

ORIGINAL



0000117340

28

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

2003 SEP 18 P 4: 32

AZ CORP COMMISSION  
DOCUMENT CONTROL

COMMISSIONERS

MARC SPITZER, Chairman  
JIM IRVIN  
WILLIAM A. MUNDELL  
JEFF HATCH-MILLER  
MIKE GLEASON

**In the matter of:**

**YUCATAN RESORTS, INC., d/b/a  
YUCATAN RESORTS, S.A.,  
3222 Mishawaka Avenue.  
South Bend, IN 46615;  
P.O. Box 2661  
South Bend, IN 46680;  
Av. Coba #82 Lote 10, 3er. Piso  
Cancun, Q. Roo  
Mexico C.P. 77500**

**DOCKET NO. S-03539A-03-0000**

**RESORT HOLDINGS  
INTERNATIONAL, INC., d/b/a  
RESORT HOLDINGS  
INTERNATIONAL, S.A.,  
3222 Mishawaka Avenue  
South Bend, IN 46615;  
P.O. Box 2661  
South Bend, IN 46680;  
Av. Coba #82 Lote 10, 3er. Piso  
Cancun, Q. Roo  
Mexico C.P. 77500**

**SECURITIES DIVISION'S RESPONSE  
TO RESPONDENTS' MOTION TO  
QUASH INVESTIGATIVE SUBPOENAS  
IN SEPARATE DIVISION INQUIRIES**

Arizona Corporation Commission

**DOCKETED**

SEP 18 2003

DOCKETED BY

**WORLD PHANTASY TOURS, INC.,  
a/k/a MAJESTY TRAVEL  
a/k/a VIAJES MAJESTY  
Calle Eusebio A. Morales  
Edificio Atlantida, P Baja  
APDO, 8301 Zona 7 Panama,**

**MICHAEL E. KELLY and LORI KELLY,  
husband and wife,  
3222 Mishawaka Avenue.  
South Bend, IN 46615;  
P.O. Box 2661  
South Bend, IN 46680**

Respondents.

1 Respondents Resort Holds International, Inc, Resort Holdings International, S.A, Yucatan  
2 Resorts, Inc., and Yucatan Resorts, S.A., (collectively "Objecting Respondents"), have filed a  
3 motion seeking to quash Securities Division subpoenas directed against individuals and entities not  
4 party to their own administrative action. Without limitation, this attempt is frivolous,  
5 unsupportable, dilatory and vexatious. As such, Objecting Respondents' motion should be denied.

6 **MEMORANDUM OF POINTS AND AUTHORITIES**

7 In August 2003, the Securities Division ("Division") issued investigative subpoenas to  
8 several Arizona-based individuals for the purpose of gaining information concerning their conduct  
9 in connection with the offer and sale of investment contracts within or from Arizona. The  
10 Division's actions in this respect were fully justified insofar as the Division had reasonable cause  
11 to believe that one or more of these individuals may have violated one or more provisions of the  
12 Securities Act of Arizona.

13 Objecting Respondents now argue that because they themselves are the subject of a formal  
14 administrative proceeding involving the same type of investment contracts, the aforementioned  
15 subpoenas must be quashed. In fact, this demand is specious on several levels: 1) Objecting  
16 Respondents have no standing to bring a motion to quash investigative subpoenas issued to other  
17 individuals implicated in the possible illegal offer and sale of securities; 2) applicable law does not  
18 constrain the Division's statutory and constitutionally-conferred investigative powers simply  
19 because a formal proceeding has been initiated; 3) Objecting Respondents rely on inapplicable  
20 Arizona Rules of Civil Procedure ("ARCP") to challenge the Division's investigative subpoenas;  
21 and 4) Objecting Respondents have no authority to obstruct lawful Division investigations under  
22 the premise that the subpoenaed individuals may ultimately become witnesses in a separate matter.

23 ...  
24 ...  
25 ...  
26 ...

