0000125849

ORIGINAL

20

[ARIZON]A CORPORATION COMMISSION

RECEIVED

2001 JUN 27 A 8: 15

AZ CORP COMMISSION
DOCUMENT CONTROL

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

In the matter of:

THE CHAMBER GROUP, INC., an Arizona Corporation, a/k/a **CHAMBER FINANCIAL GROUP** and **CHAMBER FINANCIAL**
1060 Sandretto Drive, Suite A
Prescott, Arizona 86305; and
1550 South Alma School, Suite #103
Mesa, Arizona 85210

JOSEPH L. HILAND
135 South Summit
Prescott, Arizona 86304

TYSON J. HILAND
3094 Shoshone Place
Prescott, Arizona 86301

TRAVIS D. HILAND
4801 North Meixner Road
Prescott Valley, Arizona 86314,

Respondents.

Docket No. S-03438A-00-0000

POST HEARING MEMORANDUM BY SECURITIES DIVISION

Arizona Corporation Commission
DOCKETED
JUN 27 2001

DOCKETED BY	

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

STANDARD OF PROOF

In administrative actions brought by the Commission, the well-recognized standard of proof for alleged violations of the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.*, is the "preponderance of the evidence." This standard has been uniformly applied in administrative proceedings both in this and other jurisdictions. *See, e.g. Steadman v. Securities and Exchange Commission*, 450 U.S. 91 (1981) (preponderance of evidence standard applies in administrative adjudication of federal securities law fraud violations). *See also, Geer v. Ordway*, 156 Ariz. 588, 589, 754 P.2d 315, 316 (App.1987) (preponderance of evidence standard applicable in administrative adjudication of state motor vehicle operator licensing law). It naturally follows that this standard is equally applicable in the administrative proceeding presently at issue.

DISCUSSION

The Division submits that the evidence educed in this hearing conclusively established each of the allegations brought against Respondents JOSEPH HILAND ("JOE HILAND"), TYSON HILAND ("TYSON"), TRAVIS HILAND ("TRAVIS") and THE CHAMBER GROUP, INC. ("CHAMBER"), often collectively referred to as "RESPONDENTS." RESPONDENTS made no attempt to challenge or otherwise defend against the multiple registration violations alleged in the Division's Temporary Order to Cease and Desist and Notice of Opportunity for Hearing ("Notice"), but instead directed their attention towards the multiple fraud allegations included in the Notice. In spite of RESPONDENTS' self-serving testimony denying these charges, the evidence elicited at this hearing consistently demonstrated the fraudulent nature of RESPONDENTS' conduct with respect to the offer and sale of multiple investment programs.

I.

JURISDICTION

The investment products RESPONDENTS offered and sold to Arizona investors in this matter consisted of brokered Certificates of Deposit ("Brokered CDs"), viaticals, a tax lien investment, and a money voucher investment. As will be discussed below, each of these investment "opportunities" were in fact securities per stipulation and/or as defined under the Arizona Securities Act (the "Securities Act"). As such, the Commission has jurisdiction to consider this matter and is empowered to issue an order directing the RESPONDENTS to cease and desist from each of these acts, transactions or practices and to correct the conditions resulting from such actions. *Arizona Revises Statutes (A.R.S.), §§ 44-1971; 44-2032; 44-3211; 44-3292.*

A. Brokered CDs

The offer and sale of brokered CDs is now widely recognized as the offer and sale of securities.[1] Unlike the more traditional bank CD, in which the investor deals directly with an issuing bank, the brokered CD investment is characterized by a number of additional limitations and conditions, as well as the requisite involvement of one or more "intermediaries." Together, these features serve to elevate this investment option into a security in the form of an investment contract. *See, e.g., Gary Plastic Packaging v. Merrill Lynch, Pierce, Fenner & Smith,* 756 F.2d 230 (2d Cir.1985) (brokered CDs constituted securities in the form of investment contracts for purposes of the federal Securities Acts.*)*

In this matter, however, there is no need to further address this issue. During the hearing, both parties stipulated to the fact that brokered CDs were indeed securities under Arizona law. *Hearing Transcript ("H.T."), pp. 185-186, lines 19-25 and 1-9, respectively.* Consequently, it is beyond dispute that the sale of Brokered CDs by RESPONDENTS in this case represented the sale of securities as covered under the Securities Act. It likewise follows that the Commission has jurisdiction to adjudicate any issues relating to the Brokered CDs offered and sold by the RESPONDENTS in this case.

---

[1] Much debate as to the characterization of brokered CDs as investment contracts has focused on the "efforts of others" prong of the seminal investment contract test first expounded in *S.E.C. v. W.J. Howey Co.,* 328 U.S. 293 (1946). A review of the intermediaries' roles in the offer and sale of brokered CDs demonstrates the facility in which the "efforts of others" prong of the *Howey* test is satisfied in connection with the sale of brokered CDs. Indeed, brokered CD investments involve intermediaries who are called upon to make substantial contributions to the brokered CD program to make these investments viable. Intermediary brokers must look for issuing banks with favorable interest rates to attract CD investors; they must maintain proper books and records to ensure that FDIC insurance will pass through to individual investors; they must administer and track the sale of fractionalized CDs out of a master CD; and they must create and maintain secondary markets for investors interested in early liquidation of their CDs. In light of these many distinct functions, individual investors are relying on the efforts of these intermediaries in multiple material respects. Without these efforts, passive individual investors would be unprotected and susceptible to a loss of their investments through administrative errors, bank failures or other problems stemming from their lack of privity with the CD issuing banks.

B. Viaticals

Viaticals, also referred to as "life settlement contracts," are another investment product that RESPONDENTS repeatedly offered and sold to investors in this matter. *See, e.g., Exhibit ("Exhib.") S-26(b).* Like the Brokered CDs above, a determination that the offer and sale of these viaticals also constituted the offer and sale of securities is again irrefutable.

In the recent court decision of *Siporin v. Carrington,* 347 Ariz.Adv.Rep. 5 (App.2001), an Arizona appellate court was called upon to address the precise question on viaticals that is implicated in this particular matter. Specifically, the issue raised before the court in *Siporin* was whether the sale of viaticals by defendant Carrington to two private investors in 1997 constituted the sale of securities for purposes of the Securities Act. The court, in assessing these sales, concluded that the viaticals fell squarely within the definition of an investment contract and were hence securities under the Securities Act as a matter of law.

In reaching this result, the court expressly disapproved of a previous contrary federal decision, *S.E.C. v. Life Partners, Inc.,* 87 F.3d 536 (D.C. Cir.1996). The court noted that although Arizona courts have consistently been guided by the federal courts' interpretations of federal securities laws when applying the Securities Act, "we will not defer to federal case law when, by doing so, we would be taking a position inconsistent with the policies embraced by our own legislature.[2] We will depart from those federal decisions that do not advance the Arizona policy of protecting the public from unscrupulous investment promoters." *Id. at ¶28.* The court then addressed Carrington's argument that because the company had relied on the *Life Partners* decision, a subsequent repudiation of that

---

[2] When adopting the Arizona Securities Act, the legislature suggested its purpose and proper interpretation:

> "The intent and purpose of this Act is for the protection of the public, the preservation of fair and equitable business practices, the suppression of fraudulent or deceptive practices in the sale or purchase of securities, and the prosecution of persons engaged in fraudulent or deceptive practices in the sale or purchase of securities. This Act shall not be given a narrow or restricted interpretation or construction, but shall be liberally construed as a remedial measure in order not to defeat the purpose thereof." *Laws 1951, Ch. 18, § 20.*

decision would be unfair. The court summarily dismissed Carrington's claim, stating that the company's reliance on *Life Partners* was "a calculated and voluntarily assumed business risk." *Id. at ¶37.* In sum, the court found that, irrespective of both prior federal law and the subsequent codification of viaticals as a type of security in 2000,[3] the Carrington viaticals have always been a type of security in Arizona.

The import of *Siporin* to the present case is obvious. RESPONDENTS sold Carrington- issued viaticals to investors from 1998 forward. *See Exhib. S-26(b).* It necessarily follows that the offer and sale of these investment "opportunities" were also the offer and sale of securities as a matter of law. In addition, simply because the courts addressed the nature of these investments only as recently as 2001 does not diminish the fact that these viatical were indeed securities under the Securities Act as far back as 1997. As seen with Carrington in *Siporin*, the prior offer and sale of these investment products by RESPONDENTS were a calculated and voluntarily assumed business risk.

Because the viaticals at issue in this matter were securities in the form of investment contracts as a matter of law, the Commission again has jurisdiction to adjudicate the claims associated with the offer and sale of these investment products by the RESPONDENTS.

C. <u>The "TLC America" Tax Lien Program</u>

The TLC America tax lien program offered and sold by RESPONDENTS is yet another investment program falling squarely within the definition of an investment contract. Accordingly, the offer and sale of these tax lien investments by RESPONDENTS was again the offer and sale of securities as defined under A.R.S. § 44-1801(26) of the Securities Act. As such, these particular offering and selling activities once again fell within the jurisdiction of the Commission.

The core definition of an investment contract was set forth in *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946), and this definition is now universally recognized as the starting point for assessing whether any particular offer or sale constituted the offer or sale of an investment contract. Under the

---

[3] The Arizona legislature amended A.R.S. § 44-1801 to include "viatical or life settlement contract[s]" as securities under the Arizona Securities Act in 2000 Sess. Laws, Ch. 108, § 2, effective July 18, 2000.

Howey test, an investment contract exists if it involves 1) an investment of money; 2) in a common enterprise: 3) with the expectation of profits earned solely from the efforts of others.[4] The basic framework of this definition has been repeatedly construed and expanded, and each of these three elements has since developed its own line of judicial reasoning. In Arizona, the *Howey* test remains the basis for investment contract analysis in many respects, although more recent case law has served to expand the confines of this test considerably. Citing *Howey,* Arizona courts agree that the definition of securities including investment contracts embody "a flexible rather than static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek to use the money of others on the promise of profits." *Nutek Information Systems, Inc. v. Arizona Corporation Commission*, 194 Ariz. 104, 108 (App.1998); *Rose v. Dobras*, 128 Ariz. 209, 211 (App.1981). In accordance with this view, Arizona courts have developed and adopted flexible interpretations for each of the three prongs set forth in *Howey.*

1. RESPONDENTS' TLC America Tax Lien Investment Program Involved the "Investment of Money"

In the context of examining the existence of investment contracts, the first prong of the *Howey* test - the investment of money - has rarely been the subject of dispute. This point is amply illustrated by the fact that Arizona courts have yet to have an occasion to meaningfully evaluate this particular prong. *See, e.g., Foy v. Thorp*, 186 Ariz. 151 (App.1996) ([respecting the first prong] "there is no question [plaintiff] invested money"); *Vairo v. Clayden*, 153 Ariz. 13 (App.1987) ("There is no question [plaintiff] invested money. Thus, the first prong of Howey is met"); *Daggett v. Jackie Fine Arts*, 152 Ariz. 559 (App.1986) ("The first prong of *Howey* is met in the instant case. Plaintiff made an investment of money"); *Rose v. Dobras*, 128 Ariz. 209 (App.1981) ("In this case, there clearly has been an investment of money").

---

[4] Some authorities have sought to examine this third element in terms of two separate prongs, the "expectation of profits" prong, and the "efforts of others" prong. This distinction is not important for purposes of this memorandum.

Like with the cases cited above, RESPONDENTS' TLC America tax lien program plainly involved the investment of money. As seen through both witness testimony and through hearing exhibits, each investment in this tax lien program was initiated through the investment of money into the program. The TLC America tax lien brochure that promoted this investment opportunity equally required the "investment of money" for investors to participate in the program. *See, e.g., Exhib. S-24(a).*

2. *RESPONDENTS' TLC America Tax Lien Program Required Investments in a "Common Enterprise"*

Different jurisdictions have adopted a range of definitions for the second "common enterprise" or "commonality" prong of the *Howey* test. The Ninth Circuit traditionally employs a form of commonality known as "strict vertical commonality." *S.E.C. v. Eurobond Exchange, Ltd.*, F.3d 1334 (9th Cir.1994); *See also Hector v. Wiens,* 533 F.2d 429 (9th Cir.1976); *S.E.C. v. Glen W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.1973). Under this approach, the commonality required is vertical (between the investor and the promoter) rather than horizontal (pooling among multiple investors). *Id.*

In Arizona, however, courts have adopted the Ninth Circuit's interpretation of commonality with some material modifications. In general, the fortunes of the investor must still be interwoven with and dependent upon the efforts and success of those seeking the investment. *Vairo,* 153 Ariz. at 17, *citing Turner,* 474 F.2d at 482, n.7. For the vertical form of commonality to be established, however, a positive correlation between the potential profits of the investor and the potential profits of the promoter need only be demonstrated. *Daggett,* 152 Ariz. at 566; *Vairo,* 153 Ariz. at 17; *Foy*, 186 Ariz. at 158. Arizona courts have also held that commonality will be satisfied if either horizontal or vertical commonality can be shown. *See Daggett,* 152 Ariz. at 566; *Vairo,* 153 Ariz. at 17; *Foy*, 186 Ariz. at 158.

It is evident that the tax lien program offered and sold by RESPONDENTS in this case easily satisfied the commonality prong of the *Howey* test. In fact, both vertical and horizontal commonality can be amply demonstrated with this program. In terms of the vertical commonality component, the program brochure explicitly indicates that the "profits" derived from this investment would be divided between the tax lien investors and the tax lien program managers. *See, e.g., Exhib. S-184, p. 9, ¶6.* This arrangement falls precisely within the definition of vertical commonality. *See Daggett, Vairo, supra.*

The horizontal commonality component of this program is equally evident. As demonstrated by brochures and contractual materials received in connection with this program, the monies invested into this program by investors were pooled into a "Bank Trust Account" from which purchases of tax liens and/or various real estate was purportedly purchased. *Exhib. S-184, p. 5.* This horizontal pooling is further demonstrated by the fact that investments as little as $20,000 were assigned partial ownership of various more expensive properties. The natural implication from this practice is that investor funds were being pooled together to effectuate the real estate investments in this program. In sum, the presence of both vertical and horizontal commonality in this TLC America tax lien program serve to easily satisfy the second commonality prong of the *Howey* investment contract test.

3. TLC America Tax Lien Investors had an Expectation of Profit Through the Efforts of Others

The third and final prong of the *Howey* test has evolved since it was first handed down over 50 years ago. The original definition of this third prong required that for an investment contract to be present, the investors must have had an expectation of profits solely from the efforts of others. *Howey,* 328 U.S. at 301. The rigidity of this prong was significantly lessened in *Turner, supra,* where a Ninth Circuit court concluded that the "adherence to such an interpretation could result in a mechanical, unduly restrictive view of what is and what is not an investment contract." *Id. at 482.* The *Turner* court went on to adopt "a more realistic test," where the efforts made by those other than the investor are only required to be the undeniably significant ones, those essential managerial efforts which ultimately affect the failure or success of the enterprise.

Arizona courts have followed *Turner* in broadening this third prong. *See Nutek,* 194 Ariz. at 108; *see also Foy,* 186 Ariz. 151; *Daggett,* 152 Ariz. 559. As such, in order to satisfy the third *Howey* prong in Arizona, one must only establish that the efforts made by those other than the investors were the undeniably significant ones, and were those essential managerial efforts which affected the failure or success of the enterprise. *Id.*

In view of the mechanics, terms and conditions of the TLC America tax lien program at issue, this investment program readily satisfies the third prong of the *Howey* test. As explicitly included in the TLC investment literature, all material aspects of this program, including research, real estate procurement, property management, marketing and administration, and the generation of profits were to be conducted through the "expertise" of the TLC "team." *Exhibs. S-24(a); S-184.* Through their group of "experts," TLC was to provide "the quality that assures our investors safety of principal and guaranteed returns." *See Exhib. S-184, p.3, ¶2.* In contrast, the passive investors in this tax lien program had but one requirement: to invest their money. There were no other functions falling upon the investors in this program other than to wait for their "guaranteed" returns. Because of the clearly delineated roles of the investor and promoter in this program, the investors in this TLC America tax lien investment plainly expected profits through the efforts of others, namely the TLC promoters themselves. Accordingly, this investment unequivocally met the third prong of the *Howey* test.

Because the TLC America tax lien investment easily met each prong of the *Howey* test, this program once again fell well within the recognized definition of an investment contract.[5] And, as an investment contract, this investment again fell within the definition of a security as prescribed under § 44-1801(26) of the Securities Act. It follows that the offer and sale of this investment by RESPONDENTS from 1998 through 2000 constituted yet another offer and sale of securities, once

[5] Similarly, the SEC concluded that this program was an investment contract under Federal law when it filed a preliminary injunction against the TLC entity and a number of affiliated companies. A preliminary injunction was subsequently granted by the U.S. District Court for the Central District of California and a receiver was appointed to seize all of TLC's assets.

again conferring jurisdiction to the Commission to take such action that it deems appropriate in connection with the multiple offers and sales of this investment.

D. The "MVP" Money Voucher Program

The MVP money voucher program was a fourth investment "opportunity" offered and sold by RESPONDENTS. Like the TLC America tax lien program, this money voucher program again fell precisely within the definition of an investment contract as defined by *Howey* and subsequent Arizona case law. As before, this program undeniably involved an investment of money by investors, in a common enterprise, with an expectation of profits. And, despite the issuer's transparent attempt to portray the program otherwise, the success or failure of this money voucher program was also fully dependent upon the efforts of others. As such, the activities associated with RESPONDENTS' fourth investment program again fell within the purview of the Commission.

1. RESPONDENTS' MVP Money Voucher Program Involved the "Investment of Money"

As discussed previously, a determination as to whether there was an investment of money in a particular program is traditionally not a difficult exercise. *See, e.g., Vairo, supra.* In the case of the MVP money voucher program at issue, the evidence easily demonstrates that this MVP money voucher program involved the investment of money. As witness testimony and hearing exhibits repeatedly reflected, participation in this program was predicated on the investors' investment of money.

