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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED
AUG 21 2012
DOCKETED BY

COMMISSIONERS

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

IN THE MATTER OF:

MORGAN FINANCIAL, L.L.C., an Arizona limited liability company;

MORGAN FINANCIAL LENDERS, L.L.C. an Arizona limited liability company; and

JIMMY HARTGRAVES, JR. and LAURIE HARTGRAVES, husband and wife,

RESPONDENTS.

DOCKET NO. S-20719A-09-0583

DECISION NO. 73358

OPINION AND ORDER

DATES OF PRE-HEARINGS AND STATUS CONFERENCES:	March 9, April 26, and November 2, 2010
DATES OF HEARING:	April 26, May 16 and May 17, 2011
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Marc E. Stern
APPEARANCES:	Mr. Charles R. Berry and Ms. Melissa S. Ho, POLSINELLI SHUGHART PC, on behalf of Morgan Financial, L.L.C., Morgan Financial Lenders, L.L.C., and Jimmy Hartgraves Jr. and Lauri Hartgraves; and Mr. Phong Paul Huynh, Staff Attorney, Securities Division, on behalf of the Securities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On December 30, 2009, the Securities Division ("Division") of the Arizona Corporation Commission ("Commission") filed a Notice of Opportunity for Hearing ("Notice") against Morgan Financial, L.L.C., an Arizona limited liability company ("MF") and Jimmy Hartgraves, Jr. and Laurie Hartgraves, husband and wife, (collectively "Respondents") in which the Division alleged multiple violations of the Arizona Securities Act ("Act") in connection with the offer and sale of securities in the form of notes.

The Division stated that Respondent Laurie Hartgraves ("Respondent Spouse") was joined pursuant to A.R.S. § 44-2031(C) solely for the purpose of determining the liability of the marital community.

The Respondents were duly served with copies of the Notice.

On January 28, 2010, a request for hearing was filed by Respondents.

On February 2, 2010, by Procedural Order, a pre-hearing conference was scheduled on February 25, 2010.

On February 12, 2010, a Stipulation to Continue the pre-hearing conference was filed by the parties stating that due to conflicts in Respondents' counsel's schedule a continuance was necessary. Subsequently, by Procedural Order, the pre-hearing conference was continued to March 9, 2010.

On March 9, 2010, the Division and Respondents appeared through counsel at the pre-hearing conference. Counsel for the Division indicated that discussions were being conducted with Respondents' counsel and requested that a status conference be scheduled in approximately 45 days.

On March 10, 2010, by Procedural Order, a status conference was scheduled on April 26, 2010.

On April 26, 2010, the Division and Respondents appeared through counsel at the status conference. The Division and Respondents indicated that they were continuing to attempt to settle the proceeding, but indicated that a brief hearing should be scheduled in late August or September to avoid scheduling conflicts.

On April 26, 2010, by Procedural Order, a hearing was scheduled on September 1, 2010, and a deadline for the exchange of Witness Lists and copies of Exhibits was set for August 2, 2010.

On July 27, 2010, the Division and Respondents filed a stipulation to continue the hearing and a deadline for the exchange of documentation because the parties were close to reaching a settlement.

On July 30, 2010, by Procedural Order, the hearing was continued to November 2, 2010, and a date established for the exchange of Witness Lists and copies of Exhibits.

On September 28, 2010, a Notice of Appearance was filed by a new attorney for the Respondents.

On November 2, 2010, the Division and Respondents filed a Joint Stipulation to Continue the proceeding for at least 60 days. The parties stated that additional time was needed to review and

investigate the matter based on facts recently brought to the Division's attention and that the parties required more time to discuss settlement.

On November 3, 2010, by Procedural Order, the proceeding was continued to January 13, 2011, and other procedural matters addressed.

On December 21, 2010, the Division filed a Motion to Amend the Notice due to additional issues raised during the Division's investigation of the Respondents. The Division also named an additional Respondent, Morgan Financial Lenders, L.L.C. ("MF Lenders").

On January 6, 2011, Respondents filed a Stipulated Motion to Continue ("Stipulation") the hearing scheduled on January 13, 2011. Respondents, in the Stipulation, indicated that they did not oppose the amendment of the Notice. The Respondents and the Division further stipulated to a continuance of at least 60 days to address the new issues raised by the amendment of the Notice and to continue to discuss a possible settlement.

On January 7, 2011, by Procedural Order, leave was granted for the amendment of the Notice, the hearing was continued and the parties were granted leave to exchange or amend the copies of their Witness Lists and Exhibits, if the proceeding was not settled in a timely fashion.

On January 13, 2011, the Division filed its amended Notice which added additional allegations concerning MF Lenders and allegations in connection with the offer and sale of securities in the form of investment contracts.

On April 26, 2011, the proceeding was convened before a duly authorized Administrative Law Judge of the Commission at its offices in Phoenix, Arizona. The Division and Respondents appeared with counsel. At the outset, the parties conducted additional settlement discussions. Since no agreement was reached, and because it appeared that the hearing would be more lengthy than previously thought, the parties agreed that the proceeding should be continued to the week of May 16, 2011.

On May 9, 2011, by Procedural Order, the hearing was continued as agreed by the parties to May 16, 2011.

On May 16, 2011, the proceeding was reconvened at the offices of the Commission in Phoenix, Arizona. The Division and Respondents appeared with counsel. Following the presentation

of evidence, the matter was taken under advisement pending submission of a Recommended Opinion and Order to the Commission.

On August 1, 2011, the Division and Respondents filed their post-hearing briefs in the proceeding.

On September 28, 2011, by Procedural Order, to clarify the standing of payments to investors, Respondents were ordered to file a memorandum to address the status of the following matters: the amount of each investor's funds (i.e. principal) remaining with Respondents; the amount of principal and interest which has been repaid or paid to each investor; the number of properties that have been sold from the portfolio and their selling prices; the number of properties which remain to be sold; and the date when the expected distribution of profits will be made to investors. Lastly, the date of termination of the Master Repurchase Agreement ("Repurchase Agreement") between Merrill Lynch Mortgage Capital Inc. ("Merrill Lynch Capital") and the various MF entities was to be disclosed and any possible consequences to the members of MF Lenders. The Procedural Order also ordered the Division to file a response to Respondents' filing.

On October 12, 2011, Respondents filed a memorandum which contained the information requested in the September 28, 2011, Procedural Order.

On October 26, 2011, the Division filed a response to Respondents' memorandum.

On November 14 and December 15, 2011, Respondents filed additional memoranda to supplement their payment information.

On December 22, 2011, the Division filed a response to Respondents' later filings.

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. According to the records of the Commission, MF is a limited liability company organized in Arizona on July 15, 1996.

2. MF is managed by its members, and Respondent Jimmy Hartgraves, Jr. is the managing member and controlling person of the company.

3. MF Lenders is a limited liability company organized in Arizona on May 12, 2010, and is managed by MF.

4. Respondent Laurie Hartgraves is an individual who, at all relevant times herein, was an Arizona resident and the spouse of Jimmy Hartgraves, Jr.

5. In Respondent's Answer to the amended Notice, it was admitted that Respondent Jimmy Hartgraves, Jr. was acting for his own benefit or in furtherance of his and Respondent spouse's marital community.

6. On December 30, 2009, the Notice was filed in this proceeding and subsequently amended on January 13, 2011, wherein it was alleged that Respondents Jimmy Hartgraves, Jr., MF, and MF Lenders had committed multiple violations of the Act in connection with the offer and sale of securities in the form of notes and/or investment contracts. It was alleged that Respondents committed registration violations in violation of A.R.S §§ 44-1841 and 44-1842.

7. In support of the allegations raised in the amended Notice with respect to Respondents' alleged violations of the Act, the Division called two investor witnesses to testify, Mr. Michael Graf and Mr. Stephen Barnes. Mr. Michael Brokaw, a special investigator with the Division, also testified concerning the allegations.

