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BEFORE THE ARIZONA CORPORATION COMMISSION

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

DOCKETED

MAR 20 2012

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COMMISSIONERS

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

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'
MOTION TO STAY**

**(Assigned to Administrative Law
Judge Marc E. Stern)**

The Securities Division ("Division") of the Arizona Corporation Commission ("Commission") responds to Respondents' Motion to Stay ("Motion") this case, apparently for an indefinite duration, and requests that it be denied.

A. BACKGROUND.

Respondents seek to delay this administrative proceeding yet again by arguing that Respondent David Paul Smoot ("Smoot") was recently indicted by a Maricopa County Grand Jury in February 2012. (Motion, p.2:9-14).¹ Though Smoot was arrested, Respondents admit that Smoot

¹ The parties unsuccessfully attempted to resolve this matter throughout the summer/fall of 2011. To that end, the parties agreed that in lieu of filing a notice of opportunity, the Division would initiate this matter by filing an application to open a docket on August 11, 2011, for the purposes of a possible pre-filing

1 “was released on February 14, 2012 on his own recognizance.” (Motion, p. 2:15-16). Thus,
2 Smoot is and has always been able to assist his team of approximately five attorneys associated
3 with three law firms with his defense in this matter and the criminal case.

4 Respondents’ Motion is supported by the assertion that the “facts and circumstances
5 underlying the pending felony counts are the same facts and circumstances upon which the
6 Commission brought the Commission Action.” (Motion, p.2:20-23). Respondents, however, do
7 not actually support their Motion with an appropriate analysis of the exact factual and legal
8 differences or similarities of the two matters. A search of the Maricopa County Clerk’s online
9 docket website indicates that Smoot is not being charged with securities fraud under A.R.S. § 44-
10 1991 of the Arizona Securities Act (“Act.”). On the other hand, the Division alleges that Smoot
11 committed securities fraud. (Notice, ¶¶124-126). On information and belief, the criminal matter
12 does not include a claim for a permanent injunction against all Respondents under A.R.S. § 44-
13 3032 of the Act. The Notice includes a claim for a permanent injunction. (Notice, p. 31:14-16).

14 Respondents attempt to persuade the Administrative Law Judge (“ALJ”) that Division
15 Special Investigator Garry Clapper “instigated” the criminal action. (Motion, pp. 2:23 to 3:1). In
16 reality, the criminal matter is being prosecuted by the Maricopa County Attorney’s Office. Mr.
17 Clapper is not employed by the Maricopa County Attorney’s Office, nor is Mr. Clapper an attorney
18 or prosecutor. Respondents next incorrectly insinuate that both actions are being prosecuted by the
19 same government agency, to wit the “State of Arizona.” (Motion, pp. 3:1-8). In reality, the
20 Division does not prosecute criminal cases, nor does it control criminal prosecutions or related
21 grand juries. *See e.g., Hernandez v. Superior Court*, 179 Ariz. 515, 522-23, 880 P.2d 735, 742-43
22 (App. 1994)(in holding that subsequent criminal prosecution of man who had been previously
23 found by the Commission to have violated the Act was not barred by the double jeopardy clause,

24
25 resolution. After a proposed settlement could not be achieved at that point, the Division filed the Notice Of
26 Opportunity For Hearing (“Notice”) on October 20, 2011. Respondent requested a hearing on October 31,
2011. Thereafter, Respondents sought to delay the first pre-hearing conference until January 18, 2012.
During the pre-hearing conference, Respondents urged the ALJ to not set the evidentiary hearing requested
by Respondents until at least October 2012.

1 court reasoned that “[t]he Commission did not acquit, convict, or sentence petitioners; it merely
2 subjected them to its administrative order. Moreover, the [administrative] proceeding before the
3 Commission was not a prosecution.”).

4 Respondents failed to inform the ALJ, or even speculate as to exactly when they expect the
5 criminal matter to be resolved. (*See*, Motion). They cannot. Thus, Respondents necessarily seek
6 to stay this matter indefinitely.