2. RESPONDENTS' MVP Money Voucher Program Required Investments in a "Common Enterprise"

Like the TLC America tax lien program, the MVP money voucher investment also readily satisfies *Howey's* second prong for investment contracts - commonality. As seen *supra,* either horizontal or vertical commonality will suffice in meeting the commonality requirement. In the MVP money voucher program, the more overt form of commonality exhibited was the vertical form of commonality. As the hearing exhibits reflect, the MVP investment literature provides that the servicing company "packaged" with this money voucher program would split any profits that the investors might recoup from this venture.[6] In fact, as the MVP investment program brochure explicitly provides, the servicing company associated with this program would "share" in all revenues generated by the investors' money voucher machines. *Exhib. S-173(c), p.6, ¶7.* This arrangement, where the fortunes of the promoter's servicing company are inexorably tied to the success of the investor, constitutes a well-recognized form of vertical commonality. *Cf. Daggett; Sullivan, supra.*

3. The MVP Money Voucher Investors had an Expectation of Profit Through the Efforts of Others

Despite a shallow attempt by the promoters of the MVP program to circumvent the "efforts of others" element of the *Howey* test, the MVP money voucher program inescapably falls within the purview of this final element. Indeed, the evidence educed at trial, coupled with applicable case law, plainly established that this was an investment in which the investors had an expectation of profits through the efforts of others. Conversely, the MVP investors' only roles in this program effectively became the submission of their investments and their anticipated receipt of a promised guaranteed rate of return.

As previously seen, the original definition of *Howey's* third prong was ultimately expanded to reflect "a more realistic test," where the efforts made by those other than the investor are only required to be the undeniably significant ones, those essential managerial efforts which ultimately affect the failure or success of the enterprise. *Turner, supra.* And, as also discussed, Arizona courts are in accord with *Turner* in broadening this third prong. *See, e.g., Nutek*, 194 Ariz. at 108; *see also Foy,* 186 Ariz. 151; *Daggett,* 152 Ariz. 559. As such, in order to satisfy the third *Howey* prong in Arizona, one must only establish that the efforts made by those other than the investors were the undeniably significant ones, and were those essential managerial efforts which affected the failure or success of the enterprise. *Id.*

---

[6] The servicing company associated with this investment, Douglas Enterprise Networks, is regularly packaged with the MVP money voucher investment, and DNE's servicing brochure regularly accompanies the MVP investment literature (*See, e.g., Exhib. S-173(c)).*

With its expanding definition, the third *Howey* prong has required further guidance in its interpretation and application. A number of recent Arizona court decisions have provided this guidance by identifying certain investment features that reflect upon the degree to which the "efforts of others" are an essential component to a particular investment. Three of these features include the "level of control" of the investors to their investments, their "levels of sophistication," and the "economic realities" of the particular investment.

Level of control

An essential component recognized by Arizona courts in considering the third *Howey* prong is the actual level of control retained by the investor. *Nutek*, 194 Ariz. at 109; *Foy,* 186 Ariz. at 158; *Vairo,* 153 Ariz. at 18, *citing Williamson v. Tucker,* 645 F.2d 404, 421 (5th Cir.1981); *Rose,* 128 Ariz. at 212. The greater the degree of managerial control an investor retains in his or her investment, the greater the likelihood that the investment is not an investment contract. *Foy, supra.* Conversely, where an investor has some powers of control but does not control the *"undeniably significant"* managerial efforts of the enterprise, an investment contract may very well exist. *Rose,* 128 Ariz. at 212.

This "level of control" component led to a finding of an investment contract in the case of *Nutek, supra.* In *Nutek*, the court examined the "level of control" component in the context of an LLC business arrangement. The *Nutek* court noted that in determining the level of investor control, it is necessary to look at both legal and practical control. The court continued that in order to assess this level of control, not only is a formal agreement outlining the enterprise important, but any oral representations made by the promoters at the time of the investment as well as the practical possibility that the investors could exercise the powers they purportedly possessed is also highly relevant. Citing the Fifth Circuit case of *Williamson, supra,* the *Nutek* court concluded that "an investor's knowledge of the business being operated provides one of the most reliable indicators of that investor's ability to exercise control over the investment." *Id.* at 111. Using this analysis, the court in *Nutek* concluded that the investors in an LLC were so dependent on the unique entrepreneurial and managerial abilities of the promoters, that they were incapable of exercising meaningful powers of control. As a consequence, the third prong of *Howey* was ultimately satisfied.

The *Nutek* reasoning easily transfers to the MVP money voucher program at issue. In its promotional literature, the MVP program offers two options to implement the money voucher investment. The first of these was the conspicuously termed "popular option," involving the hiring of industry professionals to handle the placement, management, service and administration of the money voucher machines. *Exhib. 173(c), p. 3, ¶7.* The alternative option required the relocation, management and servicing of these money voucher machines by the investors themselves. In connection with this latter option, investors' responsibilities would include "finding high traffic locations for your machines, installing equipment, connection to financial institution networks, and maintenance and servicing of your equipment." *Exhib. 173(c), p. 3, ¶6.* Consequently, it is quite obvious that as a practical matter, most if not all of the investors in this program were so dependent on the unique entrepreneurial and managerial abilities of the servicing agents that they were incapable of exercising any meaningful control over these investments.[7] This lack of effective control by investors is a clear factor militating towards a finding that the MVP investment was dependent upon the efforts of others.

Level of sophistication concerning the investment

Another component recognized by Arizona courts in considering the third *Howey* prong is the level of sophistication possessed by the investor in relation to the investment made. Arizona courts have been willing to disregard claims that the investors had significant control over the success of their own investments where it was readily apparent that the investors did not possess the requisite sophistication or knowledge to realistically contribute to the overall success of the enterprise - even if such control was technically possible. *Nutek,* 194 Ariz. at 111; *Daggett,* 152 Ariz. at 567; *Sullivan,* 150 Ariz. at 577.

[7] As these investment programs were sold to investors without any regard to the expertise of investors in their ability to service these machines, let alone make connections to financial institution networks, the investors' ability to choose to control their investment was, in effect, illusory.

In *Nutek,* for instance, the Division brought suit against the promoters of an LLC for the sale of unregistered securities in the form of investment contracts. The LLC promoters argued that this arrangement could not constitute investment contracts simply because the investors in this company had unambiguous legal control over the LLC pursuant to the company's articles of incorporation. While conceding that the investors did ostensibly have legal control over the company, the *Nutek* court rejected the promoters' legal control claim on the grounds that the investors did not possess the technical expertise to effectively manage the LLC. In short, the court found that in light of the investors' paucity of knowledge and sophistication in this particular telecommunications enterprise, the investors had no effective control over the investment.

A similar result was reached in *Daggett, supra.* In *Daggett*, an art dealer sold an investor a particular "art master" for $136,000 as an investment and tax shelter. When the investment proved unsuccessful on both fronts, the investor brought suit against the dealer for, *inter alia,* the fraudulent sale of securities (in the form of an investment contract). The dealer subsequently argued that since the investor was able to market the art master through either a distributor or through his own efforts, the efforts of the investor were an important component to the success or failure of the investment, and the sale of the art master was consequently not an investment contract under the *Howey* test. Although it conceded that the investor could have marketed the art master himself, the court did not accept the dealer's conclusion. Instead, the court recognized that at the time the art master transaction occurred, the dealer "knew or should have known that the facts and circumstances prohibited [the investor's] involvement with the art master beyond merely choosing a distributor." The court added that the investor owned a construction company; he had no knowledge of art and possessed no experience in the art industry. Viewing the facts in this light, the court held that it was clear that the success of the investor's investment was inescapably tied to the efforts of others, as the investor was never in a practical position to market the art master himself.

These particular holdings again buttress the conclusion that the MVP investment program was dependent upon the efforts of others. The investors in this program had no specialized knowledge in the financial networks industry, nor were they ever singled out for such knowledge.[8] Also revealing was the fact that neither the promoters of this program nor the RESPONDENTS made any effort to attract the type of investor that could actually manage this type of investment without the assistance of industry professionals. Indeed, the RESPONDENTS target population for this and other investments was admittedly retirees and other elderly individuals. *See, e.g., H.T., p. 714, lines 12-18.* It follows that although investors could have technically managed the money voucher machines themselves, the promoters and agents knew or should have known that the facts and circumstances prohibited the investors' involvement with the machines beyond merely choosing the servicing agent. As the *Daggett* court recognized, under these circumstances, it was obvious that the success of the investors' investments in this program were inescapably tied to the efforts of others, as the investors were never in a practical position to manage the voucher machines themselves.

The economic reality of the investment

Still another interrelated factor recognized by Arizona courts in assessing the third *Howey* prong involves the "economic realities" of the investment. Arizona courts have consistently recognized that the ultimate emphasis in determining whether an investment is a security is on economic reality. *Davis v. Metro Productions, Inc.*, 885 F.2d 515 (9th Cir.1989); *see also Daggett, supra*; *Sullivan, supra*. As the court in *Davis* noted, "it is well established that the courts look beyond contractual language to economic realities in determining whether an investment is an investment contract." *Id. at 525, citing Tcherepnin v. Knight,* 389 U.S. 332 (1967).

The court in *Sullivan* employed this "economic realities" analysis in assessing whether the purchase of a master videotape constituted the sale of an investment contract. The promoter insisted that the third prong of *Howey* was not satisfied in that instance because the investors in this case did not make passive investments in purchasing the master videotapes. The promoter pointed to the selling

---

[8] Investor/witness Del Valle, for instance, invested approximately $65,000 in the MVP money voucher investment program. Although not asked by RESPONDENTS, she was the owner of an antique store at the time of her investment.

brochure connected with the tapes that informed the investors that they would be responsible for distributing the tapes themselves or would be responsible for engaging an agent to distribute them. The court was not persuaded by this argument and concluded that the sales did in fact constitute the sale of investment contracts. As justification for this finding, the *Sullivan* court noted that although the brochure spoke of the investors actively distributing the tapes as though that was truly an option, the economic reality of the situation was that the investors would have to hire a sales agent to have any chance of distributing the tapes. The investments were offered without any regard to the experience or sophistication of the investors in the television industry, and it was not ultimately intended or expected by the promoter that the typical investor would attempt to market the tapes by himself. Based on these economic realities, the investors were not active participants in the success of the venture.

The economic realities of the MVP money voucher investment are hardly in question. The undeniable reality of this program was that in order to have any chance at generating profits from their investments, the investors would have to hire the packaged servicing company to manage their investments. This conclusion is self-evident for two reasons: First, none of the investors were in a position to market, transport, set up, link and manage these machines effectively. Second, investors simply did not have the requisite training or merchant contacts to even contemplate generating a profit from their investment through self-management. This point was amply demonstrated by the evidence presented at hearing. Asked how many of the investors in the MVP program had in fact chosen the self management option for these money voucher machines, RESPONDENTS testified that the grand total was in fact "none." *H.T., p. 872, lines 5-7; p. 969, lines 5-18.* In short, the economic realities of this investment option made self-management prohibitive.

Based on these factors and in light of applicable law, it is readily apparent that the MVP money voucher program was, in effect, wholly dependent upon the efforts of others, namely the promoters' servicing agent. Because this was the case, the third prong of *Howey* was again satisfied with respect to this money voucher investment.

The MVP money voucher program consequently satisfied all prongs of the *Howey* test and, as a result, fell within the definition of an investment contract under the Securities Act. As an investment contract, it constituted a security, and all activities associated with the offer and sale of this product yet again fell within the jurisdiction of the Commission.

II.

REGISTRATION VIOLATIONS

A. Offer and Sale of Unregistered Securities

The Securities Division has alleged that from 1998 forward, RESPONDENTS have repeatedly offered and sold securities within or from Arizona in violation of A.R.S. § 44-1841 of the Securities Act. This statute provides that it is unlawful for an individual to sell or offer for sale within or from this state any securities unless the securities have been duly registered or qualify as a specifically described subset of federally covered securities. *A.R.S. § 44-1841(A).* The only applicable exception to this provision is if the securities at issue fall within one of the prescribed exemptions to registration as provided under the Securities Act *See, generally, State v. Burrow*, 13 Ariz. App. 130, 132, 474 P.2d 849, 851 (1970). The evidence produced at hearing established that RESPONDENTS were in violation of this statute with regard to multiple securities on repeated occasions over a several year period. Indeed, the only true matter at issue respecting this charge relates to the actual number of violations that RESPONDENTS ultimately committed.

1. Brokered Certificates of Deposit

As previously addressed, RESPONDENTS' sale of Brokered CDs in Arizona constituted the sale of securities. *See Section I(A), supra.* Equally clear is the fact that these securities were not registered with the Division in any capacity. *See Exhib. 6(b) (Certificate of non-registration).* Despite this lack of registration, various business records reveal that RESPONDENTS sold at least 281 of these Brokered CDs since 1998. *See Exhibs. S-26(b) et seq.; S-115; S-175.* Each one of these sales constituted a separate violation of A.R.S. § 44-1841(A) for purposes of the Securities Act unless an exemption from such registration was applicable. As will be discussed below, however, no such exemption was applicable with this security under the Securities Act. Moreover, RESPONDENTS made no attempt to allege any particular registration exemption, much less meet their burden in proving that a particular registration exemption was indeed applicable.

No registration exemption applies

In accordance with the Securities Act, registration exemptions may be granted to certain classes of securities if the Commission finds that the registration of such securities is not needed for the protection of investors and does not advance the public interest by reason of the special characteristics of such securities. *A.R.S. § 44-1845.* Based on this principle, there is no reasonable justification for including brokered CDs within any of the registration exemptions prescribed under the Securities Act. Indeed, there is nothing inherent in brokered CDs as a class that would shelter investors to such an extent that the protections of the Securities Act would be unnecessary. Quite to the contrary, the dangers associated with this type of investment are plentiful. There are, in fact, at least a handful of distinct features of the brokered CD investment that can make this type of investment a particularly perilous option to the investing public.

For instance, banking institutions that traditionally issue bank CDs directly to individual investors must adhere to banking rules and regulations promulgated by the banking industry. However, because CD brokers and their agents fall outside the purview of the banking authorities, these issuers of brokered CDs have no such constraints. Accordingly, CD brokers and their agents can engage in the offer and sale of brokered CDs without any concern for applicable banking rules and regulations. This effectively leaves securities regulators as the only remaining authority able to monitor the actions and practices of these sellers. It follows that if a registration exemption was in fact applicable for brokered CDs, then any governmental oversight over these intermediaries' actions would effectively be lost. This would inevitably invite the possibility of fraud or other financial mischief.[9]

---

[9] This was precisely the concern articulated by the court in *Gary Plastic, supra.* In *Gary Plastic,* the court noted that because banking regulations do not apply in the instance of brokered CDs, "absent the Securities laws, [investors] would have no federal protection against fraud and misrepresentation by CD brokers in the marketplace." *Gary Plastic,* 756 F.2d at 241.

For instance, and as seen in the case of the CD broker San Clemente Securities,[10] CD brokers could effectively create there own disclosure rules and commissions without any governmental control. This would leave individual investors in the precarious position of depending upon the honesty, integrity and competence of a largely unmonitored securities sales operation. Equally hazardous would be the prospect that the CD broker was operating without sufficient capital to sustain its operations. Still further, if a CD broker routinely maintained its status as the beneficiary of record for its brokered CDs, and then subsequently folded, the individual CD investors might have little if any recourse to recover their investments. Countless other problematic scenarios are possible; for instance, the CD broker could tamper with administrative records of the brokered CD holders, ultimately skimming interest from these investments.

Also precarious to brokered CD investors, these investments are routinely characterized by an ambiguous "call feature." This feature often serves to mislead or confuse unsophisticated investors who are unaware of both how the call feature operates and to which parties the features applies. As seen with by the testimony elicited during this hearing, these investors regularly lacked a fundamental understanding of the call feature. *See, e.g., H.T., p. 87, lines 8-20 (Smith testimony); H.T., p. 129, lines 1-12 (Hetherington testimony).* This confusion extended even to the RESPONDENTS' own witnesses. *H.T., pp. 525-527, lines 25, 1-25 and 1-8, respectively (McDonald testimony).* The single remedy for this confusion is that sellers of this security must provide lucid and comprehensive disclosure information, both oral and written, to investors making investments in these CDs. Without a registration requirement, regulators would have no access to sellers' necessary compliance with this concern.

Brokered CDs are also characterized by lengthy maturity dates. As a consequence of this, sellers of these CDs often maintain secondary markets for these CDs to provide a level of liquidity for

[10] The principals of San Clemente Securities, a former CD broker, recently consented to a number of securities fraud violations in connection with the offer and sale of brokered CDs, including charges of misleading investors, charging hidden commissions, and providing false account statements. *NASD Disciplinary Proceeding, No. C02000042.*

the investors' CDs. This system can allow the market makers in these CDs with a great deal of latitude. This, of course, can include instances of mischief or fraud that the investors are powerless to prevent. For instance, the operators of these secondary markets could feasibly offer to liquidate the investors' brokered CDs at prices well below their market values with impunity. Because these markets are the only option available for CD holders desiring liquidation, the investors have only two choices: to sell their CDs at whatever price the secondary market makers offer or to hold their CDs to maturity, which can often be up to 20 years. Because many CD purchasers are elderly, they are constrained to choose the liquidation option and are at the mercy of the managers of the secondary market. As seen during this hearing, investors attempting to liquidate their CDs early have consistently lost a substantial portion of their principal in doing so.

