterson directly offered and sold RGD  
3 securities in face-to-face contact with offerees. He executed "Addendum to Contract" instruments  
4 with investors Herrmann, Calta and Hayes that sold interests in the RGD trading program contract  
5 executed with Joseph Patterson. *Exhs. S-38b (Patterson/ Herrmann), S-68b (Patterson/ Calta), Exh.*  
6 *S-81a-c (Patterson/ Hayes)*. Uncontested testimony from investor Herrmann established that  
7 Patterson first solicited and sold her a \$20,000 Addendum to Contract interest in the RGD/ Patterson  
8 contract. *H.T., pp. 271 line 8—287 line 11; Exhs. S-38b, 40<sup>24</sup>*. He then induced her to invest another  
9 \$50,000 directly into the RGD trading program. *H.T., pp. 287 line 12—299 line 16; Exhs. S-43b, S-*  
10 *45*. Finally, Patterson induced her to make another \$10,000 "short investment" loan to RGD for a  
11 term of one week with a \$500 return. *H.T., pp. 299 line 21—302 line 5; Exh. S-47*. In effect, this loan  
12 was for an RGD note offered by Patterson.

13           Division investigator David Adams testified that Patterson spoke to and sold investor Sal  
14 Calta a \$10,000 Addendum to Contract interest in the RGD/Patterson contract. *H.T., pp. 479 line 22—*  
15 *482 line 15; Exhs. 68b, S-69*. Adams also testified about the \$25,000 cash and \$25,000 in personal  
16 property invested by Elaine Hayes in a \$50,000 Addendum to Contract sold to her by Patterson. *H.T.,*  
17 *pp. 500 line 23—506 line 19; Exhs. S-81a-c, S-82a-c<sup>25</sup>*. According to Adams, Patterson sold to Hayes  
18 in this transaction all interest in the RGD/ Patterson contract already subject to the fractional interests  
19 Patterson previously sold to Herrmann and Calta. *H.T., pp. 503 line 7—504 line 9*. Moreover,  
20 Division expert witness Mark Klamrzynski testified that Patterson received \$7600 in direct  
21 disbursements from an RGD bank account and \$12,500 in direct disbursements from a PFM bank  
22 account. *H.T., p. 677 lines 12—20; Exhs. S-127, S-130*. Patterson offered and sold RGD securities  
23 within the meaning of A.R.S. § 44-1841.

24           <sup>24</sup> Division expert witness Mark Klamrzynski testified that the Herrmann \$20,000 check shown on Exh. S-  
25 40 was deposited in Patterson's bank account from which Patterson wrote a \$20,000 check payable to RGD that was  
deposited the following day in an RGD bank account. *H.T., p. 652 lines 2—10; Exh. S-41*.

26           <sup>25</sup> Division expert witness Mark Klamrzynski testified that the \$25,000 from Hayes deposited in Patterson's  
bank account was transferred by Patterson with a \$25,000 check paid to Guess. *H.T., p. 653 lines 1—18; Exhs. S-82c*  
*and d*.



1 App. at 544, 540 P.2d at 163. Two other individuals named Sitzer and Laurie later organized  
2 another company called Budget Controls, Inc. ("Budget") that Sitzer was to run. Laurie, the sole  
3 shareholder of Budget (but under the control of Barnes, Tash and Herzberg), initially was to  
4 release stock in blocks to Sitzer as he brought in clients. Tash helped Sitzer run Budget, while he,  
5 Barnes and Herzberg paid the Budget organizational expenses and provided operating capital in  
6 return for a share of future profits. When it became apparent Budget has insufficient capital to  
7 operate successfully, Barnes, Tash and Herzberg later lent more money to Budget through CMC  
8 and contracted for CMC to provide management services to Budget for \$3,000 a month. *Id.*

9 Continuing financial difficulties led Budget to issue and sell unregistered stock pursuant  
10 to a special exemption order obtained from the Commission. *Id.* Barnes, Tash and Herzberg  
11 increased their involvement in Budget and Tash assumed complete managerial control. In  
12 connection with his solicitation and sale of \$17,000 of this stock to Vozack, an elderly widow, a  
13 Budget employee named Hassett told her untrue statements of material fact. Budget later merged  
14 with CMC and Vozack eventually sued Budget, CMC, Hassett, Barnes, Tash and Herzberg to  
15 recover her investment.<sup>26</sup> *Id.* at 544-545, at 163-165.

16 The Court of Appeals concluded that the evidence was insufficient to prove that Barnes,  
17 Tash and Herzberg participated in Hassett's misrepresentations. *Id.* at 546, at 165. Their  
18 bankrolling of Budget and control over the stock held by Laurie "show at most that as a general  
19 proposition appellants were heavily involved in the operation of Budget Controls." *Id.* at 546-  
20 547, at 165-166.

21 Hassett, who presumably could have shed much light on the question of whether  
22 appellants participated with him in defrauding appellee, did not testify. Absent his  
23 testimony, there is no evidence that appellants directly or indirectly participated in any  
24 specific act of fraud. There is also nothing to show that appellants personally employed  
25 Hassett or that Hassett was anything but the employee of Budget controls. Finally, there is  
no evidence that appellants authorized Hassett's fraudulent acts. On this record we must  
conclude that appellants cannot be held liable for Hassett's misrepresentations to appellee.

26 <sup>26</sup> The trial court rendered a joint and several judgment against all defendants for the amounts demanded by Vozack. *Vozack I*, 24 Ariz. App. at 545, 540 P.2d at 164. Barnes, Tash and Herzberg appealed only as to themselves. *Id.* The portion of the judgment against Budget, CMC and Hassett was apparently not appealed and became final.

1 *Id.* at 547, at 166.

2 Our supreme court granted review "In Banc" as to, *inter alia*, whether the trial court  
3 evidence was sufficient to show that Barnes, Tash and Herzberg participated in the fraud. *Vozack*  
4 *II*, 113 Ariz. at 270, 271, 550 P.2d at 1071, 1072. Opining that the trial testimony "was certainly  
5 sufficient from which the court could find that Hassett *directly* violated A.R.S. §44-1991 and was  
6 guilty of statutory fraud," the court addressed whether Barnes, Tash and Herzberg "*indirectly*  
7 violated the statute." *Id.* at 273, at 1074. (Italics added.) Deposition testimony by Barnes was  
8 cited in which he admitted "a hundred percent" management over Laurie when Budget applied to  
9 the Commission for its special exemption order. *Id.* Tash's trial testimony was cited wherein he  
10 admitted that after CMC contracted to manage Budget, "we were not only running the company"  
11 but also "putting up money to fund it." Moreover, Budget "officed" with CMC "to act as their  
12 place of records" and "answering service." *Id.* Testimony by Herzberg was also cited that prior  
13 to the sales of stock to Vozack, CMC contracted to provide management services to Budget. *Id.*  
14 at 273-274, at 1074-1075.

15 The supreme court said these "three defendants all admitted by this testimony that they  
16 were, in fact running Budget Control" and it concluded that "the evidence<sup>27</sup> was sufficient from  
17 which the trial court could find that the three defendants *indirectly* fraudulently sold stock to  
18 Vozack contrary to A.R.S. § 44-1991." *Id.* at 274, at 1075. (Italics added.) *Vozack II* vacated  
19 *Vozack I* and affirmed the original trial court judgment against the three defendants. *Id.* at 275, at  
20 1076.

21 *Vozack II* established that even individual principals of an entity (CMC) that managed a  
22 second entity (Budget) were indirectly but primarily liable for untrue statements uttered to an  
23 offeree in violation of A.R.S. § 44-1991 by a securities salesman from the managed entity.<sup>28</sup> By

24 <sup>27</sup> Vozack had previously invested \$17,000 in a separate limited partnership managed by CMC, but  
25 withdrew her investment before the Commission authorized Budget to issue and sell its stock. *Vozack II*, 113 Ariz. at  
26 270, 550 P.2d at 1071. The supreme court noted it "appears to be more than a coincidence" that Hassett solicited  
Vozack to buy the Budget stock after Vozack received back her limited partnership investment. *Id.* at 274, at 1075.

<sup>28</sup> In another case affirming the securities fraud convictions of "a principal who indirectly made an untrue  
statement of a material fact" in violation of the Colorado Securities Act, the Colorado Supreme Court opined that  
where "there is evidence, such as is present in this case, of a *general mode of doing business* over which the

1 this opinion our supreme court underscored the broad reach of indirect liability under the  
2 antifraud provision of the SAA.

3 ***Respondent Davis***

4 The Division did not allege the offer or sale of RGD or PFM securities by Davis, but did  
5 allege he directly or indirectly violated A.R.S. § 44-1991(B) and (C) in connection with the RGD  
6 offering of securities. Davis was a principal of RGD. Investor witness Susan Herrmann testified  
7 that she was told that Davis was a partner in RGD who provided its office. *H.T.*, pp. 377 line 23--  
8 378 line 12. Davis testified at his EUO that he was the founder of RGD Enterprises, Inc., *Exh. S-*  
9 *125*, p. 9 lines 23--24, a respondent Arizona corporation in this matter. *Exh. S-2a and b*. Except  
10 for filing annual tax returns in connection with a wholly-owned subsidiary entity, RGD  
11 Enterprises, Inc. was dormant after 1979. *Exh. S-125*, p. 9 line 11--10 line 8. Davis and his ex-  
12 wife are the sole shareholders, officers and directors of this corporation. *Exh. S-125*, pp. 11  
13 line 15--12 line 11; *Exh. S-2b*. In early 1997 he invested \$30,000 in Guess' "money management  
14 program" involving "the investment of large dollars—large box of dollars which are then taken  
15 and reissued on the secondary market issuing notes, discount, and large volumes of profit dollars  
16 and with return of principal and earnings for the investors." *Exh. S-125*, pp. 19 line 20--20 line  
17 10, 35 lines 19--23, 36 line 4. He received payment distributions from this program from April  
18 through July 1997 and again in September 1997. *Exh. S-125*, p. 22 lines 18-23. Three payments  
19 were \$6000 each, one was \$5000 and the last was \$3000. *Exh. S-125*, p. 23 lines 16--23. He  
20 understood the first four payments were from respondent Smith. *Exh. S-125*, p. 47 lines 2--18.  
21 Davis testified that "Mike and I set up" RGD Enterprises, Inc. as "the entity that gave a corporate  
22 entity to the program." *Exh. S-125*, p. 25 lines 3--10. It was to be the entity or vehicle through  
23 which distributions were recorded and distributed. *Exh. S-125*, pp. 25 lines 20--24, 31 lines 5--  
24 10. For this purpose, "Mr. Sherriffs set up the accounts with the RGD Enterprises name

25  
26 defendant has strong overall control, it is not difficult to find that the defendant *indirectly* makes those  
representations which are conveyed by his sales representatives." *People v. Blair*, 195 Colo. 462, 463, 579 P.2d  
1133, 1144 (1978) (En Banc). (Italics added.)

1 situation,” *Exh. S-125, p. 31, lines 9–10*, which Davis considered an RGD Enterprises, Inc.  
 2 corporate account. *Exh. S-125, p. 33 lines 1--20*. Davis denied he was a signatory on this RGD  
 3 account. *Exh. S-125, p. 33 lines 21--23*.<sup>29</sup>

4 Q. Is it fair to say then that any of the funds that flowed into that account  
 5 which Mr. Sherriffs administered were funds that flowed into RGD Enterprises, Inc.

6 A. Yes. I would consider it funds that were set up. They had to set up separate  
 7 bank accounts, because I had no bank accounts for RGD Enterprises anyway. So I  
 8 considered them fair accounts.

9 Q. Was the name of that account RGD Enterprises, Inc. as the account  
 10 holder?

11 A. I don’t have a copy of the check with me. It’s RGD Enterprises. I know it  
 12 was the first line. I think Sherriffs had his name on it.

