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BEFORE THE ARIZONA CORPORATION COMMISSION

AZ CORP COMMISSION

DOCKET CONTROL

Arizona Corporation Commission

DOCKETED

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COMMISSIONERS

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GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

DOCKETED BY

DOCKET NO. S-20814A-11-0313

In the matter of:

DAVID PAUL SMOOT and MARIE
KATHLEEN SMOOT (a.k.a. "KATHY
SMOOT"), husband and wife,
NATIVE AMERICAN WATER, L.L.C. (d.b.a.
"NATAWA"), an Arizona limited liability
company,
NATAWA CORPORATION (d.b.a.
"NATAWA"), a Delaware corporation with a
revoked authorization to conduct business in
Arizona as a foreign corporation,
AMERICAN INDIAN TECHNOLOGIES
INTERNATIONAL, L.L.C. (a.k.a. "AITI"), an
Arizona limited liability company,
Respondents.

SECURITIES DIVISION'S
RESPONSE TO RESPONDENTS'
BRIEF TO COMPEL EXCHANGE
OF ARIZ. R. CIV. P. 26.1
DISCLOSURE STATEMENTS

(Assigned to Administrative Law
Judge Marc E. Stern)

Pursuant to the Administrative Law Judge's ("ALJ") February 15, 2012, Procedural Order, the Securities Division ("Division") of the Arizona Corporation Commission ("Commission") submits its Response to "Respondents' Brief To Compel The Exchange of Ariz. R. Civ. P. 26.1 Disclosure Statements" ("Brief"), and requests that it be denied.

A. Respondents' Reliance on the Legally and Factually Distinguishable Slade Decision is Misplaced.

Respondents' Brief repeatedly cites to the civil *Slade v. Schneider*, 212 Ariz. 176, 129 P.3d 465 (App. 2006) case to support the broad propositions that:

- 1 (a) Arizona courts do not hesitate to apply the Arizona Rules of Civil Procedure,
2 including Rules 26 and 26.1, to actions brought by the Commission; and
3 (b) the Division waived the confidentiality mandate of A.R.S. § 44-2042 by filing the
4 Notice of Opportunity on October 20, 2011.

5 (*See*, Brief, at p.3:15-21; p. 6:2-6, fn.4; p. 11, fn. 17; pp. 11:6 to 12:6; p. 12, fn. 19). Respondents
6 are not correct and their heavy reliance on the inapposite *Slade* decision is misplaced.¹

7 First, *Slade* involved a “civil” complaint filed by the Commission in Maricopa County
8 Superior Court under the Arizona Rules of Civil Procedure. *Slade*, 212 Ariz. at 177, 129 P.3d at
9 466. The Commission in *Slade* also filed a civil, ex parte application for a temporary restraining
10 order (“TRO”) and/or preliminary injunction, in part, under Rule 65(d) of the Arizona Rules of
11 Civil Procedure, and a motion for the appointment of a receiver to seize and control the *Slade*
12 defendants’ assets. *Id.*

13 Conversely, this is an administrative case expressly governed by the Rules of Practice and
14 Procedure Before the Commission R14-3-101, *et seq.* (“Rules”) and the Administrative Procedures
15 Act, A.R.S. § 41-1001, *et seq.* (“APA”). The *Slade* decision does not contain an analysis of
16 administrative law. Unlike the Commission in *Slade*, the Division is not seeking the appointment
17 of a receiver. The Division has not filed for an ex parte TRO. The Division’s Notice does not
18 incorporate or rely on the Arizona Rules of Civil Procedure like the civil Commission complaint at
19 issue in the *Slade* case. The *Slade* decision does not hold that courts impose the Arizona Rules of
20 Civil Procedure in administrative securities enforcement actions like this one, as suggested by

21 ¹ As discussed herein, the *Slade* case actually does not “hold” that the Commission “waived” the
22 confidentiality provision of the Act, A.R.S. § 44-2042, by merely including the facts uncovered by its
23 investigator in a civil complaint, as suggested by Respondents. Rather, the *Slade* Court narrowly held that
24 the records at issue were not confidential under the statute because the Commission had made a matter of
25 public record the contents of a detailed, sworn, testimonial affidavit executed by the investigator in support
26 of the Commission’s complaint and related civil pleadings (*i.e.*, information was not confidential because it
had been made a matter of public record). Respondents also argue that the confidentiality mandate of A.R.S.
§ 44-2042 does not apply because this matter now is a “full blown action” and is “no longer an examination
or investigation.” (*See*, Brief, pp. 10:7 to 11:6). That assertion, however, is not supported by an appropriate
citation to any rule or case law that states that an investigation is complete on the mere filing of a notice of
opportunity.