Brokered CDs present still another peril: unfounded reliance on FDIC insurance. Because brokered CDs are routinely purchased as a master CD and then fractionalized into smaller denominations, the initial beneficiary listed by the CD issuing bank for its CDs is the actual buyer, the CD broker. Under such circumstances, only the CD broker is insured by the FDIC for its master CD. Moreover, this insurance would only apply to the first $100,000 of this master despite the fact that master CDs regularly extend in value well beyond $100,000. Thus, in reality, the individual investors who purchased fractionalized brokered CDs are not insured unless the CD broker goes to certain lengths to ensure that the FDIC insurance "passes through" to the individual investors. As recently declared by the FDIC, the only way a CD broker can ensure that FDIC insurance passes through to individual investors is if 1) the broker informs the CD issuing bank that its purchase of the CD is in a custodial capacity for other individuals; and 2) the broker subsequently provides a listing or some other means such that the CD issuing bank can trace the beneficial owner of the fractionalized CDs.[11] Without performing these two tasks, the FDIC insurance will only extend so far as the broker itself. It is evident then, that the CD broker's actions are an integral component to providing FDIC insurance to

[11] 12 C.F.R. § 330.1

the individual brokered CD investors. Without regulatory oversight, there can be no assurance that the brokers are in fact undertaking or even intending to undertake this function.

In sum, the brokered CD presents a number of dangerous scenarios for CD investors who are traditionally looking for precisely the opposite in an investment – safety and guaranteed returns. In light of the above, it is readily apparent that some form of governmental oversight is both necessary for the protection of investors and in the public interest. For this reason, there are no grounds to demand nor expect that a registration exemption would be available for such an investment. Indeed, the Securities Act neither contains nor contemplates such an exemption.

<u>The registration exemption for bank-issued securities is not applicable</u>

The only registration exemption found in the Securities Act that even approaches brokered CDs is found under A.R.S. § 44-1843(A)(2) of the Securities Act. This provision, which outlines specific classes of exempt securities, states as follows:

> (2) Securities issued by a national bank, a bank or a credit or a loan association organized pursuant to an act of Congress and supervised by the United States or an agency thereof, or issued by a state bank or savings institution the business of which is supervised and regulated by an agency of this state or of the United States.

Although this provision is applicable for traditional CD sales made directly between issuing banks and individual investors, this provision loses any applicability when intermediaries intercede to resell these CDs in fractionalized forms and under varying commissions, terms, features and protections. Under this latter situation, the brokered CDs are inevitably transformed and ultimately constitute a wholly distinct security - one that is separately issued, offered and sold by the CD brokers themselves. This being the case, the exemption provision cited above has no logical applicability in the case of brokered CDs.

This point is highlighted by the distinguishing characteristic of the brokered CD as compared to the traditional CDs sold directly from issuing banks to investors. Obviously, a predominant difference between the two types of securities is that with brokered CDs, FDIC insurance does not necessarily pass through to the actual individual investors. *See FN 10, supra.* Another marked difference between the two securities is that investors in the brokered CD investments have their returns and CD ownership tracked and administered solely by the CD broker. As a consequence, this treatment of these securities is governed by a set of guidelines that have no bearing on the banking regulations from which the original issuing bank is constrained to adhere. Still further, brokered CDs may often harbor various terms and conditions that the original issuing bank CDs never contained. For instance, sales of brokered CDs can contain hidden charges and fees that may or may not be disclosed to the individual investors, such as was the case with the CD broker, San Clemente Securities. *See FN 9, supra.*

Beyond the distinguishing features of brokered CDs as compared to their traditional bank-issued CD counterparts, it is entirely evident that the drafters of the bank-related registration exemption did not contemplate extending this exemption to brokered CDs. As seen previously, the primary rationale behind registration exemptions for certain classes of securities is based on the concept that additional regulatory monitoring of these securities is not necessary to protect the investing public. This rationale collapses in the case of brokered CDs. As discussed above, the brokered CD investment is wrought with perils, these often including inadequate disclosures, fraud, defective internal policies and/or ineptitude. Moreover, the banking regulations that protect against these types of problems with bank-issued securities simply do not exist in the case of brokered CDs. Based on this profound difference, there is no salient reason to extend the banking exemption to the intermediaries that constitute the core of the brokered CD industry. Rather, the Securities Division must maintain a degree of oversight with this type of security in order to be in a position to reign in or otherwise prevent these serious investor-related problems from occurring.

<u>RESPONDENTS advanced no claim to a registration exemption</u>

Even without regard to the foregoing analysis, RESPONDENTS neither alleged nor offered any evidence to support the position that a registration exemption should in apply to their offer and sale of brokered CDs. In failing to do so, RESPONDENTS have effectively conceded to the charge levied by the Securities Division that they violated § 44-1841 of the Securities Act. This conclusion rests simply on the fact that in any court action, the burden of proving the existence of an exemption from registration under the Securities Act falls upon the party raising such a defense. *A.R.S. § 44-2033; see also State v. Barber*, 133 Ariz. 572, 578, 653 P.2d 29, 35 (App. 1982), approved, 133 Ariz. 549, 653 P.2d 6 (1982); *State v. Baumann*, 125 Ariz. 404, 610 P.2d 38 (1980). The Court in *Barber* discussed the exemption burden as follows:

> To begin our analysis of this issue, we first note that the state is not required to prove that the securities and transactions were not exempted by law. A.R.S. § 44-2033 provides: In any action, civil or criminal, when a defense is based upon any exemption provided for in this chapter, the burden of proving the existence of the exemption shall be upon the party raising the defense, and it shall not be necessary to negative the exemption in any petition, complaint, information or indictment, laid or brought in any proceeding under this chapter. *This statute clearly places the burden upon the [defendant] to prove the existence of any exemption he deemed applicable to this case.*

(Emphasis added).

During the hearing at issue, RESPONDENTS simply made no reference to the exemption provisions touching upon the registration requirements prescribed under the Securities Act. It is self-evident that through RESPONDENTS' silence on this issue, the necessary burden of proof to qualify for an exemption was not carried. It is equally evident, based on A.R.S. § 44-2033 and the cited case law interpreting this provision, that RESPONDENTS have waived any and all registration defenses predicated on exemptions provided under the Securities Act.

Summary of registration violations

In sum, RESPONDENTS offered and sold securities to investors that were neither duly registered nor exempt from registration - violations of A.R.S. § 44-1841 of the Securities Act. The ultimate inquiry inevitably becomes, with respect to the offer and sale of Brokered CDs, to what extent were these violations committed? As previously addressed, the exhibits and supporting evidence produced at hearing ultimately showed that RESPONDENTS conservatively violated this registration provision on at least 281 occasions.

. . .

2. *Viaticals*

As discussed earlier, RESPONDENTS' separate sale of viaticals also constituted the sale of securities. *See Section I(B), supra.* And, as with the Brokered CDs, is it again clear that these securities were never registered with the Division. *Exhib. S-6(c) (Certificate of Non-registration).* Despite this non-registration, evidence at trial revealed that RESPONDENTS sold a substantial number of these securities since 1998. *See, e.g., Exhibs. S-115; S-24(b).* Each one of these sales constituted a separate violation of A.R.S. § 44-1841(A) for purposes of the Securities Act unless an exemption from such registration was applicable. However, it is clear that no such exemption for this security was applicable under the Securities Act. Moreover, RESPONDENTS again made no attempt to allege any particular registration exemption, much less meet their burden in proving that a particular registration exemption was indeed applicable.

Based on these facts, the viatical sales by RESPONDENTS each constituted the sale of an unregistered security as proscribed under A.R.S. § 44-1841(A). Consequently, the only issue remaining in connection with this count is to ascertain the number of violations of this provision that RESPONDENTS actually committed. Although determining the precise number of such sales is not feasible, the evidence produced at hearing does provide a baseline number for these violations. Records obtained from San Clemente Securities included a disclosure from Respondent JOE HILAND that listed the number of viatical sales RESPONDENTS had engaged in as of June of 1999. According to that memo, RESPONDENTS had sold four separate viatical investments between September of 1998 and May of 1999. *Exhib. S-115.* Still another business record, produced by RESPONDENTS in September of 1999, revealed that at least nine additional viaticals were sold by RESPONDENTS since 1998. *Exhibs. S-99 through 107, inclusive.* However, the most comprehensive report of RESPONDENTS' viatical sales was disclosed in February of 2001. According to these business records, RESPONDENTS sold 142 viaticals during the period from January of 1999 to July of 2000. *Exhib. S-175.*

In total, then, documentation indicates that a minimum of at least 142 unregistered viaticals were sold by RESPONDENTS. As each sale constituted an independent violation of A.R.S. § 44-1841(A), RESPONDENTS committed a minimum of 142 registration violations under the Securities Act in connection with the offer and sale of viaticals.

3. *TLC America Tax Lien Investments*

As previously seen, RESPONDENTS' additional sale of TLC tax lien investments also constituted the sale of securities. *See Section I(C), supra.* And, as previously demonstrated, these securities were again never registered with the Securities Division in any capacity. *Exhib. S-6(a) (Certificate of Non-registration).* Each one of these sales consequently constituted a separate violation of A.R.S. § 44-1841(A) for purposes of the Securities Act unless an exemption from such registration was applicable. However, it is obvious that no registration exemption for this security was available under the Securities Act. Moreover, RESPONDENTS once again made no attempt to allege any particular registration exemption for these securities, much less meet their burden in proving that a particular registration exemption was indeed applicable.

In light of these facts, the tax lien investments sold by RESPONDENTS each constituted the sale of an unregistered security as prohibited under A.R.S. § 44-1841(A). It again follows that the only issue remaining in connection with this particular count rests on the number of violation that RESPONDENTS actually committed in connection with this provision. Although determining the precise number of such offers and sales is again made difficult by incomplete records, the evidence produced at hearing does provide a baseline number for these violations. Records obtained from by Robb Evans & Associates, the court-appointed receiver for this former tax lien investment program, produced sales records at hearing which evidenced the sale of 77 TLC America tax lien investments by RESPONDENTS during the period from January of 1999 to December of that same year. *Exhib. S-7.* Other germane documentation admitted at hearing included a disclosure from Respondent JOE HILAND that listed the number of tax lien sales RESPONDENTS admittedly engaged in during the period from 1999 through 2000. According to these records, RESPONDENTS had sold at least 92 TLC America tax lien investments during this period. *Exhib. S-175.*

Consequently, a minimum of 92 unregistered tax lien investments were sold by RESPONDENTS since 1998. As prescribed under the Securities Act, each one of these 92 sales constituted an independent violation of A.R.S. § 44-1841(A). RESPONDENTS thus committed a minimum of 92 such violations in connection with their offer and sale of unregistered TLC tax lien investments.

4. MVP Money Voucher Investments

Once again, RESPONDENTS' sale of MVP money voucher investments constituted the sale of securities as defined under the Securities Act. *See Section I(D), supra.* And, as with the other securities sold by RESPONDENTS, these securities were also not registered with the Division in any capacity. *Exhib. S-6(d) (Certificate of Non-registration).* Each one of these sales consequently constituted a separate violation of A.R.S. § 44-1841(A) for purposes of the Securities Act unless an exemption from such registration was applicable. As before, however, not only were no registration exemptions for this security available under the Securities Act, but RESPONDENTS made no attempt to allege any particular registration exemption for these securities.

In view of this, the MVP money voucher investments sold by RESPONDENTS each constituted the sale of an unregistered security as prohibited under A.R.S. § 44-1841(A). Although determining the precise number of such prohibited sales is again not feasible, the evidence produced at hearing does provide some indication as to the number for these violations. Documentation admitted at hearing included business records from Respondent JOE HILAND, disclosing that RESPONDENTS had engaged in a number of MVP money voucher sales during the period from June of 2000 to December of that same year. Based on these records, RESPONDENTS engaged in at least 29 sales of MVP money voucher investments during this period. *Exhib. S-175.* Witness testimony supplements this sales number. Based on the witness testimony of Del Valle and Investigator Kirst, it is apparent that RESPONDENTS offered and/or sold at least an additional two MVP money voucher investments during 1999 and 2000, respectively.

Consequently, a minimum of 31 unregistered money voucher investments were offered and sold by RESPONDENTS since 1999. As prescribed under the Securities Act, each one of these 31 sales constituted an independent violation of A.R.S. § 44-1841(A), and RESPONDENTS thus committed a minimum of 31 such violations in connection with their offer and sale of unregistered MVP money voucher investments.

B. Offer and Sale of Securities by Unregistered Dealers or Salesmen

The Division also alleges that RESPONDENTS violated A.R.S. § 44-1842 by acting as securities dealers or salesmen within or from Arizona while not registered as required under the Securities Act. Specifically, A.R.S. § 44-1842 states that it is unlawful for any dealer to sell or purchase or offer to sell or buy any securities, or for any salesman to sell or offer for sale any securities within or from this state, unless the dealer or salesman is registered as such pursuant to the registration provisions of the Securities Act. Based largely on the same analysis propounded in the prior section (*Section II, Part A*), RESPONDENTS violated this count on enumerable occasions.[12]

1. Unregistered Sale of brokered CDs

As previously established above and through the stipulation of the parties, the Brokered CDs offered and sold by RESPONDENTS in this matter were a type of security recognized under the Securities Act. *Section I(A), supra.* In light of this fact, the issues relevant to this second alleged category of securities violations revolve around three familiar issues: whether RESPONDENTS themselves were registered, whether an exemption to such registration applied, and if neither of the prior two were applicable, whether, and to what extent, did RESPONDENTS make such unregistered sales.

Respecting the initial issue of RESPONDENTS' registration status a dealers and/or salesmen in Arizona, the record is once again clear: RESPONDENTS were not registered as dealers or salesmen under the Securities Act during the majority of their selling activities. As established through a

[12] Because the legal and factual analysis for parts A and B of Section II is largely identical, and for the sake of brevity, Part B above will be condensed where possible with appropriate references to Part A.

Certificate of Non-registration issued against Respondent JOE HILAND pursuant to A.R.S. § 44-2034, JOE HILAND was not registered as a dealer or salesman in Arizona from January of 1998 through September 6, 1999, and again from June 20, 2000, to the present. *Exhib. S-5A (Certificate of Non-registration).* A similar timeframe applies to Respondents TYSON and TRAVIS. Again established through a Certificate of Non-registration issued by the Division, TYSON was not registered as a dealer or salesman in Arizona from January 1, 1998, through November 7, 1999, and again from January 8, 2000, to the present. *Exhib. S-5B (Cerificate of Non-registration).* With respect to TRAVIS, a Certificate of Non-registration establishes that this individual was not registered as a dealer or salesman in Arizona from January 1, 1998, through October 31, 1999, and again from June 20, 2000, to the present. *Exhib. S-5C (Certificate of Non-registration).* Finally, and again as evidenced by a Certificate of Non-registration, Respondent CHAMBER was never registered as a dealer or salesman in Arizona. *Exhib. S-4A (Certificate of Non-registration).*

The second issue pertaining to the Division's allegations against RESPONDENTS for securities transactions by unregistered dealers or salesmen relates to the issue of exemptions. Quite simply, RESPONDENTS made no attempt during the hearing to raise any exemption defenses to the registration requirements prescribed under A.R.S. § 44-1842. As discussed *supra*, the burden is on the respondent to raise and prove any exemption defenses, and a failure to do so prior to the close of hearing acts as a waiver to any and all such defenses. *See, generally, A.R.S. § 44-2033; See also State v. Barber*, 133 Ariz. 572, 578, 653 P.2d 29, 35 (App.1982), approved, 133 Ariz. 549, 653 P.2d 6 (1982); *State v. Baumann*, 125 Ariz. 404, 610 P.2d 38 (1980). Because RESPONDENTS neither raised nor proved any defenses premised on an exemption to the registration requirements of A.R.S. § 44-1842(A), no exemption defenses are applicable in this matter.

The third and final issue pertaining to the Division's allegations against RESPONDENTS for violations of A.R.S. § 44-1842 involves the extent to which RESPONDENTS made offers and sales of Brokered CDs while unregistered as a dealer or salesman. Plainly, because RESPONDENTS were each not registered as dealers or salesmen during the entire period from January 1, 1998 through

September 6, 1999, the number of instances in which RESPONDENTS sold Brokered CDs to investors during this period equates to the minimum number of times in which RESPONDENTS sold securities while not registered as dealers or salesmen. Based on exhibits and witness testimony produced at hearing, this figure calculates out to a minimum of 124 instances of unregistered transactions. *Exhibs. S-115; S-27 through S-98, inclusive.*

To summarize, RESPONDENTS, while unregistered with the Securities Division, functioned as securities salesmen and/or dealers during the sale of at least 124 Brokered CDs. Each instance of this conduct was an unlawful sale of securities by an unregistered salesman or dealer as proscribed under § 44-1842(A) of the Securities Act.

2. *Unregistered Sale of Viaticals, Tax Lien Investments, and Money Voucher Investments*

Also established above was the fact that the viaticals, tax lien investments and money voucher investments offered and sold by RESPONDENTS in this matter were each types of securities recognized under the Securities Act. *See Section I(B) through (D), supra.* Based on these activities, the issues relevant to these additional violations of A.R.S. § 44-1842 again revolve around the same three issues: whether RESPONDENTS were duly registered to sell these securities, whether an exemption to such registration applied, and if neither of the prior two were applicable, whether, and to what extent, did RESPONDENTS make such unregistered sales.

Respecting the initial issue of RESPONDENTS' registration status a dealers and/or salesmen in Arizona, the record is once again clear: RESPONDENTS were not registered as dealers or salesmen under the Securities Act during the majority of the selling activities with respect to these securities. As discussed *supra,* none of the RESPONDENTS were registered as dealers or salesmen in Arizona from January 1, 1998, through September 7, 1999, and again from June 20, 2000, to the present. *See Exhibs. S-5(A) through (C) and Exhib. 4(A) (Certificates of Non-registration).* As will be discussed below, the evidence educed at hearing nevertheless showed that the majority of REPONDENTS' sales of these three types of securities transpired during these very same periods of non-registration.