8. Based on the record, from October 1996 through July 2008, MF was a licensed mortgage broker with the Arizona Department of Financial Institutions ("ADFI"). On or about July 10, 2008, MF obtained a mortgage banker's license from ADFI which allowed MF to directly or indirectly make, negotiate, or offer to make or negotiate a mortgage banking loan or a mortgage loan.

9. The primary business of MF was to originate residential mortgage loans and hard money loans, which are asset-based loan financings through which a borrower receives funds and the repayment obligations are secured by specifically referenced collateral, generally real estate owned by the borrower by utilizing a deed of trust.

10. Mr. Graf identified a document which was termed a "subordinated promissory note" in the amount of $100,000 dated November 7, 2006, which promised to pay to the order of Michael D. Graf and Kathryn S. Graf $100,000 at a rate of 15 percent per annum. (Tr. 24:4-23) (Ex. S-4)

11. MF was the maker of the note and it had been signed by Mr. Hartgraves as its

manager. (Tr. 25: 4-7)

12. According to Mr. Graf, he and his wife had first dealt with Mr. Hartgraves when they obtained a first mortgage on their residence from him in July 2004. (Tr. 25: 23-25)

13. Mr. Graf testified that he understood that by lending $100,000 to MF in return for the note the funds "would become part of a pool of money from other lenders that would be used for providing loans for construction." (Tr. 26: 9-14)

14. Mr. Graf was unaware whether the money loaned to MF would be allocated to a particular property or project. In order to make their loan of $100,000 to MF, the Grafs refinanced their home with MF at the time. (Tr. 26-27: 20-5)

15. Based on the record, Mr. Graf had little experience in investing in real estate or in making loans for hard money transactions.

16. According to Mr. Graf, the Respondents had not discussed whether he was an "accredited investor" when the loan was made. At the time of the Grafs' investment, they did not have a net worth of over $1 million; Mr. Graf's salary was not in excess of $200,000; and the Grafs' combined salaries did not exceed $300,000 in the prior year. (Tr. 29-30: 13-2)[1]

17. The terms of Mr. Graf's subordinated promissory note indicated that it was a demand note, payable within 90 days following a demand by the Grafs to MF for payment. (Ex. S-5F)

18. Mr. Graf testified that he and his wife knew that another company, Capital Source Financial, LLC, ("Capital Source") had loaned funds to MF also and understood that the repayment of their funds would be subordinated to any payments that were required to be made to Capital Source. (Tr. 31: 7-18)

19. Mr. Graf stated that he and his wife executed a subordinated note with MF in November 2006, and in December 2006, they received their first interest payment of $1,500 based on the promised 15 percent return on their $100,000 investment. These monthly payments continued until February or March 2009. (Tr. 33-34: 10-2)

20. During the time that the Grafs received their interest payments, they received a total of approximately $33,000. (Tr. 34: 3-7)

[1] By definition, the Grafs did not qualify as accredited investors pursuant to A.A.C. R14-4-126.

21. After their payments stopped in February 2009, the Grafs made a demand on March 8, 2011, for a return of their principal investment and any interest due. (Tr. 35: 13-21)

22. Based on the date the Grafs made their demand for the return of their funds together with interest, the date upon which payment was due after 90 days would have been June 8, 2011. As of the date of the hearing, an agreement had not yet been concluded for the repayment of their funds. (Tr. 35-36: 22-12)

23. Further testifying, Mr. Graf identified what was termed an "Exchange Memorandum" dated May 7, 2010, which the Grafs received in an email from Mr. Hartgraves.[2] (Tr. 37: 2-17) (Ex. S-8)

24. At its outset, the memorandum states as follows:

> "This Exchange Offer is being made jointly by Morgan Financial, LLC, an Arizona limited liability company ("Morgan Financial") that is a registered mortgage banker in Arizona, and Morgan Financial Lenders, LLC, a newly formed Arizona limited liability company (the "Company"). The Company was created for a single purpose – to consolidate existing unsecured subordinated promissory notes issued by Morgan Financial (the "Old Notes") into one subordinated, secured loan with a principal amount of up to $6,234,559 (the "Loan") of the Company to Morgan Financial."[3] (Ex. S-8)

25. The introductory paragraph of the Exchange Memorandum stated that the loan would pay interest at the rate of eight percent per year which would accrue from March 1, 2009, on the full amount of principal, plus additional interest equal to one-half of all net profits, if any, generated from MF's management of what was termed the "loan portfolio." The memorandum stated that the stated interest of eight percent and additional interest would be payable solely from revenues generated from a specific portfolio of loans which MF acquired from Merrill Lynch Bank USA ("Merrill Lynch"). (Ex. S-8)

26. The Exchange Memorandum also stated that the only business of MF Lenders was to make the loan to MF and that no ownership interest in MF or its business would result. (Ex. S-8)

27. Referring to the Exchange Memorandum, Mr. Graf testified that it stated MF would act as the manager of MF Lenders. (Tr. 40: 17-19)

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[2] The Respondents developed the Exchange Memorandum investment as an alternative to provide the approximately 35 investors/lenders a means to recover their monies from their subordinated promissory notes after the real estate market collapsed.

[3] The amount included the approximate value of all loans which had been made to MF by investors/lenders including approximately $895,000 by the Hartgraves Respondents.

28. As described in the memorandum, Mr. Graf testified that the loan by MF Lenders to MF would be secured by a collateral assignment of MF's rights relative to the loan portfolio which would be subordinate to a lien securing a Merrill Lynch loan to MF of approximately $23,721,942. (Tr. 41: 4-15)

29. According to the Exchange Memorandum, Mr. Graf testified that the investors' old subordinated notes were to be exchanged for a pro-rata share of the membership interests in MF Lenders. (Tr. 41: 17-24)

30. Further, Mr. Graf stated that interest at eight percent per year was to be paid to investors from March 1, 2009, retroactively and that once all loans or debts of MF were paid off to Merrill Lynch, then the members of the MF Lenders would share equally in any net profits with MF for its management of the portfolio. (Tr. 42: 3-16)

31. Mr. Graf testified that, according to the Exchange Memorandum, MF intended to repay the loan from the members of MF Lenders within approximately 30 months from the date of the Exchange Memorandum. (Tr. 43: 2-8)

32. Mr. Graf stated that he believed he had the potential to recover his entire investment plus interest together with profits, according to the Exchange Memorandum. (Tr. 43: 19-22)

33. Although Mr. Graf stated that he was not a member of MF Lenders, he testified that he understood that the company's members would have a second priority behind a first lien which secured the repayment of the Merrill Lynch loan to MF. (Tr. 44: 1-11)

34. Referring to the memorandum, Mr. Graf described how, in May 2008, for approximately $33 million, MF was able through a wholly-owned subsidiary, Morgan AZ Financial, LLC ("MAF"), to acquire the portfolio of loans from Merrill Lynch which had been originated by a bankrupt lender. (Tr. 44: 20-25)

35. The loan portfolio consisted of construction loans to individuals and builders for custom homes and had principal balances totaling $50,200,000. The memorandum described the properties as being located in the following states: Arizona, 50 properties; California, 13 properties; Washington, 2 properties; and Nevada, 1 property. MF paid $2 million at closing with the balance financed by Merrill Lynch for approximately $31 million. The memorandum disclosed that Merrill

Lynch held a first lien on the loan portfolio and disclosed that 40 properties remained in the portfolio, all of which were located in Arizona, California and Nevada. (Tr. 45: 1-12) (Ex. S-8)

36. Mr. Graf testified that after reviewing the memorandum he and his wife concluded that the value of the remaining properties would provide an opportunity for members of MF Lenders "to be able to obtain principal and potentially interest in profits back." (Tr. 46: 11-19)