7 Respondents further assert that staying this matter, and allowing the criminal case to
8 proceed to judgment “may guide the parties in settlement discussions” and eliminate issues to be
9 resolved in this case. (Motion, p. 8:20-23). Because the parties can settle this matter now, staying
10 this matter will not assist, but would rather hinder a resolution of the same. Put another way, if this
11 matter is stayed, possibly for many years, Respondents will have no incentive to engage in
12 settlement negotiations.

13 Respondents’ Motion is also devoid of an appropriate reference to the many investors in this
14 administrative case that have allegedly lost millions of dollars. (Notice, ¶21). In this economy,
15 those investors’ losses of any money, let alone losses incurred via Respondent’s alleged fraud is
16 harmful to said investors, many of which are Arizona citizens. (*Id.*, at ¶¶21, 110). Thus, staying
17 this matter indefinitely will not only detrimental the Division’s ability to enforce the Act for the
18 benefit of the public, but it will also negatively impact the alleged victim investors at issue.

19 Respondents have also blamed a myriad of other persons for this administrative action, as
20 well as the economy for investors’ losses of millions of dollars. For example, Respondents’
21 December 2, 2011, Answer repeatedly, and unequivocally blames the inevitable failure of
22 Respondents’ so-called business on other persons including, but not limited to, the so-called
23 “independent” board of directors of the Respondents Native American Water, LLC, Natawa
24 Corporation and American Indian Technologies International, LLC (collectively, the
25 “Companies”). (Answer, ¶¶2, 11, 22, 31, 36, 39, 49, 51, 98-100, 102, 107-109, 115; p. 15).

26

1 Regardless, and even though Smoot's Fifth Amendment rights are at issue in this case (as
2 with all litigation), Smoot's invocation of said rights will not prevent Respondents from seeking to
3 introduce documentary or witness testimony in their defense including, without limitation, that
4 other persons may be responsible for violations of the Act.

5 **B. INTRODUCTION TO ARGUMENT.**

6 Arizona courts hold that a person does not have a constitutional right stay a civil action
7 pending the resolution of a related criminal matter. *State ex rel. Corbin v. Goodrich*, 151 Ariz. 118,
8 125, 726 P.2d 215, 222 (App. 1986)(reasoning that "nothing prohibits simultaneous maintenance of
9 criminal and civil actions," court found that trial court properly denied a defendant's request to stay
10 the civil proceeding, in part, because the "state had a legitimate interest in pursuing the civil action
11 and seeking to enjoin any further violations of the Arizona securities laws in order to protect its
12 residents."); *State v. Ott*, 167 Ariz. 420, 428, 808 P.2d 305, 313 (App. 1990)(court noted that
13 neither the federal nor the state constitution prohibits parallel or simultaneous civil and criminal
14 proceedings, court held that the defendant was not entitled to a stay of a civil action pending the
15 outcome of a related criminal proceeding).

16 The ALJ has the discretion to grant or deny Respondents' stay request. *See, Ott*, 167 Ariz.
17 at 428-29, 808 P.2d at 313-14; *also, Landis v. North American Co.*, 299 U.S. 248, 254-55, 57 S.Ct.
18 163, 165-66 (1936) (reversing trial court's stay order, Supreme Court noted that a litigant seeking
19 stay of proceedings in one suit to allow the resolution of another action must make a clear case of
20 hardship or inequity in being required to go forward, if there is even a fair possibility that the stay
21 for which he prays will work damage to some one else). Each case must be decided on their own
22 unique facts. *Lewis v. Moultrie*, 627 P.2d 94, 96 (Utah 1981).

23 In determining whether to grant or deny a stay, the ALJ can look to the extent that
24 Respondents' Fifth Amendment rights are actually implicated, if any, and:

- 25 (1) the interest of the plaintiffs in proceeding expeditiously with this litigation or
26 any particular aspect of it, and the potential prejudice to plaintiffs of a delay; (2) the
burden which any particular aspect of the proceedings may impose on defendants;

1 (3) the convenience of the court in the management of its cases, and the efficient use
2 of judicial resources; (4) the interests of persons not parties to the civil litigation;
3 and (5) the interest of the public in the pending civil and criminal litigation.