1           **I.        *Objecting Respondents Have No Standing to Move to Quash Investigative***  
2           ***Subpoenas Issued to Unrelated Third Parties***

3           Objecting Respondents simply have no legal standing to bring a motion to quash  
4           subpoenas issued to unrelated individuals in connection with separate Division inquiries. To have  
5           standing, a party must have a “direct and immediate interest” in the matter at hand. *In re Gosnell*  
6           *Development Corp. of Arizona*, 221 B.R. 776 (D.Ariz. 1998). In this instance, the Objecting  
7           Respondents have no direct *or* immediate interest in the results of the Division’s inquiry into the  
8           actions and conduct of unrelated individuals that are the subject of the investigative subpoenas at  
9           issue.

10          Moreover, a party may not challenge a subpoena directed towards a third party unless the  
11          objecting party can either make a claim to some personal right to privilege with respect to the  
12          subject matter of the subpoena or identify some other interest that could be vindicated by a  
13          challenge to the subpoena. *Lipschultz v. Superior Court*, 128 Ariz. 16, 623 P.2d 805 (1981); *U.S.*  
14          *v. Miller*, 96 S.Ct. 1619 (1976). As is evidenced by their motion to quash, Objecting Respondents  
15          can not - and do not - satisfy either of these criteria so as to permit a lawful challenge to the  
16          subpoenas.

17           **II.        *The Division Has Broad Investigative Powers That Authorize the***  
18           ***Issuance of Investigative Subpoenas Both Before and After Formal***  
19           ***Actions Have Been Taken***

20          Oblivious to their lack of standing, Objecting Respondents have essentially sought to  
21          frustrate legitimate Division investigations on the premise that once the Division has initiated a  
22          formal administrative proceeding, it can no longer conduct any further investigation even  
23          tangentially related to that particular proceeding. Instead, Objecting Respondents argue that any  
24          further investigation is suddenly constrained by pre-hearing discovery rules under the ARCP.  
25          Notably, Objecting Respondents are unable to cite any persuasive authority to support such a  
26          claim. Indeed, not one of the statutes, cases or rules cited by the Objecting Respondents so restrict  
          the Division’s investigative authority in such a manner.

1           In actuality, the Division simply has no duty to notify the targets of an administrative action  
2 that a subpoena has been issued to a third party for information and documents belonging to that  
3 third party. *SEC v. Jerry T. O'Brien, Inc.*, 467 U.S. 735, 104 S.Ct. 2720 (1984). The constitution  
4 is not offended when an agency uses its subpoena power to gather evidence from a third party that  
5 may be adverse to the person under investigation. *Id.* “[T]he general rule is that the issuance of a  
6 subpoena to a third party to obtain the records of that party does not violate the rights of a  
7 defendant, even if a criminal prosecution is contemplated at the time the subpoena is issued.” *U.S.*  
8 *v. Miller*, 96 S.Ct. 1619 (1976).

9           The Arizona Administrative Code (“AAC”) authorizes the Division to investigate possible  
10 violations of the Securities Act and to take testimony under oath. The Arizona legislature has  
11 given Division broad investigative powers to “investigate and examine into the affairs of any  
12 person issuing or dealing in or selling or buying or intending to issue, deal in or sell or buy  
13 securities.” *A.R.S. § 44-1822*. The Division may issue subpoenas that, “in the opinion of the  
14 commission, are necessary and proper for the enforcement” of the Securities Act. *A.R.S. § 44-*  
15 *1823(A)*. Courts “give the Commission ‘wide berth’ when they review the validity of Commission  
16 investigations.” *Carrington v. Arizona Corp. Com’n*, 199 Ariz. 303, 305; 18 P.3d 97, 99 (App.  
17 2001). Moreover, an appropriately empowered agency can investigate merely on suspicion that the  
18 law is being violated, or even if it wants assurance that it is not. *Id.*

19           In this instance, the Division is issuing investigative subpoenas precisely as contemplated  
20 under *A.R.S. § 44-1823(A)* cited above. The subpoenas at issue are directed at individuals and  
21 entities that may have violated multiple provisions of the Securities Act. Accordingly, these  
22 subpoenas are necessary and proper for the enforcement of the securities laws of the state of  
23 Arizona. The Objecting Respondents have no lawful right to impede or infringe upon such  
24 inquiries.

25 ...

26 ...

