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BEFORE THE ARIZONA CORPORATION COMMISSION

2014 SEP -5 P 1:32

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

ARIZONA CORPORATION COMMISSION
SECRET CONTROL

ORIGINAL

In the matter of:
BRIAN C. HAGEMAN, an unmarried man,
DELUGE, INC., a dissolved Delaware corporation,
HYDROTHERM POWER CORPORATION, a dissolved Delaware corporation,
Respondents.

DOCKET NO. S-20896A-13-0378

SECURITIES DIVISION'S POST HEARING BRIEF

Arizona Corporation Commission

DOCKETED

SEP 5 2014

DOCKETED BY [Signature]

The Securities Division ("Division") of the Arizona Corporation Commission ("Commission") submits its post hearing brief as follows:

I. PROCEDURAL HISTORY

On November 5, 2013, the Division filed a Notice of Opportunity against BRIAN C. HAGEMAN ("HAGEMAN"), DELUGE, INC. ("DELUGE") AND HYDROTHERM POWER CORPORATION ("HYDROTHERM"). HAGEMAN, DELUGE and HYDROTHERM may be referred to as "RESPONDENTS." On November 12, 2013, RESPONDENTS requested a hearing. Administrative Law Judge Stern ("ALJ") set a pre-hearing conference for December 10, 2013. On December 2, 2013, RESPONDENTS filed Answers. The ALJ scheduled the hearing to begin April 14, 2014, with witness lists and exhibits to be exchanged by February 28, 2014. On March 20, 2014, RESPONDENTS requested a six month continuance. On April 14, 2014, the Fourth Procedural Order was issued that continued the hearing to July 14, 2014. On June 23, 2014, RESPONDENTS requested a one year continuance. The Fifth Procedural Order denied the

1 RESPONDENTS' request for a continuance. The hearing began on July 14, 2014, and concluded
2 on July 15, 2014.

3 **II. JURISDICTION**

4 The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona
5 Constitution and the Arizona Securities Act ("Act").

6 **III. FACTS**

7 1. BRIAN C. HAGEMAN ("HAGEMAN") was an Arizona resident and has been
8 since about 1989.¹ HAGEMAN has not been registered by the Commission as a securities salesman
9 or dealer.²

10 2. DELUGE, INC. ("DELUGE") was a corporation which was organized under the
11 laws of the state of Delaware on November 15, 1996, and was dissolved by the Delaware Division
12 of Corporations on March 1, 2010.³ DELUGE's corporate status was considered void in the state of
13 Delaware.⁴ Since at least 1998, DELUGE has been conducting business within or from Arizona.⁵
14 The Corporations Division of the Arizona Corporation Commission authorized DELUGE to transact
15 business in Arizona, but its grant of authority was revoked in 2010.⁶ DELUGE has not been
16 registered by the Commission as a dealer.⁷

17 3. HYDROTHERM POWER CORPORATION ("HYDROTHERM") was a
18 corporation which was organized under the laws of the state of Delaware on May 26, 1997, and was
19 dissolved by the Delaware Division of Corporations on March 1, 2010.⁸ HYDROTHERM's
20 corporate status was considered void in the state of Delaware.⁹ Since at least 1998,
21 HYDROTHERM has been conducting business within or from Arizona.¹⁰ The Corporations

22 ¹ See Hearing Exhibit S-16, page 6, lines 3 – 7.

23 ² See Hearing Exhibit S-1.

24 ³ See Hearing Exhibit S-4. Hearing Transcript Volume I, page 94, lines 14-20.

25 ⁴ See Hearing Transcript, Volume I, page 94, lines 18 – 20.

26 ⁵ See Hearing Exhibit S-16, page 10, lines 13 – 17.

⁶ See Hearing Exhibits S-5a and S-5f. Hearing Transcript Volume I, page 94, lines 23 – 25; page 96, lines 3 – 6.

⁷ See Hearing Exhibit S-2.

⁸ See Hearing Exhibit S-6.

⁹ See Hearing Transcript, Volume I, page 98, lines 5 – 8.

¹⁰ See Hearing Exhibit S-7.

1 Division of the Arizona Corporation Commission authorized HYDROTHERM to transact business
 2 in Arizona, but its grant of authority was revoked in 2009.¹¹ HYDROTHERM has not been
 3 registered by the Commission as a dealer.¹²

4 4. At all relevant times, HAGEMAN was the president and CEO of DELUGE and
 5 HYDROTHERM.¹³

6 5. According to HAGEMAN, HYDROTHERM is the parent company of DELUGE.¹⁴
 7 Both entities are in the business of developing a thermal hydraulic engine known as the Natural
 8 Energy Engine (“NEE”).¹⁵

9 6. On December 2, 2013, RESPONDENTS filed Answers to the Notice. In the
 10 Answers, RESPONDENTS asserted that they were in compliance with “Federal and State
 11 Securities Rules.”¹⁶

12 7. In October of 1997, HAGEMAN and DELUGE submitted a Form D under Rule 506
 13 for DELUGE with the Securities and Exchange Commission (“SEC”) and filed a copy with the
 14 Commission.¹⁷ On October 22, 1997, HAGEMAN and DELUGE notified the Commission that
 15 they were terminating the DELUGE offering.¹⁸ On October 21, 1997, HAGEMAN and DELUGE
 16 filed a Form D under Rule 505 on behalf of DELUGE with the SEC.¹⁹ Another Form D was filed
 17 on behalf of DELUGE on about July 14, 2000.²⁰ No Form D’s were filed on behalf of
 18 HYDROTHERM with the SEC or the Securities Division.²¹

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20 ...

21 ¹¹ See Hearing Exhibit S-7a, 7b and 7c. Hearing Transcript Volume I, page 98, lines 10 – 15; page 98, lines 1 -5.

22 ¹² See Hearing Exhibit S-3.

23 ¹³ See Hearing Exhibit S-16, page 7, lines 1 – 8.

24 ¹⁴ See Hearing Exhibits S9; S-12, page 17 lines 11 – 18.

25 ¹⁵ See Hearing Exhibits S-8; S-9, Bates No. ACC000003 – ACC000022; S-10, Bates No. ACC000034 – ACC000039;
 26 S-13, Bates No. ACC000044 – ACC000063.

¹⁶ See Answers.

