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AZ CORP COMMISSION  
Arizona Corporation Commission  
DOCKET NO. S-20790-A-11-0104  
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8 and Westcap Energy, Inc. dba Westcap Solar



9 **BEFORE THE ARIZONA CORPORATION COMMISSION**

10 In the matter of:

**DOCKET NO. S-20790-A-11-0104**

11 DAVID SHOREY and MARY JANE  
12 SHOREY, husband and wife,

**EXCEPTIONS TO  
RECOMMENDED OPINION  
AND ORDER**

13 WESTCAP ENERGY INC., an Arizona  
14 corporation, d/b/a Westcap Solar,

15 Respondents.

16 Pursuant to A.A.C. R14-3-110(B), Respondents David and Mary Jane Shorey and  
17 Westcap Energy, Inc. ("Westcap") (collectively "Respondents") submit their exceptions  
18 to the Recommended Opinion and Order dated February 21, 2013. Respondents  
19 recommend specific changes to the Recommended Opinion and Order ("ROO") for the  
20 reasons set forth below.

21 **I. Introduction**

22 Westcap is a defunct and dissolved Arizona corporation with no assets and no  
23 shareholders. All investors in this matter own shares of Abco Energy, Inc., a Nevada  
24 corporation.

25 David Shorey was the founder of Westcap.

26 The Securities Division ("Division") seeks to destroy a successful small startup  
27 business and destroy the investments of the 24 European shareholders, who have never  
28 complained about anything. See ROO ¶ 116. The shareholders, all foreign citizens, look

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1 forward to receiving profit from their investments. All were paid 8% interest, and all  
2 preferred stock was converted to common stock. The shareholders have not been harmed  
3 in any way. No United States or Arizona government entity has ever received any  
4 complaint from these foreign citizens regarding their desire and decision to invest money  
5 in Westcap.

6 **II. Arizona does not have jurisdiction over these foreign investments.**

7 Because the application of the Arizona statutes to the facts of this case would be  
8 an unconstitutional violation of the Commerce Clause, this case should be dismissed.

9 In pertinent part, A.R.S. § 44-1841 (sale of unregistered securities) states:

10 A. It is unlawful to sell or offer for sale within or from this state any  
11 securities unless the securities have been registered pursuant to article 6  
12 or 7 of this chapter or are federal covered securities if the securities  
13 comply with section 44-1843.02 or chapter 13, article 12 of this title.

14 In pertinent part, A.R.S. § 44-1842 (transactions by unregistered salesmen) states:

15 A. It is unlawful for any dealer to sell or purchase or offer to sell or buy  
16 any securities, or for any salesman to sell or offer for sale any securities  
17 within or from this state unless the dealer or salesman is registered as  
18 such pursuant to the provisions of article 9 of this chapter.

19 In pertinent part, A.R.S. § 44-1991 (fraud in the offer or sale of securities)  
20 states:

21 A. It is a fraudulent practice and unlawful for a person, in connection  
22 with a transaction or transactions within or from this state involving an  
23 offer to sell or buy securities, or a sale or purchase of securities,  
24 including securities exempted under section 44-1843 or 44-1843.01 and  
25 including transactions exempted under section 44-1844, 44-1845 or 44-  
26 1850, directly or indirectly to do any of the following:

- 27 1. Employ any device, scheme or artifice to defraud.
- 28 2. Make any untrue statement of material fact, or omit to state any  
material fact necessary in order to make the statements made, in the  
light of the circumstances under which they were made, not misleading.

1 3. Engage in any transaction, practice or course of business which  
2 operates or would operate as a fraud or deceit.

3 In this matter, the offering was made by a European company to European  
4 investors, who purchased their securities entirely in Europe.

5 Application of A.R.S. §§ 44-1841, 44-1842, or 44-1991 to sales and offerings  
6 outside of Arizona is unconstitutional, even if the offering and sale were “from” Arizona.  
7 *Arizona Corp. Comm’n v. Media Products, Inc.*, 158 Ariz. 463, 467, 469, 763 P.2d 527,  
8 531, 533 (App. 1988) (copy attached). It is well-established under Arizona law that the  
9 Arizona Corporation Commission (“Commission”) is barred from bringing an action  
10 against a company on the basis of securities sales that were made entirely to investors  
11 outside of Arizona. *Id.* “While protecting local investors is plainly a legitimate state  
12 objective, the State has no legitimate interest in protecting nonresident shareholders.” *Id.*  
13 at 468, quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 644 (1982). All of the investors in  
14 this matter were non-U.S. citizens in Europe. Arizona has no legitimate interest in  
15 protecting foreign shareholders.

16 In *Media Products*, the Arizona Court of Appeals held that an action by the  
17 Commission to enjoin the sales of securities was in violation of the Commerce Clause,  
18 U.S. Const. art. I, § 8, cl. 3, because the securities were sold entirely to buyers outside of  
19 Arizona. *Id.* at 469. *Media Products* involved sales and offerings in other states within  
20 the United States. In this matter, there were only sales and offerings in foreign countries,  
21 and none in the United States, so any interest that Arizona could claim would be even  
22 further attenuated.

23 Under well-established Commerce Clause jurisprudence, the extraterritoriality  
24 principle “precludes the application of a state statute to commerce that takes place wholly  
25 outside of the State’s borders, whether or not the commerce has effects within the State.”  
26 *Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982); see also *In re Nat’l Century Fin.*  
27 *Enterprises, Inc., Inv. Litig.*, 755 F. Supp. 2d 857, 875-79 (S.D. Ohio 2010) (discussing  
28 the ongoing viability of the extraterritoriality principle in light of recent decisions by

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1 various Circuit Courts, including the 6<sup>th</sup> Circuit's recent holding that "a state regulation  
2 that controls extraterritorial conduct is per se invalid.").

3 The *Media Products* case was decided in 1988, adopting the extraterritoriality  
4 principle into Arizona law. Since that time, the *Media Products* holding has not been  
5 overturned by any court, nor has the legislature passed any statute altering the Court of  
6 Appeals's ruling.

7 Furthermore, the Commerce Clause also grants Congress power "[t]o regulate  
8 Commerce with foreign Nations." U.S. Const. art. I, § 8, cl. 3. As with the interstate  
9 Commerce Clause, the foreign Commerce Clause limits the power of states to  
10 discriminate against foreign commerce. *Wardair Canada, Inc. v. Fla. Dep't of Revenue*,  
11 477 U.S. 1, 7-8 (1986). The principle underlying the Clause is preservation of federal  
12 uniformity in the unique arena of foreign commerce. *Id.* "In international relations and  
13 with respect to foreign intercourse and trade[,] the people of the United States act through  
14 a single government with unified and adequate national power." *Id.* at 8 (citations  
15 omitted). Thus, the foreign Commerce Clause serves to prevent states from promulgating  
16 protectionist policies and restrains states from excessive interference with foreign affairs.  
17 *Emerson Elec. Co. v. Tracy*, 735 N.E.2d 445, 447 (2000) (citing *Japan Line, Ltd. v. Los*  
18 *Angeles Cnty*, 441 U.S. 434, 448-51 (1979), and *Nat'l Foreign Trade Council v. Natsios*,  
19 181 F.3d 38, 66 (1st Cir. 1999)).

20 Because the Commission's action in this case is in direct violation of the  
21 Commerce Clause and is barred by the holding in *Media Products*, the Recommended  
22 Opinion and Order should be amended in accordance with Respondents' Proposed  
23 Amendment #1, and this case should be dismissed with prejudice as a matter of law.