4 *See, Keating v. Office of Thrift Supervision*, 45 F.3d 322, 324-25 (9th Cir. 1995)(upholding ALJ's
5 decision to proceed with enforcement proceeding against defendant despite ongoing federal and
6 state criminal cases, in part, because defendant had sufficient time to prepare for the regulatory
7 case).

8 The ALJ may also consider whether: (a) there are "identical" parties and issues in both
9 actions, and that a decision in one will settle or resolve the other;² and (b) allowing parallel
10 proceedings would "substantially" prejudice the defendant's rights.³

11 **C. ARGUMENT**

12 **1. Three of the Four Respondents Do Not Have Fifth Amendment Rights.**

13 Respondents' Motion requests that this matter be stayed on behalf of all Respondents,
14 including the three Respondent Companies, because the Division alleges that Smoot is the founder
15 of said Companies. (Motion, p. 2, fn. 1). Respondents, however, do not allege that the three
16 Respondent Companies were indicted.

17 Regardless, corporations do not enjoy any Fifth Amendment rights against self
18 incrimination. *See e.g., Braswell v. U.S.*, 487 U.S. 99, 116, 108 S.Ct. 2284, 2294 (1988)("it is no
19 doubt true that if a subpoena is addressed to a corporation, the corporation 'must find some means
20 by which to comply because no Fifth Amendment defense is available to it.'). Thus, three of the
21 four Respondents in this case have no standing to assert any Fifth Amendment rights.

22 A corporation's business records are similarly not afforded constitutional protections
23 against production. *See, United States v. Milligan*, 371 F.Supp.2d 1127, 1129 (D. Ariz.
24 2005)(corporate custodian could not resist producing corporate documents on ground that it would

25 ² *Lewis*, 627 P.2d at 96 (court reversed decision staying employee's civil action against employer until
26 resolution of industrial commission proceeding, in part, because of prejudice to employee; court noted that a
common ground for a stay is the pendency of another action involving identical parties and issues and where
a decision in one action settles the issues in another, or when the decision in an action is essential to the
decision in another).

³ *Ott*, 167 Ariz. at 428, 808 P.2d at 313.

1 violate his Fifth Amendment right against self-incrimination, even if custodian was sole
2 shareholder, employee, and officer of corporation, and documents were sought in connection with
3 criminal investigation of custodian and his wife, where information in question was corporate, not
4 personal, in nature, and it was unlikely that corporation was one-man corporation). Here,
5 Respondents allege that other persons were involved in the operation of Respondents' business
6 activities. (Answer, ¶¶2, 11, 22, 31, 36, 39, 49, 51, 98-100, 102, 107-109, 115; p. 15). Under
7 *Milligan*, this case should not be stayed even if Smoot actually invokes his Fifth Amendment right
8 at hearing.

9 Further, the Division's case relies on, and the Notice repeatedly cites Respondents' *business*
10 records, rather than Smoot's personal records. (*See e.g.*, Notice, ¶¶6, 13-14, 25-27, etc.). In fact,
11 Respondents have already provided the Division with thousands of pages worth of business records
12 from which the Notice was drafted. Nevertheless, the Division's case is not based on any of
13 Smoot's alleged personal records. Thus, allowing this case to proceed against Smoot and the
14 Companies will not indirectly impact Smoot's ability to invoke his Fifth Amendment rights as
15 suggested by Respondents.

16 With respect to the "implication" of rights factor, the Ninth Circuit in the *Keating* case also
17 reasoned:

18 In deciding whether to proceed with the hearing, the extent to which the defendant's
19 Fifth Amendment rights are implicated is a significant factor for the ALJ to
20 consider, but it is only one consideration to be weighed against others...The ALJ's
21 discussion of the various considerations was exhaustive, and despite the potential
22 implication of Keating's Fifth Amendment rights, he did not abuse his discretion in
23 deciding that the balance favored proceeding with the [*administrative enforcement*]
24 hearing.