1 Respondents. As a result, Respondents do not have a right to obtain a disclosure statement from the
2 Division under the wholly separate Arizona Rules of Civil Procedure at issue in the *Slade* case.²

3 As explained in the Division's February 3, 2012, Opposition, the discovery and/or
4 information disclosure procedures allowed in this case are limited to:

- 5 a. The procurement of documents from witnesses or parties via subpoenas issued on a
6 showing of reasonable need (*See*, A.R.S. § 41-1062(A)(4), Rule 14-3-109(O));
- 7 b. Depositions of witnesses via subpoenas issued on a showing of reasonable need
8 (*See, See*, A.R.S. § 41-1062(A)(4), Rules 14-3-109(O), (P)); and
- 9 c. The exchange of the parties' proposed lists of witnesses and exhibits, presumably
10 about 60 days prior to the evidentiary hearing as discussed during the January 18,
11 2012, prehearing conference. (*See*, Rules R14-3-108(A); 14-3-109(L)).

12 Under A.R.S. § 41-1062(A)(4) of the APA, all other types of civil discovery are unambiguously
13 prohibited.³ Because the *Slade* decision does not even discuss the administrative rules and
14 discovery procedures applicable in this case, including the requirement that respondents
15 demonstrate a "reasonable need" to conduct the certain types of discovery listed above,
16 Respondents' reliance on the *Slade* decision is misplaced.⁴

17 Second, the Commission's TRO application in *Slade* was actually supported an investigator's
18 detailed, sworn "*affidavit*." The investigators' testimonial affidavit in the *Slade* case:

19 explained his duties as including interviewing victims, witnesses and suspects;
20 examining evidence; managing case files; preparing and serving subpoenas, other
21 legal documents and reports; and testifying in judicial proceedings. **The**

22 ² See the Division's Opposition filed on February 3, 2012, for authority holding that Respondents do not
23 have a due process right to engage in civil discovery in this administrative proceeding.

24 ³ A.R.S. § 41-1062(A)(4) of the APA states in relevant part, as follows:

25 **...no subpoenas, depositions or other discovery shall be permitted in contested cases**
26 **except as provided by agency rule or this paragraph.** (Emphasis added).

27 ⁴ Citing the *Slade* decision, Respondents' Brief also refers to other types of discovery permissible under
28 certain circumstances including depositions of witnesses. (Brief, p. 3:16-21; pp. 6:2 to 7:15). However,
29 Respondents' brief appears to be limited to the request that the ALJ adopt Rule 26.1 of the Arizona Rules of
30 Civil Procedure.

1 **investigator referred to specific** numbers of Mathon Fund and Mathon Fund I
2 **investors** that the Commission had identified. **The investigator's affidavit further**
3 **described information from these investors regarding Petitioners'**
4 **representations to them, specific securities and financial transactions involving**
5 **the two funds and Petitioners' failure to file appropriate paperwork to secure**
6 **loans. Numerous investors** also informed the investigator that they would not have
7 invested had they known about some of Petitioners' activities. Finally, the
8 investigator avowed that Petitioners admitted continuing to raise funds from
9 investors and extending loans to borrowers.

10 *Slade*, 212 Ariz. at 178, 129 P.3d. at 467 (Emphasis added). Conversely, the Division has not filed
11 any sworn testimonial affidavit of any witnesses in this case with Docket Control and/or the
12 Hearing Division.⁵

13 Third, by their own admission, Respondents seek, through the exchange of Rule 26.1
14 disclosures statements, confidential information protected by A.R.S. § 44-2042, as well as attorney-
15 client, work product and investigative privileged information. Respondents even seek
16 informational work-product that does not presently exist and would have to be generated by the
17 Division. (See, Brief, p.2:6-25; p. 4:12-18).⁶ For example, Rule 26.1, Ariz. R. Civ. P. requires, and
18 Respondents specifically want:

19 (a) A list of “[t]he names and addresses of all persons whom the party believes may
20 have knowledge or information relevant to the events, transactions, or occurrences
21 that gave rise to the action, and the nature of the knowledge or information each
22 such individual is believed to possess” (See, Rule 26.1(a)(4), Ariz. R. Civ. P., also,
23 e.g., Brief, p.4:16-18) (Emphasis added);