1                   **III.    The ARCP's Discovery Rules Do Not Govern the Issuance of**  
2                   **Investigative Subpoenas**

3                   Investigations, examinations and administrative proceedings under the Securities Act are  
4 governed by Title 14, Chapter 4, Article 3 of the AAC (hereinafter, "Article 3"). When not in  
5 conflict with Article 3, the Corporation Commission Rules of Practice and Procedure  
6 ("Commission Rules") apply to administrative proceedings. See R14-4-301. Only when a  
7 procedure is not set forth either by law, Article 3, Commission Rules or order of the Commission  
8 does the ARCP ultimately govern. R14-3-101(A).

9                   Objecting Respondents' argument demands that the Division be placed in the shoes of a  
10 private litigant once the Division has initiated an action. The ARCP's "Depositions and  
11 Discovery" section provides private parties a means to discover the opposing party's facts.  
12 However, discovery in actions brought by *regulatory agencies* is set forth by law—the discovery  
13 rules of the Rules of Civil Procedure generally do not apply. Pre-hearing discovery in agency  
14 proceedings is a matter of agency discretion. Aman and Mayton, *Administrative Law*, p. 223  
15 (1998). See also *Mister Discount Stockbroker, Inc., v. S.E.C.*, 768 F.2d 875, 878 (7<sup>th</sup> Cir. 1985).  
16 A practical means of discovery frequently provided for by regulatory agencies is the pre-hearing  
17 conference. The Commission Rules thus address discovery: R14-3-108 provides for a pre-hearing  
18 conference for the purposes of, among other things, formulating or simplifying the issues,  
19 obtaining admissions of facts, arranging for the exchange of proposed exhibits or prepared expert  
20 testimony, and other matters that may expedite the conduct of the proceeding. Additionally, as  
21 Objecting Respondents point out, R14-3-109(P) allows depositions conducted "in the manner  
22 prescribed by law and of the civil procedure for the superior court." Contrary to Objecting  
23 Respondents' assertions, however, R14-3-109(P) does not mandate depositions and clearly does  
24 not preclude the exercise of the investigative powers of the Division.

25                   Even if specific discovery procedures were adopted for administrative actions, the  
26 argument that the Division is restricted to the discovery rules of the ARCP is unsustainable. The  
Division is not a private party; the Division is a regulatory body that bears responsibility for

1 enforcing the Securities Act for the benefit of all Arizona citizens. It cannot be placed in a position  
2 of negotiating<sup>1</sup> for the consent of all parties with respect to the individuals for whom the taking of  
3 testimony is ‘necessary and proper.’ Moreover, the Division simply cannot be forced into making  
4 a choice between providing immediate protections to Arizona citizens (through the initiation of  
5 emergency administrative proceedings) or eschewing these protections for the purpose of pursuing  
6 investigations to their utter completion. Such a choice would effectively eviscerate the Temporary  
7 Order provision prescribed under A.R.S. § 44-1972(C) and ACC Rule 14-4-307.<sup>2</sup>

8 ***IV. The Objecting Respondents have no Authority to Infringe Upon***  
9 ***Lawful Division Investigations***

10 The investigative subpoenas that are the subject of this matter have been issued in response  
11 to evidence that the targets of these subpoenas may have been in violation of one or more  
12 provisions of the Securities Act. Objecting Respondents effectively seek to frustrate these separate  
13 investigations by characterizing the Division’s investigations as “discovery” and declaring the  
14 subpoena targets as “witnesses” to their case. At this stage, these speculative characterizations are  
15 wholly without merit. The subpoenas at issue are directed toward legitimate targets of a lawful  
16 Division inquiry. As such, these subpoenas fall well within the powers of the Division in its  
17 legislative mandate to protect Arizona investors. The Objecting Respondents simply have no legal  
18 authority to interfere or otherwise obstruct this effort.

19 ...

---

20  
21 <sup>1</sup> Private parties have incentive to accommodate one another regarding depositions—to agree to the  
22 deposition desired by the opposing party in order to get agreement for its own deposition. A respondent has  
no incentive to allow the Commission to continue its investigation in the form of depositions.

23 <sup>2</sup> The Division may issue temporary cease and desist orders and a notice of opportunity for hearing when  
24 the public welfare requires immediate attention. A.R.S. § 44-1972(C). If taking immediate action to  
25 protect the public welfare terminates the Division’s power to continue to investigate, the Division is placed  
26 in the position of either postponing the issuance of a temporary cease and desist order so that it may  
conduct a full and complete investigation or issuing a temporary cease and desist order and foregoing its  
investigative powers. This would defeat the remedial mandate of the Commission, either by forestalling the  
Division from preventing the public from suffering harm at the hands of miscreants through quick action to  
stop illegal conduct or by limiting the Division’s ability to further conduct private investigations.