24 **III. Alternatively, Respondents cannot be liable for fraud because federal**  
25 **requirements for Regulation S stock do not require specific disclosures.**

26 Even if the Commission asserts jurisdiction over Respondents in this matter,  
27 Respondents cannot be liable for fraud under A.R.S. § 44-1991 because the federal  
28 requirements that regulate the type of stock sold to investors do not require the

1 disclosures that the Recommended Opinion and Order cites as the basis for its findings of  
2 fraud. ROO ¶¶ 113-114.

3 A. Background

4 Shorey, a certified public account (CPA), formed Westcap to provide various  
5 solar-powered services to homes, commercial buildings, and governmental buildings.

6 During recent economic hard times, Westcap unsuccessfully attempted to borrow  
7 or raise money from the SBA, banks, hard money lenders, venture capitalists, and other  
8 sources. Page 193, Lines 6-25 to Page 194, Lines 1-21.<sup>1</sup> One potential fundraiser  
9 proposed to charge 50% of all money raised, plus \$40,000/month. Page 194, Lines 8-11.

10 Unable to raise capital from investors in the United States, Westcap entered into a  
11 contract with Litchfield Enterprises, Inc., a Colorado corporation (Litchfield) for  
12 Litchfield to raise \$1,000,000 and charge 10% of money raised (S-9, ACC00540).<sup>2</sup>  
13 Litchfield and Litchfield's attorney prepared the Private Placement Memorandum (PPM)  
14 (S-8) (Page 196, Lines 18-24) and the Subscription Agreement (S-19). Page 82, Lines  
15 17-19. At all times, Respondents relied on Litchfield and its attorney regarding all  
16 matters as to raising money. Litchfield agreed to use a European entity to raise funds in  
17 Europe. Page 283, Lines 23-25 to Page 284, Lines 1-2.

18 For many years, Litchfield had worked with Intuition Capital Corp. (Intuition)  
19 located in Barcelona, Spain. Page 254, Lines 4-16.

20 Litchfield had "vetted" Intuition and confirmed that Intuition only dealt with  
21 sophisticated and accredited investors. Shorey was so informed by Litchfield. Page 202,  
22 Lines 22-25 to Page 203, Lines 1-4, Page 285, Lines 4-13, Page 286, Lines 19-21.

23 Sophistication and accreditation are *not* required for a valid SEC Regulation S offering.

24 Respondents never had any contract with Intuition. Page 82, Lines 20-25, Page  
25 197, Lines 23-25. Intuition charged a 65% commission. Westcap successfully

26 \_\_\_\_\_  
27 <sup>1</sup> References to the transcript are to the hearing transcript for January 23 and 24, 2012 and are Page \_\_\_\_,  
Line \_\_\_\_.

28 <sup>2</sup> The Securities Division's exhibits are S-\_\_\_\_, and the references to these documents also include the  
Bates number of the document (e.g., ACC00540).

1 negotiated with Litchfield for Litchfield to lower its charge from 10% to 7.5%, resulting  
2 in total commissions of 72.5%. Page 195, Line 14-16.

3 **B. SEC Regulation S Offering**

4 Westcap's offering was pursuant to SEC Regulation S to foreign investors in  
5 Europe, with no offerings in the United States or to United States citizens. Westcap's  
6 offering complied with SEC Regulation S and was exempt from registration. *In re Royal*  
7 *Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 404 (D. Md. 2004) ("common  
8 shares sold overseas were offered pursuant to Regulation S, the SEC regulation which  
9 exempts 'offers and sales that occur outside the United States' from the registration  
10 requirements of § 5 of the Securities Act of 1933. 17 C.F.R. § 230.901").

11 ***SEC Regulation S does NOT require:***

- 12 1. ***accredited investors;***
- 13 2. ***sophisticated investors; or***
- 14 3. ***specific disclosures.***

15 Regulation S, Rule 901, *et seq.*

16 Also, SEC Regulation S does not prohibit "cold calls." *Id.*

17 Regulation S is codified in Rules 901 to 905 of the General Rules and Regulations  
18 Promulgated Under the Securities Act of 1933. Under Rule 901, "offers and sales that  
19 occur outside the United States" are deemed ***not to be included*** in the definition of "offer,  
20 offer to sell, sell, sale, and offer to buy" as defined by the Securities Act. In other words,  
21 under SEC regulations, where securities are sold only to foreign investors, with no  
22 possibility that they will be re-sold to United State citizens, they are simply regarded as  
23 not being securities sales for regulatory purposes. Rules 903 provides specific provisions  
24 guiding exclusively foreign securities sales, the substance of which is that the securities  
25 must be sold only to foreign investors and that the securities must remain off-shore.  
26 Regulation S, Rule 903; *see also*, Hazen, *Federal Securities Law*, 3<sup>rd</sup> Ed., pp.58-59.

27 The policy behind Regulation S is that U.S. securities regulations are for the  
28 purposes of protecting citizens of the United States. Protection of non-U.S. citizen

1 investors who reside outside of the United States and wish to inject capital into the  
2 United States's system should be left to their own sovereign governments: "Adopting a  
3 territorial approach, Regulation S presents domestic issuers with the choice to sell  
4 securities freely offshore while avoiding the registration requirements of the Securities  
5 Act." *The Unfounded Fear of Regulation S*, Stephen J. Choi, Duke Law Journal,  
6 December 2000, Vol. 5, No. 3 (citing SEC Offshore Offers & Sales, Exchange Act  
7 Release No. 33-6779, 53 Fed. Reg. 22,661, at 22,665 (June 17, 1988).

8 ***SEC Regulation S is not intended to protect foreign investors in foreign***  
9 ***countries. Moreover, the Arizona Securities Division has no authority to overrule or***  
10 ***interfere with SEC Regulation S or try to control foreign commerce.***

11 In all SEC Regulation S offerings, offering documents are prepared in the United  
12 States and delivered to prospective foreign investors. The offering is made overseas, as  
13 was the case here. In all SEC Regulation S offerings, investors' money is sent to the  
14 United States.

15 The Securities Division has no authority to nullify Westcap's offering, which  
16 complied with SEC Regulation S requirements. The Securities Division has no authority  
17 to nullify federal law, Rule 901, which excludes this type of Regulation S transaction  
18 from the very definition of a securities offering or sale.

19 **1. Private Placement Memorandum**

20 ***No specific disclosures are required for an SEC Regulation S offering.***

21 Litchfield's PPM did not state the exact commission to be paid for Westcap to  
22 raise money, because that amount was unknown at the time that the PPM was prepared,  
23 and could not be stated. Page 200, Lines 10-15.

24 However, the PPM ***did state that commissions or finders' fees would be paid.***  
25 Accordingly, every potential and actual investor knew that commissions or finders' fees  
26 would be paid.

27 The PPM states:  
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(1) The Shares will be offered on a "best efforts" basis by the officers and directors of the Company. These individuals will receive no commissions or other remuneration in connection with such sales. The Company, however, reserves the right to pay commissions to registered brokers or dealers registered with the National Association of Securities Dealers ("NASD") in connection with the sale of the Shares in which case the proceeds to the Company will be reduced. The Company may also pay finders' fees for introduction to persons or entities that purchase Preferred Stock in this Offering. *The amount of any commissions or finders' fees will be within the range of amounts normally paid in similar situations, in which case, the proceeds to the Company will be reduced.*

S-8, ACC000527. (Emphasis added.)