25 In contrast to Keating's interests, which were not overly burdened by proceeding
26 with the hearing, the public's interest in a speedy resolution of the controversy and
the OTS' concern for efficient administration would have been unnecessarily
impaired had the proceeding been stayed. Moreover, in light of the inordinate
amount of media attention given to the case, any delay would have been detrimental
to public confidence in the enforcement scheme for thrift institutions.

Keating, 45 F.3d at 325-26 (Emphasis added).

1 Respondents also argue that if Smoot is forced to assert his Fifth Amendment rights,
2 Respondents would thereby leave “the Commission’s allegations in the Commission Action to go,
3 for all intensive purposes, unchecked.” (Motion, p. 3:23-27). In reality, Smoot’s attorneys can still
4 attempt to introduce documentary evidence, and call defense witnesses including those that
5 Respondents assert are responsible for the violations alleged in the Division’s Notice. Indeed,
6 during the January 18, 2012, prehearing conference, Respondents boasted that they would also be
7 calling several expert witnesses to rebut the Division’s allegations. Respondents can also attempt
8 to rebut the Division’s evidence, and cross examine the Division’s proposed witnesses. As also
9 noted in the Division’s March 8, 2012, Response to Respondents’ Motion for the exchange of
10 disclosure statements, Respondents have already interviewed a “large number” of investor
11 witnesses. (Response, p. 8:4-5). Because the Division will still have to prove its case even if
12 Smoot does not testify, the Division’s allegations will not be left “unchecked” as suggested by
13 Respondents.

14 Because: (a) three of the four Respondents in this matter do not have Fifth Amendment
15 rights against self incrimination; (b) the Division’s Notice relies heavily on the Respondent
16 Companies’ business records; and (c) Smoot will have the ability to present evidence in his defense
17 even if he invokes his Fifth Amendment rights, Respondents’ Motion should be denied.

18 **2. Smoot May Invoke His Fifth Amendment Rights In This Matter.**

19 Respondents next claim that this matter should be stayed because Mr. Smoot’s Fifth
20 Amendment “are of the utmost importance at this time” and are implicated by the criminal case.
21 (Motion, p. 5:5-12-20). This factor doesn’t support Respondents’ request for a stay because a
22 person’s Fifth Amendment rights are implicated in any litigation, whether civil, criminal or
23 administrative. Indeed, Respondents acknowledge that respondents in administrative proceedings
24 like this one are often forced to chose whether to testify “under the fear or possibility of criminal
25 charges being filed,” insofar as violations of A.R.S. §§ 44-1841, 44-1842 and 44-1991 also
26 technically constitute class four felonies under A.R.S. §§ 44-1841(B) and 44-1995. (Motion, p.

1 5:18-20).⁴

2 Nevertheless, should this administrative matter proceed, nothing will prevent Smoot from
3 invoking his Fifth Amendment rights. In holding that an ALJ's refusal to stay an administrative
4 enforcement action like this one pending the outcome of related state and federal criminal trials was
5 proper, the Ninth Circuit in the *Keating* case reasoned that:

6 **A defendant has no absolute right not to be forced to choose between testifying**
7 **in a civil matter and asserting his Fifth Amendment privilege.** Not only is it
8 permissible to conduct a civil proceeding at the same time as a related criminal
9 proceeding, even if that necessitates invocation of the Fifth Amendment privilege,
but it is even permissible for the trier of fact to draw adverse inferences from the
invocation of the Fifth Amendment in a civil proceeding.

10 *Keating*, 45 F.3d at 325-26 (Emphasis added). Thus, the mere fact that Smoot's Fifth Amendment
11 rights are implicated is a distinction without a difference.

12 Because Smoot may invoke his Fifth Amendment rights in this matter, and controlling
13 authority holds that it is not a violation of Smoot's rights to proceed with this administrative case
14 even if Smoot invokes said rights, Respondents' Motion should be denied.