¹⁷ See Hearing Exhibits S-39 and S-41b.

¹⁸ See Hearing Exhibit S-25.

¹⁹ See Hearing Exhibit S-41c.

²⁰ See Hearing Exhibit S-41d.

²¹ See Hearing Exhibit S-41a.

1 8. RESPONDENTS obtained investors from the DELUGE website, family and
2 friends.²² Some investors heard about DELUGE and HYDROTHERM through HAGEMAN'S
3 radio show.²³ HAGEMAN asserted that he only accepted accredited individuals as investors.²⁴ In
4 fact, HAGEMAN asserted that the potential investor must be accredited or have a net worth of \$1
5 million or he "does not deal with them."²⁵ However, even though HAGEMAN makes the inquiry
6 about whether an individual is an accredited investor, he continues the conversation, provides
7 documentation and finds ways to have the individuals appear to be accredited.²⁶ Not all the
8 investors were accredited.²⁷

9 9. RESPONDENTS provided offerees with a subscription agreement for either
10 DELUGE or HYDROTHERM.²⁸ The subscription agreement listed categories of "Accredited
11 Investors" for the individual to initial.²⁹ One of the categories included "Other Accredited Investor
12 – Please Describe."³⁰ HAGEMAN explained that a person can be accredited if they were
13 sophisticated through personal knowledge of financial systems.³¹ However, at least one offeree
14 indicated that he was not sophisticated and was not in a business related to finance.³²

15 10. Since at least March 5, 2012, DELUGE has maintained a website at
16 www.delugeinc.com ("DELUGE website").³³ The DELUGE website provided the following
17 information on its "FAQ's" page:

18 Deluge, Inc. is the development and commercialization company for the Natural
19 Energy Engine™. Deluge, Inc. was incorporated in Delaware in 1997 with its home
20 office located in Scottsdale, Arizona. The President and CEO of Deluge, Inc. is Mr.

21 ²² See Hearing Exhibit S-16, page 58, lines 25 – page 59, lines 3.

22 ²³ See Hearing Exhibit S-16, page 82, lines 16 – 25.

23 ²⁴ See Hearing Exhibit S-16, page 59, lines 23 – page 60, lines 25.

24 ²⁵ See Hearing Exhibit S-16, page 59, lines 23 – page 60, lines 11; page 67, lines 3 – 5.

25 ²⁶ See Hearing Exhibits S-11, S-12, and S-14.

26 ²⁷ See Hearing Transcript, Volume I, page 131, lines 6 – 10.

27 ²⁸ See Hearing Exhibits S-9, Bates No. ACC00023 – ACC000026; S-13, Bates No. ACC000064 – ACC000067; S-15,
28 Bates No. ACC3917 - ACC003920.

29 ²⁹ See Hearing Exhibits S-9, Bates No. ACC00024; S-13, Bates No. ACC000065; S-15, Bates No. ACC3918.

30 ³⁰ See Hearing Exhibits S-9, Bates No. ACC00024; S-13, Bates No. ACC000065; S-15, Bates No. ACC3918.

31 ³¹ See Hearing Exhibit S-16, page 64, lines 13 – page 65, lines 2.

32 ³² See Hearing Exhibit S-12, page 4, lines 14 – 21.

33 ³³ See Hearing Exhibit S-8.

1 Brian Hageman and holds over forty (40) patents worldwide as the inventor of the
2 Natural Energy Engine.³⁴

3 11. The website contained an "Investors" page that encouraged potential investors to
4 contact DELUGE with "questions about investment opportunities with Deluge . . ." ³⁵

5 12. On November 30, 1995, HAGEMAN signed a Technology Transfer Agreement
6 ("TTA") with HYDROTHERM.³⁶ As part of this agreement, HAGEMAN would receive a "base
7 salary for so long as he is employed by [HYDROTHERM]."³⁷ HYDROTHERM received the right
8 to use, sell, license, lease, or distribute the use of HAGEMAN's "patents, copyrights, trademarks, .
9 . . relating to the development of technology to convert solar energy into electrical power."³⁸ On
10 June 1, 1998, a Second Amendment to TTA was signed between HYDROTHERM and
11 HAGEMAN.³⁹ Pursuant to the June 1, 1998, agreement, HAGEMAN, in lieu of the compensation
12 in original TTA, received a promissory note in the amount of \$2,000,000.⁴⁰ According to the
13 Promissory Note, HAGEMAN would receive \$2,000,000 with interest at the annual rate of eight
14 percent.⁴¹ According to HAGEMAN, he has never received payment on the Promissory Note and
15 interest continued to accrue.⁴² HAGEMAN was compensated through "shareholder loans" instead
16 through payments on the Promissory Note.⁴³

17 13. Sean Callahan, a certified public accountant designated as an expert, testified that an
18 independent third party should be the one to determine the value of the technology not the officers
19 and directors of the entities.⁴⁴ There was a valuation issue with the technology acknowledged by
20 HAGEMAN in a memo to the CPA firm of Arthur Andersen.⁴⁵

21 ³⁴ See Hearing Exhibit S-8 Bates No. ACC003923.

22 ³⁵ See Hearing Exhibit S-8 Bates No. ACC003943. Hearing Transcript Volume I, page 100, lines 19 – 25; page 101,
lines 1 - 8.

23 ³⁶ See Hearing Exhibit S-28.

24 ³⁷ See Hearing Exhibit S-28, Bates ACC000474.

25 ³⁸ See Hearing Exhibit S-28, Bates ACC000473 and 474.

26 ³⁹ See Hearing Exhibit S-28, Bates ACC000479.

⁴⁰ See Hearing Exhibit S-28, ACC000479 - 480.

⁴¹ See Hearing Exhibit S-28, ACC000480.

⁴² See Hearing Exhibit S-16, page 74, lines 1 -7.

⁴³ See Hearing Exhibit S-16, page 73, lines 12 – page 74, lines 7; [page 93, lines 6 – 14.

⁴⁴ See Hearing Transcript, Volume II, page 241, lines 24 – page 242, lines 25.

⁴⁵ See Hearing Exhibit S-32.