As previously stated, Litchfield had entered into a contract with Westcap and Litchfield would be paid 10%.

Litchfield's 10% was stated in the PPM under Use of Proceeds, as \$100,000 (10% of the \$1,000,000 to be raised.) S-8, ACC000528.

The PPM stated that preferred shareholders would be paid 8% interest for 12 months and each preferred share would be converted to 10 shares of common stock. S-8, ACC000527.

The 8% was paid and the shares were converted. Page 222, Lines 1-13.

**2. Subscription Agreement**

*SEC Regulation S does not require accreditation.*

Litchfield prepared the Subscription Agreement. Page 197, Line 11-17.

Article II of the Subscription Agreement has, as stated by the Division's Investigator Brokaw, the "buyer beware" warnings.

Q. Would you call this language warning language, or what kind of language would you refer to this as?

A. I would say so. Buyer beware, I guess. I don't know.

Q. Well, buyer beware, but would you say this places the buyer on notice that anybody who wanted to invest, that they should investigate?

A. Correct.

Page 116, Lines 24-25 to Page 117, Lines 1-6.

1 The Subscription Agreement clearly informs potential investors that the shares  
2 were not registered and will be restricted.

3 Article II, S-19, ACC000722, follows this page, with emphasis added.

4 **3. Accreditation**

5 ***SEC Regulation S does not require accreditation.***

6 Westcap was informed that all investors were accredited. Page 202, Lines 6-9,  
7 Page 202, Lines 22-25 to Page 203, Lines 1-4.

8 Significantly, the Securities Division offered ***no evidence that any investor was***  
9 ***not accredited.*** For example, Investigator Brokaw testified about his hearsay telephone  
10 call with repeat investor Roy Connell. Brokaw failed even to ask Connell if Connell was  
11 accredited.

12 Q. Did he specify or state whether or not he was accredited, to your  
13 recollection?

14 A. No, he didn't.

15 Page 47, Lines 22-23.

16 Q. Now, there is nothing in this memorandum that says that you asked  
17 Mr. Connell whether he was an accredited investor.

I assume you didn't ask that; is that right?

18 A. That's correct. I did not.

19 Q. Why did you not ask him that?

20 A. I don't know. It wasn't one of the questions that I just thought of, I  
guess.

21 Page 121, Lines 10-17.

22 **4. Commissions / Finders' Fees**

23 ***SEC Regulation S does not require specific disclosures.***

24 As previously stated, commissions and finders' fees were disclosed in the PPM,  
25 although not in an exact amount because that exact amount was unknown when  
26 Litchfield prepared the PPM. And, of course, a commission is charged in every  
27 investment. Page 83, Lines 6-11.

28 The Administrative Law Judge asked Brokaw:

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Q. Okay. But even ones that aren't under investigation, have you read any private placement memorandums that – where the commission or the finder fee is specified?

A. I have not.

Page 128, Lines 16-20.

Q. Okay. But in your experience in the investigation field for the Division, have you seen legitimate private placement memorandums which don't specify the amount that will be paid to the finders of investors for the company seeking investors?

A. Yes, you are right.

Page 128, Lines 23-25 to Page 129, Lines 1-3.

Litchfield's 10% was disclosed in "Use of Proceeds." S-8, ACC000528.

The issue is whether the total 72.5% commissions and finders' fees complies with the PPM's disclosure:

***The amount of any commissions or finders' fees will be within the range of amounts normally paid in similar situations, in which case, the proceeds to the Company will be reduced.***

"Normally paid in similar situations" means that the "similar situation" involves:

1. a small, startup solar business in Arizona;
2. that is risky, with many such businesses failing;
3. during a bad worldwide economy; and
4. for funds solely raised in Europe.

The Securities Division fails on this issue for four reasons.

***First***, raising funds in "similar situations" would cost more than other situations.

***Second***, again, the Securities Division presented no evidence regarding the commissions and finders' fees normally paid in similar situations. Investigator Brokaw testified:

Q. Okay. Now, what did you do, if anything, to find out the range of amounts normally paid in situations similar to Westcap Energy?

A. I didn't do anything.

Page 112, Lines 24-25 to Page 113, Lines 1-2.

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Q. And you didn't look around to find out what other small start-up companies who raise money in Europe, what the range of amounts normally paid in those situations were?

A. No, I did not.

Q. So at least from you, we don't have any evidence whatsoever of a survey, an inquiry, research, investigation, into the range of amounts normally paid in the situation similar to Westcap Energy; correct?

A. That would be correct.

Page 113, Lines 18-25 to Page 114, Lines 1-2.

Brokaw did no survey or investigation, nothing, as to whether 72.5% was the amount of commissions and finders' fees "normally paid in similar situations."

Finally, Brokaw had no testimony to offer regarding this issue.

Q. And so your testimony – you don't have any testimony about what is the range of amounts normally paid in situations similar to Westcap Energy; correct?

A. Correct.

Page 148, Lines 19-22.

The Securities Division offered no evidence regarding this, and on that basis alone the Securities Division's complaint about the amount of commissions fails.

**Third**, the total commission and finders' fees paid (the 72.5%) was \$281,756.99. S-56 (page 3). Litchfield's 10% (\$100,000) was stated in the PPM under "Use of Proceeds." Therefore, the difference is \$181,756.99.

Shorey's contributions to Westcap, in exchange for which he received nothing, more than made up for that difference.

Without receiving any stock back (Page 226, Lines 6-7), Shorey contributed \$50,000 of his own money to Westcap (Page 226, Lines 4-5). Shorey was to earn \$10,000/month for the last 36 months, but was paid nothing, contributing \$360,000 of his services to Westcap. Shorey personally guaranteed loans (Page 226, Lines 8-19) and used his personal credit card to keep the business running (Page 226, Lines 20-25 to Page 227, Lines 1-18), and the business was successful (Page 192, Lines 9-20).

**Fourth**, the Securities Division failed to prove materiality.

1           ***At the hearing, no investor testified that the 72.5% commissions and finders’***  
2 ***fees was objectionable, material, or, if the exact amount could have been known before***  
3 ***the PPM, the investors would not have invested.***

4           The Administrative Law Judge asked Shorey:

5                     “The amount of any commissions or finder fees will be within the  
6 range of amounts normally paid in similar situations, in which case the  
7 proceeds to the company will be reduced.”

8           Now, this is a statement in the private placement memorandum, and  
9 what is your basis for determining what is “amounts normally paid in  
10 similar situations”?

11           Shorey explained:

12                     A. I would say that my basis for making a statement that way is that the  
13 exact amounts may be indeterminable and they maybe change from time  
14 to time; however, my previous experience and Litchfield’s experience,  
15 who advised and wrote this, who advised me and Westcap, wrote this  
16 private placement memorandum through their attorney, advised that that  
17 wording was stated because their experience in the marketplace in  
18 Europe, which, of course, agrees with mine, was that these fees were  
19 undeterminable and that they would be normally the amounts paid to get  
20 those markets to work.

21           Q. Okay. Well, so the idea of a 65 percent commission to a finder of  
22 funding for your company, from what you learned from Litchfield and  
23 from your own experience, was that what was a normal range?

24           A. Yes, sir, that certainly was.

25           Page 278, Lines 9-25 to Page 279, Lines 1-20.

26                     The standard of materiality is an objective one. Materiality is proof of “a  
27 substantial likelihood that, under all the circumstances, the omitted fact would have  
28 assumed actual significance in the deliberations of the reasonable buyer.” *Rose v.*  
*Dobras*, 128 Ariz. 209, 214, 624 P2d 887, 892 (App. 1981).