15 **3. Allowing This Administrative Enforcement Proceeding To Proceed Will Not**
16 **Substantially or Unduly Prejudice Smoot's Constitutional Rights.**

17 Allowing this matter to proceed will not *unduly* or *substantially* prejudice Smoot's
18 constitutional rights for several reasons. See, *Blacks Law Dictionary*, (9th Ed. 2009) (the high
19 threshold of "undue prejudice" is defined as "[t]he harm resulting from a fact-trier's being exposed
20 to evidence that is persuasive but inadmissible (such as evidence of prior criminal conduct) or that
21 so arouses the emotions that calm and logical reasoning is abandoned," that may result in a
22 "preconceived judgment formed with little or no factual basis"); *State v. Lemming*, 188 Ariz. 459,
23 462, 937 P.2d 381, 384 (App. 1997)(upholding trial court's refusal to dismiss case on basis that

24 _____
25 ⁴ Respondents' Motion is even devoid of a declaration or a verified statement to the ALJ that Smoot will
26 actually or absolutely testify in this case. Rather, the Motion is merely couched in terms of Smoot's
"dilemma," or obvious ability to decide whether or not to testify in this case. (Motion, pp. 3:23 to 4:6; pp.
6:25 to 7:4). Absent such a definitive declaration or verification, Smoot's Fifth Amendment rights
"implication" argument lacks merit.

1 defendant's trial was delayed by 20 months by prosecution during which time some witnesses died,
2 court of appeals noted that, "while the Defendant may have shown some prejudice, he has not
3 shown actual and substantial prejudice...To show actual and substantial prejudice under federal
4 case law, the defendant's ability to meaningfully defend himself must actually be impaired."⁵

5 In determining whether Smoot will suffer undue/substantial prejudice should this matter not
6 be stayed, the ALJ may consider whether a decision in this matter will preclude Smoot from
7 litigating any overlapping issues in his criminal case. *See e.g., Bonneville Auto. Ins. Co. v.*
8 *Insurance Division, Dept. of Commerce*, 632 P.2d 796, 800-801 (Or. App., 1981) (stay of
9 administrative insurance matter pending resolution of two consolidated civil lawsuits involving
10 same matter was properly denied because agency had "primary responsibility for enforcing the
11 Insurance Code...To hold that the Division had to delay its consideration of the disciplinary matter
12 pending the outcome of related litigation would frustrate its enforcement efforts," and because
13 administrative decision would not bind insurance agent/defendant in his civil cases). It will not.

14 Here, a final decision in this matter will not be res judicata, or bar Smoot from re-litigating
15 any similar issues in Smoot's criminal case because the Maricopa County Attorney's Office is not a
16 party to this matter. *See e.g., Chaney Building Co. v. City of Tucson*, 148 Ariz. 571, 573, 716 P.2d
17 28, 30 (1986)("Under the doctrine of *res judicata*, a judgment 'on the merits' in a prior suit
18 involving the same parties or their privies bars a second suit based on the same cause of action.").

19 Second, the doctrine of collateral estoppel or issue preclusion will similarly not preclude
20 Smoot from litigating issues decided in this matter in his criminal case. Generally, collateral
21 estoppel may operate to preclude a party from re-litigating an issue in a second matter if, among
22 many other things, "the issue or fact to be litigated was actually litigated in a previous suit..."
23 *Chaney*, 148 Ariz. at 573, 716 P.2d at 30. However, several exceptions to the application of
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25

26 ⁵ *See e.g., Mein v. Cook*, 219 Ariz. 96, 99, fn. 2, 193 P.3d 790, 793, fn. 2 (App. 2008) ("If the legislature has not defined a word or phrase in a statute, we will consider respected dictionary definitions.").