37. Mr. Graf stated that, according to the memorandum, if MF failed to repay the loan from MF Lenders as promised, that MF lenders could foreclose on the second lien on the portfolio; however, MF Lenders' lien would be subordinate to any remaining unpaid amount to Merrill Lynch which held the first lien on the portfolio. At that time, the memorandum stated that the debt to Merrill Lynch was $23,721,942. (Tr. 47: 1-8)

38. Mr. Graf further stated that according to the memorandum, members in MF Lenders were to have little control in the management of the company. (Tr. 49: 1-7)

39. According to Commission records, MAF is identified as a foreign limited liability company domiciled in Delaware. MAF is managed by Morgan Management, LLC ("Morgan Management") that is also its sole member. Morgan Management is a domestic limited liability company whose manager is Respondent Jimmy Hartgraves and whose member is MF. (Ex. S-12: Ex. 1 and 2)

40. According to Mr. Graf, the subordinated promissory note which was executed in 2006 and subsequently amended between the Grafs and MF failed to give the Grafs any right or control over any distributions of any funds arising out of their investment with MF. (Tr. 63: 1-22)

41. Mr. Graf testified that he had contacted Respondent Jimmy Hartgraves in February 2006 to discuss refinancing the Grafs' residence in order to reduce their mortgage payments due to the illness of Mrs. Graf. (Tr. 67: 14-2)

42. Mr. Graf stated that the only documentation the Grafs received with respect to their subordinated promissory note was a similar form of note which was used as an example, after which they received the executed version of the note in November 2006. (Tr. 68: 9-19)

43. Mr. Graf recalled that in approximately April 2010, he received a draft of the proposed Exchange Memorandum to review. (Tr. 69: 12-21)

44. Mr. Graf stated that he and his wife replied via e-mail indicating that they had concerns about the proposed limited liability company (MF Lenders) described in the draft and the value of the loan portfolio, including the nature of the transaction. (Tr. 70: 1-9)

45. Mr. Graf stated that because of his and his wife's concerns, they asked Mr. Hartgraves "if it was possible for us to have someone else purchase our interest for those notes, for us not to be part of the LLC." (Tr. 70: 13-19)

46. However, the Grafs did not receive any offers for their $100,000 subordinated promissory note with MF. (Tr. 71: 1-2)

47. After receiving a revised copy of the Exchange Memorandum, the Grafs consulted with an attorney because they did not believe their concerns were being addressed, and they had previously told Mr. Hartgraves that they did not wish to exchange their subordinated promissory note for a membership interest in MF Lenders.[4] (Tr. 72: 6-24)

48. Mr. Graf testified that several days after he and his wife received the second Exchange Memorandum by e-mail, Mr. Hartgraves called them to inquire whether the Grafs would join in exchanging their subordinated promissory note for a membership interest in MF Lenders. At that time, the Grafs indicated that they had hired an attorney. Subsequently, they informed Mr. Hartgraves that they would not join in the exchange of their subordinated promissory note for a membership interest in MF Lenders. (Tr. 73: 5-13)

49. Mr. Graf stated that he and his wife have received approximately $33,000, which represents about two years worth of interest payments based on their original investment of $100,000. (Tr. 74: 18-23)

50. According to Mr. Graf, on March 8, 2011, pursuant to the terms of their subordinated promissory note as amended, the Grafs demanded the return of their principal investment plus interest, which remains due from MF. (Tr. 75: 4-20)

51. Testifying further, Mr. Graf stated that he recently had a conversation with Mr. Hartgraves who offered to settle for approximately $66,000, the amount due on the Graf's note.

[4] Mr. Graf subsequently acknowledged that he and his wife received the proposed draft of the Exchange Memorandum on about April 19, 2010, and the second draft sometime after May 7, 2010. (Tr. 80:16-24)

(Tr. 76: 8-22)

52. Mr. Stephen Barnes, a retired engineer, testified that he met Mr. Hartgraves years earlier and on March 22, 2006, executed signed a subordinated promissory note with MF in the amount of $110,000. In the promissory note, MF was identified as the maker and Mr. Barnes was identified the holder of the note. (Tr. 90: 5-19) (Ex. S-5)

53. Mr. Hartgraves had signed the note on behalf of MF as its manager. (Tr. 91-92: 21-1)

54. Mr. Barnes testified that MF had promised an interest rate of 15 percent annually on his subordinated promissory. His note also contained a provision which allowed demand by the holder requiring payment by the maker within 90 days after notice of the demand was given. (Tr. 92: 4-16)

55. Mr. Barnes testified that he received his first interest payment in April 2006 and monthly thereafter up until the point the note was amended in 2009. He received approximately $40,000 in interest during this timeframe. (Tr. 93: 1-13)

56. Mr. Barnes testified that he remembered receiving a copy of a subordination letter which informed investors that their notes with MF were subordinated to Capital Source. (Tr. 94: 8-23)

57. Mr. Barnes testified that he understood the money invested with MF was a loan and that this fund was pooled by MF with other investor funds and loaned to construction companies and utilized for home construction.

58. Mr. Barnes stated that he understood that his right to collect on his promissory note was subordinate to the right of Capital Source to be paid. (Tr. 95: 7-10)

59. Mr. Barnes testified that he used a home equity line of credit in order to obtain the $110, 000 which he invested with MF. (Tr. 96: 14-23)

60. Prior to investing with MF, Mr. Barnes testified that he had been investing for approximately 30 or 40 years using investment advisors. He also testified that he had experience in investing in several real estate limited partnerships. (Tr. 97: 9-20)

61. Mr. Barnes stated that if he suffered a loss from his investment with MF it would not be catastrophic. (Tr. 98: 9-21)

62. Mr. Barnes testified that the principal amount on his note of $110,000 has not been

repaid, and that he still has not exercised the 90-day demand provision in the note. (Tr. 101: 12-17)

63. After reviewing the Exchange Memorandum, Mr. Barnes recalled being contacted by Mr. Hartgraves who explained that the real estate market, as Mr. Barnes already knew, was not doing well and that it was going to be necessary to restructure his loan to MF. (Tr. 102: 16-25)

64. Mr. Barnes stated that he had received interest payments on his loan to MF for approximately three years when the payments stopped in 2009. (Tr. 103: 1-8)

65. After receiving and reviewing the Exchange Memorandum, Mr. Hartgraves visited with Mr. Barnes at his home to explain its terms. Mr. Hartgraves explained that in order to keep "the project viable" it would be necessary to exchange his promissory note for a membership interest in MF Lenders. (Tr. 104: 1-13)

66. According to Mr. Barnes, he was told that in return for the exchange of his subordinated promissory note for a membership interest in MF Lenders, he would be paid interest at 8 percent plus half of any profits from the sales of the properties included in the portfolio. (Tr. 105: 1-8)

67. Testifying further, Mr. Barnes read from the Exchange Memorandum that various documents would be made available to the holders of MF's subordinated promissory notes if they wished to review the documents before exchanging their notes for pro-rated membership interests in MF Lenders. (Tr. 106: 10-18)

68. Mr. Barnes testified that he believed that the terms of the Exchange Memorandum provided for his $110,000 loan to MF to be repaid in approximately 30 months with funds earned "from the management of the loan portfolio." (Tr. 110: 10-15)

69. As with his promissory note, Mr. Barnes understood the lien held by MF Lenders would be second in priority behind the first lien held by Merrill Lynch on the loan portfolio.