                   However, this hypothetical analysis is defeated by the actual facts that the  
investors who paid the commission/finder’s fees never complained, and rather reinvested,  
and will profit from their investments. Whatever the imagined materiality, there was no

1 damage. And in any event, the only evidence in the record is that the information was not  
2 material.

3 **5. Foreign Offer**

4 The purpose of an SEC Regulation S foreign offering is to encourage United  
5 States entities to raise money outside of the United States and bring that money into the  
6 United States. That purpose promotes investments in the United States economy.

7 Every Regulation S offering involves two things:

- 8 1. Offering documents prepared in the United States (e.g. PPM and  
9 Subscription Agreement) given to prospective investors outside the  
10 United States; and
- 11 2. Investors' money transferred from a foreign country to the United  
12 States.

13 The Westcap offering was pursuant to Regulation S.

14 The Subscription Agreement states:

15 **ARTICLE I**  
16 **PURCHASE, SALE AND TERMS OF SHARES**

17 The Subscription: In consideration of and in express reliance upon the  
18 representations, warranties, covenants, terms and conditions of this  
19 agreement, the Seller agrees to sell Shares in the Company to the Buyer  
20 in an offshore transaction negotiated outside the United States (U.S.)  
and to be consummated and closed outside the U.S., and the Buyer  
agrees to purchase from the Seller the number of Shares at a per share  
purchase price set forth in the above Confirmation.

21 S-19, ACC000721.

22 Intuition offered the Westcap investment in Europe, solely to European citizens.  
23 No one in the United States or any U.S. citizen was offered the Westcap investment.  
24 (Page 82, Lines 12-16.) No stock was ever sold or transferred to anyone in the United  
25 States or to any U.S. citizen living abroad.

26 Shorey's only involvement started after *Intuition in Europe* informed Shorey of a  
27 person who wanted to invest.  
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1           Although Shorey sent documents to the investor and received invested funds, as  
2 with all Regulation S offerings, *the offering was made by Intuition in Europe*. A  
3 previously stated, every foreign offering involves documents prepared in the United  
4 States and sent to prospective foreign investors outside of the United States.

5           Intuition offered the Westcap investment solely to those outside the United States,  
6 in Europe.

7           THE WITNESS: This offer was never offered in the United States. It  
8 was targeted only for foreign investors. It is referred to as a Regulation  
9 S offering, which means it's not offered, advertised, solicited, or  
delivered to anyone in the United States, and it never was.

10          ALJ STERN: Okay. Go ahead, Mr. Heurlin.

11          BY MR. HEURLIN:

12          Q. Now, of the investors, we heard yesterday that all the investors were  
in Europe; correct?

13          A. That's correct.

14          Page 201, Lines 3-13.

15          Shorey never talked to any offeree. Page 201, Lines 14-19.

16          Intuition, in Europe, talked to offerees, in Europe. Page 201, Lines 20-23.

17          **IV. Conclusion**

18          Under *Media Products*, Arizona does not have jurisdiction over Respondents  
19 because application of A.R.S. §§ 44-1841, 44-1842, 44-1991, as applied in this case,  
20 violates the Commerce Clause. Accordingly, the matter should be dismissed, and the  
Commission should adopt Respondents' Proposed Amendment #1 to address this issue.

21          If the Commission does assert jurisdiction, Respondents cannot be liable for fraud  
22 because the federal requirement for Regulation S stock do not require the disclosures that  
23 the Division alleges Respondents fraudulently omitted from their materials.

24          Consequently, the Respondents should not be liable for penalties, and the Commission  
25 should adopt Respondents' Proposed Amendment #2 to address this issue.

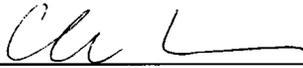
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DATED March 1, 2013.

HEURLIN SHERLOCK

By:   
Bruce R. Heurlin  
Catherine N. Hounfodji  
Attorneys for Respondents

ORIGINAL AND THIRTEEN (13) COPIES of the foregoing  
was overnight mailed on March 1, 2013, to:

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

Copy mailed March 1, 2013, to:

Matt Neubert, Director  
Securities Division  
Arizona Corporation Commission  
1300 West Washington Street  
Phoenix, Arizona 85007

Marc E. Stern  
Administrative Law Judge  
1200 West Washington  
Phoenix, Arizona 85007

Phong (Paul) Huynh  
Arizona Corporation Commission  
Securities Division  
1300 West Washington, Third Floor  
Phoenix, Arizona 85007

## RESPONDENTS' PROPOSED AMENDMENT #1

MATTER: David Shorey et al.

AGENDA ITEM NO.: \_\_\_\_\_

DOCKET NO.: S-20790-A-11-0104

OPEN MEETING DATE: \_\_\_\_\_

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Page 16, lines 1-28

DELETE: "112. Based on the record, it is established by a preponderance of the evidence that the offering by WE1 which was effected by Mr. Shorey utilizing Litchfield and in turn which utilized Intuition to sell the unregistered stock in WE1 to investors located outside of the United States did not constitute an exempt transaction under Arizona law. Neither WE1 nor Mr. Shorey were registered as a dealer and/or a salesman of securities in this instance. As cited by the Division, the burden of proof to establish an exemption of any offering is upon the party raising that defense pursuant to A.R.S. § 44-2033. In this instance, the Respondents failed to meet that burden and therefore must be held liable for violating the Act."

DELETE: "113. The PPM reserved the right to pay commissions to NASD registered broker/dealers for the sale of stock, however it limited the amount to be within the range of amounts normally paid. Although Mr. Shorey testified that 72.5% was within the "normal range," Mr. Brokaw testified that, in his experience, he had never seen such commissions in excess of 65%. We find that commissions were paid to non-registered broker/dealers and that 72.5% is outside the normal range of amounts, and such deviation from the information disclosed in the PPM is a material fact."

DELETE: "114. With respect to the issue of whether fraud was involved in the sale of WEI's stock, the evidence established that Respondents failed to disclose the excessive level of commissions paid to those individuals who sold the investors their WE1 stock. This was a material fact that should have been disclosed to investors. Under the facts disclosed during the hearing, there is sufficient evidence to establish the fact that such commissions paid to non-registered broker/dealers at the time were unreasonable based on the lack of disclosures made to the investors in the PPM."

DELETE: "115. With respect to the issue of the marital community, there was no evidence submitted that the marital community did not benefit from the violations of the Act herein, and it must be held liable."

DELETE: "116. Under the circumstances in this proceeding, including the fact that only one investor responded to the Division's complaint forms, we believe that an offer of rescission is in order in this instance, together with the appropriate penalty, rather than an order of restitution. The record established that Respondents are operating a solar installation business whose success could be endangered if restitution is ordered."

Page 17, lines 2-26

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

DELETE: "2. The investment offerings as described herein and sold by Respondents David Shorey and WEI constitute securities within the meaning of A.R.S. § 44-1801."

DELETE: "3. Respondents David Shorey and WEI acted as a dealer and/or a salesman within the meaning of A.R.S. § 44-1801(9) and (22)."

DELETE: "4. The actions and conduct of Respondents David Shorey and WEI constitute the offer and sale of securities within the meaning of A.R.S. § 44-1801(21)."

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

DELETE: "6. Respondents David Shorey and WEI offered and sold unregistered securities from Arizona in violation of A.R.S. § 44-1841."