1 collateral estoppel are present in this case and are stated, without limitation, in the *Restatement*
2 (*Second*) of *Judgments* § 28 (1982) adopted by Arizona courts:

3 (3) A new determination of the issue is warranted by differences in the quality or
4 extensiveness of the procedures followed in the two courts or by factors relating to
the allocation of jurisdiction between them; or

5 (4) The party against whom preclusion is sought had a significantly heavier burden
6 of persuasion with respect to the issue in the initial action than in the subsequent
7 action; the burden has shifted to his adversary; or the adversary has a significantly
heavier burden than he had in the first action...⁶

8 In this case, findings resulting from the administrative hearing in this case would not be binding on
9 Smoot in his criminal case because: (a) there are large differences in the quality and extensiveness
10 of the discovery procedures and evidentiary standards; (b) the burden's of proof between the two
11 actions are quite different; and (c) again, the Maricopa County Attorney's Office is not a party to
12 this matter. Because a final decision in this matter will not be res judicata or collateral estoppel on
13 Smoot in his criminal case, Respondents cannot meet their high burden of proving that allowing
14 this case to proceed will unduly or substantially prejudice Smoot's constitutional rights.

15 Conversely, though the Division would seek to use all or a portion of any criminal findings
16 against Smoot in this matter, the fact remains that an evidentiary hearing would still have to be
17 commenced and conducted in order to generate a record sufficient for the ALJ to issue a
18 recommended decision, and to support such decision on appeal. Indeed, the criminal case does not
19 even include a securities fraud charge under A.R.S. § 44-1991.

20 Presumably unlike Smoot's criminal case, the Division's Notice also seeks a permanent
21 injunction barring Respondents from further violations of the Act. (Notice, at Requested Relief, p.
22 31, ¶1). In response, Respondents argue that they promise not to violate the Act pending a
23

24
25 ⁶ See e.g., *Hullett v. Cousin*, 204 Ariz. 292, 298, 63 P.3d 1029, 1035 (2003) (applying § 28, Arizona
26 Supreme Court upheld trial court's refusal to apply the harsh doctrine of collateral estoppel noting that,
"even in cases in which the technical requirements for the application of collateral estoppel are met, courts
do not preclude issues when special circumstances exist.").

1 resolution of the criminal and administrative matters. (Motion, p.6:4-6, “Mr. Smoot will not be
2 offering securities of any kind during...” a requested stay.”). However, Arizona courts agree that a
3 respondents’ mere promise not to engage in any future violations of the Act is not a valid reasons
4 for denying the important remedy of a permanent injunction. As noted by the Arizona Court of
5 Appeals in *State ex rel. Corbin v. Goodrich*, 151 Ariz. 118, 726 P.2d 215 (App. 1986), for example:

6 Counsel for Goodrich argues without supporting affidavits from Goodrich himself
7 that Goodrich had no intention of violating Arizona law and does not intend to do so
8 in the future. Such promises, even if supported by Goodrich's own statements, do
9 not affect the power of the court to grant injunctive relief... In addition, this court
10 need not consider such promises...The trial court could properly infer the likelihood
11 of future violations by considering the amount of investor money received by
12 defendants (over \$248,000 during a six-month period), the repeated violations
13 during that period (estimates of over 90 deferred delivery contracts), Goodrich's
14 intent (lack of disclosure of the Iowa cease and desist order) and defendants’ own
15 conduct (lack of affidavit from Goodrich and failure to admit wrongdoing)...This is
16 not a case where “events make it absolutely clear the allegedly wrongful behavior
17 could not reasonably be expected to recur.” [Thus] [t]he trial court could reasonably
18 conclude that Goodrich’s telephone and mail solicitation was likely to continue.
19 There is no evidence of mootness.

20 *Goodrich*, 151 Ariz. at 125-26, 726 at 222-23 (holding that securities seller’s promises not to
21 violate Act or Consumer Fraud Act in future and statements that seller had no intention of violating
22 law did not affect power of trial court to grant preliminary injunction and did not render injunction
23 moot, and court held there was sufficient evidence to support upholding Commission’s order of the
24 permanent injunction). Moreover, Respondents even deny that they offered and sold the three
25 types of securities at issue in this case including investment contracts, stock and unsecured notes.
26 (See e.g., Answer, p. 7, ¶59, “Notes executed by Smoot on a personal basis are not within the scope
of this Notice; p. 14, ¶4, “Respondents allege that no securities are involved in the alleged
transactions.”). Thus, Smoot’s unverified assertion that he will not sell any “securities” during the
pendency of this case is disingenuous at best, and should be ignored.