13 Q. And when that account was opened, was that opened as an account for  
 14 RGD Enterprises, Inc., intended to be an RGD Enterprises, Inc. account?

15 A. Well, I—for this specific use only.

16 Q. Okay. And how did you—what do you define as the use then that the  
 17 account was put to?

18 A. The receiving of proceeds from the program and then the  
 19 distribution[SIC]—or disbursement of proceeds to investors.

20 *Exh. S-125, pp. 33 line 24--34 line 20.*

21 From information provided by Guess, Davis prepared an IRS form 1099-INT for each  
 22 RGD investor for 1997 on which RGD Enterprises, Inc. was shown as the payer of distributions  
 23 made to the investor. *Exh. S-118; Exh. S-125, pp. 25 line 25--26 line 4, 30 lines 2–25, 31 lines*  
 24 *13--19*. At his EUO in June 1998, Guess described himself as the “Administrator of RGD  
 25 Enterprises” which he identified as an Arizona corporation “owned by Richard Davis.” *Exh. S-*  
 26 *109, p. 10 lines 4--21*. By issuing these 1099-INT forms through his corporation, Davis  
 implemented his original plan conceived with Guess in early 1997 to operate the RGD  
 investment program under the canopy of RGD Enterprises, Inc. These corporate 1099s served to  
 reinforce the lulling fiction that the 1997 payments made to RGD investors were “interest”  
 distributions from profits earned by the trading program and to conceal the Ponzi nature of those  
 payments. Without Davis’ corporate camouflage of legitimacy from the start of the RGD  
 program, Guess and the other RGD principals may have been impaired in recruiting investors  
 into their program.

<sup>29</sup> Division witness Mark Klamrzynski testified that Davis was in fact a signatory on the RGD account  
 opened and used by Sherriffs for investor funds. *H.T., pp. 601 line 24–602 line 2*.

1           Davis admitted at his EUO that he was among the “initial group” or “working group to  
2 pull it all together and make it work,” with his role being “besides investment, part of putting  
3 forth the corporate structure, RGD Enterprises.” *Exh. S-125, p. 3 lines 5-14.*

4           Q.     Were you—how did it come about that this whole thing fell under RGD  
5 Enterprises? Was that an offer by you?

6           A.     To give it a—to give it a local kind of establishment type of situation.  
7 Credibility to try to develop something to move on up the –

8           Q.     So—so it was strictly for the corporate structure of RGD Enterprises, Inc.?  
9 Is that –

10          A.     See, that came—yeah. That came on after, you know. That was an  
11 afterthought, is let’s get the ball rolling here type of thing.

12          Q.     So it was—was it—was it the idea, well, hey, I’ve already got a  
13 corporation formed here, why don’t we just bring it its umbrella type thing?

14          A.     That was part of my concept, yes.

15          Q.     Were you actively involved in this trading program?

16          A.     No.

17          Q.     So, in effect you were the president of something that you didn’t have any  
18 active involvement in.

19          A.     Well, I was the president of my existing corporation, RGD Enterprises.

20          Q.     Okay. And this—you said that RGD Enterprises sort of ceased to be  
21 anything in 1979, wasn’t it?

22          A.     It ceased in doing any day-to-day activity, yes.

23          Q.     Until Mike Guess came down the pike, right?

24          A.     Right.

25          Q.     And you brought this investment program under the umbrella of RGD  
26 Enterprises as a corporate structure, right?

          A.     It ended up that way, yes.

          Q.     So that was the first active thing that RGD Enterprises had done since ’79?

          A.     That’s right. Yes.

*Exh. S-125, pp. 59 line 2--60 line 18.*

19           Davis’ involvement in the RGD offering went well beyond merely preparing Form 1099s.  
20 He provided the investment program with his initials—RGD—and authorized it to operate under  
21 the umbrella of his shell corporation RGD Enterprises, Inc. He admitted he allowed RGD to open  
22 and operate a bank account that he considered a corporate account. He was in fact a signatory on  
23 that account. Moreover, Division witness Mark Klamrzynski testified that another bank account  
24 was opened on September 19, 1997 in the name of RGD Enterprises, Inc. with Guess and  
25 Sherriffs as signatories. This account had the same federal tax identification number as RGD  
26 Enterprises, Inc. *H.T., pp. 650 line 2—651 line 5.* Investor funds from Sal Calta were deposited

1 into this account. *H.T.*, pp. 649 line 3—650 line 8; *Exh. S-73*. Investor witness Susan Herrmann  
2 testified that she telephoned Davis on November 4, 1997 to complain about the breakdown in  
3 payments to her and Davis responded “I’ll get right on this.” *H.T.*, p. 328 lines 1—6, 367 line  
4 24—370 line 10. With other RGD principals, Davis met with attorney Fred Schaffer about their  
5 investment program. *Exhs. S-125*, p. 39 line 7—12; *Exh. S-126f*. Their purpose was to develop “a  
6 refined program downstream,” *Exh. S-125*, p. 54 lines 6--14, embodied in the draft “RGD Capital  
7 Management Fund, L.L.C.” private offering memo admitted as *Exh. S-126e*. *Exh. S-125 pp. 38*  
8 *line 20--41 line 12, 62 line 12--64 line 6*. According to this “Fund” draft, the “Fund” manager was  
9 to be RGD Enterprises, Inc., an Arizona corporation, with Davis as President. *Exh. S-126e*, p. 5.

10 Davis’ role as an RGD principal close to Guess also entitled him to preferential treatment.  
11 Of the \$30,000 he invested with Bally in early 1997, he received back \$26,000 in payments that  
12 same year, an amount equal to most of his principal. *Exhs. S-118, S-127*. He testified in October  
13 1998 that “I feel very secure that I’ll get my money back,” *Exh. S-125*, p. 50 lines 18—19, and  
14 that “I’m sure that I will receive my principal back.” *Exh. S-125*, p. 51 lines 7--8. *See also Exh.*  
15 *S-125*, p. 65 lines 8--13. Indeed he did. Division witness Mark Klamrzynski testified that beside  
16 the \$26,000 Davis was paid in 1997, he was paid another \$27,000 from the PFM account in  
17 November 1998 for a total of \$53,000. *H.T.*, pp. 660 line 12—661 line 3, p. 672 lines 4--18; *Exh.*  
18 *S-130*. He also testified that one \$20,000 “preferential payment” check to Davis from PFM in  
19 1998 was annotated “Prin. Ret.” for principal return, as were other checks for much smaller  
20 amounts paid from that account to investors at that time. *H.T.*, pp. 670 line 13—674 line 23.  
21 Unlike the other RGD investors, Davis got back his \$30,000 principal plus \$23,000 extra.

22 **1. Untrue Statements and Misleading Omissions of Material Fact**

23 The elements of securities fraud under A. R. S. § 1991(2) are as follows:

- 24 1. in connection with a transaction or transactions;
- 25 2. within or from Arizona;
- 26 3. involving an offer to sell or buy securities, or their sale or purchase;

- 1 4. to directly *or indirectly*;
- 2 5. make any untrue statement of material fact;
- 3 6. or omit to state any material fact necessary in order to make the statements made, in
- 4 light of the circumstances under which they were made, not misleading.

5 Materiality is a showing of substantial likelihood that, under all the circumstances, the  
6 misstated or "omitted fact would have assumed actual significance in the deliberations" of a  
7 reasonable buyer. *Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548, 553, 733 P.2d 1131, 1136  
8 (1986), citing *Rose v. Dobras*, 128 Ariz. 209, 214, 624 P.2d 887, 892 (App. 1981), quoting *TSC*  
9 *Industries v. Northway, Inc.*, 426 U.S. 438, 96 S. Ct. 2126, 48 L. Ed. 2d 757 (1976). Under this  
10 objective test, there is no need to investigate whether an omission or misstatement was actually  
11 significant to a particular buyer.

12 The affirmative duty not to mislead potential investors in any way places a heavy burden  
13 on the offeror and removes the burden of investigation from the investor who is not required to  
14 act with due diligence. *Trimble*, 152 Ariz. at 553, 733 P.2d at 1136. A misrepresentation or  
15 omission of a material fact in the offer and sale of a security is actionable even though it may be  
16 unintended or the falsity or misleading character of the statement may be unknown. *Scienter* or  
17 guilty knowledge is not an element of a civil violation of A. R. S. § 44-1991(2). *State v.*  
18 *Gunnison*, 127 Ariz. 110, 113, 618 P.2d 604, 607 (1980) (In Banc).<sup>30</sup> A seller of securities is  
19 strictly liable for the misrepresentations or omissions he makes. *Rose v. Dobras*, 128 Ariz. at  
20 214, 624 P.2d at 892.

21 Further, if the omissions or nondisclosures meet the standards of materiality to a reasonable  
22 investor, causation and reliance can be assumed. *Trimble*, 152 Ariz. at 553, 733 P.2d at 1136,

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23 <sup>30</sup> In so interpreting A.R.S. § 44-1991(2), the Supreme Court of Arizona identified §17(a) of the federal  
24 Securities Act of 1933 ("1933 Act") as the counterpart to A.R.S. § 44-1991, then followed the corresponding federal  
25 interpretation of §17(a)(2) in *Aaron v. Securities and Exchange Commission*, 446 U.S. 680, 100 S.Ct. 1945, 64  
26 L.Ed.2d 611 (1980). *Gunnison*, 127 Ariz. at 112-113, 618 P.2d at 606-607. Our supreme court declared that although  
it was "not bound by the interpretation placed by the United States Supreme Court on the federal statute, it is helpful,  
for consistency in the application of the law, to be harmonious with the United States Supreme Court. Unless there  
is a good reason for deviating from the United States Supreme Court's interpretation, we will follow the reasoning of  
that court in interpreting sections of our statutes which are identical or similar to federal securities statutes." *Id.*

1 quoting *Harmsen v. Smith*, 693 F.2d 932, 946 (9th Cir. 1982). Additionally, there is no requirement  
 2 to show that investors relied on the misrepresentations or omissions, *Rose*, 128 Ariz. at 214, 624  
 3 P.2d at 892, or that the misrepresentations or omissions caused injury to the investors, *Trimble*, 152  
 4 Ariz. at 553, 733 P.2d at 1136.

5 The Division alleged the following specific acts by which all or certain respondents violated  
 6 A. R. S. § 1991(2) with untrue statements and misleading omissions of material fact. In view of the  
 7 defaulting respondents in this matter, the evidence will be addressed with a focus on Guess,  
 8 Sherriffs, Patterson and Davis.

9 **a. Untrue Statement of European Trading Market for Bank Debt Instruments**

10 The allegation was uncontested at the hearing that no European trading market existed for  
 11 discounted debt instruments from major banks that generated very high profits with no investor risk.  
 12 The Bally, RGD and PFM investment programs predicated investor profits and safety of principal  
 13 on such a trading market. The RGD and PFM investor contracts were circumspect in alluding to  
 14 “the investment of the aforementioned funds in trading programs,”<sup>31</sup> the “transfer of funds from  
 15 investor/client into trading bank,”<sup>32</sup> and profit disbursement “after start up of trading program.”<sup>33</sup>  
 16 *Exhs. S-4 (RGD/ Arnolds), S-10 (RGD/ Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber), S-43b*  
 17 *(RGD/ Herrmann Plan), S-64 (PFM/ Clayton), S-72b and c (RGD/ Calta), S-74a and b (RGD/*  
 18 *Calta), S-84 (RGD/ Far Horizon-Smiths), S-89 (RGD/King), S-95 (PFM/ Jacobs), S-97 (PFM/*  
 19 *Hammond), S-105b (PFM/Mader). See also Exhs. S-112b and c (Bally/ Guess), S-113b (Bally/*  
 20 *RGD), S-114 (Bally/ Guess), S-115 (Bally/ RGD), S-116 (Bally/ Guess), S-117 (Bally/ Guess).*  
 21 Collateral contract documents such as the “Joint Venture Profit Share Agreement” additionally  
 22 referred to “cash trading profits,”<sup>34</sup> while the “Specific Power of Attorney” cited “my investment  
 23 account in an investment trading program.” *See, e.g., Exh. S-43b.* The specimen Bally contract and  
 24 accompanying information provided by Guess to investor King fleshed out the trading program in

25 <sup>31</sup> See the second “whereas” clause on the first page of these contracts.