70. Mr. Barnes stated that if all else failed in terms of the Exchange Memorandum, it was his understanding that MF would remain obligated to repay his principal investment. (Tr. 112-113: 20-1)

71. Mr. Barnes testified that the reason holders of the subordinated promissory notes from MF exchanged their notes for membership interests in the LLC, MF Lenders, was because the real estate market had deteriorated and MF was unable to continue to make the 15 percent interest payments promised in the notes or to repay an investor's principal. The exchange gave the note

holders their best chance to get their money back. (Tr. 116: 10-18)

72. Although Mr. Barnes testified that Merrill Lynch was owed approximately $23 million from the loan portfolio in which MF Lenders had an interest, he was unaware of the most recent appraisal value of the entire portfolio at the time of the hearing. (Tr. 118: 7-15)

73. Mr. Barnes further testified that he did not feel pressured to exchange his subordinated promissory note for a membership interest in MF Lenders. (Tr. 124: 7-16)

74. Mr. Barnes stated that he received his last payment on his subordinated promissory note in early 2009. He also testified about a meeting between MF's note holders and Mr. Hartgraves that was held in a Phoenix library. There, Mr. Hartgraves explained to the investors that MF was experiencing a cash flow problem, and unable to make the promised monthly payments any longer. Mr. Barnes and other note holders then agreed to an amendment to their notes to defer interest payments for approximately two years. (Tr. 125: 6-24)

75. During the intervening period, Mr. Barnes testified that whenever he had questions about his investments, he spoke with Mr. Hartgraves of his concerns and got the answers to his questions. (Tr. 126: 5-14)

76. According to Mr. Barnes, he learned from speaking with Mr. Hartgraves that if an order of restitution for $100,000 or more is entered against MF, "that Merrill Lynch could call their loan." (Tr. 127: 17-24)

77. As a result, Mr. Barnes is not in favor of an order of restitution against Respondents. (Tr. 127-128: 25-2)

78. Mr. Barnes testified that based on his knowledge of the dire real estate situation in Arizona at the time he held his subordinated promissory note, he elected to attempt to recover the balance of his investment by exchanging of his note for a membership interest in MF Lenders, hoping that it would enable him to have a successful outcome from his investment. (Tr. 129: 17-23)

79. Mr. Michael Brokaw, the Division's special investigator, testified that during the course of his investigation of the Respondents, he reviewed a number of MF's subordinated promissory notes which were dated from March 2006 to June 2008. (Tr. 136: 2-7)

80. Mr. Brokaw identified Certificates of Non-Registration for MF, Mr. Hartgraves and

MF Lenders. (Ex. S-2)

81. Mr. Brokaw testified that, based on records provided by Mr. Hartgraves, the note holders originally loaned MF $5,461,700. (Tr. 139-140: 16-2) (Ex. S-13)

82. Mr. Brokaw testified that he understood that Mr. Hartgraves had also executed a subordinated promissory note between himself individually with MF in the amount of $875,000. (Tr. 140: 10-24)

83. Based on Mr. Brokaw's investigation, he found that the subordinated promissory notes which were utilized by MF with its investors were unsecured. (Tr. 141: 5-25)

84. Based on Mr. Brokaw's investigation, he found that the promissory notes executed between February of 2006 and June of 2008 between investors and MF were held longer than nine months. (Tr. 142: 1-5)

85. The Division's investigator testified about a number of documents which related to investments made in MF's promissory notes by four investors through another company known as Capital Strategies Group, LLC. (Tr. 142-148) (Ex. S-7)

86. According to Mr. Brokaw, MF's business activities were brought to the Division's attention by the ADFI which recommended that the Division investigate the matter, because its representatives believed that an offering involving investment contracts with promissory notes fell under the Commission's jurisdiction. (Tr. 149-150: 8-8)

87. Based on Mr. Brokaw's investigation, he learned that MF had obtained a mortgage banker's license and prior to that had been a licensed mortgage broker. (Tr. 150: 9-17)

88. Mr. David Bushman, testifying on behalf of the Respondents, stated that in approximately January 2006, his wife's uncle recommended that if he was interested in obtaining a loan for a construction project, he should speak with Mr. Hartgraves. (Tr. 162: 7-16)

89. Mr. Bushman stated that prior to investing $100,000 in a subordinated promissory note with MF in March or April of 2006, he spoke with Mr. Hartgraves who had answered his investment questions. Mr. Bushman further stated that he performed his own "due diligence" by verifying that an

institutional lender[5] was involved in the program. (Tr. 163: 1-23) (Ex. S-4)

90. Besides investing with the Respondents, Mr. Bushman testified that he purchased four properties in Apache Junction and built homes on three of the parcels using loans from MF. (Tr. 164: 2-10)

91. Since investing with the Respondents, Mr. Bushman testified that he has received a return of approximately $30,000 in interest payments. He also testified that he was one of the investors who met with the Respondents and agreed to defer interest payments for approximately two years after a meeting at a Phoenix public library. (Tr. 164-165: 16-1)

92. Mr. Bushman stated that he had utilized his opportunity to exchange his subordinated promissory note for a membership interest in MF Lenders after receiving a number of different documents concerning the transaction via e-mail. (Tr. 165: 2-9)

93. Mr. Bushman testified about a pamphlet that he had downloaded from the Securities and Exchange Commission's website which described certain aspects concerning an investment in a promissory note referencing registration and the fact that notes were a major source of complaints by investors involving fraudulent activity. (Tr. 168-169: 10-19)

94. Mr. Bushman stated that investors agreed to defer interest payments on their notes for two years due to the decline in the real estate market and to give investors the best opportunity to recover their principal investments and possibly interest when the market improved. (Tr. 176: 5-13)

95. Respondent, Jimmy Hartgraves, testified that he is employed by MF, which he described as a mortgage holding company that does private placement mortgages. (Tr. 209-210: 17-3)

96. According to Mr. Hartgraves, during the relevant timeframe, MF was regulated by the ADFI and had been licensed as a mortgage broker and later as a mortgage banker. (Tr. 210: 4-11)

97. Mr. Hartgraves further testified that MF had been approved by the U.S. Department of Housing and Urban Development ("HUD") and also had been approved by the Federal Housing Administration ("FHA") as a mortgage lender. (Tr. 210: 20-25)

98. At the time of the hearing, MF was no longer a mortgage broker, but had been licensed by the ADFI as a mortgage banker on July 11, 2008. (Ex. R-3)

[5] Mr. Bushman was referring to Capital Source which had a primary interest in all of the properties secured by the subordinated promissory notes.

99. Mr. Hartgraves testified that, as a result of being licensed as a mortgage banker, MF had been subject to extremely thorough audits by the ADFI to ensure that the mortgage bank met its net worth requirements. Mr. Hartgraves stated that when the ADFI was auditing MF for a mortgage broker's license, the auditor for the ADFI had suggested that MF convert to a mortgage banker's license because MF had outgrown being a mortgage broker. (Tr. 212: 8-25)

100. Mr. Hartgraves testified that MF had gotten into the business of offering the subordinated promissory notes for sale during the 2006-2007 timeframe, and had been engaged for more than 30 years in the business of making loans by utilizing mortgage-backed notes. (Tr. 214: 15-24)

101. Testifying further, Mr. Hartgraves described the procedure involved in making mortgage-backed loans whereby MF or Mr. Hartgraves personally would fund a loan and then sell it off. He described the situation where a lender/investor would receive 15 percent interest for 30, 60, or 90 days on a note secured by a deed of trust, and when the note was paid off, the investor/lender would get their money back in addition to the interest. (Tr. 215: 11-23)

102. Mr. Hartgraves described how MF began to use investor funds for longer periods of time when a former investor did not want her promissory note to be paid off because she wanted a steady monthly income instead of having to wait until MF had another borrower with a note which could be matched to the amount of funds that the lender/investor had available. (Tr. 216: 4-13)

103. Mr. Hartgraves stated that his investor wanted to keep her funds invested with MF for longer than a short-term investment. As a result, Mr. Hartgraves consulted with his attorney at the time, Mr. Donald Newman, to develop a legal procedure which would allow for the continued reinvestment of a client's funds. (Tr. 216: 14-22)