1 As a final point, Objecting Respondents' claim of "prejudice" from these separate  
2 investigations is necessarily unspecific and speculative. Any anticipated prejudice is too remote to  
3 justify so extreme an action as denying the Division its constitutional authority to conduct  
4 investigations. Objecting Respondents will receive the appropriate due process protections during  
5 the adjudication of the charges brought against it. *Compare Stoffel v. Arizona Dept. of Economic*  
6 *Sec.*, 162 Ariz. 449, 784 P.2d 275 (App. 1989); *See also* A.A.C. R14-3-109. Anticipation of  
7 wrongful use of information or evidence received as a result of an investigative formal interview is  
8 simply inappropriate at this stage of the proceedings.

9 **V. Conclusion**

10 In short, Objecting Respondents' motion to quash Division's subpoenas in separate  
11 investigations has no legal basis. Not only do Objecting Respondents lack standing to submit such  
12 an objection, but the grounds upon which they rely in making this demand are flawed. There is no  
13 statutory or administrative rule that prevents the Division from continuing its investigation after an  
14 administrative action is filed, and civil discovery rules are wholly inapplicable in considering this  
15 issue. Finally, the Objecting Respondents have no legal authority to interfere with lawful  
16 investigations concerning possible violations of the Securities Act. For the foregoing reasons, the  
17 Division requests that Objecting Respondents' Motion to Quash be DENIED.

18 RESPECTFULLY SUBMITTED this 18<sup>th</sup> day of September, 2003.

19  
20  
21 By: \_\_\_\_\_

Jamie B. Palfai, Esq.

Attorney for the Securities Division of the  
Arizona Corporation Commission

1 ORIGINAL AND THIRTEEN (13) COPIES of the foregoing  
filed this 18<sup>th</sup> day of September, 2003, with

2 Docket Control  
3 Arizona Corporation Commission  
1200 West Washington  
4 Phoenix, AZ 85007

5  
6 COPY of the foregoing hand-delivered this  
7 17<sup>th</sup> day of September, 2003, to:

8 Mr. Marc Stern  
Administrative Law Judge  
9 Arizona Corporation Commission/Hearing Division  
1200 West Washington  
10 Phoenix, AZ 85007

11  
12 COPY of the foregoing mailed  
13 this 19<sup>th</sup> day of September, 2003, to:

14 Martin R. Galbut, Esq.  
15 Jeana R. Webster, Esq.  
Jeffrey D. Gardner, Esq.  
16 GALBUT & HUNTER, P.C.  
Camelback Esplanade, Suite 1020  
17 2425 East Camelback Road  
Phoenix, Arizona 85016  
18 Attorneys for Respondents Yucatan Resorts, Inc.,  
19 Yucatan Resorts S.A., RHI, Inc., and RHI, S.A.

20 Paul J. Roshka, Jr., Esq.  
21 Dax Watson, Esq.  
ROSHKA HEYMAN & DEWULF, P.L.C.  
22 400 East Van Buren Street, Suite 800  
Phoenix, Arizona 85004  
23 Attorneys for Respondents Michael and Lory Kelly

24 ...  
25 ...  
26 ...

1 Joel Held, Esq.  
Elizabeth Yingling, Esq.  
2 BAKER & MCKENZIE  
2300 Trammell Crow Center  
3 2001 Ross Avenue, Suite 2300  
Dallas, Texas 75201  
4 Attorneys for Respondents Yucatan Resorts, Inc.,  
Yucatan Resorts S.A., RHI, Inc., and RHI, S.A.  
5

6 Tom Galbraith, Esq.  
7 Kirsten Copeland, Esq.  
MEYER, HENDRICKS & BIVANS, P.A.  
8 3003 North Central Avenue, Suite 1200  
9 Phoenix, Arizona 85012-2915  
Attorneys for Respondent World  
10 Phantasy Tours, Inc.  
11  
12  
13

14  
15 By: 