

ORIGINAL

OPEN MEETING AGENDA ITEM



0000135585

RECEIVED  
AZ CORP COMMISSION  
DOCKET CONTROL

Richard Lieberman #009754  
Jennings, Strouss & Salmon, PLC  
One East Washington St.  
Suite 1900  
Phoenix, AZ 85004-2554  
602-262-5935 (direct)  
602-495-2795 (fax)  
[rliberman@jsslaw.com](mailto:rliberman@jsslaw.com)

2012 APR 2 PM 1 14

Arizona Corporation Commission

DOCKETED

APR - 2 2012

DOCKETED BY  
MMW

**BEFORE THE ARIZONA CORPORATION COMMISSION**

COMMISSIONERS

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

In the matter of:

Morgan Financial, L.L.C., an Arizona  
limited liability company

Jimmy Hartgraves, Jr. and Laurie  
Hartgraves, husband and wife

Respondents.

DOCKET No. S-20719A-09-0583

**Response by Michael and Kathryn  
Graf to Exceptions to Order of  
Morgan Financial and Hartgraves  
and Recommended Restitution  
Order for Their Damages**

Victims Michael and Kathryn Graf (the "Graf's") respectfully submit this response to the Exceptions to Order (the "Exceptions") filed by Morgan Financial and Jimmy and Laurie Hartgraves (collectively, "Respondents"), to correct mischaracterizations of the facts and to respond to the incorrect legal analysis noted in the Exception. In addition, the Graf's request that the Commission increase the amount of restitution to be awarded to them, as the proposed order does not compensate them for all of their statutorily permitted damages.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

1. Mischaracterizations of Facts:

In their Exceptions, Respondents suggested that the Grafts were sophisticated investors experienced in real estate investing and making "hard money" loans. To support that contention, they suggested that Mrs. Graf is an attorney, and that her father had experience in loan underwriting and real estate. The contentions of Respondents stretch reality to the breaking point and do not represent the true facts.

In fact, the Grafts do NOT have ANY experience investing in real estate (other than their personal residence) or in making hard money loans. Mrs. Graf attended law school from 1996-99 and practiced estate planning and probate from 1999-2001 in Ohio for two years. During law school, she took not a single class involving real estate. During two years in practice, she dealt with no real estate transactions. She has not practiced as an attorney in well over a decade. Mrs. Graf reiterated to Mr. Hartgraves on numerous occasions that she was not a practicing attorney and that, in any case, her field had been estate planning, not real estate law, so she was no more aware of mortgage transactions than anyone off the street.

In addition, her father, Mr. Michael Sullivan, has no experience in real estate investing. He worked as a surety bond underwriter, evaluating companies to ascertain whether their surety bonds were sufficient in case they could not complete the construction projects for which they were bidding. That is NOT real estate investing or hard money lending experience. Respondents are misrepresenting the facts.

Moreover, this mischaracterization demonstrates the extent to which Respondents are attempting to justify, in hindsight, their actions with respect to the Grafts. When the original notes were sold to the Grafts, Mr. Hartgraves did not provide disclosure documents sufficient to qualify the offering of those notes under applicable securities law exemptions. At that time, he never attempted to determine their investment experience, such as to have them complete an investor questionnaire or subscription agreement. He did not attempt to determine whether they were accredited investors. (In fact, because he

1 had taken their mortgage information, he knew that they were not accredited.) Instead,  
2 rather than to comply with the securities laws, Mr. Hartgraves convinced the Grafts that  
3 they should borrow additional money on their own house (which loan he arranged for  
4 them for a fee) to allow them to invest money with his company, Morgan Financial. The  
5 Grafts are not sophisticated (or accredited) investors, and they are the kinds of investors  
6 for whom the securities laws are designed to protect.

7 The status of Mrs. Graf as an attorney does not, by itself, suggest that she is  
8 sophisticated in these matters. To suggest otherwise is to assert that any person with  
9 legal or professional training would be a “sophisticated investor.” Instead, the securities  
10 laws contemplate sophistication and experience in making the kinds of investments being  
11 offered for sale, not just being an intelligent person. The Grafts did not have experience  
12 in evaluating the risks and merits of investing in real estate or hard money lending.

13 2. The Offering of Notes to the Grafts Was Not Exempt from Registration  
Under the Securities Laws.

14 Respondents attempt to characterize the notes offered to the Grafts as “commercial  
15 paper,” which is an exempt security. In fact, the amended subordinated promissory note  
16 issued to the Grafts in March 2009 included an agreement not to demand repayment of the  
17 note for at least two years from the date of that amendment. Nothing on its face required  
18 the note to be due in nine months or less. To qualify as commercial paper, the note must  
19 mature within nine months from the date of issue. See A.R.S. § 44-1843.8 (“Commercial  
20 paper . . . evidences an obligation to pay cash within nine months of the date of issuance  
21 or sale . . . or any renewal of such paper that is likewise limited . . . .”)(emphasis added).  
22 Accordingly, the amended note did not qualify as commercial paper. Thus, it was not an  
23 exempt security.

24 3. The Offering of Notes to the Grafts Was Not Made in Compliance with  
25 Applicable Exemptions from Federal or Arizona Securities Laws.