1 14. Since about 2005 or 2006, HAGEMAN took what he termed “shareholder loans”
2 from the entities.⁴⁶ There were no written loan documents related to the “shareholder loans” and
3 none of the “shareholder loans” have been repaid.⁴⁷ HAGEMAN stated that he was “taken care of”
4 first then the expenses of the entities.⁴⁸

5 15. According to Mr. Callahan, there exist certain requirements on tracking loans taken
6 by employees or owners of entities.⁴⁹ Specific information is necessary when employees and/or
7 owners take loans from their entities. Information such as a document explaining the terms of the
8 loan, the interest rate, the repayment terms, the total amount owed to the entities should exist.⁵⁰
9 Neither the DELUGE nor the HYDROTHERM balance sheets disclosed the loans to
10 HAGEMAN.⁵¹ Having not disclosed the “shareholder loans” taken by HAGEMAN, the financial
11 statements would be incorrect and potentially may severely distort the financial statements to the
12 point of them becoming meaningless.⁵²

13 16. On March 5, 2012, Special Investigator Weiss, an Arizona resident, inputted her
14 information into the form provided in the “Investor” page of the DELUGE website.⁵³ She
15 identified herself as an Arizona investor interested in the energy investment.⁵⁴

16 17. On March 6, 2012, HAGEMAN responded via email to Special Investigator Weiss,
17 who stated “[w]e have various levels of investment for accredited investors.”⁵⁵

18 18. On March 7, 2012, HAGEMAN emailed Special Investigator Weiss. He provided a
19 copy of the information in the “FAQ’s” page of the DELUGE website, an Executive Summary, and
20 a subscription agreement for the purchase of “common stock” in HYDROTHERM.⁵⁶ The

21 ⁴⁶ See Hearing Exhibit S-16, page 73, lines 17 -20; page 75, lines 7 – page 78, lines 14; page 93, lines 6 – 14.

22 ⁴⁷ See Hearing Exhibit S-16, page 76, lines 14 – page 77, lines 20; page 98, lines 4 – page 99, lines 20.

23 ⁴⁸ See Hearing Exhibit S-16, page 78, lines 10 – 15.

24 ⁴⁹ See Hearing Transcript, Volume II, page 237, lines 22 – page 238, lines 14.

25 ⁵⁰ See Hearing Transcript, Volume II, page 240, lines 7, page 24, lines 6.

26 ⁵¹ See Hearing Transcript, Volume II, page 245, lines 7 – 11; page 247, lines 9 – 18; See Hearing Exhibits S-37 and S-38.

⁵² See Hearing Transcript, Volume II, page 248, lines 6 – 20.

⁵³ See Hearing Exhibit S-9 Bates No. ACC000002.

⁵⁴ See Hearing Exhibit S-9 Bates NO. ACC000002.

⁵⁵ See Hearing Exhibits S-9 Bates No. ACC000002.

⁵⁶ See Hearing Exhibits S-9 Bates No. ACC000001, Bates No. ACC000003 – ACC000026.

1 Executive Summary provided contact information for HAGEMAN, the DELUGE website, and an
2 Arizona telephone number.⁵⁷ HAGEMAN explained in his email to Special Investigator Weiss
3 that HYDROTHERM was the “parent company” of DELUGE, that HYDROTHERM was the
4 patent holding company, and that Special Investigator Weiss would be “buying” into the patents.⁵⁸

5 19. The Subscription Agreement provided by HAGEMAN to Special Investigator
6 Weiss was for “common stock” in HYDROTHERM at \$5 per share.⁵⁹ HYDROTHERM identified
7 itself as a Delaware corporation in the Subscription Agreement.⁶⁰ No other written materials or
8 information were provided regarding the investment.

9 20. Special Investigator Weiss informed HAGEMAN that she knew of someone that
10 might want to invest however he was not an accredited investor.⁶¹ HAGEMAN responded that they
11 “can allow people to invest if they have some degree of sophistication with investments or
12 contracts. This includes business owners, realtors, bankers, stock brokers and other management
13 skilled individuals.”⁶²

14 21. Special Investigator Weiss asked HAGEMAN a number of questions related to the
15 investment including how the investment funds would be used, and what was the expected return.⁶³
16 HAGEMAN stated that the investment would be “used in general business development helping to
17 pay for administrative costs associated with projects here in Arizona and projects planned in
18 Wyoming and other states.”⁶⁴ HAGEMAN also stated that he expected to have “the full investment
19 returned within a couple years, then dividends would be paid quarterly based on revenues
20 generated.”⁶⁵ In his response, HAGEMAN informed Special Investigator Weiss that investors had
21 invested about \$14 million in the technology.⁶⁶

22 ⁵⁷ See Hearing Exhibit S-9, Bates No. ACC000018.

23 ⁵⁸ See Hearing Exhibit S-9, Bates No. ACC000001.

24 ⁵⁹ See Hearing Exhibit S-9, Bates No. ACC000023.

25 ⁶⁰ See Hearing Exhibit S-9, Bates No. ACC000023.

26 ⁶¹ See Hearing Exhibit S-10, Bates No. ACC000028.

⁶² See Hearing Exhibit S-10, Bates No. ACC000028.

⁶³ See Hearing Exhibit S-10, Bates No. ACC000029.

⁶⁴ See Hearing Exhibit S-10, Bates No. ACC000030.

⁶⁵ See Hearing Exhibit S-10, Bates No. ACC000030.

⁶⁶ See Hearing Exhibit S-10, Bates No. ACC000030.

1 22. HAGEMAN failed to disclose to Special Investigator Weiss that neither DELUGE
2 nor HYDROTHERM are incorporated in any jurisdiction.⁶⁷ At no time did HAGEMAN disclose to
3 Special Investigator Weiss there were a number of lawsuits filed against HAGEMAN, DELUGE
4 and/or HYDROTHERM.⁶⁸ At no time did HAGEMAN disclose Special Investigator Weiss that no
5 shareholders had received any return on investments and that almost all funds came from
6 investors.⁶⁹ At no time did HAGEMAN disclose to Special Investigator Weiss that the funds raised
7 would be used to pay HAGEMAN first, then the technology.⁷⁰

8 23. On March 16, 2012, Special Investigator Santee contacted HAGEMAN in an
9 undercover capacity. Special Investigator Santee is an Arizona resident. He contacted HAGEMAN
10 through the "contact" page of the DELUGE website via email regarding investment opportunities
11 in DELUGE or HYDROTHERM.⁷¹

12 24. On March 16, 2012, Special Investigator Santee and HAGEMAN had a telephone
13 conference to discuss the investment opportunities.⁷² HAGEMAN stated that he had been selling
14 stock in his companies for 15 years, had 700 shareholders, and had brought in \$14 million in
15 investments.⁷³ HAGEMAN stated that he sold common stock to almost 500 people in DELUGE
16 and that he was now selling stock in DELUGE'S "parent"⁷⁴ company, HYDROTHERM.⁷⁵
17 HAGEMAN told Special Investigator Santee that he would receive "common stock" in
18 HYDROTHERM, which held HAGEMAN's patents,⁷⁶ and was offered the stock at a discount of
19 \$1 per share.⁷⁷

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21 ⁶⁷ See Hearing Transcript, Volume I, page 118, lines 4 – 9; Hearing Exhibits S-9 and S-10.