The second issue pertaining to the Division's allegations against RESPONDENTS for securities transactions by unregistered dealers or salesmen relates to the issue of exemptions. As reiterated in connection with their sale of Brokered CDs, RESPONDENTS made no attempt during the hearing to raise any exemption defenses to the registration requirements prescribed under A.R.S. § 44-1842. As discussed *supra*, the burden is on the respondent to raise and prove any exemption defenses, and a failure to do so prior to the close of hearing acts as a waiver to any and all such defenses. *See, generally, A.R.S. § 44-2033; See also State v. Barber*, 133 Ariz. 572, 578, 653 P.2d 29, 35 (App.1982), approved, 133 Ariz. 549, 653 P.2d 6 (1982); *State v. Baumann*, 125 Ariz. 404, 610 P.2d 38 (1980). Because RESPONDENTS neither raised nor proved any defenses premised on an exemption to the registration requirements of A.R.S. § 44-1842(A), no exemption defenses are applicable in this matter.

The third and final issue pertaining to the Division's allegations against RESPONDENTS for violations of A.R.S. § 44-1842 in connection with their offer and sale of viaticals, TLC America investments, and MVP money voucher investments involves the extent to which RESPONDENTS made offers and sales of these investments while not registered as dealers or salesmen. It is self-evident that since RESPONDENTS were not registered as dealers or salesmen during the entire period from January 1, 1998, through September 7, 1999, and again from June 20, 2000, to the present, the number of instances in which RESPONDENTS sold viaticals, tax lien investments and money voucher investments to investors during this period equates to the minimum number of times in which RESPONDENTS sold these securities while not duly registered. Based on a number of records admitted during the hearing, this sales figure equates to a minimum of 159 instances of unregistered securities transactions. *See Exhibs. S-175; S-115; and S-100 through S-111, inclusive.*

In short, RESPONDENTS, again while unregistered with the Securities Division as either salesmen or dealers, engaged in the sale of at least 159 viaticals, tax lien investments and money voucher investments. Each instance of this conduct constituted the unlawful sale of a security by an unregistered salesman or dealer as proscribed under §44-1842(A) of the Securities Act.

C. Unlicensed Provision of Investment Advisory Servcies

The Division further alleges that RESPONDENTS violated A.R.S. § 44-3151 of the Arizona Investment Management Act ("Investment Management Act") by transacting business as an investment adviser or investment adviser representative in this state without the requisite licensure. Specifically, A.R.S. § 44-3151 states that a person shall not transact business in Arizona as an investment adviser or investment adviser representative unless any of the following applies:

1) The person is licensed under the Investment Management Act;
2) The person is a federally covered advisor and has made a notice filing under the Investment Management Act;
3) The person is exempt from licensure; or
4) The person is a federally covered adviser and is not subject to the notice filing requirements prescribed in A.R.S. § 44-3153.

The evidence produced at hearing established that RESPONDENTS were in fact transacting business in Arizona as investment advisers or investment adviser representatives while failing to meet any one of the four means for gaining eligibility for such activities.

Concerning the RESPONDENTS activities, both exhibits produced at hearing and the RESPONDENTS' own testimony established that RESPONDENTS were in fact transacting business as investment advisers or investment adviser representatives. Asked directly whether the RESPONDENTS were providing investment advisory services to their clients, Respondent TRAVIS answered "Relative to the products that we were selling, yeah." *H.T., p. 871, lines 5-6.*

Several exhibits admitted during the hearing confirmed the investment advisory activities of RESPONDENTS. For instance, the CHAMBER brochures routinely held RESPONDENTS out to the public as "a professional firm specializing in financial services." *See Exhib. S-18; Exhib. S-173.*

Another brochure, entitled "Certificate Profile," was distributed to yet other potential investors. In one version, this pamphlet described RESPONDENTS as "a financial advisory firm specializing in investment and estate planning for mature investors needing a combination of added safety to principal, above market yields, and asset preservation." *Exhib. S-25(c).* In another Certificate Profile version, the pamphlet described RESPONDENTS' enterprise as "a financial services firm providing specialized products and funds to retirees, business owners and executives." *Exhib. S-129.*

RESPONDENTS also portrayed themselves as qualified financial experts through correspondence with prospective and current clients. For instance, a letter sent by JOE HILAND to investor Perry in May of 1999 closes with the words "Best regards, Joseph Hiland, CSA, Senior Financial Advisor." *Exhib. S-12.* Another correspondence was sent to investor Hetherington by TYSON in June of 2000. Under the letterhead of "Chamber Financial, Comprehensive Financial Services for Seniors," TYSON signed his name as Tyson Hiland, CSA, Senior Investment Advisor. *Exhib. S-22.*

With the fact of RESPONDENTS' investment advisory conduct established, the only remaining issue is whether any of the eligibility requirements for performing such functions were in fact met. The evidence confirms that RESPONDENTS were not permitted to conduct these activities. Initially, none of the RESPONDENTS were ever licensed as investment advisers or investment adviser representatives under the Investment Management Act. *Exhibs. 5(A) through 5(C).* Nor is there any evidence to suggest, nor reason to believe, that any of the RESPONDENTS were federally covered advisers. Equally inapplicable are the licensure exemption provisions. None apply to RESPONDENTS, and at hearing, RESPONDENTS made no assertions to the contrary.

In light of RESPONDENTS' performance of investment advisory services without the requisite qualifications, RESPONDENTS were in violation of A.R.S. § 44-3151 on multiple occasions. Although the extent of these violations is impossible to gauge, the fact that RESPONDENTS associated with hundreds of clients suggests and advertised their services to hundreds more, it is conservative to believe RESPONDENTS violated this provision on at least 200 separate occasions.

III.

SECURITIES FRAUD VIOLATIONS

The Securities Division further alleged that RESPONDENTS violated A.R.S. § 44-1991 of the Securities Act, fraud in the purchase or sale of securities. Specifically, the Division contends that RESPONDENTS violated one or more provisions of this statute on multiple occasions and in multiple fashions. As will be discussed, the evidence elicited at hearing repeatedly substantiated these contentions.

Under A.R.S. § 44-1991, it is a fraudulent practice and unlawful for a person, in connection with a transaction or transactions within or from this state involving an offer to sell or buy securities, or a sale or purchase of securities, to directly or indirectly do either of the following:

> Make untrue statements of material fact, or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading; or
>
> Engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.

A.R.S. § 44-1991(A)(2) & (3). Securities fraud may be proven by either one of these acts. *Hernandez v. Superior Court*, 179 Ariz. 515, 880 P.2d 735 (App.1994).

In the context of these provisions, the term "materiality" requires a showing of substantial likelihood that, under all the circumstances, the misstated or omitted fact would have assumed *actual significance* in the deliberations of a reasonable buyer. *Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548, 553, 733 P.2d 1131, 1136 (1986), citing *Rose v. Dobras*, 128 Ariz. 209, 214, 624 P.2d 887, 892 (App. 1981), *quoting TSC Industries v. Northway, Inc.*, 426 U.S. 438, 96 S. Ct. 2126, 48 L. Ed. 2d 757 (1976).

Additionally, the affirmative duty not to mislead potential investors in any way places a heavy burden on the offeror and removes the burden of investigation from the investor who is not required to act with due diligence. *Trimble*, 152 Ariz. at 553, 733 P.2d at 1136. A misrepresentation or omission of a material fact in the offer and sale of a security is actionable even though it may be unintended or the falsity or misleading character of the statement may be unknown. In other words, scienter or guilty knowledge is not an element of a violation of A.R.S. § 44-1991(2). See, e.g., *State v. Gunnison*, 127 Ariz. 110, 113, 618 P.2d 604, 607 (1980) (*En Banc*). Stately differently, a seller of securities is strictly liable for any of the misrepresentations or omissions he makes. *Rose v. Dobras*, 128 Ariz. at 214, 624 P.2d at 892.

A. <u>Fraud in Connection with the Offer and Sale of Brokered CDs</u>

As elicited at hearing, RESPONDENTS made a number of materials misrepresentations and omissions in connection with their offers and sales of Brokered CDs to a mostly elderly population of investors. This pattern of securities fraud took on several forms, and ultimately cost investors substantial amounts of investment funds, funds that were ironically invested for safety and security.

RESPONDENTS argued that everything was properly disclosed to investors, and that the investors themselves were to blame for their losses. *See, e.g., H.T. p. 917, lines 18-25 ("investor Smith was very foggy on much of everything we had discussed.") (TYSON testimony).* The evidence produced at hearing consistently contradicted these claims. One telling point was that RESPONDENTS were in fact selling 20 year CDs to unsophisticated investors, on fixed and limited incomes, who ranged well into their 80's. There is simply no rational explanation for these individuals to enter into such investments when many of these investors required ready access to these funds for personal uses. Indeed, investors repeatedly testified at hearing that they understood these Brokered CD investments as short-term, guaranteed investments. As discussed below, this understanding was starkly at odds with the true nature of these investments. RESPONDENTS' mischaracterization of these Brokered CDs is conspicuously supported by the fact that RESPONDENTS could produce *no* investment literature to support their disclosure claims. To the contrary, the submitted documentation at this hearing repeatedly served only to substantiate the investor-witnesses' testimony. *See, e.g.,* *Exhibs. S-24(c); S-129.* Taken as a whole, the evidence elicited at hearing undeniably demonstrates that RESPONDENTS repeatedly misled investors with respect to their Brokered CD investments.

1. RESPONDENTS Misrepresented to Investors the Actual Maturity Dates of their Brokered CD Investments

A recurring misrepresentation RESPONDENTS made in connection with their brokered CD offers and sales related to the maturity terms of their Brokered CD investments. As illustrated during the hearing and discussed below, RESPONDENTS repeatedly used the "one year" label on their Brokered CD presentations and advertisements to entice potential investors to invest in these Brokered CDs and to develop a larger client base. It is obvious that a seller's representations to a potential investor concerning the maturity dates of a CD investment would be material to that investor's decision-making process. Because these representations were, at best, inaccurate, these statements plainly constituted material misrepresentations in connection with the offer or sale of securities.

The evidence elicited at trial consistently demonstrated RESPONDENTS' willingness to misrepresent the maturity dates of their Brokered CDs. In testimony by investor Perry, Perry recounted the exchange with Respondent JOE HILAND during JOE HILAND'S solicitation of investor funds from Perry:

> Q. (Division) Do you recall who you met with at the Chamber offices?
> A. (Perry) Joe Hiland.
> Q. What did you discuss at this initial meeting?
> A. I wanted to make the investment. My CD had matured, and I wanted to invest it in the 9 percent CD that he advertised.
> Q. During this meeting with Joe Hiland, did you convey to him your wish that you wanted to withdraw your investment monies after one year?
> A. Yes, I did.
> Q. During this meeting, did Joe Hiland indicate that the CD investments he was offering had a maturity date of 20 years?
> A. Never did say that.
> Q. Do you recall what types of things Joe Hiland did say about The Chamber Group CD investment?
> A. He said it was a one-year investment. I told him I needed my money in a year because I used the interest to supplement my Social Security, and he said there would be no problem in cashing it in a year.

H.T., p. 49-50, lines 8-25 and 1-6, respectively (Perry testimony).

Following this testimony, Ms. Perry was further pressed to explain her understanding concerning the maturity date of the Brokered CD investment. Ms. Perry then continued to recount her exchange with JOE HILAND:

> Q. (Division) During your meeting with Joe Hiland in Prescott, was Joe Hiland's claim that you could cash out your CD investment in one year without any loss an important factor in your decision to invest with The Chamber Group?
> A. (Perry) Absolutely.
> Q. And why do you say that?
> A. Because I needed my money liquid. I couldn't leave it in more than a year. All my CDs at banks were for either six months or one year.
> Q. Did you have any extra money stored away in case of emergency other than these CD investments?
> A. Just a few thousand dollars.
> Q. Would you have ever considered investing in a 20-year CD?
> A. Never, especially at my age. It would be ridiculous.
> Q. Well, let me ask you this. How old would you be if you purchased a 20-year CD this year and waited until the CD matured?
> A. I would be 101.

H.T., p. 52-53, lines 10-25 and 1-5, respectively (Perry testimony).

Ms. Perry's claims concerning the maturity dates for the CDs as represented by JOE HILAND were in fact substantiated by a letter that JOE HILAND had sent to Ms. Perry only a week prior to the personal meeting referenced above. In this letter, JOE HILAND had explicitly stated "In response to your request for written information, I have enclosed a description of our Certificate of Deposit program, which will give you the greatest return without risking your principal." *H.T., Exhib. S-9.* Following this introduction, JOE HILAND described the CD program as "8.25% - 1 year." *Id.* Absolutely no mention was made in this "description" concerning any other dates associated with this CD investment.

RESPONDENTS echoed this maturity misrepresentation to each of the other CD investor witnesses that testified at hearing. On such CD investor was witness Hetherington, who invested $25,000 into a Brokered CD with Chamber in June of 1999. *(See Exhib. S-19).* This time, during a

TYSON sales presentation, TYSON assured Ms. Hetherington that she could withdraw her investment monies out of her Brokered CD investment within a year without penalty. Asked precisely the information that TYSON disclosed, Ms. Hetherington testified as follows:

Q. (Division) Ms. Hetherington, prior to or at the time you made the CD investment, what types of information did you receive about the investment from Tyson Hiland?
A. (Hetherington) Not much. I knew it was a CD with LaSalle Bank. That was all I knew.
Q. Did he provide you with any other verbal information about this investment?
A. No. Not really. He said you could buy it in blocks of $5,000.
Q. What did Tyson tell you about the maturity date of the CD you were purchasing, if anything?
A. Nothing really. He knew that, I thought he knew that I needed it back in one year, and you know, he said my principal was safe, so that was it.
Q. Is it possible that Tyson Hiland actually told you that you were purchasing a 20-year CD?
A. No. It's not possible.
Q. Why do you say it's not possible?
A. Because I would not have invested in it if it were a 20-year CD.
Q. And why is that?
A. Because I only, I needed my money back in one year.
Q. Why did you need your money back in one year? I think you might have covered it.
A. I needed to pay capital gains tax on a business I had sold, and I didn't know what the amount of that tax was going to be at that time.

H.T., pp. 124-125, lines 15-25 and 1-19, respectively (Hetherington testimony).

Not coincidentally, witness Smith has a similar experience. She indicated an interest in purchasing a CD with Chamber in the fall of 1998. Like with the prior two witnesses, she again had no interest in acquiring a long-term CD. Nevertheless, she purchased a 20 year, $20,000 brokered CD from JOE HILAND in November of 1998. Asked why she purchased this CD, Ms. Smith testified that she had no idea she was in fact purchasing such an investment:

Q. (Division) Going back to your investment, would you have ever considered investing in a 20-year CD?
A. (Smith) No, I wouldn't.
Q. Why do you say that?
A. Because I wouldn't be around in 20 years.
Q. Were there any other reasons?
A. I needed the money.
Q. Were you on a fixed income at this time?
A. Yes, I was on a fixed income.
Q. Were there any particular reasons you would need your money in a shorter term than 20 years?

A. Yes, I had gotten a divorce and was having a house built and I was starting from, starting from scratch, and I had to have furnishings and landscaping, all kinds of things.
Q. So are you saying you were planning on using these investment funds for your own personal use in the near future?
A. Yes, I was.
Q. How old would you be if you purchased the CD today, a 20-year CD today and waited until it matured?
A. I would be 96.
Q. At the conclusion of your first meeting with Joe Hiland, did any investments take place?
A. Yes, I got the CD.

H.T., pp. 79-80, lines 3-25 and 1-4, respectively (Smith testimony)

Based on this testimony, it is readily apparent that the RESPONDENTS were neither fully nor properly disclosing the maturity terms of their Brokered CD investments. In fact, the misleading informational disclosures provided to investors were equally prevalent in RESPONDENTS' own investment literature. For instance, in their "Certificate Profile" which they disseminated to prospective investors such as witness Del Valle in July of 1999, RESPONDENTS outlined their CD investment program in a roughly three-page pamphlet. *Exhib. S-129; H.T., p. 463, lines 8-19.* Among other comments, this pamphlet lists the "period of optimum liquidity" for RESPONDENTS' Brokered CD investment. In unequivocal print, the optimum period of liquidity listed for this Brokered CD investment is *½ to 1 year*. *Exhib. S-129, p. 2.*

Similar investment literature was provided to investor Hetherington in June of 1999. *Exhib. S-18; H.T., p. 120, lines 5-16.* On page 3 of this pamphlet, RESPONDENTS again make reference to the maturity dates for their Brokered CDs. And again, these disclosures are woefully misleading. Rather than making any reference to the actual maturity dates of these Brokered CDs, RESPONDENTS state: "The flexibility of Transferable Custodial CDs [brokered CDs] enables you to make your own decisions at any time instead of being dictated by set terms and maturity dates." *Exhib. S-18, p. 4.* The natural import of this statement is that these CDs have no maturity dates to impact the value of these investments. Such a representation is patently false.

In line with their investment literature, the Brokered CD advertisements published by RESPONDENTS were equally misleading. In one such advertisement, published in August of 1999, RESPONDENTS boldly advertised the terms of their brokered CD as a "9.0% guaranteed one year FDIC insured CD." *Exhib. S-25, p. 2.* No limiting language was included to provide any indication that these were anything but one year CDs. During the hearing, a qualified CD expert was questioned about his impressions of this particular advertisement:

> Q. (Division) Now, on this, on the CD advertisement, if you read the CD advertisement, how long do you think the maturity rate of the CD would extend?
> A. (CD expert Donovan) It says guaranteed one year, so I would presume it would be one year.
> Q. Is there any reason you would think differently?
> A. No, there's nothing here to indicate any other term.