24 (b) “The names and addresses of all persons who have given statements, whether
25 written or recorded, signed or unsigned, and the custodian of the copies of those
26 statements” (See, Rule 26.1(a)(5), Ariz. R. Civ. P., also, e.g., Brief, p.2:8-25)
(Emphasis added); and

⁵ The *Slade* decision does reference the term “waived,” apparently in dicta, while discussing A.R.S. § 44-2042. See, *Slade*, 212 Ariz. at 181, 129 P.3d at 470. However, as a threshold matter, the Commission cannot “waive” the legislative mandate imposed by the confidentiality statute of the Act, A.R.S. § 44-2042.

⁶ Without limitation, Respondents have demanded the Division’s entire un-redacted investigative file. (See, Division Opposition, pp. 2:17 to 3:2).

1 (c) “A list of the documents or electronically stored information, or in the case of
2 voluminous documentary information or electronically stored information, a list of
3 the categories of documents or electronically stored information, **known by a party**
4 **to exist whether or not in the party's possession, custody or control and which**
5 **that party believes may be relevant to the subject matter of the action, and**
6 **those which appear reasonably calculated to lead to the discovery of admissible**
7 **evidence**, and the date(s) upon which those documents or electronically stored
8 information will be made, or have been made, available for inspection, copying,
9 testing or sampling. Unless good cause is stated for not doing so, a copy of the
10 documents and electronically stored information listed shall be served with the
11 disclosure. **If production is not made, the name and address of the custodian of**
12 **the documents and electronically stored information shall be indicated.** A party
13 who produces documents for inspection shall produce them as they are kept in the
14 usual course of business.” (See, Rule 26.1(a)(9), Ariz. R. Civ. P., *also, e.g.*, Brief,
15 p.2:8-25) (Emphasis added).⁷

16 However, the *Slade* decision itself supports a finding by the ALJ that the confidential and
17 privileged information sought by Respondents through the exchange of Rule 26.1 disclosures
18 statements is improper because the Division has not yet “publicly filed” any records contained in
19 the Division’s confidential investigative file with Docket Control and/or the Hearing Division. As
20 the *Slade* Court reasoned:

21 The Commission responds that the confidentiality of the names, documents and
22 information does not terminate unless the Division files the information and
23 documents with a public tribunal, making them a matter of public record... Though
24 no published cases interpret when the Commission makes the names, information
and documents a matter of public record, **we need not determine all of the**

25 ⁷ In other words, the Division would have to devote considerable time and resources to identify persons and
26 entities that may have information pertaining to not only the Division’s claims, but also to the Respondents’
numerous factual and legal defenses, whether they are ultimately deemed to have merit or not.

1 **Commission's actions that would result in the names, information and**
2 **documents no longer being confidential because we agree with the Commission**
3 **that this occurs when the Commission files the information or documents with**
4 **a public tribunal.**

5 *Slade*, 212 Ariz. at 181-182, 129 P.3d at 470-471(emphasis added).⁸

6 Further, despite the inapplicable, broad discovery rules at issue in *Slade* including, without
7 limitation, Rules 26 and 26.1 of the Arizona Rules of Civil Procedure, the *Slade* Court held that the
8 Commission in that case had not waived its work-product privilege even though it had filed the
9 investigator's affidavit:

10 The Commission also explained that the investigator was not expressing opinions in
11 his affidavit but was instead providing a factual summary of portions of his
12 investigation. Because the investigator is not a testifying expert, the Commission
13 did not waive its work-product immunity.

14 *Slade*, 212 Ariz. at 181, 129 P3d at 470.

15 Thus, Respondents are also not entitled to the information contained in the Division's
16 investigative file regarding the Division's investigation because such information is protected by
17 the work-product, attorney-client and investigative privileges and the confidentiality provision of
18 the Act, and said privileges and confidentiality have not been "waived" or otherwise diminished
19 even under reasoning set forth in Respondents' legally and factually distinguishable *Slade* case.