1           Because the notes were securities under Federal and Arizona securities laws,  
2 Respondents needed to comply with applicable exemptions from registration to avoid the  
3 requirements that they register the offering and also that they be licensed as securities  
4 dealer or salesmen. They failed to demonstrate in their Exceptions that the offering was  
5 exempt pursuant either Federal or Arizona securities laws.

6           Respondents appear to imply that the offering qualified for the “Regulation D”  
7 exemption on the Federal level, and Arizona’s counterpart, “Rule 126,” when they assert  
8 that the Grafts were “sophisticated investors.” (Selling to sophisticated investors is  
9 permitted pursuant to those rules if the other requirements of those rules are satisfied.)  
10 As the record demonstrates, as set forth in the proposed Order by the Magistrate, the  
11 Grafts were not accredited investors. (See Tr. 29-30: 13-2 and the Proposed Order at  
12 ¶16.) As such, both Regulation D and Arizona Rule 126 would therefore require that the  
13 issuer of securities provide specified information concerning the offering to the investors  
14 at the time of the offer and sale of the securities to qualify for those exemptions, if any of  
15 the purchasers were not accredited investors. Respondents failed to provide the required  
16 information and only gave the Grafts the note itself. Thus, it would not matter how  
17 sophisticated were the Grafts – Regulation D and Rule 126 were not available to  
18 Respondents, as they failed to comply with the express provisions of those rules.

19           Respondents also appear to be attempting to rely on the disclosures provided to the  
20 other victims through the exchange offer made in 2010 to indicate that they gave  
21 appropriate information to the Grafts back in 2006 and 2009 when Respondents issued the  
22 notes to them. The Grafts did not accept the exchange offer, and those late disclosures  
23 would not serve to cure the original misrepresentations or material omissions made when  
24 the Grafts invested in the notes. The Grafts were induced to invest in debt securities  
25 offered by Respondents without the benefit of any information or disclosures, in violation  
26 of Federal and Arizona law. Respondents did not qualify that offering of securities  
pursuant to any exemption available under Federal and Arizona law, and Respondents

1 were not licensed securities dealers or salesmen, as required. Accordingly, the Grafts  
2 should be entitled to full restitution of the amounts they invested with or through  
3 Respondents, plus interest and attorneys' fees incurred by them in pursuing recovery of  
4 their damages.

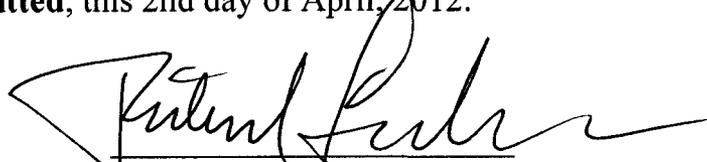
5 4. The Damages in the Recommended Order Do Not Fully Compensate the  
6 Grafts for Their Damages.

7 The Grafts invested \$100,000.00 with Respondents, which was derived from the  
8 then-existing equity on their home, at the urging of Respondents. Respondents paid them  
9 \$33,000.00 of interest, but none of their principal has been returned. Hence, they should  
10 be paid the full \$100,000.00 of their principal back, plus their attorney's fees.

11 Alternatively, they should be paid the \$67,000.00 difference owed to them plus interest at  
12 the judgment rate plus attorneys' fees. See A.R.S. § 44-2001.A. Respondents will tender  
13 the Note issued to them in exchange for payment of the appropriate amount.

14 Accordingly, the Grafts respectfully request that the Commission increase the amount of  
15 restitution to be awarded to the Grafts by one of those formulas, and that it include an  
16 award for all of their attorneys' fees incurred. To date, those amounts have exceeded  
17 \$10,000.00.

18 **Respectfully submitted**, this 2nd day of April, 2012.

19  
20 

21 Richard Lieberman  
22 Jennings Strouss & Salmon, PLC  
23 One E. Washington St., 19<sup>th</sup> Floor  
24 Phoenix, AZ 85004-2554  
25 Attorneys for the Grafts  
26

1 Original and 13 copies filed  
2 this 2nd day of April, 2012  
3 with the Arizona Corporation Commission  
4 Docket Control Center

5 Copies hand-delivered this same date to:

6 Administrative Law Judge Marc E. Stern  
7 Arizona Corporation Commission, Securities Division  
8 1200 W. Washington St.  
9 Phoenix, AZ 85007

10 Ernest G. Johnson, Executive Director  
11 Arizona Corporation Commission  
12 1200 W. Washington St.  
13 Phoenix, AZ 85007

14 Matthew J. Neubert, Director  
15 Arizona Corporation Commission, Securities Division  
16 1200 W. Washington St.  
17 Phoenix, AZ 85007

18 Phong (Paul) Huynh, Esq.  
19 Arizona Corporation Commission, Securities Division  
20 1200 W. Washington St.  
21 Phoenix, AZ 85007

22 Charles R. Berry, Esq.  
23 Melissa S. Ho, Esq.  
24 Polsinelli Shugart PC  
25 One E. Washington St.  
26 Suite 1200  
Phoenix, AZ 85004  
Attorneys for Respondents