104. According to Mr. Hartgraves, his attorney developed a draft of a promissory note which the attorney concluded would not constitute a security because of the inclusion of a 90-day demand clause in the note. Mr. Hartgraves testified that his attorney believed that the use of such a clause would cause the notes to be defined as commercial paper used in a current transaction and be exempt from the registration requirements of the Act. (Tr. 218-219: 18-11)

105. Mr. Hartgraves stated that based on his attorney's advice, both his and his chief financial officer's concerns were satisfied that such a note would not be classified as a security which

would require registration under the Act. (Tr. 219: 14-23)

106. Subsequently, Mr. Hartgraves testified that other clients who wished to retain the benefits of steady monthly interest payments began utilizing the new promissory notes with the 90-day demand feature instead of the mortgage-backed promissory notes previously utilized by MF. (Tr. 220-221: 16-1)

107. Mr. Hartgraves stated that approximately 25 to 35 investors with MF stopped investing in the mortgage-backed notes and switched over to the subordinated promissory notes with the 90-day demand feature. (Tr. 221: 6-10)

108. Mr. Hartgraves stated that he had also invested a little under $900,000 in MF's subordinated promissory notes. (Tr. 222: 23-24)

109. Mr. Hartgraves explained that after MF "ended up with 4-million-plus dollars worth of people's money in our portfolio" in short-term mortgages secured by deeds of trust, he decided that MF could work with a master lender with their existing loans and establish a credit line so that MF could expand its business in the market. (Tr. 223-224: 16-1)

110. According to Mr. Hartgraves, at the time, mortgage-backed securities "were gold," "super safe" and the "super secure side" of the investment market. (Tr. 224: 8-12)

111. Respondent Hartgraves testified that MF had found a company, Capital Source, from Chevy Chase, Maryland that enabled MF to expand its business by using Capital Source's funds as a line of credit. This enabled MF to put in 20 percent of the funds and Capital Source to put in 80 percent of the funds, and allowed the transition from what was termed a "pure promissory note" to the use of the subordinated promissory note as described in this proceeding. (Tr. 224: 14-25)

112. Mr. Hartgraves stated that under the scenario with Capital Source, it was the primary lender on the subordinated promissory notes and when the notes were paid off, Capital Source would be paid their funds first and MF and its lenders/investors would be paid their money second, but in the interim, the investors also were receiving a 15 percent interest check on their principal investments every month until the notes were paid off. (Tr. 225: 8-21)

113. According to Mr. Hartgraves, the attorneys for Capital Source examined the issue of whether the subordinated promissory notes constituted securities, but accepted MF's attorney's legal

opinion that the notes constituted commercial paper and loaned MF $20 million to conduct its business. (Tr. 226: 14-19)

114. Mr. Hartgraves testified that when he noted that there was "a little bit of a dip in the real estate market," MF started reducing lending on their loans from 75 percent loan-to-value down to 65 percent loan-to-value due to the declining real estate market. (Tr. 227-228: 21-2)

115. Mr. Hartgraves testified as MF started restricting its loans he adopted a strategy that, since MF was primarily a construction lender, it was time to locate a financial institution or a bank, and find a pool of construction loans which could be purchased at a discount in order to earn income "since most financial institutions don't understand construction." (Tr. 228: 3-12)

116. Mr. Hartgraves stated that MF had looked for "a broken pool of construction loans" and found such a group held by First Magnus, a Tucson company which was in bankruptcy. According to Mr. Hartgraves, one group of these construction loans, originally valued at $100 million, was controlled by Merrill Lynch which did not have a construction division and did not know what to do with the loans. (Tr. 229-230: 10-20)

117. Mr. Hartgraves testified that Respondents contacted Merrill Lynch and inquired whether they could purchase this pool of loans at a discount. (Tr. 230: 13-22)

118. Mr. Hartgraves testified that the construction pool held by Merrill Lynch had a high loan-to-value ratio of 56 percent, which reduced the amount of money that Respondents were required to use to purchase the portfolio. Mr. Hartgraves further testified that MF was able to purchase the portfolio for approximately $32 million. (Tr. 231: 1-24)

119. Referring to the Repurchase Agreement between Merrill Lynch Capital as buyer, MAF as seller and MF as guarantor, Mr. Hartgraves stated that, in addition to the $32 million value of the portfolio, Merrill Lynch also included a $5 million line of credit to enable Respondents to finish the construction of what Mr. Hartgraves termed A-paper single-family residences. (Tr. 232: 8-25) (Ex. R-8)

120. Mr. Hartgraves testified about the portfolio's value from a spreadsheet which apparently was provided by Merrill Lynch. A discounted valuation for the Merrill Lynch portfolio was stated at $74,397,000, and according to Mr. Hartgraves this represented a good investment for

his clients. (Tr. 237: 8-15) (Ex. S-7)

121. Mr. Hartgraves testified further that the Merrill Lynch portfolio contained properties whose notes were purchased at extremely large discounts due to the recession. According to Mr. Hartgraves, but for the recession factor, Respondents would have been able to pay all of the investors back and earn a very nice profit. (Tr. 237: 16-21)

122. While MF was in the process of securing its mortgage banker's license in 2008, the ADFI requested Mr. Hartgraves to provide a copy of MF's subordinated promissory note to the Division. As a result, Mr. Hartgraves met with the Division's investigator and provided him with copies of all of the notes along with any marketing materials. (Tr. 238: 1-17)

123. Subsequently, at a meeting with representatives of the Division, Mr. Hartgraves together with his attorney were informed that it was the Division's position that the subordinated promissory notes constituted securities and were not commercial paper.

124. Mr. Hartgraves testified that in order to address the Division's concerns with the status of the promissory notes, Respondents consulted with another attorney. (Tr. 241: 5-22)

125. According to Mr. Hartgraves, his new attorney recommended a proposal utilizing the Exchange Memorandum with proper disclosures to learn whether lenders/investors in the subordinated promissory notes would be willing to transfer their investments into membership interests in MF Lenders. (Tr. 242-243: 21-5)

126. Mr. Hartgraves testified that in an attempt to comply with Arizona law, a decision was made to proceed with the planned exchange of the notes for the membership interests in MF Lenders and calls were made to the investors to explain the situation which had arisen between the Respondents and the Division involving the subordinated promissory notes. (Tr. 245: 1-5)

127. Initially, Respondents believed that all of the prior investors would exchange their notes for the membership interests in MF Lenders under the terms of the initial Exchange Memorandum, but after speaking with the Grafs, Respondents learned that they were not interested in the exchange. (Tr. 245: 16-22)

128. Mr. Hartgraves testified that initially a copy of the Exchange Memorandum had been sent to the Division prior to sending it to MF's clients, but when Respondents became aware that the

exchange would not work for all investors, the document was redrafted to allow people to abstain from the exchange. (Tr. 245-246: 23-4)

129. According to Mr. Hartgraves, at the time the investors accepted the exchange program, he thought that there was no opposition to this action by the Division, and he believed that if an investor did not wish to proceed with the exchange, Respondents would have to make other arrangements with them. The Grafs were the only investors who did not complete the exchange. (Tr. 247: 1-10)

130. Testifying further, Mr. Hartgraves described the method in which the purchase of the Merrill Lynch portfolio was effectuated, stating that Merrill Lynch required MF to be legally separated from the holding company involved in the purchase, MAF, which was managed by Morgan Management that was owned and controlled by MF. The remaining MF entity is MF Lenders, the former holders of the promissory notes from MF who exchanged them for the pro-rated membership interests in MF Lenders. (Tr. 248-249: 12-4)

131. According to Mr. Hartgraves, the reason for the Repurchase Agreement between Merrill Lynch Capital and MAF was to allow Merrill Lynch Capital to reach the assets in the portfolio "with a minimum amount of court/attorney interference." (Tr. 249: 20-24)