22 ⁶⁸ See Hearing Transcript, Volume I, page 118, lines 10 – 12.

23 ⁶⁹ See Hearing Transcript, Volume I, page 119, lines 13 – 17.

24 ⁷⁰ See Hearing Transcript, Volume I, page 121, lines 17 – 20.

25 ⁷¹ See Hearing Exhibits S-8, S-11, S-12 and S-13; Hearing Transcript, Volume I, page 67, lines 6 – 9; page 66, lines 7 –
26 8.

27 ⁷² See Hearing Exhibit S-12.

28 ⁷³ See Hearing Exhibit S-12, page 4, lines 5 – 8; page 16, lines 16 - 17.

29 ⁷⁴ Parent companies usually hold 100% of the stock of the held company. HYDROTHERM did not hold 100% of the
30 DELUGE stock. See Hearing Exhibit S-16, page 47, lines 18 – 24; page 48, lines 17 – page 49, lines 1.

31 ⁷⁵ See Hearing Exhibits S-9, S-12, page 17, lines 2 – 15.

32 ⁷⁶ See Hearing Exhibit S-12, page 16, lines 12 – 17; page 16, lines 23 -24; page 17, lines 2 – 18.

33 ⁷⁷ See Hearing Exhibit S-12, page 22, lines 7 – 20.

1 25. HAGEMAN told Special Investigator Santee that the return on investment with
2 HYDROTHERM would be slower, but other investments that paid more quickly had a higher
3 risk.⁷⁸ HAGEMAN also stated that Special Investigator Santee would get 100% return on his
4 investment within 3-5 years.⁷⁹

5 26. HAGEMAN provided Special Investigator Santee copies of the DELUGE
6 Executive Summary, DELUGE Frequently Asked Questions and HYDROTHERM Subscription
7 Agreement.⁸⁰ The HYDROTHERM Subscription Agreement stated that HYDROTHERM was a
8 Delaware corporation.⁸¹ Further, the HYDROTHERM Subscription Agreement listed seven
9 categories for "Accredited Investors."⁸² One of the categories was "Other Accredited Investor."⁸³

10 27. HAGEMAN stated to Special Investigator Santee that they needed to stick to the
11 accredited investor standard.⁸⁴ However, HAGEMAN then stated that the accredited investor
12 standard was "fairly loose in its interpretations."⁸⁵ Special Investigator Santee described his
13 undercover background by stating he was a disabled construction worker who had received an
14 inheritance.⁸⁶ HAGEMAN advised Special Investigator Santee that in order to qualify as an
15 accredited investor he could estimate his income from his inheritance and disability income and
16 that he expected to make more money.⁸⁷ HAGEMAN then explained to Special Investigator Santee
17 that "we're not required to verify any of the information on your subscription agreement . . . we
18 just need to have a signed piece of paper in our file."⁸⁸

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⁷⁸ See Hearing Exhibit S-12, page 8, lines 2 - 9.

⁷⁹ See Hearing Exhibit S-12, page 18, lines 20 - 23.

⁸⁰ See Hearing Exhibit S-13, Bates No. ACC000064.

⁸¹ See Hearing Exhibit S-13, Bates No. ACC000064. See Hearing Transcript, Volume I, page 72, lines 15 - page 73, lines 5.

⁸² See Hearing Exhibit S-13, Bates No. ACC000065. See Hearing Transcript, Volume I, page 73, lines 14 - 23.

⁸³ See Hearing Exhibit S-13, Bates No. ACC000065. See Hearing Transcript, Volume I, page 73, lines 16 - 23.

⁸⁴ See Hearing Exhibit S-12, page 4, lines 2 - 3.

⁸⁵ See Hearing Exhibit S-12, page 4 lines 5 - 8.

⁸⁶ See Hearing Exhibit S-12, page 4, lines 15 - 21.

⁸⁷ See Hearing Exhibit S-12, page 6, lines 2 - 13.

⁸⁸ See Hearing Exhibit S-12, page 6, lines 18 - 23.

1 28. HAGEMAN did not inquire about Special Investigator Santee's sophistication or
2 experience as an investor.⁸⁹

3 29. HAGEMAN failed to disclose to Special Investigator Santee that DELUGE and
4 HYDROTHERM were no longer valid corporations in Arizona and Delaware.⁹⁰ In addition,
5 HAGEMAN failed to disclose to Special Investigator Santee that there were numerous judgments
6 against him and his entities.⁹¹ Moreover, HAGEMAN failed to disclose to Special Investigator
7 Santee that, although he had been raising money from investors for 12 to 15 years, none of those
8 shareholders had received a return on their investments.⁹² Further, HAGEMAN failed to disclose to
9 Special Investigator Santee that any funds he invested would go to HAGEMAN first then to the
10 company.⁹³

11 30. On June 5, 2013, another potential Arizona offeree, Special Investigator Barrett,
12 inputted his information into the form provided in the "Investor" page of the DELUGE website.⁹⁴
13 Special Investigator Barrett identified himself as an Arizona investor interested in the energy
14 investment.⁹⁵

15 31. On June 6, 2013, HAGEMAN responded to Special Investigator Barrett's email
16 with two attachments, a subscription agreement and a DELUGE licensing plan.⁹⁶ HAGEMAN
17 indicated that he had "investment opportunities to accredited investors."⁹⁷ Special Investigator
18 Barrett responded that he was "interested in information about investment opportunities."⁹⁸ No
19 mention was made regarding whether Special Investigator Barrett was accredited or not. Without
20 confirming that the person he was speaking with was accredited, HAGEMAN provided copies of
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22 ⁸⁹ See Hearing Transcript, Volume I, page 82, lines 3 -5.