H.T., p. 171, lines 8-17(Donovan testimony)

In their case-in-chief, RESPONDENTS alleged that they told every investor about the terms and conditions of these investments. Such claims ring hollow on many fronts. First, it is self-evident that octogenerian investors would have little interest in 20-year CDs when they require their money back for their own financial needs. Second, testimony regarding RESPONDENTS' representations concerning the one-year nature of their brokered CDs was recounted by *every single of the five investor witnesses called by the Division.* And, as if that was not enough, RESPONDENTS' investment literature, CD advertisements, and correspondence corroborate the very misrepresentations alleged by the investor-witnesses against the RESPONDENTS. Much to the contrary, the only evidence offered by RESPONDENTS to deny these profound misrepresentations was the claim that the necessary disclosures for these complex investments were "always" made - orally. The overwhelming evidence presented at hearing belies this assertion.

In sum, the evidence educed at hearing demonstrated that RESPONDENTS enticed investors to purchase their Brokered CDs by claiming that the maturity dates of these CDs were one year, when in fact these maturity dates ranged from 15 to 20 years. These were egregious material misrepresentations that would ultimately cost investors substantial portions of their principal investments.

2. *RESPONDENTS Misrepresented Their Brokered CD Investments as Risk-Free Investments, when in Fact Subsequent Liquidations Resulted in Investor Losses*

In connection with their Brokered CD promotional efforts, RESPONDENTS consistently maintained that their Brokered CDs were completely risk-free investments, with no threats to the investors' principal. *See, e.g., Exhib. S-18; Exhib. S-25; Exhib. S-129; Exhib. S-176.* Not surprisingly, this enticement was a primary motivating factor for a population of largely elderly investors. As was borne out, however, countless investors lost substantial portions of their principal upon the liquidation of their Brokered CDs in the secondary market. As it turned out, this no-risk claim was yet another material misrepresentation.[13]

Witnesses consistently recounted RESPONDENTS' position with regard to their Brokered CDs – that principal investments were fully guaranteed. After a year had expired and the investors began expecting (if not requiring) the return of their principal, however, investors were shocked to find out that their CDs were in fact scheduled to mature in up to 20 years. *See, e.g., H.T., p. 58, lines 7-21 (Perry testimony).* This necessitated many investors to seek an alternative solution, one that RESPONDENTS subsequently relayed to angry investors. Essentially, investors were told that they could either continue to hold on to their CDs for an indefinite period of time (up to twenty years), or that they could liquidate these CDs on the secondary market. This was, in fact, an illusory choice for many retired investors on fixed incomes, who were constrained to elect the only realistic option – early liquidation. The subsequent liquidations by investors cost these investors approximately 10 to 20% of their principal in a CD investment that was purportedly "risk free."

During testimony, investor Perry recounted how she never would have invested if she would have known the dangers associated with this investment:

---

[13] Related to this misrepresentation, RESPONDENTS made a material omission to investors by excluding any reference to the fact that market fluctuations would ultimately influence the value of these Brokered CDs upon early liquidation. This particular feature, directly impacting the present value of the investors' CD investments, was not disclosed to even one of the Brokered CD investors who testified at trial. *See, e.g., H.T., p. 84, lines 6-25 (Smith testimony); H.T., pp. 50-51, lines 25 and 1-4, respectively (Perry testimony); H.T., p. 126, lines 6-9 (Hetherington testimony).*

Q. (Division) Prior to the time of your investment in 1999, did Joe Hiland ever tell you that by cashing in your CD after one year, you could lose close to 10 percent of your principal investment?
A. (Perry) No.
Q. Ms. Perry, would you have ever purchased this CD if you knew the risk to your principal?
A. Never.
Q. And why not?
A. Because I can't afford to lose that kind of money.
Q. Has this loss caused any financial hardships for you?
A. Yes, it did, because I live off my principal in addition. I cannot live off just my Social Security.

H.T., pp. 60-61, lines 14-25 and 1, respectively.

Investor Smith discovered that there was a very real risk to her Brokered CD investment only a year after making her investments with RESPONDENTS. Smith, who invested $31,000 in brokered CDs, recounted the point at which she found out that she was facing liquidation penalties:

Q. (Administrative Law Judge) And so it just, when you went in, was it approximately one year later that you went in to Chamber Group? Did you call up first or --
A. (Ms. Smith) I called up first.
Q. And what did you say?
A. I told them I was going to come in to take out the money from the CD.
Q. Okay.
A. And I went in plenty of time for both of them.
Q. Excuse me?
A. I went in, I called in plenty of time to, that they would be ready for me.
Q. Oh, you just assumed then by --
A. November, December of that year.
Q. Okay. And did you talk to Mr. Hiland at that time?
A. I talked to Tyson, yes. Joe wasn't around at that time.
Q. Okay. And Mr. Tyson Hiland, he's one of the parties here, did he tell you that you were going to lose some money by cashing these CDs at this point?
A. He just told me at that time that the bank had to call it. And I said, well, when do they do that. And he said it could be next month or it could be next year or whatever.
Q. In other words, if the bank called it, you got your full investment?
A. Yes.
Q. If you went in early you were subject to a penalty?
A. Yes. And I didn't find out about the penalty until sometime later when I tried to take it out.
Q. Nobody told you this before you invested?
A. No.

H.T., pp. 110-111, lines 5-25 and 1-16, respectively.

As with the two investor-witnessed above, each of the other three investors who testified at hearing, investors Del Valle, Hetherington and Maass, also lost a percentage of their principal when they each determined that the only practical recourse for their CDs was early liquidation. Through these liquidations on the secondary market, investor Hetherington lost approximately 13 percent of her principal, investor Maass lost approximately 9 percent of CD principal, and investor Del Valle lost approximately 13 percent of her principal investment. Based on this evidence, RESPONDENTS' claim that their brokered CDs were entirely risk free investments with guaranteed principal was an obvious fallacy; indeed, the dangers to the very principal of these brokered CD investments was not only real, but repeatedly realized.

As the evidence at hearing showed, RESPONDENTS' investment literature also touted the absolute safety of the Brokered CD investments. In their company brochures, RESPONDENTS' prominently displayed mission statement was to "provide the maximum return possible while never risking principal." *Exhib. S-18, p. 1; S-176, p. 1.* As seen, however, RESPONDENTS had no basis to make such a statement when risk to principal was in fact an inherent component to the investors' Brokered CD investments. RESPONDENTS continued to advertise the risk-free nature of their Brokered CDs in other places. In their "Summary Considerations" section of similar company brochures, RESPONDENTS maintained their position that the Brokered CD investment could not lose. In listing the brokered CD's features, RESPONDENTS characterized the investment as "guaranteed" with respect to both principal and interest. *Exhib. S-129, p. 11.* In the "Summary Considerations" section of another company brochure, RESPONDENTS included additional features to the Brokered CD investment. Beyond the "guarantee" of both principal and interest, RESPONDENTS added "safety, security, and diversification" and "free from market risk and price fluctuation" to the attributes of this particular investment option. *Exhib. S-18, p. 3.* With no other provisions in the literature to qualify these features, these representations manifestly mischaracterized this investment.

RESPONDENTS may contend that there actually was no risk involved with these CDs because the investors could have always opted to hold on to their CDs until maturity, thereby avoiding any risk to their principal.[14] In view of the CD investors targeted by the RESPONDENTS, this argument has no merit. RESPONDENTS specifically sought to offer and sell these securities to an elderly population. *See H.T., p. 714, lines 9-18 (JOE HILAND testimony).* This business strategy is further evidenced by RESPONDENTS' various promotional materials. *See, e.g., Exhib. S-23 ("Senior Current" newsletter).* Based on this target population, it is hardly surprising that the age of the RESPONDENTS' clients made it impractical for many of these investors to wait out the protracted maturity dates of their Brokered CDs. This, of course, does not even consider whether this fixed income population could even afford to lock their funds up for such a lengthy period. In short, any claim to the effect that there was no real risk to these investors is simply ignoring the economic and temporal realities of this investment situation.

Of course, there were still other potential risks to the principal of these Brokered CDs other than forced liquidations into the secondary market. As discussed earlier with respect to the perils of brokered CDs, these investments could suffer more than a percentage loss to principal – they could be entirely lost. Summarizing an earlier discussion, the insolvency of the CD broker, fraud on the part of the CD broker or its agent, ineffective pass through measures to ensure FDIC insurance, administrative errors by intermediaries, and excessive hidden commissions are all potential events that could have jeopardized the safety of RESPONDENTS' Brokered CD investments.

These facts, coupled with evidence elicited at trial, demonstrate that the unqualified claims made by RESPONDENTS concerning the guaranteed nature of the brokered CD investments were inappropriate, inaccurate and, ultimately, another material misrepresentation to investors.

. . .

. . .

. . .

[14] As seen through CD confirmation statements admitted during the hearing, the most common maturity dates for these brokered CD was 20 years, with most of the CDs sold by RESPONDENTS maturing in 2019.

3. RESPONDENTS Failed to Disclose to Investors that Their Brokered CD Investments were Callable, but only at the Discretion of the CD Issuing Banks

One of the primary characteristics routinely associated with the brokered CD investment is the "call" feature. This feature, which was also applicable in connection with the Brokered CDs offered and sold by RESPONDENTS,[15] essentially affords the CD issuing bank an opportunity to call or redeem their CDs after one year and periodically thereafter. This provides the CD issuing bank with the option of redeeming their CDs when the prevailing interest rates drop to such a level that it is no longer economical to continue paying the interest rates associated with their earlier CDs. By calling in their high interest CDs, they can conserve funds by reissuing competitive CDs at a lower rate of interest.

The call feature is particularly important to articulate to investors for different reasons. Of course, this feature can serve to terminate an investor's brokered CD investment if the CD issuing banks decide to call in their CDs. A related issue concerns the brokered CD practice of fractionalizing larger so called "master" CDs into smaller CDs for individual sale. The issuing bank may call the master CD, but it is incumbent upon intermediaries to ensure that the funds disbursed for the master CD make it to the individual brokered CD investors. However, from a practical standpoint, a far more important matter is the fact that this call feature is held solely by the CD issuing banks – not the investors. This distinction is highly relevant to investors for one simple reason: CDs listed as "callable in one year" may be one year CDs for the issuing bank, but they are NOT one year CDs for investors. The danger to investors (and perhaps sellers) in misinterpreting this call feature is amplified by the fact that brokered CD investments are usually depicted as "callable in one year" on verification statements and other documentation associated with these investments - without any indication as to how this callable feature applies. *See, e.g., Exhibs. S-14(a) and (b).*

---

[15] In connection with the brokered CDs offered and sold by RESPONDENTS, this feature was applicable as evidenced by the call language included on the confirmation notices associated with the purchases of these CDs. *See Exhibs. S-14(a) and (b); See also H.T., p. 222, lines 13-21 (CD expert testimony)*

As evidenced at hearing, the investors who purchased Brokered CDs from the RESPONDENTS had no understanding about the call feature associated with their investments. Likewise, each of the investor witnesses recalled how RESPONDENTS failed to provide any lucid instruction on the implications of this call feature. The lack of understanding, coupled with RESPONDENTS lack of disclosure, was no better reflected than in the testimony of investor Perry. In response to the specific question as to whether JOE HILAND ever discussed anything about a callable feature during his Brokered CD sales presentation, investor Perry responded: "No. At the time, all I was interested in was the one year." *H.T., p. 51, lines 9-12 (Perry testimony).*

During her testimony, investor Smith demonstrated a similar fundamental lack of understanding about the brokered CD's call feature. Asked about her discussions with JOE HILAND concerning the Brokered CD's call feature, Ms. Smith recounted the following:

> Q. (Division) Do you recall what types of things Joe Hiland said about this Chamber CD investment?
> A. (Smith) Pardon?
> Q. Do you recall what types of things Joe Hiland said about this CD investment?
> A. That they would be callable in one year, and that they were paying 7 percent interest and would step down to 6 percent after the first year.

H.T., p. 78, lines 7-14 (Smith testimony).

Soon thereafter, Ms. Smith was specifically asked about her knowledge of the call feature in brokered CDs as it appeared in a verification form she received following her investment:

> Q. Do you have any understanding as to what the term callable after one year refers to in this particular verification form?
> A. I thought that it would just mature after one year.
> Q. Did anyone at Chamber explain to you the meaning of this clause or whether this callable feature would affect your ability to liquidate your CD?
> A. Only after the following year when I went to collect the money, then they told me it was callable by the bank, callable by the bank, that they didn't know when it would be.

H.T., p. 87, lines 8-20 (Smith testimony).

Similar testimony was provided by each of the other investor-witnesses. In response to a similar line of questioning, Ms. Hetherington stated that during her meeting with TYSON prior to her

CD investment, TYSON mentioned nothing about a callable feature for her Brokered CD. *H.T., pp. 125-126, lines 24-25 and 1-2, respectively.* Later, when Ms. Hetherington was asked what was meant by the "callable in one year" language found in the investment verification form that she subsequently received, Hetherington testified:

> A. (Hetherington) I didn't then. I do now. And I thought that it meant that that was, you know, that I would get it back in one year. That's what I thought it meant.
> Q. (Division) Did anyone at Chamber explain to you what a callable term meant at the time before or after you made your investment?
> A. No.

H.T., p. 129, lines 4-12.

Investor Maass relayed practically the same experience. TYSON never mentioned anything to Ms. Maass about a callable feature for the Brokered CD prior to her investment. *H.T., pp. 366-367, lines 24-25 and 1-2, respectively.* Then, when subsequently asked what the callable language found on a subsequent Brokered CD statement referred to, Maass testified that she simply had no idea what this language meant. She continued that none of these terms were ever explained to her by TYSON. *H.T., pp. 369-370, lines 22-25 and 1-5, respectively.*

Finally, investor Del Valle was cross-examined by defense counsel regarding her knowledge and understanding of the "call" feature. As before, this witness displayed a total lack of understanding with respect to this element of her Brokered CD investment :

> Q. (Respondents' Counsel) Now, regarding the certificates of deposit --
> A. (Del Valle) Yes.
> Q. Well, actually, regarding all of the investment programs, were they all presented at once, or were they presented at different times?
> A. They were all presented at our initial meeting.
> Q. How long was that initial meeting?
> A. I don't recall.
> Q. And your recollection about the certificates of deposit was that they were described to you, including the provisions of the interest rate, correct?
> A. They were described to us as a one-year certificate of deposit with a 9 1/4 percent return.
> Q. My recollection from your testimony is that the provision that made them callable was discussed, but you don't recall what was discussed about the callability of them?
> A. No, because I don't understand that feature.
> Q. Right, but that your husband did understand the callability feature?

A. I can't speak for him. I don't recall.
Q. My understanding was in your testimony that you believed your husband understood it.
(Division): I believe it misstates the [prior] testimony.
(Respondents' counsel) Well, she can state what her testimony is.
(Administrative Law Judge): Ma'am, if you don't know what your husband knows, then --
A. (Del Valle) I don't know what my husband understood. I haven't really discussed it with him, what he understood.

H.T., pp. 525-527, lines 25, 1-25 and 1-8, respectively.

In short, each of the investor-witnesses at hearing testified that they received inadequate or no information from the RESPONDENTS concerning the call feature for their brokered CD investments. More importantly, this testimony revealed that this fundamental lack of awareness about a primary feature of their investments caused investors to misconstrue the maturity dates of their CDs. As a consequence, the "callable in one year" language served only to perpetuate RESPONDENTS' claims that the brokered CDs were in fact one-year CDs. Only a year following these investments, when this callable language was ultimately exposed as being applicable solely to the issuing banks, did investors realize the true nature of their investments.

Despite this repeated investor testimony, RESPONDENTS nevertheless argued that they always made full disclosures with respect to the Brokered CD's call feature. Remarkably, however, RESPONDENTS could not generate one piece of tangible evidence at hearing to substantiate such claims. RESPONDENTS' company brochures, of which there are several, speak to the many characteristics and attributes of their Brokered CD program. Not one makes any reference to the call feature for their Brokered CDs. *See, e.g., Exhib. S-129.* Even RESPONDENTS own investor witnesses could not articulate how the call feature worked in connection with their CDs. RESPONDENTS called a purported investor by the name of Mr. Wesson to support their claims. Mr. Wessen initially claimed that he knew "everything" about RESPONDENTS' brokered CD program, and that he understood each of its features including the CD's call provision. On cross-examination, however, Mr. Wessen appeared to exhibit more of a fundamental misunderstanding about this feature than anything else:

Q. (Division) You just testified that Joe Hiland told you everything about the investment, right?
A. (Wessen) That's right.
Q. Everything?

A. Everything that I wanted to know, I asked questions.
Q. Did he tell you that the callable feature applied to San Clemente? Is that one of the things he told you?
A. Oh, yeah.
Q. Would it surprise you to know that San Clemente couldn't call the CDs?
A. Does it surprise me?
Q. Yes.
A. I have no idea, nothing about it.
Q. So he told you --
A. He told me it was callable. Both of them.
Q. And he told you --
A. And I understood that, and that's all I asked for.
Q. And did you ask who they were callable by?
A. No. I didn't care. It's just like going to a bank. If I cash one of them before its time, I have to pay a penalty.
Q. So other than being callable, do you have any idea what the callable feature was all about?
A. I don't know anything about it.
Q. You don't know anything about the callable feature?
A. Sure don't. I never checked into it any farther than what we talked about.
Q. What did you talk about?
A. Just what I've told you.
Q. That there was a callable feature?
A. Yes, sir.
Q. And it ended at that?
A. That's right.

H.T., pp. 678-679, lines 9-25 and 1-22, respectively.

Despite a declaration that he understood RESPONDENTS' Brokered CD call feature as well, the RESPONDENTS' other investor-witness also had little luck in making such a case. Upon cross-examination, this investor, Mr. McDonald, testified that the insurance company Conseco had the right to call his CDs, and that previous to that, he believed that San Clemente had held that option. *H.T., pp. 525-527, lines 25, 1-25 and 1-8, respectively.* Of course, because neither of these entities is a CD issuing bank, Mr. McDonald was still another investor confused as to how the call feature pertained to his investments.