26 <sup>32</sup> See subsection 2.3 in these contracts.

<sup>33</sup> See subsection 3.1 in these contracts.

<sup>34</sup> See §1 “Profit Share” in the “Joint Venture Profit Share Agreement.”

1 greater detail. *Exhs. S-88, S-89.*

2 Oral presentations by respondents to offerees were far less restrained. Investor witness Jill  
3 Arnold described what was said by Guess at her first meeting with him:

4 Q. Okay. Let's go back to that evening meeting for a little bit. You've described  
5 a rather lengthy evening presentation that was made.

6 Do you remember any of the specifics that were provided to you during that  
7 meeting about how this return was to be earned as to pay you this kind of payback on the  
8 investment?

9 A. That our money was to be pooled with other investors and that it would be --  
10 he mentioned instruments. The entire night that was -- that it was going to be pooled together  
11 and that there would be profits paid. And that the instruments when the money was pooled  
12 together and sent to banks, that they would actually—my understanding was they would  
13 actually be borrowing from blocks of money that were pooled together. That the banks  
14 would actually be borrowing from the money.

15 And Michael said that it was extremely conservative. He said that the only  
16 way that this program would fail is if the world monetary system would completely collapse.  
17 And even at that our entire investment of \$75,000 would be returned at 108 percent interest.

18 He said that Lee Iacocca from the Chrysler company, that when he invested  
19 that was how Lee Iacocca turned the Chrysler Corporation around. He told us that the  
20 Kennedys and the Rothchilds and many large families that that's how they had made their  
21 money, loaning money to the banks.

22 And he seemed very knowledgeable, and when I asked him he said that he  
23 had seven years experience in the trading programs and that it was a very successful  
24 program. And that was the information that he gave us.

25 Q. Would it be fair to say, then, that Mr. Guess represented to you that there was  
26 some European trading market for major bank debt instruments?

A. Yes.

Q. and that this was going to generate high profits with no risk?

A. Yes.

...

A. Mr. Guess did discuss it that the world trading banks—that was mentioned to  
us. And that they were in Europe and the trading would be done in Europe, but I don't recall  
exactly that language. But I do know that he referred to the money would be pooled and it  
would be traded in Europe. *H.T., pp. 66 line 16—71 line 15.*

Witness investor Jean Smith testified that Guess described such a program to her, *H.T., pp.*  
*118 line 4—119 line 6*, as did investor Yvonne Aitken, *H.T., pp. 190 line 19—191 line 18*, and  
investor Lyle Mader. *H.T., p. 450 lines 7—23*. Witness investor Brian Weber heard the same  
description from Guess, *H.T., pp. 240 line 21—241 line 6*, and more:

Q. You use the word industry. What did you or what did you understand him to  
mean by using that term?

A. Just some very top secret European banking debt instrument industry that  
existed that regulations and authorities said didn't exist and said it was nothing but a scam.  
But, you know, he knew otherwise, and he knew that it did exist and that profits were being  
made.

1 And it essentially had a humanitarian aspect to it that really, you know  
 2 personally appealed to me. That supposedly the proceeds of these investments were used to  
 3 help out developing Third World countries to help out with natural disasters. To help out  
 4 when, you know, a huge flood hit somewhere or a drought. So those aspects really appealed  
 5 to me. And that the industry was actually accomplishing humanitarian welfare projects  
 6 essentially. And that the people that invested their money in there were assisting in helping  
 7 that type of relief effort to take place. *H.T.*, pp. 242 line 23—243 line 18.

8 Guess even diagrammed the program for Weber “with a bunch of boxes and arrows and  
 9 things.” *H.T.*, pp. 248 line 24—249 line 17; *Exh. S-33b*. Witness investor Susan Herrmann had a  
 10 more refined recollection of what she was told about the program:

11 Q. Can you describe what representations were made to you about this  
 12 investment opportunity?

13 A. Yes. My understanding of the investment opportunity is that this was a  
 14 trading program done overseas. That the trading program was backed by bank guarantees,  
 15 and that the profit really was coming from the trading process, not from owning the assets  
 16 myself. But that it was backed by the bank guarantee and so it was safe.

17 Q. Excuse me for one moment.

18 You said it was profits made by the trading process itself and not something  
 19 else. What was the other thing?

20 A. Versus owning the securities. The distinction in my mind when I met with  
 21 him and talked about it is that when you own the security you’ve got—in my mind you’ve  
 22 got the risk of that. But they were making all their profits just from the trading, and it was  
 23 supposed to be the matching of the buyer and the seller.

24 And it was my understanding they didn’t own the assets unless they already  
 25 had a buyer. So if you’ve got a seller and a buyer, you’re making your profit just from  
 26 executing the trade. There’s relatively little risk as you’re not holding inventory. . . . Your  
 profits would be a function of how many times could you trade the individual items.

In my mind your worst down side was something would change in the  
 international market so corporations and governments would borrow from a different area.  
 So the worst thing what would happen is you couldn’t have a trade, but you would still  
 always have your money and you would always have the bank guarantee behind it.

Q. Prior to any actual investment, whom did you discuss this investment  
 opportunity with, if anybody, other than Mr. Patterson?

A. Before I actually made it I think it was just Mr. Patterson.

Q. So all of the information was coming to you through him?

A. Yes.

Q. Okay. Was this represented as an investment in a European trading market  
 for major bank debt instruments?

A. Yes.

Q. That would generate high profits?

A. Oh, very high profits, yes.

Q. With no risk of loss of principal?

A. That is correct.

*H.T.*, pp. 271 line 19—273 line 19.

Herrmann also had compiled a diagram of the program based on what she was told by Patterson,

1 Guess and Sherriffs. *H.T.*, pp. 290 lines 10-23, 306 line 24—312 line 20; *Exh. S-42*.

2 Division expert witness Boris Kozolchyk<sup>35</sup> testified at the hearing that the bank instrument  
3 trading market described in Bally, RGD and PFM offering materials was “fraudulent,” *H.T.*, p. 408  
4 line 24, and “a total fabrication. Nothing of that exists.” *H.T.*, p. 417 line 19—20. Moreover,  
5 Division witness David Adams testified that all such trading programs in European debt instruments  
6 he had investigated for the Division were fraudulent and that he was unaware of any that were  
7 legitimate. *H.T.*, p. 555 lines 3--21.

8 **b. Untrue Statement of RGD Investor Funds Safekeeping in Escrow**

9 The Bally, RGD and PFM contracts with investors provided under §2 “Procedure” that  
10 investor funds would be held for “safekeeping” until transferred to a trading bank. *Exhs. S-4 (RGD/  
11 Arnolds), S-10 (RGD/ Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber), S-43b (RGD/ Herrmann  
12 Plan), S-64 (PFM/ Clayton), S-72b and c (RGD/ Calta), S-74a and b (RGD/ Calta), S-84 (RGD/ Far  
13 Horizon-Smiths), S-89 (RGD/King), S-95 (PFM/ Jacobs), S-97 (PFM/ Hammond), S-105b  
14 (PFM/Mader). See also Exhs. S-112b and c (Bally/ Guess), S-113b (Bally/ RGD), S-114 (Bally/  
15 Guess), S-115 (Bally/ RGD), S-116 (Bally/ Guess), S-117 (Bally/ Guess). Investor witness Jill  
16 Arnold testified she understood the RGD bank account to which their funds were wired was this  
17 escrow account. *H.T.*, p. 77 lines 3-12. She was told by Guess and Sherriffs that these funds “would  
18 be put in a escrow account where the money would be pooled together with other investors before it  
19 would be traded.” *H.T.*, p. 75 lines 2--5. Investor witness Jean Smith also understood her investment  
20 funds would be escrowed until transfer to a trading bank. *H.T.*, pp. 121 line 19--122 line 1, 124 lines  
21 6--10. Division expert witness Mark Klamrzynski testified that only \$230,000<sup>36</sup> of the \$492,755 in  
22 investor funds deposited into the RGD “escrow” bank account was actually transferred directly to*

23 <sup>35</sup> In Arizona Corporation Commission Decision No. 61291 in “the matter of the securities offering by:  
24 European Marketing Group, L.C.” et al., the Commission made a finding that “Dr. Kozolchyk was eminently  
25 qualified as an expert in the field of the purported investments which were promoted by EMG’s managers.”  
*Decision No. 61291*, p. 11. The investments at issue in that case were for the trading of European bank notes in the  
secondary market. *Id.* at pp. 4-5.

26 <sup>36</sup> Of this amount, \$124,402 was transferred back to the RGD account for payments to Guess and others  
from April through July 1997, leaving a net transfer to Smith of \$105,598 as shown on *Exh. S-127*. *H.T.*, p. 612 lines  
3—22, 619 line 10—621 line 21.

1 Randall Smith or to the Bally "Client Management Services" account<sup>37</sup> in Alabama controlled by  
 2 Smith. *H.T.*, pp. 612 lines 2—614 line 12. The remainder of these funds was disbursed to Guess,  
 3 Sherriffs, Davis, Patterson and others, including \$73,750 to the investors themselves as "profits."  
 4 *H.T.*, pp. Exh. S-127. Klamrzynski found no disbursement from the RGD account to any identifiable  
 5 "trading bank." *H.T.*, pp. 612 line 23—613 line 3. Moreover, this witness also testified that neither  
 6 the Client Management Services account nor the Oasis Cellular account controlled by Smith were  
 7 operated as the trust or trading account described in RGD or Bally investor contracts. *H.T.*, pp. 616  
 8 line 8—619 line 9. Smith disbursed funds from the Oasis Cellular account for personal uses and  
 9 other fraudulent schemes, *H.T.*, pp. 617 line 6—619 line 9. Klamrzynski also testified that his review  
 10 of the PFM bank account records disclosed no indication of any transfers to any identifiable trading  
 11 bank, *H.T.*, p. 640 lines 18—24, and that \$150,000 in investor funds received into this account were  
 12 misused by Guess for purposes other than safekeeping for transfer to a trading bank. *H.T.*, p. 642,  
 13 line 4—24, Exh. S-130. The Bally, RGD and PFM "safekeeping" escrow accounts were never more  
 14 than bogus enticements to offerees.

15 **c. Untrue Statement of Bank Guarantee Protecting Investor Funds**

16 The Bally, RGD and PFM contracts with investors provided under §3.1 "Profit Return" that  
 17 investor principal will have a 106% or 108% "bank guarantee" from "top fifty West European  
 18 Bank." Exhs. S-4 (RGD/ Arnolds), S-10 (RGD/ Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber),  
 19 S-43b (RGD/ Herrmann Plan), S-64 (PFM/ Clayton), S-72b and c (RGD/ Calta), S-74a and b  
 20 (RGD/ Calta), S-84 (RGD/ Far Horizon-Smiths), S-89 (RGD/King), S-95 (PFM/ Jacobs), S-97  
 21 (PFM/ Hammond), S-105b (PFM/Mader). See also Exhs. S-112b and c (Bally/ Guess), S-113b  
 22 (Bally/ RGD), S-114 (Bally/ Guess), S-115 (Bally/ RGD), S-116 (Bally/ Guess), S-117 (Bally/  
 23 Guess). See also Exhs. S-16a and b (§3 "Safety") (RGD--Sherriffs/ Heritage Trust—Smiths).  
 24 Investor witnesses Jill Arnold, Jean Smith and Brian Weber testified about how Guess explained this

25 \_\_\_\_\_  
 26 <sup>37</sup> Klamrzynski testified that this Client Management Services account was nothing more than a "dummy  
 clearing account" from which investor funds were transferred to another bank account controlled by Smith under the  
 DBA of "Oasis Cellular." *H.T.*, pp. 613 line 12—614 line 16, 615 line 24—616 line 3.