23 ⁹⁰ See Hearing Transcript, Volume I, page 82, lines 6 - 9.

24 ⁹¹ See Hearing Transcript, Volume I, page 82, lines 10 - 15.

25 ⁹² See Hearing Transcript, Volume I, page 82, lines 16 - 23.

26 ⁹³ See Hearing Transcript, Volume I, page 83, lines 9 - 13.

⁹⁴ See Hearing Exhibits S-8; S-14.

⁹⁵ See Hearing Exhibit S-14.

⁹⁶ See Hearing Exhibits S-14 and S-15.

⁹⁷ See Hearing Exhibit S-14.

⁹⁸ See Hearing Exhibit S-14, Bates No. ACC003883.

1 the offering documents to Special Investigator Barrett.⁹⁹ HAGEMAN stated that Special
2 Investigator Barrett needed to sign the subscription agreement and the minimum investment for
3 DELUGE "common stock" was \$25,000.¹⁰⁰ HAGEMAN provided Special Investigator Barrett a
4 DELUGE subscription agreement.¹⁰¹

5 32. Nita Killibrew ("Mrs. Killibrew") testified that in 1997, she and her husband were
6 told by the RESPONDENTS that DELUGE stock was "going to go public" and they would receive
7 a "tremendous return."¹⁰² "If it went public, the shares would be worth more and we would be
8 liquidatable."¹⁰³

9 33. Mrs. Killibrew testified that the funds used to purchase the stock would be used to
10 develop the technology to make the engine smaller so it would be easier to sell.¹⁰⁴ The dividends
11 were to be paid from the sale of the engines.¹⁰⁵

12 34. Mrs. Killibrew testified that she and her husband made several investments in both
13 DELUGE and HYDROTHERM.¹⁰⁶

14 35. Mrs. Killibrew testified that the RESPONDENTS would tell them that they could
15 expect returns in a short period of time but that never occurred.¹⁰⁷

16 36. At some point, according to Mrs. Killibrew's testimony, they wanted their money
17 back because "it was obvious they were just going out and getting new investors, instead of doing
18 what was prudent for their investors that they had."¹⁰⁸

19 37. Mrs. Killibrew testified that she and her husband invested a total of \$37,500 in
20 DELUGE and HYDROTHERM and received \$50,000 when an employee of the entities sold a
21 portion of their stock to another investor.¹⁰⁹

22 ⁹⁹ See Hearing Exhibit S-14.

23 ¹⁰⁰ See Hearing Exhibit S-14, Bates No. ACC003883

24 ¹⁰¹ See Hearing Exhibit S-15, Bates No. ACC003917.

25 ¹⁰² See Hearing Transcript, Volume I, page 32, lines 7 - 10.

26 ¹⁰³ See Hearing Transcript, Volume I, page 32, lines 18 - 24; page 35, lines 12 - 14.

¹⁰⁴ See Hearing Transcript, Volume I, page 34, lines 6 - 18.

¹⁰⁵ See Hearing Transcript, Volume I, page 59, lines 2 - 23.

¹⁰⁶ See Hearing Exhibit S-27.

¹⁰⁷ See Hearing Transcript, Volume I, page 49, lines 15 - 19.

¹⁰⁸ See Hearing Transcript, Volume I, page 46, lines 2 - 10.

1 38. John Rhodes ("Mr. Rhodes"), another investor, testified to his purchase of
2 DELUGE and HYDROTHERM stock. Around the late 1990's, Mr. Rhodes heard about DELUGE
3 and HYDROTHERM from a friend.¹¹⁰ Mr. Rhodes then visited HAGEMAN's office and discussed
4 the investment opportunity with HAGEMAN.¹¹¹ Mr. Rhodes had no pre-existing business
5 relationship with HAGEMAN prior to making his investment.¹¹²

6 39. Mr. Rhodes believed he would receive dividends on his investment.¹¹³ Mr. Rhodes
7 understood that the company would be "going public" in the next couple of years.¹¹⁴ One of the
8 reasons Mr. Rhodes invested was because he understood that DELUGE and HYDROTHERM
9 would "go public."¹¹⁵

10 40. Mr. Rhodes believed his investment funds would be used for the experimentation,
11 the production and the testing of the equipment.¹¹⁶ Also the funds would be used to operate the
12 office.¹¹⁷

13 41. Mr. Rhodes purchased stock in DELULGE and HYDROTHERM.¹¹⁸ A total of
14 \$44,500 was invested by Mr. Rhodes for both DELUGE and HYDROTHERM.¹¹⁹ DELUGE and
15 HYDROTHERM were to earn income or revenue through having entities use or sell the NEE.¹²⁰

16 42. According to the minutes of the Board of Directors of DELUGE, at the time Mr.
17 Rhodes invested, the checkbook balance was only \$23.¹²¹ Had Mr. Rhodes known this fact prior to
18 his investment, he would have been concerned.¹²²

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21 ¹⁰⁹ See Hearing Transcript, Volume I, page 53, lines 2 – 20. See Hearing Exhibit S-27.

¹¹⁰ See Hearing Transcript, Volume II, page 175, lines 19 – page 176, lines 10.

¹¹¹ See Hearing Transcript, Volume II, page 176, lines 9 – 10.

¹¹² See Hearing Transcript, Volume II, page 218, lines 10 – 17.

¹¹³ See Hearing Transcript, Volume II, page 176, lines 24 – page 177, lines 12.

¹¹⁴ See Hearing Transcript, Volume II, page 180, lines 1 – 7.

¹¹⁵ See Hearing Transcript, Volume II, page 197, lines 4 – 21.

¹¹⁶ See Hearing Transcript, Volume II, page 178, lines 8 – 18.

¹¹⁷ Id.

¹¹⁸ See Hearing Exhibit S-35; Hearing Transcript, Volume II, page 183, lines 12 – page 184, lines 19.

¹¹⁹ See Hearing Transcript, Volume II, page 187, lines 11 – 14.

¹²⁰ See Hearing Transcript, Volume II, page 188, lines 24 – page 189, lines 3.

¹²¹ See Hearing Exhibit S-30.