In sum, the Division's witness testimony in this case uniformly testified that a primary feature of the brokered CD, the call feature, was omitted from sales presentations delivered by the RESPONDENTS. Moreover, this omission perpetuated the belief that these Brokered CDs were short-term CDs, when in fact the maturity dates actually spanned 15 to 20 years. As a consequence, this fundamental lack of disclosure was a material omission for purposes of the fraud provisions of the Securities Act. Such a conclusion is only reinforced by both RESPONDENTS' own investment literature and by their own investor witnesses; neither offered any hint of evidence that the call feature was ever effectively disclosed.

B. Fraud in Connection with the Offer and Sale of Viaticals, TLC Tax Lien Investments, and MVP Money Voucher Investments

One of the most pertinent items of information that influences whether an individual will invest in an investment opportunity relates to the degree of risk associated with that investment. A misrepresentation by a seller of securities that concerns the amount of risk associated with a particular investment is routinely recognized as a material misrepresentation. *See, e.g., Nutek,* 194 Ariz. at 113 (omission of investment's risk factors a clear material omission). In this matter, the evidence demonstrated that RESPONDENTS consistently misrepresented the true degree of risk associated with each of the Viatical, TLC America tax lien, and MVP money voucher investment programs. In accordance with Securities Act, these misrepresentations constituted forms of securities fraud.

In addition to the element of risk, the amount of commissions a seller is earning in connection with the sale of a particular security will also often fall within the class of information that a reasonable investor would deem material in the context of evaluating an investment opportunity. This is particularly so when the commissions are so large as to raise concerns over the legitimacy of these investments. In this case, RESPONDENTS omitted any disclosures referencing the large amounts of commissions they were reaping in connection with the offer and sale of their viatical, TLC America tax lien and MVP money voucher investments. This lack of disclosure was yet another material omission constituting securities fraud.

. . .

. . .

1. RESPONDENTS Misrepresented the Degree of Risk Associated with the Viatical Investment

Both RESPONDENTS' investment literature and their subsequent testimony evidenced an alarmingly distorted understanding of the risks associated with RESPONDENTS' viatical investment program. The resulting risk factor misrepresentations to investors was initially apparent from the viatical brochure RESPONDENTS were providing to investors.[16] This brochure made only marginal efforts to identify a fraction of the risks associated with this investment. These particular disclosures on the matter of risk factors are found on a single page, page 8 of this brochure. *Exhib. S-24b, p. 8 (ACC bates number ACC01076).* On this page, the gamut of risks associated with this investment are purportedly addressed. These consist of a total of four identified risks: 1) life expectancy; 2) liquidity (qualified by comments to the effect that policies can sometimes still be liquidated); 3) insurance company obligations; and 4) tax implications. In essence, only one of these "risks" actually touches on the possibility that the fixed returns for these investments might actually be in jeopardy (i.e, risk number "3"). In fact, and as will be discussed below, there are a multitude of tangible risks associated with this viatical investment program that could ultimately render investments in this program valueless.

The misleading risk disclosures RESPONDENTS provided to investors concerning this viatical program were even more profound. During hearing, several of the RESPONDENTS were asked to describe the various risk factors that they recognized or otherwise disclosed to investors in connection with this particular investment. RESPONDENTS' counsel first asked Respondent JOE HILAND about the standard presentation that he made with regard to the viatical investment. *H.T., p. 651, lines 18-20.* JOE HILAND was then asked by his own counsel about the degree of risk involved with this particular investment:

> Q. (Respondent's counsel) What did you believe the risks of that investment were?
> A. (Joe Hiland) The time. And our explanation often would be let's say that somebody went to South America and ate a magic lily and lived forever. Then you would have to wait till that person passes away to get your return.

---

[16] RESPONDENTS' viatical investment brochure was prepared and provided to RESPONDENTS for dissemination by Carrington Investment Services, a Mesa-based viatical issuer.

> Q. (Administrative Law Judge): Do you think there was any concern for fraud in the application for the policy?
> A. I don't know what you mean, Your Honor.
> Q. Well, say somebody has AIDS and they apply for a policy and don't tell the insurance company that they have AIDS.
> A. We thought about that. And we had seen a lot of these viatical brokers that were not using escrow companies. We used an escrow. The check was payable to Arizona Escrow, not to Rick Carrington or to us. We felt that was -- was a good secure thing, obviously.

H.T., pp. 652-653, lines 21-25 and 1-16, respectively.

This same testimony was echoed during cross-examination. To follow up on JOE HILAND'S earlier answer relating to viatical risks, the Division posed a similar question to JOE HILAND concerning his understanding of the risks associated with the viatical investment program. The response given once again evidenced the egregious lack of awareness by this seller as to the risks associated with this investment. It is not difficult to imagine RESPONDENTS' clients getting the same misleading information.

> Q. (Division) Now, I believe you testified that you provided investors with a Carrington brochure and also told them about the return of viatical investments and how they might change, depending on the life span of the insured, is that correct?
> A. (Joe Hiland) Yeah.
> Q. You didn't tell them anything else about the risks of this investment, did you?
> A. Other than the life expectancy?
> Q. Right.
> A. I didn't see any other significant risk.

H.T., p. 799, lines 7-20.

Other RESPONDENTS admitted to similar misleading disclosures in their viatical sales presentations to investors. Respondent TRAVIS was also asked what risks he saw and discussed with respect to the viatical investment program. He stated that the only thing, other than the contestability of contestable viaticals (which he claimed Carrington bought back anyway), was the variableness of the life expectancy of the insured. *H.T., pp. 858-859, lines 20-25 and 1-14, respectively.* Later, the Division asked TRAVIS what would happen if Carrington, the conceded owner of the insured's insurance policies,[17] decided not to pay the premiums on the various insurance policies. TRAVIS responded: "I don't know." *H.T., pp.889-890, lines 20-25 and 1, respectively.* Respondent TYSON subsequently testified that he communicated the same types of viatical risks to investors as those that his brother TRAVIS had discussed during his testimony the previous day. *H.T., pp. 908-909, lines 14-25 and 1, respectively.* TYSON went on to testify that there were in fact only two main risks to this program – life expectancy and a two-year window of contestability. *H.T., p. 973, lines 12-25.*

The misrepresentations made to investors concerning the risks associated with RESPONDENTS' viatical investment program were equally evidenced by the testimony of the investor-witnesses. Investor Maass was one investor who purchased a viatical from TYSON in February of 2000. When asked what information she received about viaticals, she indicated that she received no written materials or brochures and only limited verbal information about the different returns available. This information remarkably included nothing about the risks to the viatical investment. *H.T., p. 383, lines 7-25.* Investor witness Del Valle recounted a similar experience:

> Q. (Division) You told us earlier that at your initial meeting with Tyson Hiland in August 1999, you also invested in a viatical?
> A. Yes.
> Q. Is that correct?
> A. Yes, it is.
> Q. Why did you invest in a viatical policy?
> A. Principal would be intact, and it was a high rate of return.
> Q. Who told you about the viatical policy at The Chamber Group?
> A. Tyson Hiland.
> Q. Did he tell you anything about the type of investment it was?
> A. Yes. It is actually buying life insurance policies, and what it was was that there was a certain time frame of the person whose policy we bought. And what it did was give them cash to perhaps, you know, have a vacation before they died or to pay for medical costs or something, virtually cashing in their insurance policy. We would be buying all or a portion of it, and then once they passed on, we would receive our principal back, plus a certain amount of interest.
> Q. Did Tyson Hiland ever mention any risks involved with this sort of investment?
> A. No. There were no -- according to Tyson, there was no risk involved.
> Q. Did Tyson Hiland ever mention what would happen to your rate of return if the viator or the person who sold the policy lived longer than expected?

[17] See *H.T., p. 881, lines 3-9.*

A. I don't recall exactly.
Q. Did he ever mention that some insurance companies refused to honor viatical insurance policies on the basis they're fraudulent?
A. No. That was never told to us.
Q. Did he ever mention what would happen, if the person who was insured lived longer than expected, who would pay the premiums on the policy?
A. No.
Q. Did he ever mention who would be the owner of the policy?
A. Not that I recall.
Q. Did he ever mention the commission he was going to receive for selling the policy?
A. No.
Q. Prior to the time you made your investment, did you receive any information regarding the viatical policy, other than what's already been shown as Exhibit S-129?
A. Not that I recall.

H.T., pp. 511-513, lines 16-25, 1-25 and 1-19, respectively (Del Valle testimony).

In essence, this witness testimony amply demonstrated that the lack of RESPONDENTS' understanding as to the risks associated with the viatical investment ultimately manifested itself during the risk disclosures that RESPONDENTS provided to investors about this investment option.

In actuality, the viatical investment opportunity offered and sold by RESPONDENTS contained many perils far beyond the mere element of time. It is true that better medicines or a faulty prognosis of a viator could serve to substantially lower the annual returns realized by a viatical investor. Indeed, AIDs patients are a current example of viators that are far outliving their life expectancy prognoses. However, there are at least four cognizable risks with the viatical investment program that go so far as to put at risk the investor's actual principal in jeopardy. An obvious risk to these investments is that the premiums on the investors' designated insurance policies could lapse. If the viator outlives his life expectancy and the premiums on the insurance policy continue for several more years, who will pay this policy? According to the RESPONDENTS' viatical brochure, Carrington will withhold, in escrow, premiums equal to 1½ times the life expectancy of the viator. *Exhib. S-24b, (p. ACC 01075).* This begs the question: If the viator lives beyond 1½ times his life expectancy, who will make the premium payments? Will the designated investors be informed that the premiums on the policy are in fact due? In actuality, if no-one pays, the very likely result is that the insurance policy will lapse, leaving the investor with a worthless policy.

Other risks are inherent in these investments. As previously discussed, Carrington is the owner of these policies. A natural risk associated with this arrangement is that if Carrington becomes insolvent or declares bankruptcy, who will make the insurance premium payments and administer the insurance designations? The insolvency of Carrington could ultimately leave countless investors without any knowledge of the condition of their designated viators, without the ability to actually trace their viators and, ultimately, no way of preventing the lapsing of their investments. Associated with this risk is the fact that any fraudulent activities on the part of Carrington could dramatically reduce the amount of funds that are available for investors to ultimately recover. For instance, Carrington could feasibly be over-designating the beneficial interests of investors in a particular insurance policy, causing eventual claims on the policy to exceed the available insurance funds. That, of course, assumes that Carrington is even using the investor funds for the purchase of actual insurance policies.

Still further, fraudulent insurance applications by viators can always be contested. Despite RESPONDENTS' belief that all of Carrington's insurance policies are sound after a two-year contestability period, the fact of the matter is that insurance companies can challenge the validity of a particular insurance policy indefinitely if the policy was intentionally submitted in error. The two-year contestability issue raised by RESPONDENTS has only limited application. In an open insurance policy, where facts or unknown pre-existing conditions are mistakenly omitted from an insurance policy, insurance companies traditionally have a two year period to contest the accuracy of these insurance applications. This particular window of opportunity is inapplicable to instances where insurance applicants resort to intentional fraud.

Still another risk with viaticals relates to the solvency and credit worthiness of the insurance companies themselves. If these companies go bankrupt or otherwise refuse to honor their insurance obligations, the insurance policies go unpaid. It follows that the investors who were the beneficiaries of thee insurance policies could lose most if not all of their investments in such an event. If Carrington began associating with less than grade "A" insurance companies, this risk would only increase. Carrington may very well have been buying less than grade "A" insurance policies.

By misrepresenting the true risks associated with the viatical investment, RESPONDENTS committed one of the most basic forms of securities fraud. Investors must now confront the possibility that they will never recover any of the interest on their investments, let alone their principal.

2. *RESPONDENTS Misrepresented the Degree of Risk Associated with the TLC America Investment*

RESPONDENTS' investment literature and subsequent testimony again evidenced a distorted understanding of the risks associated with the TLC America Tax Lien/Opportunity Properties investments.[18] This fundamental misunderstanding led to material misrepresentations concerning the risks associated with RESPONDENTS' TLC America investment program. The TLC brochure, upon which RESPONDENTS relied in attracting willing investors, is yet another example of a woefully deficient handout with respect to its disclosures of investment risk. In fact, a reading of this tax lien literature would leave one with the impression that there were no risks to the investment at all. Considering that TLC America investors may ultimately recover approximately 50 cents on their investment dollar, there were of course very real dangers to this investment. *See H.T., p. 600, lines 12-21 (Johnson testimony).*

Far from discussing risk, the TLC brochure RESPONDENTS disseminated to clients touted its tax lien program as a "safe, liquid, fixed rate investment." *Exhib. S-184, p. 1.* The brochure continued that, for a minimum investment of $20,000, investors could enjoy "guaranteed high returns." *Id., p. 2.* The TLC promoters were not finished making the guaranteed nature of this investment known to investors; on the following page, the TLC brochure claimed that the program team's "experience, knowledge, and credibility guarantee high returns." *Id., p. 3.* According to the literature, this investment essentially involved thorough research by the "TLC AMERICA team," followed by the purchase of

[18] The TLC Tax Lien and TLC Opportunity Properties investments were two similar programs run by the same promoter, TLC America. The only practical difference between the two programs was that the tax lien program would attempt to capitalize on redemption fees before reselling properties, whereas the Opportunity Property program would forego the tax lien redemption gambit and allegedly focus more on the resale aspect of the properties. *Compare Exhibs. S-24(a) and S-184.*

favorable properties prior to the properties going to auction or being foreclosed. Subsequently, these properties would be resold, resulting in a "guaranteed" fixed rate of return to investors. *Id., pp. 4-5.* Conspicuously absent from these promotional materials was any reference to the concept of risk. Of course, by repeatedly highlighting the guaranteed returns of their investment opportunity, TLC America had little room to suggest that a risk factor might even exist.

To still other investors, RESPONDENTS provided another TLC brochure that focused more predominantly on real estate tax liens. *Exhib. S-24(a).* Beyond the difference in methodology for generating income in this program (redeeming property tax liens as opposed to reselling properties), the representations about the success of this investment opportunity was equally as optimistic. Once again, TLC America repeatedly guaranteed high, fixed rates of returns. *Exhib. 24(a), p.2.* This brochure even went so far as to claim that the high rates of return from their program were mandated by state statutes! And, like with the earlier TLC brochure, any risk factors for this program were again completely ignored.

This attitude of guaranteed returns was carried forward by the RESPONDENTS. Indeed, given an opportunity to explain some of the risks associated with the TLC programs, RESPONDENTS struggled to identify even a single one. Perhaps this is why RESPONDENTS were able to sell so many of these investments within a one-year period. Asked whether he told investors that the TLC America investment was safe and secure, JOE HILAND simply responded, "Yes." *H.T., pp. 803-804, lines 25 and 1-2, respectively.* Yet when asked whether he could explain the redemption technique that TLC America was allegedly using to make profits on the TLC America tax lien investment, JOE HILAND then stated that he could not. *H.T., p. 804, lines 6-9.* Remarkably, even faced with the prior testimony of a court-appointed receiver that the TLC America investors would likely receive approximately 50 cents on the dollar, JOE HILAND would not acknowledge that the TLC investments held any risk to investors:

> Q. Tax liens that are now in receivership and may be 50 cents on the dollar, did those investors risk their principal?
> A. We have no control over a rogue president of a company.
> Q. I understand that. But was their principal at risk?
> A. It was backed by property.

Q. If you're going to get back 50 percent of what you invested, there was a risk involved, wouldn't you agree with that?
A. I don't know what they're going to get back.

H.T., p. 771, lines 4-16.

Similarly, Respondent TRAVIS could not identify any risks with the TLC investment even as it stood in receivership. TRAVIS was asked what risks he saw in the TLC investment programs. In essence, TRAVIS saw none. He explained that in a worst case scenario, if TLC America ceased to exist, "the individual investor would have real assets backing up dollars invested." He continued that "the investor would still have property, but that they would have to deal with the secondary market or a retail market." *H.T., pp. 855-856, lines 8-25 and 1-2, respectively.* Respondent TYSON had no better luck attempting to identify any risk factors associated with this program that the Securities and Exchange Commission had previously termed a typical "ponzi scheme." *See H.T., p. 588, lines 11-21 (Johnson testimony).* TYSON initially indicated that there was a page in the TLC brochure making up Exhibit S-184 that explained the risk factors. Once there, however, he was unable to point to any provisions that could ever be mistaken for an actual disclosed risk factor.

Based on the TLC investment literature and RESPONDENTS attitude concerning these investment opportunities, it is hardly surprising that RESPONDENTS misrepresented the TLC America investment programs to investors as essentially risk-free. Investor-witness Maass testified that TYSON mentioned absolutely nothing about the risks associated with the TLC America investment program. *H.T., p. 344, lines 21-25.* Investor-witness Del Valle recounted a similar experience. After recalling that the TLC America program guaranteed a 12 to 14 percent return, Del Valle was also asked whether TYSON ever discussed any potential risks with her about this investment. Del Valle recounted that TYSON made no reference to risk, and instead claimed that their principal "would be completely, completely intact." *H.T., pp. 497-498, lines 13-15 and 1-10, respectively.* Currently, both investors are waiting to learn what fraction of their investments will ultimately be salvaged by the court-appointed receiver.

. . .