1 guarantee to each of them. *H.T.*, pp. 70 line 20—71 line 17, 118 lines 6--12, 235 line 21—236 line  
2 10. Investor witness Herrmann testified how Patterson described the guarantee to her. *H.T.*, pp. 292  
3 line 15—293 line 7. The Division alleged that no such guarantee could be obtained for funds  
4 invested in the RGD or Bally program. No evidence was offered or admitted at the hearing to prove  
5 the existence of any bank guarantee. Moreover, Division expert witness Boris Kozolchyk testified  
6 that “such guarantees are not issued by these banks for this type of an transaction” and that he has  
7 “never known a European bank to issue a guarantee for this type of an investment at all. So these are  
8 totally false representations.” *H.T.*, p. 411 lines 4-13. He also elaborated on the legitimate uses of  
9 bank guarantees and the impossibility of such use for respondents’ investment program. *H.T.*, pp.  
10 411 line 14—412 line 11, 418 line 20—421 line 11. Kozolchyk’s testimony was uncontested. The  
11 European “bank guarantee” representation was bogus.

12 **d. Untrue Statement of Payments to Investors From Profits**

13 The Division alleged that Guess made the untrue statement that payments to investors were  
14 from trading program profits. Section 3 (“Profit Return”) of the Bally, RGD and PFM investor  
15 contracts provided for “payouts” to investors from profits earned in the trading programs. *Exhs. S-4*  
16 *(RGD/ Arnolds)*, *S-10 (RGD/ Heritage Trust-Smiths)*, *S-33a (PFM/ BVWI-Weber)*, *S-43b (RGD/*  
17 *Herrmann Plan)*, *S-64 (PFM/ Clayton)*, *S-72b and c (RGD/ Calta)*, *S-74a and b (RGD/ Calta)*, *S-84*  
18 *(RGD/ Far Horizon-Smiths)*, *S-89 (RGD/King)*, *S-95 (PFM/ Jacobs)*, *S-97 (PFM/ Hammond)*, *S-*  
19 *105b (PFM/Mader)*. See also *Exhs. S-112b and c (Bally/ Guess)*, *S-113b (Bally/ RGD)*, *S-114*  
20 *(Bally/ Guess)*, *S-115 (Bally/ RGD)*, *S-116 (Bally/ Guess)*, *S-117 (Bally/ Guess)*. See also *Exhs. S-*  
21 *16a and b (§4 “Profits”)* *(RGD--Sherriffs/ Heritage Trust—Smiths)*. Investor witnesses testified  
22 they received payments from RGD and PFM represented to be profit payments. However, Division  
23 witness Mark Klamrzynski testified that he found no indication of trading profits entering the Oasis  
24 Cellular, RGD or PFM bank accounts. *H.T.*, pp. 620 line 13—19, 640 lines 2--17, 642 lines 4—21,  
25 643 lines 6—10, 644 lines 18—23, 653 line 19—654 line 7; *Exhs. S-127, S-130*. His testimony was  
26 uncontested.

1           **e.       Untrue Statement of Preserving Status of Investor IRA Funds**

2           The Division alleged that Guess made the untrue statement that investment funds received  
3 from an investor's qualified Individual Retirement Account ("IRA") would be handled to retain their  
4 tax-deferred status. Division investigator David Adams testified that RGD investor Sal Calta rolled  
5 over IRA funds into investments with Guess and RGD with the understanding that their tax-deferred  
6 status would be preserved. *H.T.*, pp. 485 lines 12—487 line 6; 487 line 20—490 line 14; *Exh. S-72a*.  
7 Division witness Mark Klamrzynski testified that the Calta funds were never transferred to an  
8 identifiable IRA qualified custodial account. *H.T.*, p. 651 lines 6—19. This testimony from Adams  
9 and Klamrzynski was uncontested.

10           **f.       Misleading Omission of Investor Funds Misuse for Personal Purposes**

11           The Division alleged that Guess, Sherriffs, Patterson, Smith and others failed to disclose  
12 their misuse of investor funds for personal expenditures. Investor witnesses Jill Arnold and Jean  
13 Smith testified that they was never informed when they invested that their funds would be used for  
14 anything other than placement into the RGD trading program. *H.T.*, p. 75 lines 6—15, 124 lines 6--  
15 10. They were not told that their funds could be used for personal expenses. *H.T.*, p. 77 lines 17--20,  
16 124 lines 11--14. Division witness Mark Klamrzynski testified that investor funds received into the  
17 Oasis Cellular/ Smith, RGD and PFM bank accounts were misused for personal expenditures. *H.T.*,  
18 pp. 629 line 13—630 line 19, 642 line 25—643 line 5; *Exhs. S-127, 130*. His testimony in this  
19 regard was uncontested at the hearing.

20           **g.       Misleading Omission of Investor Fund Misuse for Ponzi Payments**

21           No Bally, RGD or PFM offering document offering document disclosed any use of investor  
22 principal for distributions to investors during the term of the contract. *Exhs. S-4 (RGD/ Arnolds), S-*  
23 *10 (RGD/ Heritage Trust-Smiths), S-33a (PFM/ BVWI-Weber), S-43b (RGD/ Herrmann Plan), S-64*  
24 *(PFM/ Clayton), S-72b and c (RGD/ Calta), S-74a and b (RGD/ Calta), S-84 (RGD/ Far Horizon-*  
25 *Smiths), S-89 (RGD/King), S-95 (PFM/ Jacobs), S-97 (PFM/ Hammond), S-105b (PFM/Mader).*  
26 *See also Exhs. S-112b and c (Bally/ Guess), S-113b (Bally/ RGD), S-114 (Bally/ Guess), S-115*

1 (*Bally/ RGD*), *S-116 (Bally/ Guess)*, *S-117 (Bally/ Guess)*. See also *Exhs. S-16a and b (RGD--*  
2 *Sherriffs/ Heritage Trust—Smiths)*. The Division alleged that Guess, Sherriffs, Patterson and certain  
3 other defaulted respondents failed to disclose their misuse of investor funds for payments to  
4 investors. Investor witnesses Jill Arnold and Jean Smith testified that they were never informed  
5 when they invested that their funds would be used for anything other than placement into the RGD  
6 trading program. *H.T.*, *p. 75 lines 6—15, 124 lines 6--10*. They were not told that their funds could  
7 be used for payments to other investors. *H.T.*, *p. 77 lines 17—20, 124 lines 11--14*. Division witness  
8 Mark Klamrzynski testified that he found no evidence of trading profits entering the Oasis Cellular/  
9 Smith, RGD or PFM bank accounts and that these accounts were operated as Ponzi schemes. *H.T.*,  
10 *pp. 620 line 13—19, 636 line 10—642 line 24, 643 lines 6—10; Exhs. S-127, S-130*. Klamrzynski's  
11 testimony in this regard was uncontested by any other evidence at the hearing.

12 **h. Misleading Omission of Business Experience and Background Information**

13 The Division alleged that respondents failed to disclose the business experience and  
14 background of Smith, Guess, Sherriffs and Davis. Failure to disclose the business history of a  
15 securities issuer and the business backgrounds and experience in investments of its principals is a  
16 misleading omission of material fact. *State ex rel. Corbin v. Goodrich, 151 Ariz. 118, 126-127, 726*  
17 *P.2d 215, 223-224 (Ct. App. 1986)*. Investors had no due diligence burden of investigation to ask for  
18 this information. See *Trimble, 152 Ariz. at 553, 733 P.2d at 1136*. None of the Bally, RGD or PFM  
19 offering documents received by investors disclosed the business experience or background of these  
20 entities or their principals. Investor witness Jill Arnold testified that no she received no information  
21 when she invested about the business experience of background of Davis and Smith. The only such  
22 information provided to her about Guess was that he had been involved in similar trading programs  
23 for seven years. *H.T.*, *p 78 lines 7--24*. Investor witness Jean Smith could not recall anything told to  
24 her about Guess' business experience and background. *H.T.*, *p. 125 lines 2--11*. No such  
25 information was given to her about respondents Davis and Smith. *H.T.*, *p. 125 lines 12--18*.  
26 However, she had been told by Sherriffs that he was a Certified Public Accountant. *H.T.*, *pp. 124*

1 line 18—125 line 1. Sherriffs admitted to the Division at his EUO that he was never a CPA. *Exh S-*  
2 *110, p. 16 lines 16-18.*

3 **i. Misleading Omission of Financial Statements**

4 The Division alleged that respondents failed to disclose financial statements reflecting the  
5 financial condition of RGD, PFM and Bally. Failure to disclose the financial condition of a  
6 securities issuer is a misleading omission of material fact. *Goodrich, 151 Ariz. at 126-127, 726 P.2d*  
7 *at 223-224.* Investors had no due diligence burden of investigation to ask for this information. *See*  
8 *Trimble, 152 Ariz. at 553, 733 P.2d at 1136.* No such financial information is found in any of the  
9 RGD, PFM or Bally offering documents admitted into evidence at the hearing. Investor witnesses  
10 testified at the hearing that they did not receive or see any financial statements for RGD, PFM or  
11 Bally. *H.T., pp. 78 line 25—79 line 2 (Jill Arnold), 127 lines 21—25 (Jean Smith), 192 lines 2—4*  
12 *(Yvonne Aitkin—no documents received describing the investment), 246 lines 13—16 (Brian*  
13 *Weber), 294 line 20—25 (Susan Herrmann), pp. 456 line 23—457 line 1 (Lyle Mader).* No evidence  
14 was admitted contesting the non-disclosure of financial information.

15 **2. Fraudulent Transactions, Practices or Courses of Business**

16 The Division alleged that in connection with their offers or sales of securities, certain  
17 respondents directly or indirectly engaged in transactions, practices or courses of business which  
18 operated or would as a fraud or deceit upon offerees and investors within the meaning of A.R.S. §  
19 44-1991(3), including misusing investor proceeds for personal and other unauthorized uses and to  
20 make Ponzi-type payments to investors that were falsely represented as trading profits.

21 The elements of securities fraud under A.R.S. § 44-1991(3) are as follows:

- 22 1. in connection with a transaction or transactions
- 23 2. within or from Arizona
- 24 3. involving an offer to sell or buy securities, or their sale or purchase
- 25 4. to directly or *indirectly*
- 26 5. engage in

1           6.       any transaction, practice or course of business

2           7.       which operates or *would operate* as a fraud or deceit.

3           This subsection is similar to that found at § 17(a)(3) the federal Securities Act of 1933  
4 ("1933 Act"). *See State v. Superior Court*, 123 Ariz. 324, 331, 599 P.2d 777, 784 (1979)<sup>38</sup>,  
5 *overruled in part on other grounds, Gunnison, id.*, 127 Ariz. at 113, 618 P.2d at 607; *State v.*  
6 *Barber*, 133 Ariz. 572, 575 n. 1, 653 P.2d 29, 32 n. 1 (Ct. App. 1982), *aff'd*, 133 Ariz. 549, 653  
7 P.2d 6 (1982); *Greenfield v. Cheek*, 122 Ariz. 70, 73, 593 P.2d 293, 296 (Ct. App. 1978), *aff'd*, 122  
8 Ariz. 87, 593 P.2d 280 (1979), *overruled in part on other grounds, Gunnison, id.*, 127 Ariz. at 113,  
9 618 P.2d at 607; *Baker v. Walston & Company*, 7 Ariz. App. 590, 593, 442 P.2d 148, 151 (Ct.  
10 App. 1968). Under our supreme court mandate in *Gunnison, id.*, 127 Ariz. at 112-113, 618 P.2d at  
11 606-607, to follow the United States Supreme Court in interpreting this federal counterpart,  
12 *scienter* is not an element of this SAA subsection.<sup>39</sup> *See Aaron v. Securities and Exchange*  
13 *Commission*, 446 U.S. 680, 696, 100 S.Ct. 1945, 1956, 64 L.Ed.2d 611 (1980).