¹²² See Hearing Transcript, Volume II, page 190, lines 13 – 22.

1 43. HAGEMAN failed to disclose the TTA prior to Mr. Rhodes purchasing stock in
2 either DELUGE OR HYDROTHERM.¹²³ Mr. Rhodes testified that he would have wanted to know
3 about the TTA and the Second Amendment to the TTA.¹²⁴ Mr. Rhodes testified that it would have
4 affected his decision to invest.¹²⁵ The information regarding the technology transfer is something
5 Mr. Rhodes testified that he would have wanted to know prior to investing additional funds.¹²⁶

6 44. Mr. Rhodes testified that he would have wanted to know about the “shareholder
7 loans” that HAGEMAN took.¹²⁷

8 45. According to HAGEMAN, HYDROTHERM investors received no offering
9 documents except those from DELUGE.¹²⁸ Only if investors ask for more information does
10 HAGEMAN provide a risk statement from DELUGE.¹²⁹ HAGEMAN explained that since
11 DELUGE was HYDROTHERM’s main licensee, investors would only need the information from
12 DELUGE.¹³⁰ HAGEMAN stated that he only provided verbal information related to the use of
13 funds in HYDROTHERM.¹³¹

14 46. DELUGE and HYDROTHERM have received limited revenue from the sale of
15 prototypes.¹³² HAGEMAN stated that HYDROTHERM received its revenue “only through
16 investor.”¹³³

17 47. According to HAGEMAN, he is the only one that makes the offer for shares in both
18 companies.¹³⁴ HAGEMAN admitted that he does not know all of the offerees or investors
19 personally.¹³⁵

21 ¹²³ See Hearing Exhibit S-28; Hearing Transcript, Volume II, page 201, lines 17 – page 204, lines 18.

22 ¹²⁴ See Hearing Transcript, Volume II, page 204, lines 10 – 20.

23 ¹²⁵ See Hearing Transcript, Volume II, page 207, lines 6 – 13.

24 ¹²⁶ See Hearing Transcript, Volume II, page 208, lines 6 – 10.

25 ¹²⁷ See Hearing Transcript, Volume II, page 206, lines 4 – 22.

26 ¹²⁸ See Hearing Exhibit S-16, page 88, lines 13 – 20; page 89, lines 14 – 23.

¹²⁹ See Hearing Exhibit S-16, page 88, lines 21 – page 89, lines 4.

¹³⁰ See Hearing Exhibit S-16, page 88, lines 13 – 20.

¹³¹ See Hearing Exhibit S-16, page 89, lines 5 – 13.

¹³² See Hearing Exhibit S-16, page 70, lines 4 – 7.

¹³³ See Hearing Exhibit S-16, page 73, lines 2 – 4.

¹³⁴ See Hearing Exhibit S-16, page 66, lines 14 -16. See Hearing Transcript, Volume I, page 117, lines 17 – 23.

¹³⁵ See Hearing Exhibit S-16, page 66, lines 17 -20.

1 48. According to HAGEMAN, the funds raised for HYDROTHERM were to be used
2 for "company expenses to advance the technology and to take care of company obligations."¹³⁶

3 49. Besides the Delaware tax obligations, DELUGE had numerous outstanding
4 judgments against it for over \$350,000 due to nonpayment to vendors.¹³⁷

5 50. No DELUGE or HYDROTHERM investor has received return of their principal or
6 dividends on their stock purchases.¹³⁸

7 51. Since at least 1998, RESPONDENTS have raised a total of \$11,243,754.89.¹³⁹

8 **IV. LEGAL ARGUMENT**

9 **A. Pursuant to A.R.S. §44-1841, Securities Must Be Registered Or Qualify For A 10 Valid Exemption.**

11 Pursuant to A.R.S. § 44-1841, it is unlawful to offer or sell securities within or from
12 Arizona unless the securities have been registered or there is an applicable exemption. In this case,
13 the RESPONDENTS have admitted that they offered and sold securities in the form of stock.¹⁴⁰
14 The securities were not registered and there was no applicable exemption from registration.
15 Accordingly, RESPONDENTS violated the registration provisions of the Securities Act under
16 A.R.S. § 44-1841.

17 **B. Under A.R.S. §44-1842, RESPONDENTS Were Required To Be Registered Or 18 Have A Valid Exemption.**

19 Pursuant to A.R.S. §44-1842, it is unlawful for any dealer or salesman to offer to sell
20 securities within or from Arizona unless the dealer or salesman is registered under the Act.

21 Pursuant to A.R.S. §44-1801(9)(b), the definition of dealer includes an issuer who directly
22 or through an officer, director, employee or agent, who is not registered as a dealer under the Act,
23 engages in selling securities issued by such issuer. Contrary to the Answers filed on behalf of

24 ¹³⁶ See Hearing Exhibit S-16, page 69, lines 9 – 14.

25 ¹³⁷ See Hearing Exhibits S-18, S-19, S-20, S-21, S-22 and S-23.

26 ¹³⁸ See Hearing Exhibits S-16, page 52, lines 7 – 10.S-24a, S-24b and S-24c. Mrs. Killibrew was able to sell a portion of their shares.

¹³⁹ See Hearing Exhibits S-24a, S-24b and S-24c.

¹⁴⁰ After 2010, DELUGE and HYDROTHERM were no longer valid corporations. The Court in *State v. Goodman*, 110 Ariz. 524, 526, 521 P.2d 611, 614 (1974), held that the offer or sale of "non-existent" securities is still subject to prosecution for the violation of AR.S. §§ 44-1842 and 44-1842, the registration provisions of the Act.

1 DELUGE and HYDROTHERM, under A.R.S. §44-1801(9)(b), both entities meet the definition of
2 dealer and therefore must be registered or meet an exemption from registration.¹⁴¹

3 HAGEMAN asserted in his Answer that he “acted as an Officer of the Corporations
4 Deluge, Inc. and Hydrotherm Power Corporation. Hageman is not required to be registered by the
5 Commission as a securities salesman or dealer.”¹⁴² Pursuant to A.R.S. §44-1801(22), HAGEMAN
6 is a salesman as defined by A.R.S. §44-1801(22). A.R.S. §44-1801(22) provides that “partners or
7 executive officers of a **registered dealer** shall not be deemed salesmen within the meaning of this
8 definition.” (emphasis added). Since DELUGE and HYDROTHERM were not “registered dealers”
9 under the Act, HAGEMAN would be required to be registered.