The fact that the TLC America investment program was closed on the basis that it was an investment scam should indicate that there were indeed serious risks to this investment opportunity. And, as selling agents for TLC America's investment program, is was incumbent upon the RESPONDENTS to at least raise the specter that this program might not perform as advertised, i.e., that fraudulent conduct by the issuers of the program could jeopardize the investors' returns or even their principal. As it stands today, RESPONDENTS' investors in this program stand to lose upwards of 50 percent of their principal investments on account of this fraud. This point was addressed during the testimony of Kent Johnson, a partner with Robb Evans & Associates, the court –appointed receiver of TLC America's assets:

> Q. (Division) Mr. Johnson, as a representative of the receiver in this TLC matter, can you say whether the investor funds reflected in these listings will ever be fully refunded?
> A. (Johnson) I can tell you that it is most unlikely that they would be fully repaid. The receiver has indicated in reports to the court that he hopes to, based on current information, recover about 50 percent of what people have invested.
> Q. And can you explain why only 50 percent of the investment funds are still available?
> A. Well, there's really several reasons. Number one, some of the investments that were made were poorly made. There were poor selections, that the people paid more for property than they should have paid. Second, there was a lot of wasted money. There was a 5 1/2 million investment on racehorses and racing dogs. There was $10 million invested in an off-shore prime bank scheme, much of which has not been recovered. There was $20 million paid out to brokers in commissions. There were instances of chartered jet aircraft for personal travel by the principals. So much of the money that was raised from the investors was not used for the purpose that it was promised to be used for, and, in fact, when it was used for that purpose, it was used unwisely.

H.T., pp. 600-601, lines 12-25 and 1-17, respectively.

Other than this outright risk of fraud, Johnson's testimony reveals another prominent yet unavoidable risks associated with this TLC America investment program. First, some of the investments TLC America made in real estate turned out to be "poor selections," leading to losses. This is an inevitable risk with a real estate investment program; if purchases and/or resales are unsuccessful, or the real estate market dips, losses will be sustained by the program. It necessarily follows that if the program suffers losses, investors will not be able to receiver their promised guaranteed rates of return.

Respondents' counsel subsequently cross-examined Johnson about the chance that the program would have been successful if it weren't for the fraud and the irresponsible investments. In his testimony, Johnson believed that the TLC program could not have produced its "guaranteed" returns regardless of these factors:

> Q. (RESPONDENTS' Counsel) If the investment was pursued the way it was offered and, in fact, was an investment in tax liens and run properly, would this, in your opinion, have been a legitimate investment opportunity, aside from the fact that we don't have any evidence it was registered as a security or anything like that?
> A. (Johnson) Well, in my opinion, based upon my review of, you know, what I know, it would not have been a good opportunity. First of all, it's very difficult to make, even on a tax lien certificate investment program, you know, anything in excess of 10 percent. The company was paying out 14 percent interest, plus paying out about 5 percent interest in sales commission, plus incurring the overhead and expense of running an operation. It probably would have never been able to be successful.
> Q. Well, have you ever seen legitimate tax lien certificate programs?
> A. Well, I -- you know, I understand the principal of the tax lien investment.

H.T., pp. 607-608, lines 20-25 and 1-18, respectively.

Investors in RESPONDENTS' investment programs were looking for safety and security in their investments. As a predominantly retired investment population, these investors especially needed to know whether a particular investment could in fact pose any risks to their return or even their principal. RESPONDENTS utterly failed to provide these investors with an accurate assessment of the risk factors associated with the TLC America investment program, and even went so far as fostering a false sense that the investments were risk-free. These misrepresentations undoubtedly cost investors hundreds of thousands of dollars. They also constituted security fraud.

3. RESPONDENTS Misrepresented the Degree of Risk Associated with the MVP Money Voucher Investment

RESPONDENTS' testimony concerning the risks associated with the MVP money voucher program once again confirmed that they had no grasp of the risk factors present in such an investment program. Moreover, RESPONDENTS' testimony revealed that their refusal to acknowledge the risk factors associated with this investment program directly colored the faulty representations they made to investors in their attempts to sell this MVP money voucher investment.

. . .

JOE HILAND was asked to discuss what risks he provided to investors in connection with his sales of MVP money voucher investments. Not only was JOE HILAND unable to articulate any legitimate risk factors associated with this program, but he even appeared to have difficulty in understanding the whole concept of risk:

Q. (Division) And what risks do you normally present? What risks are you talking about?
A. (Joe Hiland) Didn't I just say that?
Q. With the Money Voucher program, what risks are you talking about?
A. That as long as there are the transactions of people needing and using ATM cards, credit cards, and debit cards, that there would be a return and that anytime it fell below a certain point, they would find another merchant for their machine.
Q. That doesn't sound like a risk, though, does it?
A. I don't know if we're communicating here, so I don't understand.
Q. I asked if you mentioned any risks, and you said you did. And I asked you to explain what type of risks you mentioned.
A. The risk of what?
Q. What risks --
A. Risk -- I'm sorry.
Q. What risks to this program did you disclose to investors?
A. I'm having a difficult time when you say "risk." To me -- to me, that's a very broad issue. Risk of what? And I'm not trying to be evasive. I just don't know what risk you mean. Risk to principal or risk to interest?
Q. Risk of loss. Did you ever provide any information to potential investors in the Money Voucher program as to the risk of loss?
A. Loss of principal?
Q. Yes.
A. Loss to their purchase?
Q. Loss of principal. Let's start with that.
A. Loss of their purchase. $4,000 machine, it is insured for theft. It is serialized.
Q. Right. I understand that. But my question is did you ever discuss any risks, not any qualities about them, but any risks?
A. Yes.
Q. Please tell me what risks of loss to principal you discussed.
A. I was.
Q. Please continue.
A. The machine is insured. That protects the risk of it being stolen.
Q. Is that your answer?
A. It's part of it. And the risk to their interest is that it will always be placed in a retail firm that has transactions. So the risk of not getting your interest is being in a place where there are no transactions.
Q. Now, how can you guarantee a return if there's a risk that there might be a place where there's no transactions?

A. Because the servicing organization will move it to where there is transactions.

H.T., pp. 812-814, lines 6-25, 1-25, and 1-14, respectively.

Some time following this testimony, TRAVIS was asked by his own counsel what he saw as the risks to the MVP money Voucher program. TRAVIS responded that he would explain to investors that in a worst-case scenario, somebody could steal or destroy the voucher machines. He then added, "and then we would explain that the machines are all insured." *H.T., p. 854, lines 6-12.* During his testimony, TYSON also discussed whether he addressed risk factors in his MVP investment presentations. He claimed that risks were disclosed, and he proceeded to identify the two main risks associated with this program. First, he stated that there was a risk that no-one would use these machines, but then hastened to add that if that occurred, an investor would get his money back. The second risk he identified was that the voucher machines could be damaged, although, like his brother TRAVIS, he then added that such damage is covered by an insurance policy. *H.T., pp. 986-987, lines 19-25, 1-16, respectively.* TYSON then stated that those were the two principal considerations, and he could not recall any additional risks. *H.T., p. 987, lines 15-16.*

The MVP money voucher investment literature that RESPONDENTS provided to investors was again devoid of any disclosures touching on the issue of risk. *See Exhib. S-173(c).* This brochure (as well as the accompanying "DNE" voucher machine servicing brochure) essentially touts the MVP money voucher program as an investment with tremendous income potential without any concomitant risk. This was the type of information conveyed to RESPONDENTS' money voucher clients. Undercover Division investigator Kirst inquired about this particular investment program at the CHAMBER branch office in Mesa, Arizona. Both JOE HILAND and another representative at this office discussed this MVP investment with Mr. Kirst at some length. Investigator Kirst testified that he did not recall either of these individuals ever addressing the issue of risk with respect to this investment option. *H.T., pp. 440-441, lines 24-25 and 1-2, respectively.*

Investor Del Valle became interested in investing in this MVP voucher program when TYSON informed her that by rolling her CD investment funds into this voucher program, RESPONDENTS and

MVP would together make up 10 percent of the principal that was lost in Del Valle's Brokered CD investment. *H.T., pp. 448-449, lines 21-25 and 1-10, respectively.* TYSON also told Del Valle that she would be receiving a 16 percent return on her money voucher investments, with the potential for even higher returns. In addition, he claimed that if the percentage of return ever fell below 16 percent, that she could opt to sell the voucher machines back to DNE and recover her principal. *H.T., p. 490, lines 3-14.* In short, investor Del Valle received no indications that her investment had any associated risk.

Despite this rosy outlook, the reality of this investment is just beginning to unfold. Asked about the current status of the MVP investment she made with RESPONDENTS approximately one year ago, Del Valle testified as follows:

> Q. (Division) Do you know what the current status of your investment with the Money Voucher program is?
> A. (Del Valle) Not really.
> Q. Do you know the location of your machines?
> A. No.
> Q. Have you ever seen your machines?
> A. No.
> Q. Do you know how many transactions each of your machines is doing?
> A. No. We have not received anything according -- we have not received anything other than a basic check of $854.40.
> Q. At the time you made your investment, did you expect to receive some information about how the investment was doing?
> A. Yes, we were told by Tyson, and we were also told, if you read this letter, that -- that we would be getting a package, including pictures, of where the machines were located, a list of where they were located, and each month we would get a readout of how many transactions were recorded on each one of our machines. We have never received that.

H.T., pp. 495-496, lines 8-25 and 1-7, respectively.

In actuality, any legitimacy in the MVP money voucher investment program offered and sold by RESPONDENTS is only beginning to come to light. Irrespective of whether this program turns out to indeed be a fraud, it is patently obvious that a major risk factor associated with this MVP program is whether the issuers of this company will legitimately operate the program, buy money voucher machines, and use investment funds for their intended purposes. Like the earlier investment programs, the MVP money voucher investment has a host of other inherent risks. For example, these include the possibility that the MVP management will incur such losses with their voucher program that they will be unable to refund the investors' full principal, that the servicing company (DNE) will fail to provide a proper accounting of the transactions made by each investor's machines, or that the MVP issuers and/or servicing company will declare bankruptcy and/or dissolve, leaving investors with no effective recourse for recouping their investments.

RESPONDENTS did not inform investors in the MVP money voucher investment program about any of these obvious risk factors. Only time will tell whether, like with the TLC America investment, these risk factors ultimately become realized and RESPONDENTS' investors are once again facing substantial losses in what they were told was a fully secure investment. RESPONDENTS' misrepresentations as to the risks to this money voucher investment once again constituted an elemental form of securities fraud.[19]

4. RESPONDENTS Omitted All References to the Amount of Commissions They were Receiving in Connection with their Sale of the Viatical, TLC America Tax Lien, and MVP Money Voucher investments

Through their testimony, RESPONDENTS conceded that they withheld information about their commissions with respect to their sales of viaticals and MVP money voucher investments. Not surprisingly, witnesses confirmed that the withholding of commission information by RESPONDENTS extended into the tax lien investments as well. Whether these omissions were an oversight or designed so as not to discourage clients from investing, this failure to disclose still constituted a material omission for purposes of the Securities Act.

During the hearing, JOE HILAND was initially asked what commissions he was receiving in connection with the sale of viatical investments. He responded that he was receiving a 5 to 6 percent commission on each sale. When asked whether he disclosed any of these commissions to his investors,

[19] The fact that RESPONDENTS may not have known about the risks to a particular investment does not exonerate them from making material misrepresentations and/or omissions to investors. A strict liability standard applies to securities fraud, and ignorance is not a defense.

he admitted that he did not. *H.T., p. 802, lines 5-10.* The Division also inquired about the commissions RESPONDENTS were earning on the MVP money voucher investment. JOE HILAND explained that the commission he earned on the sale of these investments was in fact 13 percent. Asked whether he disclosed any of these commissions to investors in this MVP program, JOE HILAND again admitted that he did not. *H.T., p. 816, lines 3-12.*

These omissions over commissions were again evidenced through the testimony of investor-witnesses. Investor Maass testified that TYSON never discussed anything concerning the commissions he would be receiving in connection with her tax lien investments.[20] *H.T., p. 345, lines 1-5.* Similarly, investor Maass received no disclosures about the commissions TYSON was to earn in connection with her investment in the viatical program. Investor Del Valle had the same experience. She testified that TYSON mentioned nothing about the commissions he would be receiving in connection with Del Valle's investment of $175,000 into the TLC America tax lien program. *H.T., p. 498, lines 9-11.* Del Valle also testified that in connection with her viatical investment, TYSON again made no reference to the commission he was to receive for making this sale. *H.T., p. 513, lines 13-15.*

These commissions, which made up a substantial portion of the investments being invested with RESPONDENTS, remained hidden from investors until this hearing. Certainly these commissions could have provided a red flag to investors to suggest that RESPONDENTS' enthusiasm over these investment programs may have at least been partially influenced by the profits that RESPONDENTS were poised to reap from making these sales. This commission information surely constituted part of the "total mix" of information that would be necessary for a reasonable investor to make an informed decision about whether to invest in a viatical, tax lien or money voucher program. It follows that these omissions were both material omissions and securities fraud under the Securities Act.

---

[20] The commissions RESPONDENTS were earning on sales of the TLC tax lien investment can be ascertained from sales and commission records seized from TLC America by the court-appointed receiver. Based on these records, RESPONDENTS were earning roughly a 5 percent commission on each investment they sold with TLC America. These commissions totaled over $136,000 in 1999 alone. *See Exhib. S-7.*

IV.

INVESTMENT ADVISORY FRAUD

Pursuant to the Investment Management Act, it is a fraudulent practice and unlawful for a person, in connection with a transaction or transactions within or from this state involving the provision of investment advisory services, directly or indirectly to do any of the following:

(A) Make any untrue statement of material fact, or fail to state any material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not misleading; or

(B) Misrepresent any professional qualifications with the intent that the client rely on the misrepresentation.

A.R.S. §44-3241(2) and (3).

As the evidence at hearing demonstrated, RESPONDENTS violated these provisions with complete indifference.

The most strikingly evidence of these violations can be seen through various promotional materials, company pamphlets, and correspondence disseminated by the RESPONDENTS' to potential investors. For instance, the Chamber brochures routinely held RESPONDENTS out to the public as "a professional firm specializing in financial services." *Exhib S-18; Exhib. S-173.* At the time these brochures were disseminated, the RESPONDENTS were insurance agents. Another brochure, entitled "Certificate Profile," was distributed to yet other potential investors. In one version, this pamphlet described RESPONDENTS as "a financial advisory firm specializing in investment and estate planning for mature investors needing a combination of added safety to principal, above market yields, and asset preservation." *Exhib. S-25(c).* In another Certificate Profile version, the pamphlet described RESPONDENTS as "a financial services firm providing specialized products and funds to retires, business owners and executives." *Exhib. S-129.* Again, RESPONDENTS were insurance agents when these "Certificate Profile" brochures were disseminated.

RESPONDENTS also portrayed themselves as qualified financial experts through correspondence with prospective and current clients. For instance, a letter send by JOE HILAND to investor Perry in May of 1999 closes with the words "Best regards, Joe Hiland, CSA, Senior Financial Advisor." *Exhib. S-12.* If anything, JOE HILAND was a licensed solely as an insurance agent at the time. Another correspondence was sent to investor Hetherington by TYSON in June of 2000. Under the letterhead of "Chamber Financial, Comprehensive Financial Services for Seniors," TYSON signed his name as Tyson Hiland, CSA, Senior Investment Advisor. *Exhib. S-22.* TYSON held no securities licenses or registrations with the state at this time.

More recently, in September of 2000, investigator Kirst made an undercover visit to the Chamber Group branch office in Mesa, Arizona. While there, investigator Kirst recovered several items. Three of these included the business cards of JOE HILAND and two other representatives working at the office. These cards list JOE HILAND as a certified senior advisor, and the other representatives as certified advisors. *Exhib. S-173(a).* None of the three held any investment licenses with the state at the time. Investigator Kirst also received a Chamber Financial Group informational pamphlet. This pamphlet states "We are pleased to provide you with information on our most popular programs and believe you will be excited to learn how easy it is to earn high yields on your money without the market risk. Our approach is to empower our clients to make informed decisions *by being excellent teachers and coaches.*" (Emphasis added). *Exhib. S-173(b), p. 2.* After receiving these documents, JOE HILAND provided investigator Kirst with a sales presentation on the money voucher investment.

In light of this documentation, it is readily apparent that RESPONDENTS routinely misrepresented their professional qualifications as financial advisors with the intent that their clients and prospective clients relied on these misrepresentations. It is equally apparent that RESPONDENTS made untrue statements of material fact about their qualifications or, at a very minimum, failed to state the facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. In either case, these misrepresentations occurred in the context which led RESPONDENTS to generate substantial incomes through multiple sales transactions. Based on these circumstances, RESPONDENTS activities constituted a clear pattern of investment advisory fraud.

V.

CONTROL PERSON LIABILITY

Section 44-1999(B) of the Securities Act states: "Every person who, directly or indirectly, controls any person liable for a violation of §§ 44-1991 or 44-1992 is liable jointly and severally with and to the same extent as the controlled person to any person to whom the controlled person is liable unless the controlling person acted in good faith and did not directly or indirectly induce the act underlying the action." Each primary "violation" of A.R.S. § 44-1991 by a controlled person is an "act" for the purpose of imposing statutory vicarious liability on a controlling person under A.R.S. § 44-1999.

The words "controlling person" and "controls" are neither defined in the statute nor elsewhere in our Securities Act for purposes of this statute. However, the 1996 enactment that added this statute specified a permissive intent that in construing Securities Act provisions, the courts may use, as a guide, the interpretations given by the Securities and Exchange Commission and the federal or other courts in construing substantially similar provisions in the federal securities laws of the United States. *Laws 1996*, Ch. 197, § 11(C). Since the relevant part of this statute has language "substantially similar" to the Section 20(a) "control person" provision in the federal 1934 Act,[21] Arizona courts and the Commission, acting in its adjudicative capacity, may look to the interpretations given to that federal provision by the SEC and federal courts.

---

[21] Sec. 20(a) states: "Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constitutingthe violation or cause of action." *15 U.S.C. § 78t(a).* The federal 1933 Act also has its own "control person" provision at Section 15 with language similar to A.R.S. § 44-1999(A).