DELETE: "7. Respondents David Shorey and WEI offered and sold securities from Arizona without being registered as a dealer and/or salesman in violation of A.R.S. 44-1842."

DELETE: "8. Respondents David Shorey and WEI committed fraud in the offer of an unregistered security, engaging in transactions, practices,

or a course of business which involved untrue statements and omissions of material facts in violation of A.R.S § 44-1991.”

DELETE: “9. The marital community of Respondents David Shorey and Mary Jane Shorey should be included in any order of rescission and penalties ordered hereinafter.”

DELETE: “10. Respondents David Shorey and WEI 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, 44-1842, 44-1991 and all other provisions of the Act.”

DELETE: “11. The actions and conduct of Respondents David Shorey and WEI constitute multiple violations of the Act and are grounds for an order of rescission pursuant to A.A.C. R14-4-308 and administrative penalties pursuant to A.R.S. § 44-2036.”

INSERT: “1. Under *Arizona Corporation Commission v. Media Products, Inc.*, 158 Ariz. 463, 467, 469, 763 P.2d 527, 531, 533 (App. 1988), application of A.R.S. A.R.S. §§ 44-1841, 44-1842, 44-1991 to the facts of this case would violate the Commerce Clause of the United States Constitution. The Arizona Corporation Commission, therefore, does not have jurisdiction over this proceeding.”

INSERT: “2. David and Mary Shorey and Westcap Energy, Inc. should be dismissed from this proceeding.”

Page 18, line 2 – Page 19, line 22:

DELETE: “IT IS THEREFORE ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2032, Respondents David Shorey and Westcap Energy, Inc. shall cease and desist from their actions described hereinabove in violation of A.R.S. §§ 44-184, 44-1842 and 44-1991.”

DELETE: “IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2036, Respondents David Shorey, Westcap Energy, Inc. and the marital community of David Shorey and Mary Jane Shorey, 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 penalties for the violation of A.R.S. §§ 44-1841 the sum of \$2,500; for the violation

of A.R.S. § 44-1842 the sum of \$2,500; and for the violation of A.R.S. § 44-1991 the sum of \$5,000. The payment obligation for these administrative penalties shall be subordinate to any rescission obligation and shall become immediately due and payable only after rescission payments have been paid in full or upon Respondents' default with respect to Respondents' rescission obligations."

DELETE: "IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2036, that Respondents Westcap Energy, Inc. and David and Mary Jane Shorey, husband and wife, to the extent allowable pursuant to A.R.S. § 25-215, jointly and severally, shall pay the administrative penalties 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 into the general fund for the State of Arizona."

DELETE: "IT IS FURTHER ORDERED that if Respondents Westcap Energy, Inc. and David and Mary Jane Shorey fail to pay the administrative penalties ordered hereinabove, any outstanding balance plus interest at the rate of the lesser of 10 percent per annum or the rate per annum that is equal to 1 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 may be deemed in default and shall be immediately due and payable, without further notice."

DELETE: "IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. §§ 44-2031(C) and 44-2032, Respondents Westcap Energy, Inc. and David and Mary Jane Shorey, husband and wife, to the extent allowable pursuant to A.R.S. § 25-215, jointly and severally, shall make an offer of rescission with respect to the Westcap Energy, Inc. stock sale which offer of rescission 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 offer of rescission to be made within 60 days of the effective date of this Decision."

DELETE: "IT IS FURTHER ORDERED that the offer of rescission ordered hereinabove shall bear interest at the rate of the lesser of 10 percent per annum or at a rate per annum that is equal to 1 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.”

- DELETE: “IT IS FURTHER ORDERED that all rescission payments as ordered hereinabove shall be deposited into an interest-bearing account (s), if appropriate, until distributions are made.”
- DELETE: “IT IS FURTHER ORDERED that Respondents Westcap Energy, Inc., and David and Mary Jane Shorey 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.”
- DELETE: “IT IS FURTHER ORDERED that default shall render Respondents Westcap Energy, Inc., and David and Mary Jane Shorey liable to the Commission for its cost of collection and interest at the maximum legal rate.”
- DELETE: “IT IS FURTHER ORDERED that if Respondents Westcap Energy, Inc., David Shorey and Mary Jane Shorey fail to comply with this order, the Commission may bring further legal proceedings against the Respondent(s) including application to the Superior Court for an order of contempt.”
- INSERT: “IT IS THEREFORE ORDERED that all Respondents are dismissed from this proceeding.”

## RESPONDENTS' PROPOSED AMENDMENT #2

MATTER: David Shorey et al.

AGENDA ITEM NO.: \_\_\_\_\_

DOCKET NO.: S-20790-A-11-0104

OPEN MEETING DATE: \_\_\_\_\_

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Page 16, lines 12-14

DELETE: “We find that commissions were paid to non-registered broker/dealers and that 72.5% is outside the normal range of amounts, and such deviation from the information disclosed in the PPM is a material fact.”

Page 16, lines 15-20

DELETE: “the evidence established that Respondents failed to disclose the excessive level of commissions paid to those individuals who sold the investors their WEI stock. This was a material fact that should have been disclosed to investors. Under the facts disclosed during the hearing, there is sufficient evidence to establish the fact that such commissions paid to non-registered broker/dealers at the time were unreasonable based on the lack of disclosures made to the investors in the PPM.”

INSERT: “we cannot find that the non-specific information provided about commissions paid resulted in any fraud because Regulation S stocks do not require specific disclosures. A finding to the contrary would impose more strict requirements on Regulation S stocks under Arizona law than permissible under U.S. law. Furthermore, there is no evidence that contradicts Respondents' claim that it complied with U.S. law and SEC Regulation S requirements.”

Page 17, lines 16-18

DELETE: “8. Respondents David Shorey and WEI committed fraud in the offer of an unregistered security, engaging in transactions, practices, or a course of business which involved untrue statements and omissions of material facts in violation of A.R.S § 44-1991.”

Page 17, line 22

DELETE: "44-1991"

Page 18, line 4

DELETE: "§§ 44-184, 44-1842 and 44-1991"

INSERT: "§§ 44-1841 and 44-1842"

Page 18, line 9

INSERT: "and" after "\$2,500"

Page 18, line 10

DELETE: "; and for the violation of A.R.S. § 44-1991 the sum of \$5,000"

Page 18, line 17

DELETE: "\$10,000"

INSERT: "\$5,000"

158 Ariz. 463  
Court of Appeals of Arizona,  
Division 1, Department C.

The ARIZONA CORPORATION  
COMMISSION, Plaintiff–Appellee,  
v.  
MEDIA PRODUCTS, INC., a Delaware  
corporation, Defendant–Appellant.

No. 1 CA–CIV 9655. | June 16,  
1988. | Review Denied Nov. 22, 1988.

State corporation commission brought action under Securities Act to enjoin initial public stock offering and for other related relief. The Superior Court, Maricopa County, No. CV–87–00708, I. Sylvan Brown, J., determined that corporation had violated securities laws of state and corporation appealed. The Court of Appeals, Shelley, J., held that: (1) state statute which prohibited unregistered sales of securities from state applied to sales which were negotiated out of state by out-of-state agent underwriter with out-of-state purchasers, and (2) application of statute violated commerce clause.

Reversed and remanded.

Corcoran, J., filed dissenting opinion.

#### Attorneys and Law Firms

**\*\*528 \*464** Robert K. Corbin, Atty. Gen. by Patrick M. Murphy, Chief Counsel, Financial Fraud Div., and W. Mark Sendrow, Sharon A. Fox, Asst. Attys. Gen., and Bradley S. Carroll, Sp. Asst. Atty. Gen., Phoenix, for plaintiff-appellee.