10 Neither HAGEMAN nor his entities were registered as dealers or salesmen under the
11 Act.¹⁴³ Accordingly, RESPONDENTS violated the registration provisions of the Securities Act
12 under A.R.S. § 44-1842.

13 **C. The Burden Is On The Person Claiming an Exemption To Prove It Is**
14 **Applicable.**

15 Pursuant to A.R.S. §44-2033, in any action, when a defense is based upon any exemption
16 under the Act, the burden of proving the exemption exists shall be upon the party raising the
17 defense. “The general rule governing the burden of proof in Arizona is that a party who asserts the
18 affirmative of an issue has the burden of proving it.”¹⁴⁴ In any action, civil or criminal, the burden
19 of proving the applicability of an exemption from registration under the Act falls upon the party
20 raising such a defense.¹⁴⁵

21 The RESPONDENTS failed to provide testimony or evidence to establish that there were
22 any applicable exemptions available to them from the registration provisions of the Act.
23 RESPONDENTS asserted in their Answers that the “securities were sold only in compliance with

24 ¹⁴¹ See DELUGE Answer page 4, lines 4 -5 and HYDROTHERM Answer page 3, lines 21 – 23.

25 ¹⁴² See HAGEMAN’s Answer, page 2, lines 12 – 15.

26 ¹⁴³ See Hearing Exhibits S-1 and S-2.

¹⁴⁴ *Black, Robertshaw, Frederick, Copple & Wright, P.C. v. U.S.*, 130 Ariz. 110, 634 P.2d 398 (App. 1981) quoting
Harvey v. Aubrey, 53 Ariz. 210, 213, 87 P.2d 482, 483 (1939).

¹⁴⁵ A.R.S. §44-2033. See also, *State v. Barber*, 133 Ariz. 572, 578, 653 P.2d 29 (App. 1982).

1 Federal and State regulations.¹⁴⁶ RESPONDENTS further stated that they were not “required to
2 register as a stock broker, dealer or salesman.”¹⁴⁷ RESPONDENTS had the opportunity to provide
3 testimony and evidence to support their claims of an exemption but voluntarily chose not to. By
4 failing to provide testimony and evidence to support their claims of exemptions from registration,
5 the RESPONDENTS have failed to overcome the burden necessary to prove the existence of any
6 exemption.

7 **D. The Respondents Were Not In Compliance With Federal And State**
8 **Regulations.**

9 Although the RESPONDENTS did not provide evidence or testimony on this issue at
10 hearing, in their Answers they asserted that the securities were sold in compliance with Federal
11 and State regulations. This is not the case. In 1997 and 2000, HAGEMAN and DELUGE filed
12 three “Form Ds”¹⁴⁸ on behalf of DELUGE. Nothing was filed on behalf of HYDROTHERM. For
13 the reasons listed below, the stock offered and sold by HAGEMAN and DELUGE did not qualify
14 for an exemption from registration.

15 HAGEMAN and DELUGE simply do not meet the requirements under Section 4(2) of the
16 Securities Act of 1933 or A.R.S. §44-1844(a)(1). Section 4(2) of the federal Securities Act of 1933
17 provides an exemption from registration for “transactions by an issuer not involving any public
18 offering.” Section 44-1844(A)(1) of the Act is the state equivalent to Section 4(2). In order to
19 satisfy the statutory private offering exemption, the securities cannot be sold through advertising
20 and the sales must be made to only a limited number of sophisticated people who have access to
21 the information that would be included in a registration statement.¹⁴⁹

22
23
24 ¹⁴⁶ See Answers filed by RESPONDENTS.

25 ¹⁴⁷ See Answers filed by RESPONDENTS.

26 ¹⁴⁸ To take advantage of the exemption or safe harbor from registration offered in federal Regulation D, Rules 505 or 506, an issuer must file a “Form D” with the SEC, and file a notice with the Commission that the issuer is making offers and/or sales in Arizona. See A.R.S. § 44-1843.02 and A.A.C. R14-4-126.

¹⁴⁹ See *SEC v. Murphy*, 626 F.2d 633 (9th Cir. 1980).

1 Regulation D of the Securities Act of 1933 outlines two exemptions¹⁵⁰ and a “safe harbor”
2 with respect to Section 4(2) of the Securities Act of 1933. Since the HAGEMAN and DELUGE
3 stated only that they were in compliance with Federal and State regulations and they had filed the
4 Form D’s, the Securities Division assumed that HAGEMAN and DELUGE are referencing Rule
5 505¹⁵¹ which is an exemption and 506¹⁵² which is the safe harbor to the 4(2) exemption of the
6 Securities Act of 1933.

7 Rule 505 provides an exemption from registration. A.A.C. 14-4-126(E) is the comparable
8 Arizona rule. In order to qualify for the exemption, HAGEMAN and DELUGE are required to
9 meet certain conditions.¹⁵³ The offering must not exceed \$5 million within the twelve months
10 before the start of and during the offering of securities. Also, there are to no more than 35
11 unaccredited purchasers of securities. In this case, over \$11 million was raised from close to 700
12 investors.¹⁵⁴ Further, in order to qualify for this exemption, the issuer must have had a relationship
13 with the offeree that was substantive and preexisting. HAGEMAN admitted to not knowing all of
14 his investors prior to the investor investing.¹⁵⁵ This exemption is not available to HAGEMAN and
15 DELUGE.

16 Rule 506 provides a “safe harbor” to the private offering exemption under the Securities
17 Act of 1933. A “safe harbor” is a rule that explicitly states the requirements an issuer must meet.
18 If an issuer complies with all of the requirements of the rule, it is deemed to have complied with
19 the statute. In this case, if HAGEMAN and DELUGE complied with Rule 506 of Regulation D,
20 the issuer will be deemed to have met the requirements for the section 4(2) private placement
21 exemption. Offerings of any amount by any issuer to an unlimited number of accredited investors
22

23 ¹⁵⁰ Rule 504 and Rule 505 are exemptions from registration for limited offerings on the federal level. A.A.C. 14-4-
126(E) is similar to Rule 505, and also outlines exemptions to registration. Although there is no equivalent to Rule 504
24 under the Arizona Securities Act, a transaction exempt under Rule 504 may be exempt under other provisions of the
Arizona Securities Act.