14           **a.       Misuse of Investor Proceeds for Personal and Other Uses**

15           The Division alleged that by misusing investor proceeds for personal and other  
16 unauthorized uses, Guess, Sherriffs, Patterson, Smith and others engaged in transactions, practices  
17 or courses of business which operated or would operate as a fraud or deceit on offerees and  
18 investors. The above discussion under Part IV (A) (1) (f) established the evidence for the  
19 misleading omission by these respondents of material disclosure of such uses. This omission is  
20 alternatively alleged here as a fraudulent practice or course of business by these respondents.

21  
22           <sup>38</sup> The Arizona Supreme Court opined: "The provisions of A.R.S. s 44-1991 are almost identical to the  
23 antifraud provisions of the 1933 Securities Act, 15 U.S.C. s 77q (1970)." *Superior Court*, 123 Ariz. at 331, 599 P.2d  
at 784.

24           <sup>39</sup> The Idaho Securities Act antifraud provision at I.C. § 30-1403 (1967) provides in relevant part: "It is  
25 unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly ... (3) to  
26 engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any  
person." Noting that § 17(a)(3) the federal 1933 Act is "virtually identical" to this provision, the Idaho Supreme  
Court held that *scienter* is not an element of securities fraud under this state act subsection, citing *Aaron v. Securities*  
*and Exchange Commission*, 446 U.S. 680 (1980) for authority. *See State v. Shama Resources Limited Partnership*,  
127 Idaho 267, 272, 899 P.2d 977, 982 (1995).

1           **b.       Misuse of Investor Proceeds for Ponzi-type Payments to Investors**

2           The Division alleged that by misusing investor proceeds to make Ponzi-type payments to  
3 investors falsely represented as trading profits, Guess, Sherriffs, Davis, Patterson, Smith and others  
4 engaged in transactions, practices or courses of business which operated or would operate as a  
5 fraud or deceit on offerees and investors. The above discussion under Part IV (A) (1) (g)  
6 established the evidence for the misleading omission by these respondents of material disclosure of  
7 such Ponzi-type payments. This omission is alternatively alleged here as a fraudulent practice or  
8 course of business by these respondents.

9           **B.       Secondary or Vicarious Liability Under A.R.S. § 44-1999**

10          In connection with the A.R.S. § 44-1991 violations alleged against Bally, RGD and RGD  
11 Enterprises, Inc., the Division also alleged that certain other respondents directly or indirectly  
12 controlled these persons within the meaning of A.R.S. § 44-1999, thereby making the controlling  
13 respondents jointly and severally liable to the same extent as the controlled persons for such  
14 violations. This secondary or vicarious liability is imposed on a "Controlling person" by A.R.S. §  
15 44-1999 because another "controlled person" has violated the SAA.

16          The relevant<sup>40</sup> portion of this statute states: "Every person who, directly or *indirectly*,  
17 controls any person liable for a *violation* of §§ 44-1991 or 44-1992 shall be liable jointly and  
18 severally with and to the same extent as the controlled person to any person to whom the controlled  
19 person is liable unless the controlling person acted in good faith and did not directly or *indirectly*  
20 induce the act underlying the action." (Italics added.) Each specific violation of A.R.S. § 44-1991  
21 cited against respondents alleged to be controlling persons in this matter is an "act" for the purpose  
22 of imposing statutory vicarious liability under A.R.S. § 44-1999. Each respondent alleged as a  
23 controlling person under A.R.S. § 44-1999 is *alternatively* subject to that vicarious liability in  
24 addition to direct or indirect primary liability alleged for violations of A.R.S. § 44-1991.

25          The words "controlling person" and "controls" are neither defined in the statute nor

26          <sup>40</sup> A.R.S. § 44-1999(B). Subsection A does not apply to control liability predicated on the violation of  
A.R.S. § 44-1991 and therefore is inapplicable to this matter.

1 elsewhere in the SAA for purposes of this statute. However, the 1996 enactment that added this  
 2 statute specified a permissive intent that in construing SAA provisions "the courts *may* use as a  
 3 guide the interpretations given by the securities and exchange commission and the federal or other  
 4 courts in construing substantially similar provisions in the federal securities laws of the United  
 5 States." *Laws 1996*, Ch. 197, § 11(C). (Italics added.) Since the relevant part of this statute has  
 6 language "substantially similar" to the Section 20(a) "control person" provision in the federal  
 7 Securities Exchange Act of 1934 ("1934 Act"),<sup>41</sup> the Commission in its adjudicative capacity may  
 8 look to the interpretations given to that federal provision. In visiting such interpretations, however,  
 9 the Commission *must* follow the legislative "Intent and Construction" mandated for the SAA by  
 10 *Laws 1951*, Ch. 18, § 20:<sup>42</sup>

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

17           While the legislative purpose for the SAA is clearly investor protection,<sup>43</sup> the federal

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18           <sup>41</sup>Sec. 20(a) states: "Every person who, directly or indirectly, controls any person liable under any provision  
 19 of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same  
 20 extent as such controlled person to whom such controlled person is liable, unless the controlling person acted in  
 21 good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." *15*  
*U.S.C. § 781(a)*. The federal 1933 Act also has its own "control person" provision at Section 15 with different  
 22 language similar to the first sentence in A.R.S. § 44-1999. Although the affirmative defense clauses differ in the two  
 23 federal statutes, the threshold issue of control under both statutes is determined by the same decisional law standard.  
 24 *See, e.g., Abbott v. Equity Group, Inc.*, 2 F.3d 613, 619 n. 15 (5<sup>th</sup> Cir. 1993), *cert. denied* 510 U.S. 1177 (1994) (both  
 25 statutes interpreted with same controlling person definition); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1578  
 26 (9<sup>th</sup> Cir. 1990), *cert. denied* 499 U.S. 976 (1991) (same controlling person analysis under both statutes); 3 A.  
 Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud* § 8.5 (810) (2d ed. 1996) (hereinafter  
 "Bromberg & Lowenfels").

27           <sup>42</sup>"When the text of a statute is capable of more than construction or result, legislative intent on the *specific*  
 28 *issue* is unascertainable, and *more than one interpretation is plausible*, we ordinarily interpret the statute in such a  
 29 way as to achieve the general legislative *goals* that can be adduced from the body of legislation in question."  
 30 *Standard Chartered PLC v. Price Waterhouse*, 190 Ariz. 6, 42-43, 945 P.2d 317, 353-54 (Ct. App. 1997). (Italics  
 31 added.)

32           <sup>43</sup>The "basic purpose" of the SAA is "the prevention of fraud upon the consumers of securities." *People ex*  
 33 *rel. Babbitt v. Green Acres Trust*, 127 Ariz. 160, 166, 618 P.2d 1086, 1092 (Ct. App. 1980). "The securities laws are  
 34 designed to protect less-than-prudent investors from giving their money to irresponsible or unscrupulous  
 35 businessmen." *Nutek Information Systems v. Arizona Corp. Com'n*, 1998 WL 767176 at 5 (Ariz. Ct. App. 1998). The  
 36 Arizona Supreme Court has declared that regulation of securities is "designed to protect the public from fraud and  
 37 deceit arising in those transactions. Since much of the public lacks the knowledge and sophistication of those who

1 securities laws instead serve multiple purposes. *See, e.g., United States v. Naftalin*, 441 U.S. 768,  
 2 775-76, 99 S.Ct. 2077, 2082-83, 60 L.Ed.2d 624 (1979) (investor protection not sole purpose of  
 3 federal 1933 Act). Therefore, the Commission may only look to interpretations of federal law that  
 4 comport with the protective purpose of the SAA.<sup>44</sup> Indeed, Arizona courts have consistently  
 5 construed the SAA in an expansive fashion resulting in greater liability than exists under federal  
 6 securities law.

### 7 1. The Test for Control

8 The threshold issue is whether a person controlled a primary violator.<sup>45</sup> *See Kersh v. General*  
 9 *Council of Assemblies of God*, 804 F.2d 546, 548 (9<sup>th</sup> Cir. 1986). The person alleging control bears  
 10 the burden of proving it. *E.g., G. A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945, 958 (5<sup>th</sup> Cir.  
 11 1981). Since Section 20(a) of the federal 1934 Act also does not define control,<sup>46</sup> *Harriman v. E. I.*  
 12 *Dupont De Nemours & Co.*, 372 F. Supp. 101, 104 (D.Del. 1974), and the U. S. Supreme Court has  
 13 not addressed this issue, lower federal courts have developed different tests for control.<sup>47</sup> One

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14 trade regularly in the securities marketplace, blue sky laws act as a buffer between purveyors of worthless securities  
 15 and that segment of the public which can ill afford to fall victim to fraudulent investment schemes." *State v.*  
*Baumann*, 125 Ariz. 404, 411, 610 P.2d 38, 45 (1980) (In Banc).

16 <sup>44</sup> "Because state securities laws should be more broadly construed than federal securities laws, and *because*  
 17 *of our legislative mandate*, this Commission *must* broadly interpret the Act as a remedial measure to ensure *the*  
 18 *protection of Arizona investors.*" *In the Matter of the Offering of Securities By: The Woodington Group, Inc. et al.*,  
 19 Arizona Corporation Commission Decision No. 58113 (December 10, 1992), p. 11. (Italics added.)

20 <sup>45</sup> This determination is analogous to whether a person is a principal subject to vicarious liability for the acts  
 21 of an agent. However, the legislative history of Sec. 20(a) appears to support a congressional intent to extend  
 22 liability beyond normal common law concepts of a principal's responsibility for the actions of an agent. Bromberg &  
 23 Lowenfels, *supra* § 8.5 (821); *see Harriman v. E.I. DuPont De Nemours and Company*, 372 F.Supp. 101, 104  
 24 (D.Del. 1974). "Sec 20(a) ... was intended 'to prevent evasion' of the law 'by organizing dummies who will  
 25 undertake the actual things forbidden,'" *Hollinger*, 914 F.2d at 1577, and to impose liability on "the [person] who  
 26 stands behind the scenes and controls the [securities violator] who is in a nominal position of authority." *Wool v.*  
*Tandem Computers, Inc.*, 818 F.2d 1433, 1441 (9<sup>th</sup> Cir. 1987) (quoting 1934 legislative history).

<sup>46</sup> For purposes of registration and reporting under the 1934 Act, Rule 12b-2 under that Act defines  
 "Control" as follows: "The term 'control' (including the terms 'controlling,' 'controlled by' and 'under common control  
 with') means the possession, direct or indirect, of the *power* to direct or cause the direction of the management and  
 policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 CFR §  
 240.12b-2. (Italics added.) Rule 405 of Regulation C under the 1933 Act has an identical definition of control. *See*  
 17 CFR § 230.405. Federal and state courts have relied upon this definition to help define "control person." 12A J.  
 Long, *Blue Sky Law* § 7.08(3) (1984 rev. ed., 11/98 supp.); *see, e.g., G. A. Thompson & Co., Inc. v. Partridge*, 636  
 F.2d 945, 957-958 (5<sup>th</sup> Cir. 1981) (Rule 405 provides standard for Sec. 20[a] liability); *Abbott*, 2 F.3d at 619 n. 15.