Brown & Bain, P.A. by C. Randall Bain and Jennifer B. Beaver, Phoenix, for defendant-appellant.

Carson, Messinger, Elliott, Laughlin & Ragan, Evans, Kitchel & Jenckes, P.C., Fannin, Terry, Hay & Lemberg, P.A., Fennemore Craig, P.C., Phoenix, Furth, Fahrner, Bluemle & Mason, Scottsdale, Gaston, Snow, Moya, Bailey, Bowers & Jones, Phoenix, Hecker, Phillips & Hooker, Tucson, Jennings, Strouss & Salmon, O'Connor, Cavanagh, Anderson, Westover, Killingsworth & Beshears, Storey & Ross, P.C., Streich, Lang, Weeks & Cardon, P.A., Phoenix, for amici curiae.

#### Opinion

#### OPINION

SHELLEY, Judge.

The Arizona Corporation Commission (Commission) brought this action under the Securities Act (Act) to enjoin the initial public stock offering of Media Products, Inc. (Media), for civil penalties under A.R.S. § 44–2037, restoration to investors of amounts paid for Media stock, and other related relief. The offering was not registered in the State of Arizona. The parties stipulated to consolidate the preliminary injunction request with the trial of all other matters raised in the complaint. Prior to trial, the court bifurcated the liability and remedies portion of the case and proceeded to try only the liability issues. We summarize the trial court's conclusions as follows:

1. That A.R.S. § 44–1841 required the registration of securities sold entirely to persons residing outside of the state by an underwriter located outside of the state on behalf of a foreign corporation having a base of operations in Arizona; and
2. That Arizona has a sufficient state interest in the issuance of securities by a company with a base of operations in the state, even though it was incorporated in the State of Delaware so that Arizona's prohibition of the sale of Media Products stock in other states is not an impermissible burden on interstate commerce in contravention of the United States Constitution.

The trial court entered a final appealable order pursuant to rule 54(b), Arizona Rules of Civil Procedure, adjudging that Media had violated the securities laws of Arizona by failing to register the sale of its initial public offering with the Commission. The court reserved determination of any applicable remedies following appeal. Media timely appealed.

Media is a Delaware corporation with its principal offices in Arizona. It entered into a “Selling Agency Agreement” with First Devonshire Securities, Inc. of Spokane, Washington, wherein the “agent” agreed, on a “best efforts, all-or-none” basis, to sell its initial public stock offering of 1,300,000 shares of common stock. Media's offering was properly registered with the federal Securities and Exchange Commission (SEC). Media's offering was also

duly registered under applicable Blue Sky laws in California, Colorado, Connecticut, Georgia, Idaho, Illinois, Minnesota, Montana, New Jersey, New York, Oregon, Pennsylvania and Washington. It made application to the Securities Division of the Commission to register the offering in Arizona but subsequently withdrew its application. The agent as underwriter then informed the Securities Division that it would proceed with the offering in the states where registration had been accomplished. The Securities Division informed Media that such an offering would constitute a violation of the Act. Media then informed the Securities Division that it would proceed, as it did not agree with the Division's interpretation of the Act.

Sales of the entire issue were negotiated out-of-state solely by the out-of-state agent \*\*529 \*465 underwriter and its selling out-of-state broker-dealers with purchasers who were residents of states where the offerings were duly registered. No sales or offers of sale were made in Arizona or to Arizona residents. There is no contention that the offerings were fraudulent.

[1] In reviewing the trial court's conclusions of law, this court is not bound by those conclusions, and we will determine questions of law independently of the trial court. *Gary Outdoor Advertising v. Sun Lodge, Inc.*, 133 Ariz. 240, 242, 650 P.2d 1222, 1224 (1982).

I.

The first issue on appeal is:

Did the court err as a matter of law in interpreting A.R.S. § 44-1841 to prohibit the sale of securities by a foreign corporation having a base of operations in Arizona where (i) all of the sales activities were conducted by out-of-state broker-dealers in states other than Arizona, (ii) the offers to purchase were made and accepted out-of-state, and (iii) no sale or offer of sale was made to any resident of Arizona?

Arizona Revised Statutes § 44-1841(A) reads:

**Sale of unregistered securities prohibited; classification**

It is unlawful to sell or offer for sale within or from this state any securities unless such securities have been registered by description under §§ 44-1871 through 44-1875 or registered by qualification under §§ 44-1891 through 44-1900, except securities exempt under §§ 44-1843 or 44-1843.01 or securities sold in exempt transactions under § 44-1844.

Media posits that A.R.S. § 44-1841 is inapplicable to the Media offering because the offers to sell and the sales were not made within or from the State of Arizona. Media and *Amici Curiae* assert that in interpreting A.R.S. § 44-1841, the court should look to the interpretation of the California Blue Sky Statutes by the California Department of Corporations. They cite A.R.S. § 44-1815, which reads:

The director shall cooperate with the administrators of the securities laws of other states and of the United States with a view to achieving maximum uniformity in the interpretation and enforcement of *like* provisions of the laws administered by them. (Emphasis added)

The pertinent California statute states in detail under what circumstances an offer to sell or sale of securities is considered to be made within or to originate from that state. Arizona Revised Statutes § 44-1841 only states that "It is unlawful to sell or offer to sell within or from this state any securities unless such securities have been registered ..." The pertinent California statute does not contain provisions "like" A.R.S. § 44-1841. As a result, the California Department of Corporations' interpretation of its statute is irrelevant.

[2] The key words in our statute are "sell or offer for sale within *or from* this state any securities unless such securities have been registered ..." A.R.S. § 44-1841. Media posits that the Commission created a legal fiction in holding that the sale took place *from* Arizona because the issuer only performed ministerial actions from its base of operations in Arizona. We disagree. The following actions by Media took place within the State of Arizona:

1. The principal place of business and base of operations for Media is in Arizona.
2. The officers and directors operated from and reside in Arizona.

3. The stock certificates were prepared and issued by the transfer agent in Arizona.

4. The Board of Directors' meetings took place in Arizona.

5. The Selling Agency Agreement stated: "[N]otice given pursuant to any of the provisions of this Agreement shall be in writing and shall be delivered (a) to the Company at the office of the Company, 3230 East Roeser Road, Phoenix, Arizona 85040, Attention: David J. Riddle ..."

**\*\*530 \*466** 6. The agreement designated an Arizona bank as the escrow agent.

7. The agreement states:

## VI. PAYMENT AND DELIVERY

A. Payment for the one million three hundred thousand (1,300,000) Shares shall be made to the Company at the offices of Lukins & Annis, P.S., by the Escrow Agent by certified or bank cashier's check in United States currency, same day funds, upon satisfying the conditions of escrow and upon delivery to the Escrow Agent of certificates for such Shares, registered in such name or names and in such denominations as the Agent shall have requested, in all cases against the signed receipt of the Escrow Agent. The Company shall pay to the Agent from funds paid to it by the Escrow Agent the agreed commission provided for hereinabove. *The date on which the sale of securities described in this Section A of Article VI occurs is herein referred to as the "Closing Date."*

*B. The Company agrees to cause certificates for Shares, which the Company agrees to sell, to be made available to the Agent at the Company's address at least one full business day prior to the relevant Closing Date for checking and packaging.*

C. A Closing Date, as referred to in this Agreement, shall be the date or dates mutually agreed upon within three (3) regular full business days after written notice by the Agent to the Company, on which the Agent or the Escrow Agent, in the case of the Closing Date, shall make payment for and the Company shall deliver certificates for the Shares, in accordance with this Article VI. (Emphasis added)

Media's actions were more than ministerial. Pursuant to the contract, the agent had the duty not only to notify the company's escrow agent of the names under which shares were to be registered and in what denominations, but the certificates for these shares were to be made available to the agent at the company's Arizona address at least one full business day prior to the closing date for checking and packaging. Pursuant to the agreement, the date on which the sale of the securities occurred is the closing date of the escrow. The closing occurred in Arizona.