132. Mr. Hartgraves testified that the reason the big financial institutions structured their purchase agreements and repurchase agreements in the manner in which they did, was to recover the assets while recognizing the businesses could become involved in litigation, but in the event of a default or a judgment of more than $100,000, Merrill Lynch Capital had the option "to pull all their property back." (Tr. 249-250: 20-19)

133. Mr. Hartgraves testified that he fears that, in the event of an administrative order from the Commission in excess of $100,000, Merrill Lynch Capital will exercise its rights under the Repurchase Agreement. (Tr. 251: 1-9)

134. Mr. Hartgraves explained that under the original purchase agreement it was contemplated that Merrill Lynch Capital would be paid the total amount of the money which it was owed for the portfolio, and the members of MF Lenders could expect in excess of $13 million or double the amount of the funds invested with MF. However, at the time of the Exchange

Memorandum, Mr. Hartgraves indicated that he and his wife would essentially receive almost nothing from the portfolio, but would still be able to pay off the members of MF Lenders. (Tr. 254: 1-25)

135. Mr. Hartgraves stated when appraisals were done on three different properties in the Flagstaff Ranch in Flagstaff, Arizona, there were significant discrepancies requiring reappraisals of the properties and ultimately resulting in what was termed "Amendment Six" to the purchase agreement. Instead of Merrill Lynch Capital being paid first and MF Lenders receiving the remaining money, Merrill Lynch Capital would allow MF Lenders to share in the profits of every single sale. According to Mr. Hartgraves, of the 70 properties initially in the portfolio there were 24 properties left and he anticipated selling approximately 10 or 12 in 2010, and if the market worked out, perhaps the remainder in 2011. (Tr. 259: 1-23)

136. Mr. Hartgraves testified that when MF loaned money to borrowers for construction loans on properties which were secured by deeds of trust, the only business that MF did at the time was to make loans for single-family residences, construction fix-and-flips, and rehab transactions, which involved three-, six- and nine-month notes. (Tr. 264-265: 25-4)

137. Mr. Hartgraves referred to Exhibit R-7, an excerpt from a federal reserve bank in Richmond, Virginia published in 1998 that described commercial paper. Mr. Hartgraves believed that Respondents' issuance of the subordinated promissory notes constituted commercial paper based on his reading of the excerpt and his understanding that non-bank financial institutions constituted 61 percent of the commercial paper market.[6] (Tr. 272-276)

138. Mr. Hartgraves testified that from approximately February 2006 to approximately June 2008, MF executed subordinated promissory notes with approximately 35 Arizona residents and entities. (Tr. 280: 1-15)

139. Prior to utilizing the subordinated promissory notes with investors, Mr. Hartgraves testified that Respondents were engaged in a loan business involving what were termed "one-off notes" whereby MF would close on a loan in its name and then sell off the note to a lender/investor with the transaction secured by a deed of trust. Subsequently, Respondents began to pool investor

[6] Mr. Hartgraves testified that his reference to the excerpt from the Federal Reserve Bank of Richmond, Virginia, was obtained from the internet from a posting at the Cornell University School of Law.

funds which were raised by the use of MF's subordinated promissory notes, and individual note holders no longer held a collateralized interest in a particular project. (Tr. 281-282: 14-13)

140. Mr. Hartgraves further testified that investors had no control in decision making or in the day-to-day operation of Respondents' business. (Tr. 282: 14-24)

141. Mr. Hartgraves avowed that between approximately February 2006 to June 2008, MF issued subordinated promissory notes totaling approximately $5,461,000. (Tr. 283: 1-5)

142. Mr. Hartgraves stated that with respect to the Exchange Memorandum, the Division and its representatives did not indicate whether the proposal cured Respondents' problems with respect to the subordinated promissory notes held by the investors. (Tr. 291-292: 20-1)

143. Mr. Hartgraves stated that he relied on his attorney's advice when Respondents adopted the use of the Exchange Memorandum to resolve the Division's issues with the Respondents with respect to the issuance of the subordinated promissory notes by MF. (Tr. 292: 7-11)

144. In part, Mr. Hartgraves testified that the fact that the Division's representatives did not reject or criticize the adoption of the proposed Exchange Memorandum constituted a "screaming acceptance" by the Division due to the silence of its representatives. (Tr. 292: 20-23)

145. According to Mr. Hartgraves, after first meeting with representatives of the Division, Respondents raised no further funds than had been originally raised with the subordinated promissory notes. (Tr. 294: 12-17)

146. Mr. Hartgraves testified that he made the decision to invest in the Merrill Lynch loan portfolio as a member of MF and it was not a decision approved by a formal vote of a majority of the individual holders of the subordinated promissory notes. (Tr. 297: 7-21)

147. Mr. Hartgraves further testified that he decided to invest in the Merrill Lynch loan portfolio because, "I felt it would be a good asset for Morgan Financial, which would reap good rewards for Morgan Lenders, yes." (Tr. 298: 10-16)

148. Mr. Hartgraves stated that, according to Amendment No. 6 dated January 31, 2011, to the Repurchase Agreement, MAF as the seller, is entitled to between three and five percent of the net cash proceeds payable depending upon the number of properties sold from the portfolio. (Tr. 301: 14-19) (Ex. R-9)

149. While there is no provision in MF Lenders' operating agreement for payment from MF to MF Lenders, Mr. Hartgraves testified that there is a promissory note between MF and MF Lenders for approximately $6.1 million which dictates that payments be made by MF for the benefit of the former note holders with proceeds received by MAF from the sale of portfolio assets. (Tr. 302-303: 1-8)

150. Mr. Hartgraves testified that, with respect to the subordinated promissory notes, MF primarily sought out investors who could invest a minimum of $100,000, but according to him only a handful of investors in the subordinated promissory notes invested less than $100,000. (Tr. 312-313: 21-6)

151. According to Mr. Hartgraves, at the time of the purchase of the Merrill Lynch portfolio in 2008, it was estimated that the current value of the portfolio to MF was approximately $13 million, but in approximately May 2010, MF's equity in the loan portfolio was only a little over $4 million. (Tr. 319-321: 4-19)

152. Based on the record, the Merrill Lynch portfolio has reached a negative value, but the return to MAF and MF is now based off sales and/or the liquidation of the properties from which the members of MF Lenders will be paid. Although the terms of the amended agreement call for payment on the portfolio to Merrill Lynch by October 31, 2011, or Merrill Lynch could reclaim the properties, MAF and MF had been successful in extending their agreement previously.[7] MF is receiving a negotiated management fee from Merrill Lynch since MF has no other sources of revenue separate and apart from the percentages received for sales of the properties. (Tr. 325-326: 16-1)

153. Testifying further, Mr. Hartgraves stated that three of the properties in the Merrill Lynch portfolio had been sold in 2011 and three percent of the total sales or approximately $54,000 have been or will be distributed on a pro-rata basis to the members of MF Lenders by MF. (Tr. 331-332: 10-12)

154. Mr. Hartgraves verified that from May of 2008 to the hearing, approximately half of the Merrill Lynch properties had been sold before the execution of Amendment No. 6 to the Master Repurchase Agreement, and all of the proceeds of the sales prior to the amendment went to Merrill Lynch to either repay the principal or any outstanding amount owed by MF to Merrill Lynch. (Tr. 336: 1-10)

155. Mr. Hartgraves further testified that the members of MF Lenders will receive their

[7] Respondents' line of credit and construction line of credit total approximately $25,792,000 due to Merrill Lynch at the end of the agreement. (Tr. 323: 2-19)

pro-rata share of any percentages received from the sales of the remaining properties in the Merrill Lynch portfolio and whatever else they can recover from MF, but according to Mr. Hartgraves MF is merely a servicing company at this point with no assets.[8] (Tr. 345-346) 15-5)

156. Mr. Hartgraves testified that only 25 properties remained from the original Merrill Lynch portfolio and he hoped to see at least seven more properties added to the three already sold for 2011. (Tr. 347: 2-13)