<sup>47</sup> "Congress deliberately did not define 'control,' thus indicating its desire to have the courts construe the  
 applicable provisions of the statute along with the evidence adduced at trial." *Rochez Brothers v. Rhoades*, 527 F.2d  
 880, 891 (3rd Cir. 1975). However, Sec. 20(a) is remedial and to be construed liberally, *Harrison v. Dean Witter*

1 leading authority identifies five different tests used by federal courts. *See* 3 A. Bromberg & L.  
 2 Lowenfels, *Securities Fraud & Commodities Fraud* § 8.5 (832) (2d ed. 1996) (hereinafter  
 3 "Bromberg & Lowenfels").

4 Of these tests, two appear to most closely match the investor protection purpose of the  
 5 SAA.<sup>48</sup> The most compatible test originated with the adoption by the federal Fifth Circuit of the  
 6 Rule 12b-2/405 definition of "control" as "the *possession*, direct or indirect, of the *power* to direct or  
 7 cause the direction of the management *and* policies of a person ... ." (Italics added.) *Thompson*, 636  
 8 F.2d at 957-958; *Pharo v. Smith*, 621 F.2d 656, 670 (5<sup>th</sup> Cir. 1980), *aff'd on rehearing, remanded in*  
 9 *part on other grounds*, 625 F.2d 1226 (1980). The *Thompson* court opined that "[n]either this  
 10 definition nor the statute appears to require *participation* in the wrongful *transaction*," and affirmed  
 11 the control liability of a defendant who "had the requisite power to directly or indirectly control or  
 12 influence corporate policy." *Thompson, id.*, 636 F.2d at 958. (Italics added.)<sup>49</sup> Revisiting this  
 13 standard over a decade later, the Fifth Circuit apparently interpreted *Thompson* to require "actual  
 14 power or influence over the controlled person." *Abbott v. Equity Group, Inc.*, 2 F.2d 613, 620 (5<sup>th</sup>  
 15 Cir. 1993), *cert. denied sub nom. Turnbull v. Home Ins. Co.*, 510 U.S. 1177 (1994). However, the

16  
 17 *Reynolds, Inc.*, 974 F.2d 873, 880 (7<sup>th</sup> Cir. 1992), *cert. denied*, 113 S.Ct. 2994 (1993), *Myzel v. Fields*, 386 F.2d  
 18 718, 738 (8<sup>th</sup> Cir. 1967), *cert. denied*, 390 U.S. 951 (1968)), "requiring only some sort of indirect means of discipline  
 19 or influence short of actual direction to hold a control person liable." *Harrison, id.* That "'indirect means of  
 20 discipline or influence' need not be stock ownership. It may arise from business relationships, interlocking directors,  
 21 family relationships and a myriad of other factors." *Harriman*, 372 F.Supp. at 105. "Furthermore, a controlling  
 22 person need not be the only person or entity with 'direct means of discipline or influence.'" *Harriman, id.*

23 <sup>48</sup> Two of these tests appear to be inapplicable in this matter. One is the *per se* control liability of securities  
 24 broker-dealer firms for conduct by their registered representatives within the firms' statutory control. *See* Bromberg  
 25 & Lowenfels, *supra* at § 8.5 (832), (833). Since no Respondent in this matter was registered as a dealer or salesman,  
 26 *Exhs. S-141, S-161 para, 20*, this test need not be addressed here. At the other extreme is the rigorous "culpable  
 participation" test that requires a *prima facie* showing of bad faith and inducement among the elements of control.  
*See* Bromberg & Lowenfels, *supra* at § 8.5 (832) (837). As a minority view that fell into disfavor over the last  
 decade in all but the federal Third Circuit, *id.*, this test is the least favorable to the investor and therefore  
 incompatible with the investor protection purpose of the SAA. The plain meaning of Sec. 20(a) does not require  
 participation in the violative activity. *See Metge v. Baehler*, 762 F.2d 621, 631 (8<sup>th</sup> Cir. 1985), *cert. denied sub nom.*  
*Metge v. Bankers Trust Co.*, 474 U.S. 1057 (1986). Moreover, requiring actual participation in the violation creates  
 primary liability and would render meaningless the concept of secondary liability. *See Binder v. Gordian Securities,*  
*Inc.*, 742 F. Supp. 663, 668 (N.D. Ga. 1990).

<sup>49</sup> Following *Thompson*, a federal district court in that Circuit denied summary judgment in favor of an  
 alleged control person on grounds he was "fully capable of apprising himself of any ... business dealings" by a  
 primary violator as its vice-president and employee. *Binder*, 742 F.Supp. at 668.

1 court declined to address whether there must be a showing of the actual *exercise* of that power over  
2 the controlled person. *Abbott, id.* Under this test, therefore, liability accompanies possession of the  
3 actual power to directly or indirectly control or influence the general affairs and policy of the  
4 primary violator. *See Brown v. Mendel*, 864 F. Supp. 1138, 1145 (M. D. Ala. 1994) ("*Brown I*"),  
5 *aff'd sub nom. Brown v. Enstar Group, Inc.*, 84 F.3d 393 (11<sup>th</sup> Cir. 1996) ("*Brown II*"), *cert. denied*,  
6 117 S. Ct. 950 (1997); Bromberg & Lowenfels, *supra* at § 8.5 (834).

7 Adding a second prong to this Fifth Circuit standard, the federal Eleventh Circuit recognized  
8 a more rigorous test devised in a lower court opinion. Under this test, liability attaches to a person  
9 possessing (1) "the *power* to control the *general* affairs" of the controlled person when it violated the  
10 securities laws *and* (2) the "requisite *power* to directly or indirectly control or influence the *specific*  
11 corporate policy which resulted in the primary liability." *Brown II.*, 84 F.3d at 396. (Italics added.)  
12 See Bromberg & L. Lowenfels, *supra* at § 8.5 (835). In adopting this test, the Circuit court clarified  
13 that "participation in the wrongful transaction" was *not* required, *Id.* at 397 n. 5, and declined to  
14 address whether the first prong required "simply abstract power to control, or actual exercise of the  
15 power to control." *Id.* at 397 n. 6. Apparently in reference to the second prong, however, the district  
16 court opinion affirmed in *Brown II* had cited other district court authority in the Circuit that this  
17 power need not be exercised; "possession of the power is enough to support a finding that the  
18 defendant was a 'controlling person'". *Brown I*, 864 F.Supp. at 1144. Liability under this Eleventh  
19 Circuit test therefore requires the possession of power to control *both* the general affairs of the  
20 primary violator and its specific policy that resulted in the violation.

21 A third test is also two-pronged, requiring the *actual exercise* of control over the general  
22 affairs of the primary violator *and* possession of power to control the specific violative activity  
23 (whether or not exercised). *See* Bromberg & Lowenfels, *supra* at § 8.5 (836). Although this test is  
24 now the most widely accepted among the federal circuits, Bromberg & Lowenfels, *supra* at § 8.5  
25 (832), apparently including the Ninth Circuit,<sup>50</sup> *see Kaplan v. Rose*, 49 F.3d 1363, 1382 (1994), *cert.*

26 <sup>50</sup> Since 1990 the Ninth Circuit has held that control liability does not require a showing of "culpable participation" in the violation. *See, e.g., Paracor Finance, Inc. v. General Elec. Capital Corp.*, 79 F.3d 878, 889 (9<sup>th</sup>

1 *denied*, 116 S.Ct. 58 (1995), the additional evidentiary burden imposed by its first prong  
 2 significantly narrows the application of control liability and undercuts the SAA's protective purpose  
 3 by rewarding artful concealment behind "dummies" as well as negligent or reckless indifference.  
 4 Ninth Circuit interpretations of federal securities law have not always comported with the  
 5 construction mandated by our legislature for the SAA.<sup>51</sup> In determining whether the an LLC  
 6 membership interest was an investment contract security under the SAA, Division One of our Court  
 7 of Appeals recently rejected a liability test followed by the Ninth Circuit in favor of a less  
 8 burdensome Fifth Circuit test because "it better protects the intent behind the securities laws and  
 9 takes account of the economic realities of the transaction." *Nutek Information Systems v. Arizona*  
 10 *Corp. Com'n*, 1998 WL 767176 at 5 (Ariz. Ct. App. 1998). Indeed, the Arizona Supreme Court itself  
 11 has declared that in interpreting the SAA it will deviate even from United States Supreme Court  
 12 interpretations of identical or similar federal securities statutes where "there is a good reason."  
 13 *Gunnison*, 127 Ariz. at 112-113, 618 P.2d at 606-607. Therefore, only the first two tests described  
 14 above will be applied herein to the record in this matter.

#### 15 *Affirmative Defense to Control Liability*

16 Satisfying the control test subjects a control person to a rebuttable presumption of vicarious  
 17 liability under A.R.S. § 44-1999. Such liability can still be avoided under this statute, however, if  
 18 "the controlling person acted in good faith *and* did not directly or indirectly induce the act  
 19 underlying the action." (Italics added.) All but one federal Circuit shift the burden to prove this two-  
 20 pronged "good faith defense"<sup>52</sup> on the controlling person.<sup>53</sup> See Bromberg & Lowenfels, *supra* at §

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21 Cir. 1996); *Hollinger*, 914 F.2d at 1575. Under its current test, this Circuit has clarified that a person is subject to  
 22 such liability "not because he controlled *those marketing* the investment contracts but because he was *one* of the  
 23 persons controlling *the issuer* of the investment contracts." *Arthur Children's Trust v. Keim*, 994 F.2d 1390, 1397 (9<sup>th</sup>  
 24 Cir. 1993). (Italics added.)

25 <sup>51</sup> With no Arizona case law yet addressing A.R.S. § 44-1999, the Commission is not required to follow  
 26 Ninth Circuit or other federal decisional law in interpreting this statute. See *Laws 1996*, Ch. 197, § 11(C) (federal  
 court interpretations "may" be used as a guide). Indeed, the absence of Arizona decisional authority allows the  
 Commission to devise its own control standard under this statute in order to better serve the protective purpose of the  
 SAA mandated by *Laws 1951*, Ch. 18, § 20.

<sup>52</sup> Both prongs are often referred to under the general rubric of the good faith defense. Bromberg &  
 Lowenfels, *supra* at § 8.5 (840).

<sup>53</sup> "According to the statutory language, once the plaintiff establishes that the defendant is a 'controlling

1 8.5 (840), (842[4]). By prevailing on both prongs of this affirmative defense, an otherwise  
 2 controlling person sheds the vicarious liability imposed by operation of law for the primary violation  
 3 by a otherwise controlled person.

4 The first "acted in good faith" prong requires a controlling person of a primary violator to  
 5 prove "his absence of scienter."<sup>54</sup> *Arthur Children's Trust v. Keim*, 994 F.2d 1390, 1398 (9<sup>th</sup> Cir.  
 6 1993). To the extent there is any *scienter* requirement for control liability, it arises only in the  
 7 context of this prong. *See Drobbin v. Nicolet Instrument Corp.*, 631 F.Supp. 860, 885 (S.D.N.Y.  
 8 1986). Beside this showing, the plain language of the prong also requires that a control person  
 9 "acted" without *scienter*. A control person must also affirmatively establish some supervisory  
 10 procedures or other precautionary measures appropriate under the circumstances. *See IX Loss &*  
 11 *Seligman, Securities Regulation*, 4472 (3d ed. 1992).