Because: (a) Smoot may invoke his Fifth Amendment rights in this case; (b) Respondents’
can present their case via documentary evidence and witness testimony; and (c) Smoot will not be
unduly or substantially prejudiced should this matter proceed to an evidentiary hearing now,

1 Respondents' Motion should be denied.

2 **4. Staying This Proceeding Will Negatively Impact The Investor Victims At Issue**
3 **And Improperly Impair the Commission's Constitutional Mandate To Enforce**
4 **The Securities Act.**

5 Respondents claim that a stay of this matter will "be a minor inconvenience to the
6 Commission, especially when compared to civil stays that are issued automatically upon a party's
7 bankruptcy..." (Motion, pp. 5:21 to 6:4) (Emphasis added).

8 However, in recognition of the high importance of securities regulation for the protection of
9 investors above and beyond even a Chapter 7 debtor's bankruptcy rights, 11 U.S.C. § 362(b)(4) was
10 amended in 1990 to exempt this administrative securities enforcement action from an automatic
11 stay. *See, also, SEC v. Towers Financial Corporation*, 205 B.R.27, 28-31 (S.D.N.Y. 1997)(court in
12 *Towers* noted that according to the, "Ninth Circuit Court of Appeals, the policy behind §362(b)(4)
13 is to prevent the bankruptcy court from becoming a haven for wrongdoers."⁷ As the *Towers*
14 Court stated:

15 Where a governmental unit is suing a debtor to prevent or stop violation of fraud, ...
16 or similar police or regulatory laws, or attempting to fix damages for violations of

17 ⁷ Section 362(b)(4) provides the automatic stay does not apply to:

18 . . . the commencement or continuation of an action or proceeding by a
19 governmental unit . . . to enforce such governmental unit's . . . police and regulatory power,
20 including the enforcement of a judgment other than a money judgment, obtained in an
21 action or proceeding by the governmental unit to enforce such governmental unit's . . .
22 police or regulatory power.

23 Thus, Section 362(b)(4) permits the government to initiate or continue an action under its police or
24 regulatory powers without the restrictions of the automatic stay. *In Re Universal Life Church, Inc.*, 128
25 F.3d 1294, 1297 (9th Circuit 1997); 3 Collier on Bankruptcy § 362.05[5][b], at 362-58 (15th ed. 1996). The
26 purpose of this exception is to prevent a debtor from "frustrating necessary governmental functions by
seeking refuge in bankruptcy court." *S.E.C. v. Brennan*, 230 F.3d 65, 71 (2nd Cir. 2000). To prevent
bankruptcy from becoming "a haven for wrongdoers," the automatic stay should not prevent governmental
regulatory, police and criminal actions from proceeding. *In Re Universal Life Church, Inc.*, 128 F.3d at
1297; 3 Collier on Bankruptcy § 362.05[5][a], at 362-54 (15th ed. 1996). The legislative history of §
362(b)(4) indicates that when a governmental unit brings a legal action against a debtor in order "to prevent
or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or
regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not
stayed under the automatic stay." S.Rep. No. 95-989 at 52 (1977), reprinted in 1978 U.S.C.C.A.N. 5787,
5838; H.R.Rep. No. 95-595 at 343 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6299; *In Re Universal Life
Church, Inc.*, 128 F.3d at 1298.

1 such law, the action or proceedings is not stayed under the automatic stay.
2 *Id* at 29-30 (citing *S.Rep.No.95-989* at 52, reprinted in 1978 U.S. Code Cong. and Admin.News at
3 5787, 5838, court held that SEC's action against Chapter 7 debtor, arising from alleged Ponzi
4 scheme involving sale of promissory notes, which sought injunctive relief and disgorgement from
5 debtor, was not stayed under automatic stay, as it was instituted by governmental unit to protect
6 public from future fraud, rather than for pecuniary gain);⁸ *also*, Decision No. 71160, at ¶¶24, 30-32,
7 44 (finding that debts arising from violations of the Act are non-dischargeable in bankruptcy
8 proceedings).