Arguably, either of two distinct lines of reasoning could be used in determining the applicable test for a "control person" in this jurisdiction. The Ninth Circuit test for control requires the actual exercise of control over the general affairs of the primary violator as well as possession of power to control the specific violative activity. *See Kaplan v. Rose*, 49 F.3d 1363, 1382 (1994), *cert. denied*, 116 S.Ct. 58 (1995). 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*, 79 F.3d at 889; *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1575 (9th Cir. 1990). However, the second prong has appeared in some Ninth Circuit cases to require actual participation in the specific violative activity. This variant first emerged in *Kaplan*, which reviewed a summary judgment for the defendant with "scrutiny" of his "power to control corporate actions" and "participation in the day-to-day affairs of the corporation." *Id.*, 49 F.3d at 1382.

The Commission has previously acknowledged and applied a less stringent test that comports more neatly with the Fifth and Eleventh Circuits' interpretation for control, based in part on the on the holding in *G. A. Thompson Co., Inc. v. Partridge*, 636 F. 2d 945 (5th cir. 1981).[22] In *G.A. Thompson,* "liability accompanies possession of actual power to directly or indirectly influence the general affairs and policy of the primary violator." Additionally, the Commission has previously recognized the similar control test elements from *Brown v. Mendel*, 864 F. Supp. 1138 (M. D. Ala. 1994) ("*Brown I*"), *aff'd sub nom. Brown v. Enstar Group, Inc.*, 84 F.3d 393 (11th Cir.1996) ("*Brown II*"), *cert. denied,* 117 S. Ct. 950 (1997). Under this two-part control test, liability attaches to a person possessing (1) "the *power* to control the general affairs" of the controlled person when it violated the securities laws and (2) the "requisite *power* to directly or indirectly control or influence the specific corporate policy which resulted in the primary liability." *Brown II.*, 84 F.3d at 396. (Emphasis added).

Based on the influence and control that TRAVIS possessed over the violative conduct of the remaining Respondents, TRAVIS readily satisfied either of the above "tests" for purposes of control

---

[22] *See In the Matter of: Forex Investment Services Corp., et al.,* Arizona Corporation Commission Decision No. 62403 (March 31, 2000).

person liability under the Securities Act. Initially, TRAVIS held a position of control at CHAMBER that directly enabled him to influence the many selling activities of the other Respondents. TRAVIS was the president of CHAMBER in both 1997 and 1998. *H.T., p. 866, lines 4-10; Exhib. S-2.* The following year, in 1999, TRAVIS became both the president and CEO of CHAMBER. *H.T., p. 866, lines 11-13; Exhib. S-2.* TRAVIS again held the titles of president and CEO of CHAMBER in 2000, and subsequently added the position of "manager" to his resume in connection with an affiliated entity, Chamber Group, L.L.C. *H.T., pp. 866-867, lines 17-25 and 1, respectively; Exhib. S-2.* These official titles obviously gave TRAVIS the ostensible ability to research different investment products, to select the various investment products to be sold by RESPONDENTS, to design marketing strategies, and to train the employees on methods of solicitation. As discussed below, these are precisely the activities that TRAVIS admitted to undertaking.

Respondent TRAVIS also testified at some length concerning his day-to-day functions with CHAMBER. This testimony indicated that beyond his titles of authority with CHAMBER, TRAVIS also exercised this authority in actual practice. During questioning by his own counsel, TRAVIS initially testified to having several functions with the company. Among these CHAMBER functions, TRAVIS admitted to meeting with clients to "teach them the programs [that] we offer," to creating or "synthesizing" advertising materials for the company, and to offering and selling various investment products. *H.T., p. 841, lines 3-20.* During cross-examination, TRAVIS disclosed some of his other duties with the company. For instance, TRAVIS admitted to also being the "marketing officer" for CHAMBER, which included a responsibility for designing marketing materials. *H.T., p. 865, lines 6-17.* Asked how he designed these materials, TRAVIS stated that he used sources that he deemed to be "authentic and straight to the source." *H.T., p. 867, lines 6-14.* TRAVIS then went on to testify that he conducted research into the various investment products before marketing these investment materials, including meeting with people associated with these programs. *H.T., p. 867, lines 18-22.* TRAVIS also conceded that he routinely taught and gave presentations concerning the details of the Brokered CD, Viatical, TLC tax Lien and MVP money voucher investments that RESPONDENTS were offering for sale. *H.T., p. 868, lines 10-21.*

TRAVIS further testified that he played an integral role in developing the sales presentations given to prospective investors by each of the other Respondents. Specifically, TRAVIS testified that he had trained "all" of the other salesmen in the CHAMBER office concerning the manner in which sales presentations to investors were to be given. *H.T., p. 874, lines 7-22.* As a result of this training, TRAVIS claimed that he had a great trust concerning what was transpiring in the CHAMBER offices at all time. *H.T., pp. 874-875, lines 23-25 and 1, respectively.* TRAVIS went so far as to monitor other salesmen's investment presentations. Asked whether he knew what Respondent TYSON was disclosing to investors in connection with the sale of investment products, TRAVIS testified that, on "many occasions," he had monitored these presentations, both in person and surreptitiously.

Beyond his managerial functions in the office, TRAVIS also admitted that he participated in the sale of the Brokered CDs, viaticals, TLC America investments, and the MVP money voucher investments. *H.T., p. 841, lines 16-20.* TRAVIS later testified that in addition to these four investment options, TRAVIS also engaged in the sale of the Yucatan timeshare investments in Mexico. *H.T., p. 865, lines 18-23.*

Based on the positions of control TRAVIS held within CHAMBER, along with the many duties, functions, responsibilities, and influences that TRAVIS had in connection with the CHAMBER operations, TRAVIS'S activities readily met the prongs of the "control person" tests for both the Ninth Circuit and the Commission. Indeed, as seen above, TRAVIS exercised influence and control over the general affairs of the primary violators in this matter in several respects. These included the selection of the types of investment products RESPONDENTS would ultimately sell, the training over Respondents' sales presentations, and the preparation of marketing materials for investors. Also discussed above, TRAVIS actually participated in these specific violative activities. *Compare Kaplan v. Rose*, 49 F.3d 1363, 1382 (1994), *cert. denied*, 116 S.Ct. 58 (1995). Finally, TRAVIS had the "requisite *power* to directly or indirectly control or influence the specific corporate policy which resulted in the primary liability" of the other Respondents. This power included a direct influence over the investment products to be sold by CHAMBER, as well as the responsibility to ensure that both company salesmen as well as the CHAMBER investment literature met the requisite disclosure obligations to prospective investors.

Because TRAVIS was a "control person" of primary violators under any applicable test for control person liability, TRAVIS is subject to the provisions of Section 44-1999(B) of the Securities Act.[23] Under this section, TRAVIS is jointly and severally liable for all fraud violations of the controlled persons, with and to the same extent as these individuals. Accordingly, TRAVIS is equally liable for each of the securities fraud violations committed by the primary violators in this case, that being Respondents JOE HILAND and TYSON.

VI.

REQUESTED RELIEF

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, RESPONDENTS should be ordered to permanently cease and desist from violating A.R.S. §§ 44-1841, 44-1842 and 44-1991 of the Securities Act. Further, pursuant to A.R.S. § 44-3292, RESPONDENTS should be ordered to permanently cease and desist from violating A.R.S. §§ 44-3151 and 44-3241 of the Investment Management Act.

. . .

. . .

. . .

. . .

---

[23] Moreover, TRAVIS freely admits that he directly induced the activities of the other Respondents, including the type of investment products sold as well as the manner of the sales presentations. This being the case, the affirmative defense available under A.R.S. Section 1999(B) is not applicable to TRAVIS in any respect.

B. Order of Restitution and/or Rescission

Pursuant to A.R.S. §§ 44-2032(1), 44-3292(1) and A.A.C. R14-4-308, and on account of RESPONDENTS' registration violations, securities fraud and investment advisory fraud, Respondents Joseph Hiland, Travis Hiland, Tyson Hiland and the Chamber Group should be ordered to jointly and severally pay monetary restitution and/or make rescission offers as follows:

1. Brokered CDs

In accordance with the Securities Act, RESPONDENTS should pay restitution equal to the amount of lost principal for each investor who purchased brokered CDs from RESPONDENTS since January 1, 1998 and who have subsequently liquidated these CDs for a lesser value than their original investment. Pursuant to A.C.C. R14-4-308(C)(4), RESPONDENTS should be ordered to provide a listing of the names, addresses, and telephone numbers of all Brokered CD purchasers who have a right to receive restitution under this Order, as well as the dates of purchase and the amounts of principal these investors lost in connection with these purchases. This listing should include the total amount of restitution due from RESPONDENTS on this lost principal. Further, the Division should be allowed to supplement this listing if it deems or otherwise discovers that that RESPONDNENTS' listing is deficient.

Additionally, interest should be assessed on this restitution amount, in accordance with A.A.C. R14-4-308(C)(1), at the statutory rate of ten percent per annum, retroactive to the date from which the entry of this restitution order is made, until paid in full. Finally, of this total restitution amount, RESPONDENTS should receive <u>no</u> credit for compensating investors for lost Brokered CD principal by the rolling of the investors' funds into the Yucatan timeshare investment, the MVP Money Voucher investment, or any other investment program.

2. Viaticals

In accordance with the Securities Act, RESPONDENTS should be required to offer rescission to all investors who invested with RESPONDENTS in the Carrington-issued viatical program since January 1, 1998, and who have yet to recoup their investments. In accordance with A.C.C. R14-4-308(B), RESPONDENTS should comply with all disclosure provisions of the rescission offer, including the provision of a listing providing the names, addresses and telephone numbers of all viatical holders who have a right to receive the rescission offer pursuant to this Order, as well as the dates of purchase and the amounts of principal that these investors invested in connection with these purchases. Further, the Division should be allowed to supplement this listing if it deems or otherwise discovers that that RESPONDENTS' listing is deficient.

Alternatively, RESPONDENTS should be required to pay restitution equal to the amount of principal for each investor who invested in the viatical program with RESPONDENTS since January 1, 1998, and who have yet to recoup their investment. Pursuant to A.C.C. R14-4-308(C)(4), RESPONDENTS should be ordered to provide a listing of the names, addresses, and telephone numbers of all viatical purchasers who have a right to receive restitution under this Order, as well as the dates of purchase and the amounts of principal that these investors invested in connection with these viatical purchases. This listing should include the total amount of restitution due from RESPONDENTS on this viatical investment program. Further, the Division should be allowed to supplement this listing if it deems or otherwise discovers that that RESPONDENTS' listing is deficient.

Additionally, interest should be assessed on this restitution amount, in accordance with A.A.C. R14-4-308(C)(1), at the statutory rate of ten percent per annum, retroactive to the date from which the entry of this rescission/restitution Order is made, until paid in full.

3. TLC America Tax Lien Investments

In accordance with the Securities Act, RESPONDENTS should be required to pay restitution equal to the amount of principal for each investor who made an investment in the TLC America program with RESPONDENTS since January 1, 1998, and who have yet to recoup their investment. Pursuant to A.C.C. R14-4-308(C)(4), RESPONDENTS should be ordered to provide a listing of the names, addresses, and telephone numbers of all TLC America investment program purchasers who have a right to receive restitution under this Order, as well as the dates of purchase and the amounts of principal that these investors have invested in connection with these purchases. This listing should provide the total amount of restitution due from RESPONDENTS on their investors' TLC America investments. The Division should be allowed to supplement this listing if it deems or otherwise discovers that RESPONDENTS' listing is deficient.

Concerning the restitution, RESPONDENTS should be credited for any monies that the court-appointed receiver recovers from the TLC America program and remits to those investors who purchased their TLC America investments from RESPONDENTS. Additionally, interest should be assessed on this restitution amount, in accordance with A.A.C. R14-4-308(C)(1), at the statutory rate of ten percent per annum, retroactive to the date from which the entry of this restitution order is made, until paid in full

4. MVP Money Voucher Program

In accordance with the Securities Act, RESPONDENTS should be required to offer rescission to all investors who invested with RESPONDENTS in the MVP-issued money voucher investment program since January 1, 1998, and who have yet to recoup their investments. In accordance with A.C.C. R14-4-308(B), RESPONDENTS should comply with all disclosure provisions of the rescission offer, including the provision of a listing providing the names, addresses and telephone numbers of all MVP money voucher investors who have a right to receive the rescission offer pursuant to this Order, as well as the dates of purchase and the amounts of principal that these investors invested in connection with these purchases. The Division should be allowed to supplement this listing if it deems or otherwise discovers that that RESPONDENTS' listing is deficient.

Alternatively, RESPONDENTS should be required to pay restitution equal to the amount of principal for each investor who invested in the MVP money voucher investment program with RESPONDENTS since January 1, 1998, and who have yet to recoup their investment. Pursuant to A.C.C. R14-4-308(C)(4), RESPONDENTS should be ordered to provide a listing of the names, addresses, and telephone numbers of all MVP money voucher purchasers who have a right to receive restitution under this Order as well as the dates of purchase and the amounts of principal these investors invested in connection with these purchases. This listing should also provide the total amount of restitution due from RESPONDENTS to their MVP money voucher investors. Further, the Division should be allowed to supplement this listing if it deems or otherwise discovers that that RESPONDENTS' listing is deficient.

Additionally, interest should be assessed on this restitution amount, in accordance with A.A.C. R14-4-308(C)(1), at the statutory rate of ten percent per annum, retroactive to the date from which the Entry of this rescission/restitution order is made, until paid in full. In connection with these interest payments, RESPONDENTS should be credited for any interest payments that their investors receive from the MVP money voucher program subsequent to the entry of this restitution order.

C. Administrative Penalties

1. *Securities Act Violations*

Pursuant to A.R.S. § 44-2036(A), RESPONDENTS should be assessed administrative penalties in an amount not to exceed five thousand dollars for *each* Securities Act violation. From the foregoing review of evidence, it is clear that RESPONDENTS violated the antifraud and registration provisions of the Securities Act with the bulk of their sales of Brokered CDs, viaticals, TLC America tax lien investments, and MVP Money Voucher investments. Therefore, RESPONDENTS are subject to cumulative penalties for multiple violations.

As outlined in prior sections above, the Division has alleged and proven 305 separate acts by RESPONDENTS that violated the two registration provisions and/or the antifraud provision of the Securities Act in connection with the sale of brokered CD securities. Given these figures, RESPONDENTS have committed at least 305 Securities Act violations and should be assessed administrative penalties accordingly. The Division believes that an appropriate administrative penalty for this conduct should not be less than $61,000.

As outlined in prior sections above, the Division has alleged and proven at least 142 separate acts by RESPONDENTS that each violated the two registration provisions and/or the antifraud provision of the Securities Act in connection with the sale of viatical securities. Given these figures, RESPONDENTS have committed at least 142 Securities Act violations and should be assessed administrative penalties accordingly. The Division believes that an appropriate administrative penalty for this conduct should not be less than $28,400.

As outlined in prior sections above, the Division has alleged and proven a minimum of 92 separate acts by RESPONDENTS that each violated the two registration provisions and/or the antifraud provision of the Securities Act in connection with the sale of TLC America tax lien securities. Given these figures, RESPONDENTS have committed at least 92 Securities Act violations and should be assessed administrative penalties accordingly. The Division believes that an appropriate administrative penalty for this conduct should not be less than $18,400.

As outlined in prior sections above, the Division has alleged and proven at least 31 separate acts by RESPONDENTS that each violated the two registration provisions and/or the antifraud provision of the Securities Act in connection with the sale of MVP money voucher securities. Given these figures, RESPONDENTS have committed at least 31 Securities Act violations and should be assessed administrative penalties accordingly. The Division believes that an appropriate administrative penalty for this conduct should not be less than $6,200.

In total, the Division believes that an appropriate administrative penalty for RESPONDENTS in connection with their violations of the Securities Act in this matter should not be less than $113,100. If RESPONDENTS comply and otherwise satisfy the restitution/rescission provisions included in Part (B) directly above, this administrative penalty of $113,100 should be reduced by one half.

2. Investment Management Act Violations

Pursuant to A.R.S. § 44-3296, RESPONDENTS should be assessed administrative penalties in an amount not to exceed $1,000 for *each* Investment Management Act violation. From the foregoing review of evidence, it is clear that RESPONDENTS violated the antifraud and registration provisions of the Investment Management Act in connection with the bulk of their sales of Brokered CDs, viaticals, TLC America tax lien investments, and MVP Money Voucher investments. Therefore, RESPONDENTS are subject to cumulative penalties for multiple violations.

As outlined in prior sections above, the Securities Division has alleged and proven a minimum of 200 separate acts by RESPONDENTS that violated the licensing provisions and/or the antifraud provision of the Investment Management Act in connection with the sale of various securities. Given these figures, RESPONDENTS have committed at least 200 Investment Management Act violations and should be assessed administrative penalties accordingly. The Division believes that an appropriate administrative penalty for this conduct should not be less than $20,000.

D. **Other Relief**

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

RESPECTFULLY SUBMITTED this 27th day of June, 2001.

JANET NAPOLITANO
Attorney General
Consumer Protection & Advocacy Section

BY: ______________________
JAMIE B. PALFAI
Special Assistant Attorney General
JENNIFER BOUCEK
Assistant Attorney General
Attorneys for the Securities Division
Arizona Corporation Commission

ORIGINAL AND TEN (10) COPIES of the foregoing filed this 27th day of June, 2001, with

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

COPY of the foregoing hand-delivered this 27th day of June, 2001, to:

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

COPY of the foregoing mailed this 27th day of June, 2001, to:

David Jordan, Esq.
TITUS BRUECKNER & BERRY, P.C.
7373 North Scottsdale Road, Suite B-252
Scottsdale, AZ 85253-3527
Attorney for Respondents

By: Tony Bingham