12 The "in good faith" *scienter* burden imposed on the controlling person by the first prong  
 13 should be construed to reflect essential differences between the SAA and federal law. Because Sec.  
 14 20(a) is a 1934 Act provision, this definition reflected the high level of *scienter* required by  
 15 decisional law<sup>55</sup> to prove a *primary* violation of the Sec. 10(b) antifraud provision in that law and  
 16 Rule 10b-5 thereunder. This primary violator *scienter* has evolved through case law to encompasses  
 17 a multitude of gradations shading from negligence through recklessness to specific intent. *See*  
 18 *Bromberg & Lowenfels, supra* at § 8.4 (501-504), (540). In *public enforcement* actions alleging Sec.  
 19 10(b) violation, negligence is sufficient "everywhere" to satisfy this requirement. *Bromberg &*  
 20 *Lowenfels, supra* at § 8.4 (501), (585[6]). Unlike this federal antifraud provision, *scienter* is not an

21 person,' then the defendant bears the burden of proof to show his good faith." *Hollinger*, 914 F.2d at 1575. "Its effect  
 22 is to impose secondary or derivative liability on any person who controls a violator of the act or of any regulation  
 23 promulgated thereunder and who does not carry the day on the good faith defense provided therein." *Harriman*, 372  
 24 F. Supp. at 104.

25 <sup>54</sup> "To establish the liability of a controlling person, the plaintiff does *not* have the burden of establishing  
 26 that person's scienter distinct from the controlled corporation's scienter." *Keim*, 994 F.2d at 1398. (Italics added.) A  
 controlling person is liable if the *primary* violator "intentionally or recklessly *permitted* the fraudulent marketing of  
 its securities." *Id.* (Italics added.) The controlling person then "has the burden of showing that he acted in good faith,  
 and so did not share in the scienter required for liability under Sec. 10(b)." *Kaplan v. Rose*, 49 F.3d 1363, 1382  
 (1994), *cert. denied*, 116 S.Ct. 58 (1995).

<sup>55</sup> The United States Supreme Court imposed this requirement in *Ernst & Ernst v. Hochfelder*, 425 U.S.  
 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976).

1 element of the primary violations of A.R.S. § 44-1991(2) and (3) alleged as predicates for control  
 2 liability in the instant matter. *See Gunnison*, 127 Ariz. at 113, 618 P.2d at 607; *Aaron*, 446 U.S. at  
 3 696, 100 S.Ct. at 1956. Therefore, the need to define the "good faith" prong as "absence of scienter"  
 4 in regard to the last two subsections of the SAA anti-fraud provision should be interpreted to require  
 5 a controlling person to affirmatively prove the absence of all *scienter* including negligence, even  
 6 where no *scienter* need be shown for the primary violator.

7 The good faith defense *also* requires an affirmative showing under its second prong that the  
 8 control person "did not directly or indirectly<sup>56</sup> induce the act underlying the action." *See Nordstrom*,  
 9 *Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1434 (9<sup>th</sup> Cir. 1995); *Zweig v. Hearst Corp.*, 521 F.2d  
 10 1129, 1132 (9<sup>th</sup> Cir. 1975), *cert. denied*, 423 U.S. 1025 (1975). In this matter, each specific violation  
 11 of A.R.S. § 44-1991 alleged against Bally, RGD or RGD Enterprises, Inc., is an "act" for the  
 12 purpose of this prong. The Ninth Circuit found inducement under this prong in the review and  
 13 approval of misleading public information releases by corporate directors and officers who believed  
 14 in good faith they were not perpetuating a fraud. *See Nordstrom, id.* Despite satisfying the good faith  
 15 prong, their inducement *alone* was sufficient to preclude invocation of the good faith defense. *See*,  
 16 *id.*; *Myzel v. Fields*, 386 F.2d 718, 738-739 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968) (good  
 17 faith inducement precludes defense). This construction comports with both the statutory language as  
 18 well as the strict liability nature of the primary SAA violations alleged as predicates for control  
 19 liability in the instant matter. Since "induce" means in part to "bring on or about, to affect, cause, to  
 20 influence to an act or course of conduct," *Black's Law Dictionary* 697 (5<sup>th</sup> ed. 1979),<sup>57</sup> it clearly  
 21 includes inaction as much as action. Therefore, the requisite showing under the prong should  
 22 encompass affirmative evidence where applicable that the control person "did not directly or  
 23 indirectly induce the act" by inaction.<sup>58</sup> Insofar as Smith, Guess, Sherriffs and Davis are burdened

24 <sup>56</sup> Thus where primary liability arises from *indirectly* violating A.R.S. § 1991, a control person cannot avoid  
 25 derivative liability who has *indirectly* "induced" that indirect primary violation.

26 <sup>57</sup> Compare with the legal dictionary definition of "participate" to mean in relevant part "to partake of;  
 experience in common with others; to have or enjoy a part or share in common with others." *Black's Law Dictionary*  
 1007 (5<sup>th</sup> ed. 1979).

<sup>58</sup> Apparently combining the two prongs of the good faith defense, the Fifth Circuit held that "the burden on

1 with asserting and proving this affirmative defense by a preponderance of the evidence and failed to  
2 do so at the hearing, its application to the hearing record will not be addressed herein.

3 **a. Controlling Person of Bally**

4 The Division alleged that Smith directly or indirectly controlled Bally within the meaning  
5 of A.R.S. § 44-1999. Although these are both defaulted respondents, it is noted that Smith  
6 admitted in his federal plea agreement that he operated Bally from October 1, 1996 through April  
7 30, 1997. *Exhs. S-138b and c.* Moreover, the Bally contracts with RGD and Guess and collateral  
8 documents admitted into evidence are all executed by Smith on behalf of Bally. *Exhs. S-112b and c*  
9 *(Bally/ Guess), S-113b (Bally/ RGD), S-114 (Bally/ Guess), S-115 (Bally/ RGD), S-116 (Bally/*  
10 *Guess), S-117 (Bally/ Guess).* Smith clearly exercised the requisite control over Bally throughout the  
11 period of the RGD trading program offering and is liable to the same extent as Bally for *its* violations  
12 of A.R.S. § 44-1991.

13 **b. Controlling Persons of RGD**

14 The Division alleged that Guess, Sherriffs and Davis directly or indirectly controlled RGD  
15 within the meaning of A.R.S. § 44-1999. The above discussion under Parts II(E)(1) and (2) and  
16 under IV(A) established the evidence for the requisite control over RGD by these three  
17 respondents who are liable to the same extent as RGD for *its* violations of A.R.S. § 44-1991.

18 **c. Controlling Persons of RGD Enterprises, Inc.**

19 The Division alleged that Guess and Davis directly or indirectly controlled RGD  
20 Enterprises, Inc. within the meaning of A.R.S. § 44-1999. The above discussion under Parts  
21 II(E)(1) and under IV(A) established the evidence for the requisite control over RGD Enterprises,

22 the controlling person is to establish that he did not act recklessly in inducing, either by his action or his inaction, the  
23 'act or acts constituting the violation' of 10b-5." *Thompson*, 636 F.2d at 960. The Circuit court further held that the  
24 "degree" of such recklessness is less than the "severe form of recklessness" required for primary liability, and would  
25 be whether the controlling person was "almost certainly aware of the danger." *Id.* at 960, 960 n. 28, 962 n. 33. Under  
26 this interpretation of the defense, negligence would apparently satisfy the good faith prong and sustain the defense  
even if the controlling person induced the primary violation by action or inaction. However, the plain language of the  
statute favors the opposing interpretation adopted by other circuits that good faith inducement precludes the defense.  
*See Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1434 (9<sup>th</sup> Cir. 1995); *Myzel*, 386 F.2d at 738-739 (8<sup>th</sup> Cir.).  
The *Thompson* court itself acknowledged that under a literal reading of the statute an indirect good faith inducement  
would give rise to liability. *Thompson*, *id.* at 960 n. 27.

1 Inc. by these two respondents who are liable to the same extent as RGD Enterprises, Inc. for *its*  
2 violations of A.R.S. § 44-1991.

3  
4 **V.  
TRANSACTIONS BY UNREGISTERED INVESTMENT ADVISER OR  
REPRESENTATIVE**

5 Beside his alleged SAA violations, the Division *alternatively* alleged that Sherriffs  
6 conducted business in Arizona as an investment adviser or investment adviser representative in  
7 violation of A.R.S. § 44-3151 of the Arizona Investment Management Act (“IMA”). Although  
8 Sherriffs requested a hearing, neither he nor his attorney were present at the hearing in this matter.  
9 This respondent has not contested his violation of this statute or the Division certificate of non-  
10 licensure admitted into evidence against him pursuant to A.R.S. § 44-3294. *Exh. S-3b.*

11 The IMA defines investment adviser as “any person who, for compensation, engages in the  
12 business of advising others ... as to the value of securities or as to the advisability of investing in,  
13 purchasing or selling securities ... . Investment adviser includes ... persons who, as an integral  
14 component of other financially related services, provide the foregoing investment advisory  
15 services to others for compensation and as part of a business or who hold themselves out as  
16 providing the foregoing investment advisory services to others for compensation.” *A.R.S. § 44-*  
17 *3101(4)*. An investment adviser representative is defined to include “any individual who occupies  
18 a status or performs functions similar to a partner, officer or director of an investment adviser ...  
19 and who ... [m]akes any recommendations or otherwise renders advice regarding securities” or  
20 “[m]anages accounts or portfolios of clients.” *A.R.S. § 44-3101(5)*.

21 The above discussion under Part II(E)(2) established the evidence for the offer and sale of  
22 securities by Sherriffs that is alternatively applicable to establish his conduct of business as an  
23 investment adviser or investment adviser representative. Moreover, witness Tammy D’Angelo  
24 testified how Sherriffs, who had been her tax preparer for two years, offered and provided  
25 investment advisory services to her and her husband in October 1997 for a \$350 annual fee she  
26 paid to him. *H.T., pp. 39 line 3—43 line 20, 47 line 8—48 line 11, 49 line 11—50 line 3; Exhs. S-*

1 134 a and b. His services focused on a recommendation she invest \$30,000 in an “International  
 2 Trading Program ... based on trading mid term notes on the International Market. Rate of return is  
 3 5% per month, if monthly income is drawn. If not is compounded.” *H.T.*, pp. 44 line 2—47 line 7;  
 4 *Exh. S-134a pp. 2-3*. Sherriffs would take custody of her invested funds under a power of attorney  
 5 for investment through his Better Days Ahead<sup>59</sup> in a World Trading Alliance bank debt instrument  
 6 trading program operated by Lora Kidd in Utah. *H.T.*, pp. 45 line 4—46 line 15, 48 line 12—49  
 7 line 10, 50 line 4—55 line 14, 56 lines 9--15; *Exhs. S-134c and d*. Sherriffs admitted he would also  
 8 receive compensation in the form of a commission on funds invested in the WTA program. *H.T.*,  
 9 p. 55 lines 18—23. Investor witness Jill Arnold also testified that her blind mother acted on a  
 10 recommendation from Sherriffs in December 1997 to invest \$25,000 through Better Days Ahead in  
 11 the WTA program. *H.T.*, pp. 90 line 20—96 line 17.

## 12 VI.

### 13 FRAUD IN THE PROVISION OF INVESTMENT ADVISORY SERVICES

14 Besides Sherriffs’ alleged SAA violations, the Division *alternatively* alleged that in  
 15 connection with a transaction or transactions within or from Arizona involving the provision of  
 16 investment advisory services, Sherriffs violated A.R.S. § 44-3241 by directly or indirectly making  
 17 untrue statements and misleading omissions of material fact. The Division further alleged that he  
 18 also violated this antifraud statute by directly or indirectly engaging in transactions, practices or  
 19 courses of business which operated or would operate as a fraud or deceit.