9 This exemption also applies to a bankruptcy proceeding filed by a Chapter 11 debtor. *See*
10 *In re Knoell*, 160 B.R. 825, 826 (D. Ariz. 1993)(automatic stay did not preclude investigation by
11 Arizona Corporation Commission regarding possible violations of state securities laws;
12 investigation fell within Commission's police or regulatory powers).

13 The Commission is constitutionally and legislatively tasked with enforcing the Arizona
14 Securities Act to protect the integrity of the financial markets, the public and investors.⁹ Courts
15 routinely give great weight to an agency's regulatory power when deciding whether to stay a civil
16 or administrative action. *See, Federal Sav. And Loan Ins. Corp. v. Molinaro*, 889 F.2d 899, 902-03
17 (9th Cir. 1989)(held that district court's refusal to stay an administrative agency's civil action
18 against sole shareholder for breach of fiduciary duty to savings and loan after his arrest by the FBI

19 _____
20 ⁸ The legislative history of the 1990 amendment to § 362 sheds additional light on the government
21 exemption from the automatic stay:

22 Section 362(b)(4) indicates that the stay under section 362(a)(1) does not apply to affect the
23 commencement or continuation of an action or proceeding by a governmental unit to enforce
24 the governmental unit's police or regulatory power. **This section is intended to be given a
25 narrow construction in order to permit governmental units to pursue actions to protect
26 the public health and safety** and not to apply to actions by a governmental unit to protect a
pecuniary interest in property of the debtor or property of the estate.

24 *Towers*, 205 B.R. at 29 (emphasis added).

25 ⁹ *See e.g., Siporin v. Carrington*, 200 Ariz. 97, 98, 23 P.3d 92, 93 ("By legislative design, the Arizona
26 Securities Act protects the public by preventing dishonest promoters from selling financial schemes to
unwary investors who have little or no knowledge of the realistic likelihood of the success of their
investments.").

1 was not abuse of discretion; court determined, in part, that agency would be prejudiced by delay
2 since shareholder continued to attempt to dispose of his assets, action had been pending for years
3 and the court had interest in clearing its docket, and interest of nonparties including depositors and
4 the public would be frustrated by further delay); *Keating*, 45 F.3d at 325-26 (the public's interest in
5 a speedy resolution of the controversy and agency's concern for efficient administration would
6 have been unnecessarily impaired had the proceeding been stayed, and any delay would have been
7 detrimental to public confidence in the enforcement scheme for thrift institutions).

8 Applied here, the ALJ should give great weight to the Division's securities regulatory
9 enforcement powers and allow this matter to proceed so that the Division can attempt to protect the
10 investor interests at issue. This matter also brought well prior to the criminal case, and should not
11 be further delayed in the interests of justice.

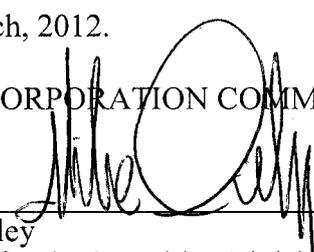
12 Finally, Respondents' Motion improperly fails to consider the prejudice to the many
13 investors at issue in this case should it be indefinitely stayed. Again, Respondents cannot even
14 estimate as to exactly when the criminal case will be resolved. The longer this matter is delayed,
15 the longer investors will have to wait for a resolution of the allegations set forth in the Division's
16 Notice. Because the Division's right to enforce the Act and the rights of the victim investors in
17 this case outweigh any possible prejudice to Smoot should this matter proceed, Respondents'
18 Motion should be denied.

19 **D. CONCLUSION.**

20 Based on the foregoing, the Division respectfully requests that Respondents' Motion to
21 indefinitely stay this matter be denied.

22 RESPECTFULLY SUBMITTED this 20th day of March, 2012.

23 ARIZONA CORPORATION COMMISSION

24
25 By  _____
26 Mike Dailey
Attorney for the Securities Division of the
Arizona Corporation Commission

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2 filed this 20th day of March, 2012 with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 W. Washington St.
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8 this 20th day of March, 2012 to:

9 Marc E. Stern
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11 Arizona Corporation Commission/Hearing Division
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