Media and *Amici Curiae* assert that their position is supported by analogous provisions of the Uniform Securities Act of 1956. We disagree. Section 414 of the Uniform Act, which specifies its scope, is not analogous to A.R.S. § 44-1841, which covers the scope of the Arizona Act. Arizona Revised Statutes § 44-1841(A) states only: "It is unlawful to sell or offer for sale within or from this state unless such securities have been registered ..." In contrast, § 414, which sets forth the Uniform Act's scope, consists of 6 paragraphs, four of which read as follows:

(c) For the purpose of this section, an offer to sell or to buy is made in this state, whether or not either party is then present in this state, when the offer (1) originated from this state or (2) is directed by the offeror to this state and received at the place to which it is directed (or at any post office in this state in the case of a mailed offer).

(d) For the purpose of this section, an offer to buy or to sell is accepted in this state when acceptance (1) is communicated to the offeror in this state and (2) has not previously been communicated to the offeror, orally or in writing, outside this state; and acceptance is communicated to the offeror in this state, whether or not either party is then present in this state, when the offeree directs it to the offeror in this state reasonably believing the offeror to be in this state and it is received at the place to which it is directed (or at any post office in this state in the case of a mailed acceptance).

(e) An offer to sell or to buy is not made in this state when (1) the publisher circulates or there is circulated on his behalf in this state any bona fide newspaper or other publication of general, regular, and paid circulation which is not published in this state, or which is published in this state but has had more than **\*\*531 \*467** two-thirds of its circulation outside this state during the past twelve months, or (2) a radio or television program originating outside this state is received in this state.

(f) Sections 102 and 210(c), as well as section 405 so far as investment advisers are concerned, apply when any act instrumental in effecting prohibited conduct is done in this state, whether or not either party is then present in this state.

Arizona Revised Statutes § 44-1841(A) leaves the interpretation of the term "from the state" to the courts. In contrast, § 414 defines and delimits the application of the Uniform Act in interstate transactions with only some of their elements in the state. 12 J. Long, *Blue Sky Law*. App. D-61.

The *Amici* brief quotes from 12 J. Long, *Blue Sky Law* § 3.02[3] as follows:

... the mere maintenance of a principal place of business or any place of business within the state is not sufficient to trigger the local version of the Uniform Act. (Emphasis added)

Factually this case has considerably more connections within Arizona than the mere maintenance of a principal place of business in this state. In 12 J. Long, *Blue Sky Law*, § 3.01 at 3-4 and 3-5, we read: "Nor is this discussion intended to suggest what necessarily should be the jurisdictional rules in those states which have not adopted § 414 or an equivalent statute." Arizona has not adopted § 414 or an equivalent statute.

We conclude that the offering of the stock and the sales of the stock were "from" Arizona.

## II.

The other issue on appeal is:

Did the trial court err in concluding that A.R.S. § 44-1841, as applied in this case, did not violate the Commerce Clause of the United States Constitution?

The Commerce Clause (Article I, Section 8, Clause 3 of the United States Constitution) regulates commerce occurring "among the several states." The Commerce Clause provided Congress with the power to enact laws protecting and encouraging commerce among the states, and the power to "by its own force created an area of trade free from interference by the states ... [that] even without implementing legislation by Congress [serves as a] limitation upon the

power of the state." *Great Atlantic and Pacific Tea Co. v. Cottrell*, 424 U.S. 366, 370-371, 96 S.Ct. 923, 927-28, 47 L.Ed.2d 55, 60 (1976), quoting *Freeman v. Hewit*, 329 U.S. 249, 252, 67 S.Ct. 274, 276, 91 L.Ed. 265, 271-272 (1946).

[3] As interpreted by the United States Supreme Court, the Commerce Clause invalidates any state statute which *directly* burdens interstate commerce. *Edgar v. Mite Corp.*, 457 U.S. 624, 640, 102 S.Ct. 2629, 2639-40, 73 L.Ed.2d 269, 282 (1982); *Shafer v. Farmer's Grain Co.*, 268 U.S. 189, 45 S.Ct. 481, 69 L.Ed. 909 (1925). Moreover, any state statute which *incidentally* affects commerce will be struck down under the Commerce Clause if the burden imposed upon commerce is clearly excessive in relation to the putative local benefits. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174, 178 (1970); *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 443, 80 S.Ct. 813, 815-16, 4 L.Ed.2d 852, 856 (1960).

We hold that the application of the statutes to the facts of this case constitutes an improper interference with interstate commerce.

*Edgar* involved an Illinois statute regulating takeover offers. The statute required the shares of a target company to be registered with the Illinois Secretary of State. A target company is defined as a corporation or other issuer of securities in which Illinois shareholders own 10% of the class of equity securities subject to the takeover offer or when any two of the following conditions are met: the corporation has its principal executive offices in Illinois, is organized under the laws of Illinois, or has at least 10% of its stated capital and paid-in surplus represented within the state. Mite Corp. was incorporated under the laws of Delaware, with its principal executive offices in Connecticut. Mite \*\*532 \*468 initiated a tender offer for all outstanding shares of Chicago Rivet & Machine Co., a publicly held Illinois corporation, without complying with the Illinois statute. The State of Illinois sought to prevent Mite from proceeding with its tender offer to not only the shareholders living in Illinois, but also to those living in other states.

The Court stated:

The Commerce Clause provides that "Congress shall have Power ... [t]o regulate Commerce ... among the several States." U.S. Const., Art. I, § 8, cl. 3. "[A]t least since *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299, 13 L.Ed. 996 (1852), it has been clear that 'the Commerce Clause... even without implementing

legislation by Congress is a limitation upon the power of the States.’ ” Not every exercise of state power with some impact on interstate commerce is invalid. A state statute must be upheld if it “regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental ... unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. The Commerce Clause, however, permits only *incidental* regulation of interstate commerce by the States; *direct regulation is prohibited*.

....

States have traditionally regulated intrastate securities transactions, and this Court has upheld the authority of States to enact “blue-sky” laws against Commerce Clause challenges on several occasions. The Court's rationale for upholding blue-sky laws was that they only regulated transactions occurring within the regulating States. “The provisions of the law ... apply to dispositions of securities *within* the State and while information of those issued in other States and foreign countries is required to be filed ..., they are only affected by the requirement of a license of one who deals with them *within* the State.... Such regulations affect interstate commerce in [securities] only incidentally. *Hall v. Geiger-Jones Co.*, *supra*, 242 U.S. [539] at 557–558, 37 S.Ct. [217] at 223 [61 L.Ed. 480, 492]. (Citations omitted)

....

*While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders. Insofar as the Illinois law burdens out-of-state transactions, there is nothing to be weighed in the balance to sustain the law.* (Emphasis added)

*Edgar*, 457 U.S. at 640–44, 102 S.Ct. at 2639–41, 73 L.Ed.2d at 282–284.