#### 20 A. Untrue Statements and Misleading Omissions of Material Facts

##### 21 1. Untrue Statements of Material Facts

22 The untrue statements alleged against Sherriffs include two that are identical to those  
 23 alleged above as violations of A.R.S. § 44-1991(B) under the SAA: that there was a European  
 24 trading market for discounted debt instruments from major banks that generated very high profits  
 25 with no risk to the investor; and that RGD investor funds would be held in escrow for safekeeping

26 <sup>59</sup> Exh. S-134c shows Sherriffs as “President” of Better Days Ahead, “an “unincorporated Company of Scottsdale, Arizona.”

1 until transfer to a trading bank. The above discussions under Part IV(A)(1)(a) and (b) established  
2 the evidence for these untrue statements which also applies to these IMA antifraud violations.

3 Also alleged against Sherriffs is the untrue statement to an investor couple that he retained  
4 custody in his Strategy Business Trust account of \$150,000 they invested with RGD. The above  
5 discussion under Part II(E)(2) recited the evidence establishing Sherriffs October 1997 inducement  
6 to Jean and Billy Smith to invest \$150,000 with RGD through him and his subsequent  
7 representation that he would hold their funds in escrow until placed with the WTA trading  
8 program. Division witness Mark Klamrzynski testified that the Smiths' \$150,000 was initially  
9 deposited into the RGD bank account in November 1997, then transferred by Sherriffs that month  
10 to a Strategy Business Trust bank account he controlled. *H.T., pp. 621 line 22—623 line 13.*  
11 Between November 1997 and March 1998, Sherriffs misused \$80,000 from these funds by  
12 disbursing \$70,000 for his personal expenditures and \$10,000 to the Smiths as bogus interest  
13 earned on their funds. *H.T., pp. 623 line 18—625 line 20.* The remaining \$70,000 was transferred  
14 by Sherriffs in March 1998 through another account to a WTA account in Utah. *H.T., pp. 623 lines*  
15 *18-25, 625 line 21—626 line 16.* Klamrzynski's testimony about this transaction was uncontested.

## 16 **2. Misleading Omissions of Material Facts**

17 Finally, the Division alleged that Sherriffs failed to disclose to RGD investors that he was  
18 receiving compensation from Smith and RGD for his participation in the formation and operation  
19 of RGD. Subsection 2.3 of early RGD investor contracts disclosed only that Sherriffs would  
20 receive "Professional fees" from RGD for maintaining a "safekeeping" escrow account for  
21 investor funds. *Exhs. S-4, S-10.* Investor witness Jill Arnold testified that Sherriffs never discussed  
22 with her whether he received compensation for his involvement with RGD other than the  
23 "Professional fees" referred to in § 2.3 of her RGD investor contract admitted as Exh. S-4. *H.T., p.*  
24 *77 lines 21--25.* Division expert witness Mark Klamrzynski testified that Sherriffs actually  
25 received net disbursements of \$233,299 from the RGD bank account in 1997. *H.T., pp. 611 line*  
26 *18—612 line 4; Exh. S-127.* Klamrzynski further testified that from the monthly \$31,1000

1 payments wired into the RGD account from respondent Smith in April, May, June and July 1997,  
2 Sherriffs was paid at least \$20,000. *H.T.*, pp. 619 line 10—621 line 17, 658 lines 1—13, 668 line  
3 23—670 line 4. This witness found no evidence that Sherriffs invested in the RGD program. *H.T.*,  
4 p. 659 lines 8—11. Respondent Davis also had no knowledge of any investment by Sherriffs in the  
5 RGD program. Exh. S-125, p. 48 lines 4-6. Davis explained that the disbursements to Sherriffs  
6 from the April-July 1997 payments to RGD from Smith were because Sherriffs “had a function to  
7 perform as a part of the group and from the accounting standpoint.” *Exh. S-125, p. 48 lines 10—20.*  
8 Sherriffs simply failed to disclose to RGD investors compensation disbursed to him for being an  
9 RGD principal.

10 **B. Fraudulent Transactions, Practices or Courses of Business**

11 **1. Steering Clients into RGD Program Without Disclosing Compensation**

12 The Division alleged that Sherriffs fraudulently steered his tax preparation clients to invest  
13 with RGD without disclosing he was an RGD principal who received compensation from Smith  
14 and Bally for participating in its formation and operation. The above discussion under Part II(E)(2)  
15 established the evidence for the offer and sale of securities by Sherriffs that, together with the  
16 evidence recited under Parts V and VI(A)(2) above, is alternatively applicable to show this  
17 respondent engaged in these fraudulent transactions, practices or courses of business.

18 **2. Misuse of Investor Funds**

19 The Division also alleged that Sherriffs fraudulently misused for his personal, business and  
20 other uses more than half of the investment funds he claimed to hold in custody for an investor  
21 couple pending transfer to the WTA trading program. The above discussions under Part II(E)(2)  
22 and VI(A)(1) concerning Sherriffs’ second RGD investment transaction with Jean and Billy Smith  
23 established the evidence that is alternatively applicable to show this respondent engaged in this  
24 fraudulent transaction, practice or course of business.

25

26

**VII.**  
**RELIEF REQUESTED**

In light of the foregoing, the Division requests that the Commission grant the following relief against respondents.

**A. Cease and Desist Order**

Pursuant to A.R.S. § 44-2032, Guess, Sherriffs, Patterson and Davis should be ordered to permanently cease and desist from violating A.R.S. §§ 44-1841, 44-1842 and 44-1991 of the SAA. Pursuant to A.R.S. § 44-3292, Sherriffs should additionally be ordered to permanently cease and desist from violating A.R.S. §§ 44-3151 and 44-3241 of the IMA.

**B. Order of Restitution**

Pursuant to A.R.S. § 44-2032(1) and A.A.C. R14-4-308(C)(1), Guess, Sherriffs, Patterson and Davis should be ordered to pay monetary restitution as follows:

***RGD***

Under the SAA, Guess, Sherriffs and Davis should jointly and severally pay the total amount of \$232,075 in restitution to those RGD investors who suffered losses as shown on Exh. S-133, together with interest pursuant to A.A.C. R14-4-308 from the dates of investment at the statutory rate of ten percent per annum.<sup>60</sup> Of this \$232,075 restitution amount and in connection with his various sales to investors Calta, Hayes and Herrmann,<sup>61</sup> Patterson should also be jointly and severally liable with Guess, Sherriffs and Davis for up to \$57,730<sup>62</sup> of that total in regard to investors Calta, Hayes and Herrmann.

Pursuant to A.R.S. § 44-3292(1), A.A.C. R14-6-104 and A.A.C. R-14-4-308(C)(1), Sherriffs should *alternatively* pay restitution under the IMA to the Arnolds, Billy and Jean Smith,

<sup>60</sup> Guess, Sherriffs and Davis should alternatively pay joint and several restitution in this amount as controlling persons of RGD pursuant to A.R.S. § 44-1999(B). RGD has defaulted. Moreover, Guess and Davis should alternatively pay joint and several restitution in this amount as controlling persons of RGD Enterprises, Inc. pursuant to A.R.S. § 44-1999(B). RGD Enterprises, Inc. has also defaulted.

<sup>61</sup> \$10,000 from Calta on 7/21/97; \$50,000 from Hayes on 7/29/97; \$80,000 total from Herrmann on 7/22/97, 7/24/97 and 8/22/97. *Exh. S-133*.

<sup>62</sup> \$41,200 (Hayes) plus \$11,000 (Herrmann) plus \$5530 (proportional amount of \$47,000 total owed Calta, based on \$10,000 portion of total Calta \$85,000 investment in RGD) equals \$57,730 total.

1 and Connie and Joan Smith in the total amount of \$63,875 as shown on Exh. S-133, together with  
2 interest pursuant to A.A.C. R14-4-308 from the dates of investment at the statutory rate of ten  
3 percent per annum.

4 ***PFM***

5 Under the SAA, Guess should pay the total amount of \$414,325 in restitution to those PFM  
6 investors who suffered losses as shown on Exh. S-133, together with interest pursuant to A.A.C.  
7 R14-4-308 from the dates of investment at the statutory rate of ten percent per annum.

8 **C. Administrative Penalties**

9 Pursuant to A.R.S. § 44-2036(A), Guess, Sherriffs, Davis and Patterson should be assessed  
10 administrative penalties in an amount not to exceed five thousand dollars for *each* SAA violation.  
11 From the foregoing review of evidence, it is clear that Guess, Sherriffs and Patterson violated the  
12 antifraud and both registration provisions of the SAA with each sale of a security for which the  
13 Division is seeking restitution. Davis violated only the antifraud provision of the SAA in  
14 connection with each sale of a security by RGD. The Division alleged up to eleven separate acts  
15 that *each* constituted a *separate* violation of the SAA antifraud provision in connection with *each*  
16 *sale* of an RGD or PFM security. Therefore, these respondents are subject to cumulative penalties  
17 for multiple violations.

18 Moreover, pursuant to A.R.S. § 44-3296, Sherriffs should be *alternatively* subject to  
19 administrative penalties in an amount not to exceed one thousand dollars for each IMA violation.

20 ***Guess***

21 Exh. S-133 shows 26 sales of RGD or PFM securities, each in violation of the antifraud  
22 and both registration provisions of the SAA. Moreover, the Division alleged and proved eleven  
23 separate acts by Guess that each violated the antifraud provision in connection with each sale.  
24 Guess committed 338 SAA violations and should be assessed administrative penalties in the  
25 amount of \$100,000.

**Sherriffs**

Exh. S-133 shows 18 sales of RGD securities, each in violation of the antifraud and both registration provisions of the SAA. Moreover, the Division alleged and proved nine separate acts by Sherriffs that each violated the antifraud provision in connection with each sale. Sherriffs committed 198 SAA violations and should also be assessed administrative penalties in the amount of \$100,000 in view of the trust he breached with his tax preparation clients and the harm caused therefrom.

Alternatively, the Division proved Sherriffs violated the registration provision of the IMA in transacting investment advisory business with the Arnolds, Jill Arnold's mother, Jean and Billy Smith (two transactions), Connie and Joan Smith and Tammy D'Angelo. Moreover, the Division alleged and proved up to six separate acts by Sherriffs that each violated the IMA antifraud provision. Sherriffs committed six IMA registration violations. He also committed 23<sup>63</sup> IMA antifraud violations that were originally alleged by the Division. Sherriffs should alternatively be assessed administrative penalties under the IMA in the amount of \$29,000.

**Davis**

Exh. S-133 shows 18 sales of RGD securities, each in violation of the antifraud provision and both registration provisions of the SAA. Moreover, the Division alleged and proved six separate acts by Davis that each violated the antifraud provision in connection with each sale. Davis committed 144 SAA violations and should be assessed administrative penalties in the amount of \$25,000.

**Patterson**

This respondent made 5<sup>64</sup> sales of RGD securities in violation of both registration provisions of the SAA. Moreover, the Division alleged and proved nine separate acts by Patterson that each violated the SAA antifraud provision in connection with each sale. Patterson committed

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<sup>63</sup> Four violations against the Arnolds, four violations against Jill Arnold's mother, ten violations against Jean and Billy Smith, four violations against Connie and Joan Smith and one violation against D'Angelo.

<sup>64</sup> One sale to Calta, one to Hayes and three to Herrmann. *See Exh. S-133.*

1 55 SAA violations and should be assessed administrative penalties in the amount of \$25,000.

2 **D. Other Relief**

3 The Division further requests any other relief that the Commission in its discretion deems  
4 appropriate and authorized by law.

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RESPECTFULLY SUBMITTED this 6<sup>th</sup> day of November, 2000.

JANET NAPOLITANO  
Attorney General  
Consumer Protection & Advocacy Section

BY:   
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1 ORIGINAL AND TEN (10) COPIES of the foregoing  
2 filed this 6<sup>th</sup> day of November, 2000, with:

3 Docket Control  
4 Arizona Corporation Commission  
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6 Phoenix, AZ 85007

7 COPY of the foregoing mailed this  
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26