20 Applied here, the Division has not waived the confidential nature of its investigative file, or
21 the work-product, attorney-client or investigative privileges relating to the Division's ongoing
22 investigation of Respondents' alleged violations of the Act by virtue of the fact that it filed the

23 ⁸ Respondents essentially argue that an enforcement action brought by the Division results in the termination
24 of all confidentiality and privilege considerations discussed herein. Respondents' interpretation of A.R.S. §
25 44-2042 cannot be valid for two additional reasons: (a) such an interpretation is so broad that its application
26 would completely defeat the purpose of the confidentiality statute; (2) the legislature could have, but did
 not, dictate that the confidentiality statute no longer applied upon the commencement of an administrative or
 civil action. Holding otherwise would also be tantamount to supporting the untenable proposition that a
 party to an administrative lawsuit like this one waives all privileges, etc. pertaining to the contents of the
 litigation file by merely filing a complaint or an answer that necessarily incorporates any information
 contained in the litigation file.

1 Notice.⁹ Because the information required to be disclosed under Rule 26.1, Ariz. R. Civ. P. is still
2 confidential and privileged, Respondents' request for the a disclosure statement issued under the
3 Arizona Rules of Civil Procedure should be denied.

4 **B. Respondents' Cannot Demonstrate That They Have a Reasonable Need to Have**
5 **the Division Prepare, and Presumably Continue to Prepare Disclosure**
6 **Statements Under Rule 26.1, Ariz. R. Civ. P.**

7 Alternatively, and as stated in the Division's February 3rd Opposition, Respondents should
8 have to demonstrate to the ALJ that they have a "reasonable need" to have the Division prepare a
9 disclosure statement under Rule 26.1 of the Arizona Rules of Civil Procedure. As argued in the
10 Division's February 3rd Opposition, Respondents cannot meet that threshold burden.

11 Moreover, as noted Respondents' recent Motion to Stay filed on March 6, 2012,
12 Respondents assert that Respondent David Paul Smoot was recently indicted, arrested and released
13 "on his own recognizance." (Motion to Stay, p.2:9-19). In that motion, Respondents assert that the
14 "facts and circumstances underlying the pending the pending felony counts are the same facts and
15 circumstances upon which the Commission brought the Commission Action." (Motion p.2:20-23).
16 As a result, Smoot and his team of 5 attorneys with three law firms will presumably receive
17 documents and discovery from the Maricopa County Attorney's Office under the applicable rules
18 for Arizona Criminal Procedure. (*See e.g.*, Rule 15, Ariz. R. Crim. P., relating to extensive
19 prosecutorial evidence disclosures).

20 Second, Respondents have repeatedly boasted of the fact that Respondents' attorneys will
21 be able to rebut each and every allegation in the Notice, in part, due to their own thorough and
22 detailed investigation. For instance, Mr. Galligan wrote an eleven page letter to the former
23 Division Assistant Chief Counsel of Enforcement dated September 28, 2011, that states, without
24 limitation:

25 ⁹ Like the *Slade* decision, Respondents' Brief also does not address the Division's assertion of the attorney-
26 client privilege as to certain information sought by Respondents under the guise of a Rule 26.1 disclosure
statement issued under the Arizona Rules of Civil Procedure.

1 ...it is simply not ok to seek out only, and rely almost exclusively on, a small circle
2 of individuals, some with less than ethical intentions, many of whom were at least
3 equally or more responsible than Smoot for initiating investor communications,
4 including Board members who failed in their coup attempt to oust Smoot after they
5 realized the **mega-value of the company** in 2006.

6 **I have contacted directly and indirectly a large number of investors, none of**
7 **whom have been approached by the ACC...**I can assure you, the folks I have
8 talked to have a radically different view of the core representation of material facts
9 issue in this case than was propounded relentlessly over and over and over again in
10 the consent order tome. And all are more than anxious to testify as to what they
11 believe was said/written/IMPLIED and not said/written/IMPLIED to prospective
12 investors. (Emphasis added)

13 Thus, by Respondents' own claims/admissions, they have no need for the Division to provide to
14 them a disclosure statement issued under the inapplicable Rules of Arizona Civil Procedure because
15 they claim they already conducted an exhaustive investigation, and sufficient information to
16 allegedly enable them to rebut the Division's allegations.

17 Finally, Respondents' Brief is even supported by arguments over the *meaning* of documents
18 that Respondents themselves have provided to the Division. For instance, Respondents note that
19 they provided the Division with "initial accounting" documents that a CPA named Candia
20 Grunwald prepared for Respondents. (Brief, p. 4:19-26). They cite these documents in support of
21 the claim that they do not understand the Division's allegation that Respondents did not obtain
22 "audited" financials. (*Id.*; also, Notice, ¶105). However, that fact that Respondents are attempting
23 to make arguments over documents they clearly have access to belies any claim by Respondents
24 that they are litigating this case in the dark.