Subsequently, in *CTS Corporation v. Dynamics Corporation of America, et al.*, 481 U.S. 69, 107 S.Ct. 1637, 95 L.Ed.2d 67 (1987), the United States Supreme Court upheld an Indiana Act which regulated tender offers made to shareholders of corporations incorporated in Indiana. The Court stated:

No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders. See restatement (Second) of

Conflict of Laws § 304 (1971) (concluding that the law of the incorporating State generally should “determine the right of a shareholder to participate in the administration of the affairs of the corporation”). Accordingly, we conclude that the Indian Act does not create an impermissible risk of inconsistent regulation by different States.

....

It thus is an accepted part of the *business landscape in this country for States to create corporations*, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in *the corporations it charters*, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.

There can be no doubt that the Act reflects these concerns. *The primary purpose of the Act is to protect the shareholders of Indiana corporations.*

....

**\*469 \*\*533** *We agree that Indiana has no interest in protecting nonresident shareholders of nonresident corporations.* (Emphasis added)

*CTS Corporation*, 481 U.S. at —, 107 S.Ct. at 1644–51, 95 L.Ed.2d at 85–87.

In this case, Media was not incorporated in Arizona. All of the stock purchasers are nonresidents.

[4] Under the facts of this case, Arizona had no duty to the purchasers whose home states had already determined that the offerings met their own state's standards and had registered the offerings in those states and with the Securities and Exchange Commission. To hold otherwise would allow the Commission to have an effective veto over offerings and sales approved by the Securities and Exchange Commission and securities officials from other states, even though no purchases were made by Arizona residents. The business reputation of the State of Arizona is not at stake under the facts of this case.

We conclude that the Act, as applied in this case, constitutes a direct burden upon interstate commerce. Even if we assume that the burden imposed is incidental, rather than direct in order to satisfy constitutional scrutiny, the burden may not be excessive in relation to the local interests sought to be served.

*Pike v. Bruce Church, Inc.*, 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970).

The state asserts that if a statute as applied to this case creates a burden on interstate commerce, it is only incidental and the burden is not excessive in relation to the local interests sought to be served. The state correctly asserts that Arizona has an important interest in keeping itself free of enterprises which offer questionable investment opportunities.

In 12 J. Long, *Blue Sky Laws* § 3.04[3][a], Mr. Long states: "A state has an interest in seeing that its territory is not used as a base of operations to conduct illegal sales in other states. Thus, the host state has an interest in protecting its reputation as not being a center for illegal or questionable securities activity."

The relevant facts on this issue are:

1. Media was incorporated in the State of Delaware and the prospectus so stated.
2. The underwriter, brokers and dealers involved in the securities offerings and sales were not Arizona residents.
3. No sales were solicited or made to Arizona residents.
4. The purchase contracts were not made in Arizona.
5. The offer and sale of the securities were properly registered with the federal Securities and Exchange Commission and in the states where the purchasers resided.
6. Media's Supplemental Prospectus, dated December 30, 1986, stated:

*The Company has withdrawn its application to sell shares included in this offering to Arizona residents due to objections raised by the Arizona Securities Division (the "Division").* The Division may still claim that the offering should not be made to non-Arizona residents even though the offering has been declared effective by the Federal Securities and Exchange Commission and by the State Securities Commissioners of 12 other states. The Company disputes any such claim by the Division and would vigorously contest it. However, if such a claim is successfully pursued, the Company could be subject to injunctive and other remedies, including penalties of up to \$1,000,000 and possible rescission by purchasers in this offering. This could have a negative impact on the selling effort of the Underwriter and on

the ability to complete the offering within the original 90 day period. *In addition, the defense costs in any such litigation would be an additional use of the working capital of the Company.* (Emphasis added)

The prospectus and supplement placed prospective purchasers on notice that Media was a Delaware corporation, that the offerings and sales were not approved by \*\*534 \*470 the Arizona Corporation Commission, and that the Arizona Corporation Commission might file suit asking for injunctive and other remedies. These statements negate the Commission's position that if the sale was unfair, blame could be placed on Arizona, tarnishing its reputation. Any out-of-state buyer who familiarized himself with the prospectus and supplement would be advised that it was his own state, not Arizona, that regarded the offer as appropriate. In this case, the state does not have an overriding regulatory policy need. Under the facts of this case the burden, even if it were only incidental, is excessive.

[5] Media has requested attorney fees pursuant to A.R.S. § 12-348 and rule 21(c), Arizona Rules of Civil Appellate Procedure. The state failed to respond to this request. The discretionary provisions of § 12-348 do not apply in this case; therefore, this court has no discretion to deny attorney fees. Media is awarded attorney fees under rule 21(c).

The judgment of the trial court is reversed and the case is remanded to the trial court with directions to enter judgment in favor of Media.

FIDEL, J., concurs.

CORCORAN, Judge, dissenting:

I respectfully dissent from that portion of the opinion that concludes that Arizona's interest in its business reputation is insufficient to justify the incidental burden imposed on interstate commerce by the Arizona Securities Act. I would uphold the trial court's conclusion that "Arizona has a sufficient state interest in the issuance of securities by a company with a base of operations in the state, even though it was incorporated in the State of Delaware so that Arizona's prohibition of the sale of Media Products stock in other states is not an impermissible burden on interstate commerce in contravention to the United States Constitution."

The facts cited by the majority to conclude that the offering and sale of the stock were "from" Arizona within the

meaning of A.R.S. § 44-1841 also support the legitimate state interest Arizona has in requiring registration under these facts. Arizona is not only the corporation's principal place of business or "base of operations," but is also the corporation's *only* place of business. Media Products has no headquarters outside of Arizona. It is an "Arizona" enterprise.

Furthermore, all the important aspects of the transaction took place in Arizona: the terms of the sale were formed here; the escrow was set up and closed here; and all the stock was issued from Arizona. The corporation's entire existence centers around Arizona; its formal incorporation in Delaware gives it only the most tenuous and fictional relationship with that state. The impression afforded the corporation's nonresident investors under these circumstances is that they are investing in a *de facto* Arizona corporation. Additionally, if litigation results from this securities transaction, the courts of Arizona may be called upon to host the proceedings. Arizona will have redressive jurisdiction; it should also have preventive jurisdiction.

This is not a case where regulation is excessive because the state has no local interest in protecting nonresident investors. *Cf. Edgar v. MITE Corp.*, 457 U.S. 624, 102 S.Ct. 2629, 73 L.Ed.2d 269 (1982). Here, the state's legitimate local

interest is in protecting its business reputation. The state's interest in preventing its territory from being used as a base of operations for unregulated transactions has been widely recognized under federal securities law. *See* 12 J. Long, *Blue Sky Law* § 3.04[3][a] at 3-46 (rev. ed. 1987), and cases cited therein. Professor Long relates circumstances in the 1970s that gave Tennessee a "black eye" in the municipal bond industry, gave Oklahoma and Texas a bad name in the oil and gas lease market, and allowed Utah to become known as a "cesspool of securities fraud." *Id.* Professor Long concludes that "the host state has an interest in protecting its reputation as not being a center for illegal or questionable securities activity." *Id.*

Under the specific facts of this case, I would hold that Arizona had a sufficient **\*\*535 \*471** interest in its business reputation among the nonresident purchasers of Media Products stock to justify its regulation of the offering and sale of that stock under the Securities Act. I would affirm on that basis.

#### Parallel Citations

763 P.2d 527, Blue Sky L. Rep. P 72,749, 57 USLW 2028

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