157. Mr. Donald Newman, MF's attorney in 2005, testified he was retained by MF to provide legal advice with respect to allowing MF to retain investors' money for periods of time longer than nine months. (Tr. 362-363: 2-5)

158. According to Mr. Newman, he believed that MF's subordinated promissory notes constituted an exempt security pursuant to A.R.S. § 44-1843A(8). (Tr. 363: 10-22)

159. Mr. Newman testified that the form of MF's promissory note was designed as a demand note with the right to repayment within 90 days following a demand by a holder to MF, the maker of the note. (Tr. 364: 1-8)

160. Mr. Newman testified that in 2006, during the timeframe when the subordinated promissory notes were utilized, MF had been negotiating with Capital Source, based in Maryland, for a $20-plus-million loan. During the course of those negotiations, Capital Source was represented by a Dallas, Texas, law firm named Patton & Boggs, which crafted the subordinated provisions of the notes and conducted their own inquiry as to the exempt status of the notes. (Tr. 364: 4-19)

161. According to Mr. Newman, after an initial meeting with representatives of the Division, Respondents assured the Division they had no intention of soliciting additional capital and would pursue registration if required, but in the interim, it was the Respondents' intention to resolve any problems with respect to registration and ultimately consulted with an attorney experienced in securities law. (Tr. 366: 7-24)

162. Testifying further, Mr. Newman stated that as a result of the discussion with the

[8] Subsequent to the hearing Exhibit R-10 was filed consisting of a Collateral Assignment by MAF dated June 3, 2010, whereby MAF assigned to MF Lenders all its rights under the Purchase Agreement with Merrill Lynch dated April 25, 2008, as collateral security for a Promissory Note which was attached promising payment by MF as "maker" to MF Lenders as "holder" the sum of $6,134,599.

Division's representatives, the Exchange Memorandum was created and approximately 41 of 42 note holders exchanged their subordinated promissory notes for membership interests in MF Lenders. Mr. Newman stated that, although the Division did not pass judgment on the Exchange Memorandum when it was submitted for review, the Respondents assumed that it was acceptable since Respondents heard no objections to the proposed exchange. (Tr. 367: 3-13)

163. Mr. Newman testified that Respondents looked to the Division to try and resolve the issue that had been raised with respect to the subordinated promissory notes. (Tr. 369: 18-24)

164. Mr. Douglas Odom, MF's former chief financial officer, testified that he recalled speaking with Mr. Newman concerning the registration issue involving subordinated promissory notes, and recalled that he had been told that the notes did not need to be registered and were exempt. (Tr. 384: 16-25)

165. After a review of the entire record, the evidence clearly established that Respondents were selling notes, which by definition are securities under the Act.

166. Based on a preponderance of the evidence, the MF Lenders membership interests which were acquired by MF's former note holders pursuant to the terms of the Exchange Memorandum constituted investment contracts with the investors who had loaned funds to MF. It was clearly established that the investors' funds were utilized by MF in the acquisition of the Merrill Lynch portfolio which was the basis of the common enterprise for the expected profits that MF projected it would earn from the management and sale of the properties in the portfolio, which profits MF would distribute to the members of MF Lenders.[9] As is the case with notes, investment contracts too, by definition, are securities under the Act.

167. Based on the record, and after reviewing all of the evidence, we find that Respondents violated the Act by acting as unregistered dealers and selling unregistered securities. Pursuant to A.R.S. § 44-2033, Respondents bore the burden of proof to establish that exemptions existed with respect to the registration requirements under that Act. Respondents did not meet the required burden

[9] See *Rose* v. *Dobras,* 128 Ariz. 209, 211, 624 P.2d 887, 889 (Ariz. App. 1981); *Daggett* v. *Jackie Fine Arts, Inc.,* 152 Ariz. 559, 566, 733 P.2d 1142, 1149 (Ariz. App.1986); and *S.E.C. v. W.J. Howey Co.,* 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946).

of proof because in the case of both offerings, Respondents failed to present sufficient evidence to prove that either offering was exempt.

168. We are particularly concerned with the provision in the Repurchase Agreement dealing with any judgment against the Respondents for the payment of money in excess of $100,000 being assessed by an administrative tribunal or other body. Since it appears that this provision could negate any further return to investors resulting from the sales of the Merrill Lynch portfolio, we believe that an order of restitution to the members of MF Lenders should be held in abeyance until Respondents have received all monies from the sale of the Merrill Lynch portfolio. Payments to investors should be under the supervision of the Division and will help achieve our goal that investors be made whole as a result of this action. Further, we shall require the Division to further monitor the situation closely and at the conclusion of the sales of the Merrill Lynch portfolio, make a filing which indicates any outstanding amount remaining to be paid to investors and whether an order of restitution should be assessed.

169. Additionally, there is sufficient evidence that established that the marital community benefited from Mr. Hartgraves and his related business entities' activities as described in this proceeding. Mr. Hartgraves presented no evidence in rebuttal, and therefore, the community should be held liable.

170. Lastly, since the Grafs were not participants in the Exchange Memorandum offerings we believe that restitution should be ordered with respect to the Grafs for the remainder of their investment, approximately $67,000.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction of this matter pursuant to Article XV of the Arizona Constitution and A.R.S. § 44-1801, *et seq.*

2. The investment offerings as described herein and sold by Respondents Jimmy Hartgraves, Jr., MF and MF Lenders constitute securities within the meaning of A.R.S. § 44-1801.

3. Respondents Jimmy Hartgraves, Jr., MF and MF Lenders acted as dealers and/or a salesman within the meaning of A.R.S. § 44-1801(9) and (22).

4. The actions and conduct of Respondents, Jimmy Hartgraves, Jr., MF and MF Lenders constitute the offer and sale of securities within the meaning of A.R.S. § 44-1801(21).

5. The securities were neither registered nor exempt from registration, in violation of A.R.S. § 44-1841.

6. Respondents offered and sold unregistered securities within Arizona in violation of A.R.S. § 44-1841.

7. Respondents offered and sold securities within or from Arizona without being registered as a dealer and/or salesman in violation of A.R.S. § 44-1842.

8. The marital community of Respondents Jimmy Hartgraves, Jr. and Laurie Hartgraves should be included in any order of restitution and penalties ordered hereinafter.

9. Respondents Jimmy Hartgraves, Jr., MF and MF Lenders have violated the Act and should cease and desist pursuant to A.R.S. § 44-2032 from any future violations of A.R.S. §§ 44-1841 and 44-1842 and all other provisions of the Act.

10. The actions and the conduct of Respondents Jimmy Hartgraves, Jr., MF and MF Lenders constitute multiple violations of the Act and are grounds for an order assessing restitution to Mr. and Mrs. Michael Graf pursuant to A.R.S. § 44-2032 and administrative penalties pursuant to A.R.S. § 44-2036.

11. The actions and conduct of Respondents Jimmy Hartgraves, Jr., MF and MF Lenders should be examined after the completion of the sales of all Merrill Lynch properties in the portfolio as discussed herein prior to any future order of restitution being assessed for the benefit of the members of MF Lenders pursuant to A.R.S. § 44-2032.

12. This docket should remain open and the Securities Division should monitor the activities of Respondents Jimmy Hartgraves, Jr., MF and MF Lenders with respect to the liquidation, marketing and selling of the properties in the Merrill Lynch portfolio, including the real property, notes and other personal property included therein (the "Portfolio Properties"), receipt of payments from Merrill Lynch and the prompt payout of all available proceeds to investors hereinafter ("Available Proceeds"). The Securities Division should monitor such activities to determine whether Respondents have used their best efforts in disposing of the Portfolio Properties and will take into

consideration the contractual terms and obligations between Respondents and Merrill Lynch, the prompt payout of Available Proceeds, and relevant financial documents and data. Within 90 days after the final disposition of the Portfolio Properties or December 31, 2015, whichever occurs first, the Division, in its discretion, may request a hearing to present evidence regarding whether Respondents have performed their best efforts in disposing of the Portfolio Properties and, if Respondents have not so performed, whether additional restitution or administrative penalties should be ordered.