25 Respondents further cite to "contracts" they provided to the Division in support of their
26 claim that Respondents do not understand the Division's fraud claim that Respondents'
representations to investors that the "contracts" were assets and/or revenue sources totaling millions
of dollars were misleading. (Brief, p. 5:1-10). Again, Respondents' interpretation of their own
documents cannot reasonably support their Rule 26.1, Ariz. R. Civ. P. disclosure statement request.
As also noted in the Division's February 3rd Opposition, the Division's Notice provides

1 Respondents' with the detail and legal basis for the Division's fraud claims. (See, Opposition, p.
2 8:6-16; also, Notice). Respondents will have ample opportunity to call witnesses and present their
3 own interpretations of the business records during the evidentiary hearing.

4 Because Respondents have not, and cannot show that they have a reasonable need for the
5 Division to provide Respondents with a disclosure statement that conforms to Rule 26.1 of the
6 Arizona Rules of Civil Procedure, the Division requests that Respondents request be denied.

7 **C. Respondents' Remaining Legal Authority is Inapplicable.**

8 Respondents' other cited legal authority is inapplicable and should be ignored. As a
9 threshold matter, Respondents' Brief is devoid of any Arizona case law holding that Rule 26.1,
10 Ariz. R. Civ. P., disclosure statements can be issued in an "administrative" proceedings like this
11 one. For instance, Respondents cite *Gerow v. Covill*, 192 Ariz. 9, 960 P.2d 55 (App. 1998), for
12 the proposition that the Rule 26.1 is designed to allow parties to prepare for trial or settlement, and
13 to "maximize the likelihood of a decision on the merits." (Brief, p.3:2-7). *Gerow*, however,
14 involved a divorce proceeding filed in Maricopa County Superior Court pursuant to the Rules of
15 Civil Procedure. *Gerow* does not hold that there will not be a "decision on the merits" in this case
16 if the ALJ does not order the exchange of Rule 26.1 disclosure statements.

17 Similarly, the *Bryan v. Riddel*, 178 Ariz. 472, 875 P.2d (1994) decision cited by
18 Respondents in their Brief involved an employee's civil suit against his former employer for
19 wrongful termination, and a dispute over discovery issued under the Arizona Rules of Civil
20 Procedure. (See, Brief, at p. p. 8:10-18; p. 8, fn. 7; p. 10:2-5; p.10, fn. 14). Again, there are no
21 such facts or civil procedural rules at issue in this case.

22 Respondents also incorrectly cite various provisions of the APA out-of-context, including
23 A.R.S. § 41-1061(B)(4) of the APA for the proposition that Respondents are entitled to a "more
24 definite and detailed" statement of the alleged facts. (Brief, p. 5:17-20). Respondents, however,
25 fail to cite to the other provisions of that statute that make clear that due process is satisfied so long
26 as Respondents are provided with a "short and plain statement of the matters asserted." See, A.R.S.

1 § 41-1061(B)(4). Undersigned counsel submits that the Division's detailed thirty-three page, one
2 hundred and twenty-six (126) paragraph Notice provides Respondents with ample notice of the
3 factual and legal issues in dispute.

4 **D. Conclusion.**

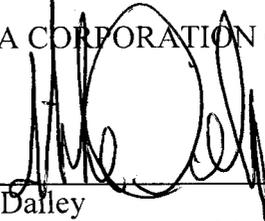
5 The Division intends to provide Respondents with its witness list and copies of the exhibits
6 the Division will seek to introduce as evidence at the evidentiary hearing of this matter. The
7 Division has also already provided Respondents with its investor cash flow accounting analysis,
8 and supporting work papers or 96 megabit database. No further discovery is necessary.

9 For the reasons set forth above and in the Division's February 3, 2012, Opposition, the
10 Division respectfully requests the ALJ to deny Respondents' request that the parties exchange
11 disclosure statements issued under Rule 26.1, Ariz. R. Civ. P.

12 RESPECTFULLY SUBMITTED this 8th day of March, 2012.

13 ARIZONA CORPORATION COMMISSION

14
15 By _____

16 
17 Mike Dalley
18 Attorney for the Securities Division of the
19 Arizona Corporation Commission

20 ORIGINAL AND EIGHT (8) COPIES of the foregoing
21 filed this 8th day of March, 2012 with:

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26 COPY of the foregoing hand-delivered
this 8th day of March, 2012 to:

Marc E. Stern
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