ORDER

IT IS THEREFORE ORDERED pursuant to the authority granted to the Commission under A.R.S. § 44-2032, Respondents Morgan Financial, L.L.C., Morgan Financial Lenders, L.L.C., and Jimmy Hartgraves, Jr. shall cease and desist from their actions described hereinabove in violation of A.R.S. §§ 44-1841 and 44-1842.

IT IS FURTHER ORDERED that pursuant to authority granted to the Commission under A.R.S. § 44-2036, Respondent Jimmy Hartgraves, Jr., Morgan Financial, L.L.C., and the marital community of Jimmy Hartgraves, Jr. and Laurie Hartgraves, pursuant to A.R.S. § 44-2031(C), to the extent allowable by law pursuant to A.R.S. § 25-215, jointly and severally, shall pay as and for administrative penalty for the violation of A.R.S. §§ 44-1841 and 44-1842 the sum of $10,000. The payment obligation for this administrative penalty shall be subordinate to any restitution obligation ordered subsequently and shall become immediately due and payable only after restitution payments, if ordered, have been paid in full or upon Respondents' default with respect to Respondents' restitution obligations, if ordered subsequently.

IT IS FURTHER ORDERED the Respondents shall use the their best efforts in disposing of the Portfolio Properties and promptly pay out the Available Proceeds to investors.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2032, Respondents Jimmy Hartgraves, Jr., Morgan Financial, L.L.C., and the marital community of Jimmy Hartgraves, Jr. and Laurie Hartgraves, pursuant to A.R.S. § 44-2031(C), to the extent allowable pursuant to A.R.S. § 25-215, jointly and severally, shall make restitution to Mr. and Mrs. Michael Graf in the amount of $62,784.32 which restitution shall be made pursuant to A.A.C.

R14-4-308 subject to legal set-offs by the Respondents and confirmed by the Director of Securities, said restitution to be paid in full no later than December 31, 2015. Prior to December 15, 2015, Jimmy Hartgraves, Jr. and Laurie Hartgraves shall submit to Mr. and Mrs. Graf a pro-rata payment of 1.63% of proceeds from each payment, received by MF Lenders, resulting from the disposition of the Portfolio Properties.

IT IS FURTHER ORDERED that the restitution ordered hereinabove shall bear interest at the rate of the lesser of ten percent per annum or at a rate per annum that is equal to one per cent plus the prime rate as published by the board of governors of the Federal Reserve System in statistical release H.15 or any publication that may supersede it on the date that the judgment is entered.

IT IS FURTHER ORDERED that all restitution payments ordered hereinabove shall be deposited into an interest-bearing account(s), if appropriate, until distributions are made.

IT IS FURTHER ORDERED that the Commission shall disburse the funds on a pro-rata basis to the investors shown on the records of the Commission. Any restitution funds that the Commission cannot disburse because an investor refuses to accept such payment, or any restitution funds that cannot be disbursed to an investor because the investor is deceased and the Commission cannot reasonably identify and locate the deceased investor's spouse or natural children surviving at the time of distribution, shall be disbursed on a pro-rata basis on the remaining investors shown on the records of the Commission. Any funds that the Commission determines it is unable to or cannot feasibly disburse shall be transferred to the general fund of the State of Arizona.

IT IS FURTHER ORDERED that pursuant to authority granted to the Commission under A.R.S. § 44-2036, that Respondents Jimmy Hartgraves, Jr., Morgan Financial, L.L.C., and the marital community of Jimmy Hartgraves, Jr. and Laurie Hartgraves shall pay the administrative penalty ordered hereinabove in the amount of $10,000 payable by either cashier's check or money order payable to "the State of Arizona" and presented to the Arizona Corporation Commission for deposit in the general fund for the State of Arizona.

IT IS FURTHER ORDERED that if Respondents Jimmy Hartgraves, Jr., Morgan Financial, L.L.C., and the marital community of Jimmy Hartgraves, Jr. and Laurie Hartgraves fail to pay the administrative penalty ordered hereinabove, any outstanding plus interest at the rate of the lesser of

ten percent per annum or at a rate per annum that is equal to one percent plus the prime rate as published by the board of governors of the Federal Reserve System in Statistical Release H.15 or any publication that may supersede it on the date that the judgment is entered.

IT IS FURTHER ORDERED that if any of the Respondents Jimmy Hartgraves, Jr., Morgan Financial, L.L.C., and the marital community of Jimmy Hartgraves, Jr. and Laurie Hartgraves fail to comply with this Order, any outstanding balance shall be in default and shall be immediately due and payable without notice or demand. The acceptance of any partial or late payment by the Commission is not a waiver of default by the Commission.

IT IS FURTHER ORDERED that default shall render Respondents Jimmy Hartgraves, Jr., Morgan Financial, L.L.C., and the marital community of Jimmy Hartgraves, Jr. and Laurie Hartgraves liable to the Commission for its cost of collection and interest at the maximum legal rate.

IT IS FURTHER ORDERED that if any of the Respondents Jimmy Hartgraves, Jr., Morgan Financial, L.L.C., Morgan Financial Lenders, L.L.C., and the marital community of Jimmy Hartgraves, Jr. and Laurie Hartgraves fail to comply with this Order, the Commission may bring further legal proceedings against the Respondents, including application to the Superior Court for an Order of Contempt.

IT IS FURTHER ORDERED that this docket shall remain open and the Securities Division shall monitor the activity of Respondents Jimmy Hartgraves, Jr., Morgan Financial, L.L.C., Morgan Financial Lenders, L.L.C., and the marital community of Jimmy Hartgraves, Jr. and Laurie Hartgraves with all relevant financial data provided by Respondents with respect to the receipt of payment and distribution of any monies to the members of MF Lenders, L.L.C., and within 90 days after the final disposition of the Portfolio Properties or December 31, 2015, whichever occurs first, the Division, in its discretion, may request a hearing to present evidence regarding whether Respondents have performed their best efforts in disposing of the Portfolio Properties and, if Respondents have not so performed, whether additional restitution or administrative penalties should be ordered after further hearing, if requested within twenty (20) days of the Division filing its memorandum. If the Division does not request a hearing, the docket in this matter shall be closed.

IT IS FURTHER ORDERED that Respondents Jimmy Hartgraves, Jr., Morgan Financial,

L.L.C., Morgan Financial Lenders, L.L.C., and the marital community of Jimmy Hartgraves, Jr. and Laurie Hartgraves, shall provide to the Division copies of all relevant financial documents and data with respect to the receipt of payment and distribution of any monies to the members of Morgan Financial Lenders, L.L.C.

IT IS FURTHER ORDERED that pursuant to A.R.S. §44-1974, upon application the Commission may grant a re-hearing of this Order. The application must be received by the Commission at its offices within twenty (20) calendar days after entry of this Order. Unless otherwise ordered, filing an application for re-hearing does not stay this Order. If this Commission does not grant a re-hearing within twenty (20) calendar days after filing the application, the application is considered to be denied. No additional notice will be given of such denial.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER

COMMISSIONER Paul Newman COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 21st day of August 2012.

ERNEST G. JOHNSON
EXCUTIVE DIRECTOR

DISSENT _____

DISSENT _____

MES:db

SERVICE LIST FOR: MORGAN FINANCIAL, L.L.C., AN ARIZONA LIMITED LIABILITY COMPANY ("MORGAN") AND JIMMY HARTGRAVES, JR. AND LAURIE HARTGRAVES, HUSBAND AND WIFE

DOCKET NO.: S-20719A-09-0583

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