25 ¹⁵¹ 17 C.F.R. §230.505; See Hearing Exhibit S-41c.

26 ¹⁵² 17 C.F.R. §230.506(a); See Hearing Exhibit S-41b.

¹⁵³ 17 C.F.R. §230.505; A.A.C. 4-14-126(E)(2).

¹⁵⁴ See Hearing Exhibits S-24a, S-24b and S-24c.

¹⁵⁵ See Hearing Exhibit S-16, page 66, lines 17 – 20.

1 plus 35 “sophisticated” persons are exempt from federal registration under Rule 506. However,
 2 Regulation D prohibits the use of general solicitation or general advertising under Rule 506.¹⁵⁶
 3 RESPONDENTS do not meet the requirements of Rule 506. As the evidence and testimony
 4 provided by the Securities Division at hearing showed, HAGEMAN and DELUGE sought
 5 investors over the Internet,¹⁵⁷ through HAGEMAN’s radio show¹⁵⁸ and with anyone who wanted
 6 to invest. The offering would be deemed a “public offering” and not eligible for the “statutory
 7 private offering exemption.”

8 A.A.C. R14-4-126, contains similar provisions as federal Regulation D. Rule 126(F)
 9 provides a safe harbor for the A.R.S. §44-1844(A)(1) exemption from registration for private
 10 placements. Although Rule 126(F) does not contain limits on the amount of securities offered,
 11 general solicitation or general advertising is prohibited.¹⁵⁹ HAGEMAN and DELUGE do not meet
 12 the requirement of Rule 126(F). As shown at hearing, HAGEMAN and DELUGE sought investors
 13 over the Internet, on the radio and through referrals.

14 RESPONDENTS provided no evidence to establish that the offering met any exemption or
 15 safe harbor from the registration provisions of the Act.

16 **E. HAGEMAN, DELUGE And HYDROTHERM Violated The Antifraud**
 17 **Provisions Of The Arizona Securities Act.**

18 Under A.R.S. § 44-1991, it is a fraudulent practice and unlawful for a person, in connection
 19 with a transaction or transactions within or from this state involving an offer to sell or buy
 20 securities, or a sale or purchase of securities, to directly or indirectly do any of the following: (1)
 21 employ any device, scheme or artifice to defraud; (2) make untrue statements of material fact, or
 22 omit to state any material fact necessary in order to make the statements made, in the light of the
 23 circumstances in which they were made, not misleading; or (3) engage in any transaction, practice

24 ¹⁵⁶ 17 C.F.R. 230.502(c), Limitation on manner of offering. “neither the issuer . . . shall offer to sell the securities by
 25 any form of general solicitation or general advertising . . .”

¹⁵⁷ See Hearing Exhibit S-16, page 58, lines 25 – page 59, lines 3.

¹⁵⁸ See Hearing Exhibit S-16, page 82, lines 16 – 25.

26 ¹⁵⁹ A.A.C.14-4-R126(C)(3), Limitation on manner of offering. “[n]either the issuer . . . shall offer or sell the securities
 by any form of general solicitation or general advertising . . .”

1 or course of business which operates or would operate as a fraud or deceit.¹⁶⁰ Securities fraud may
2 be proven by **any one** of these acts.¹⁶¹

3 In the context of these provisions, “materiality” requires a showing of substantial likelihood
4 that, under all the circumstances, the misstated or omitted fact would have assumed actual significance
5 in the deliberations of a **reasonable buyer**.¹⁶² Under this objective test, there is no need to investigate
6 whether an omission or misstatement was actually significant to a particular buyer. Courts look to the
7 significance of an omitted or misrepresented fact to a **reasonable investor**.¹⁶³ “It is whether the
8 existence or nonexistence of the fact in question is a matter to which a **reasonable man** would attach
9 importance in determining his choice of action in the transaction.”¹⁶⁴

10 There is an affirmative duty not to mislead potential investors in any way and places a heavy
11 burden on the offeror and removes the burden of investigation from the investor.¹⁶⁵

12 A misrepresentation or omission of a material fact in the offer and sale of a security is
13 actionable even though it may be unintended or the falsity or misleading character of the statement
14 may be unknown. In other words, scienter or guilty knowledge is not an element of a violation of
15 A.R.S. § 44-1991(A)(2).¹⁶⁶ Stated differently, a seller of securities is strictly liable for any of the
16 misrepresentations or omissions he makes.¹⁶⁷ Additionally, there is no requirement to show that
17 investors relied on the misrepresentations or omissions or that the misrepresentations or omissions
18 caused injury to the investors.¹⁶⁸ “Plaintiffs’ burden of proof requires only that they demonstrate that
19 the statements were material and misleading.”¹⁶⁹

21 ¹⁶⁰ See A.R.S. § 44-1991(A).

¹⁶¹ *Hernandez v. Superior Court*, 179 Ariz. 515, 521, 880 P.2d 735, 741 (App. 1994).

22 ¹⁶² See *Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548, 553, 733 P.2d 1131, 1136 (App. 1986) (emphasis added)
citing *Rose v. Dobras*, 128 Ariz. 209, 214, 624 P.2d 887, 892 (App. 1981), quoting *TSC Industries v. Northway, Inc.*,
23 426 U.S. 438 (1976).

¹⁶³ See *TSC Industries*, 426 U.S. at 445, 96 S. Ct. 2126, 48 L. Ed. 2d 757 (1976). (emphasis added).

24 ¹⁶⁴ See *SEC v. Seaboard Corporation*, 677 F.2d 1301, 1306 (9th Cir. 1982) (emphasis added).

¹⁶⁵ *Trimble*, 152 Ariz. at 553, 733 P.2d at 1136.

25 ¹⁶⁶ See e.g., *State v. Gunnison*, 127 Ariz. 110, 113, 618 P.2d 604 (1980); *Allstate Life Ins. Co. v. Baird & Co., Inc.*, 756
F.Supp.2d 1113 (2010).

¹⁶⁷ *Rose*, 128 Ariz. at 214, 624 P.2d at 892.

26 ¹⁶⁸ *Trimble*, 152 Ariz. at 553, 733 P.2d at 1136.

¹⁶⁹ *Aaron*, 196 Ariz. at 227, 314 P.2d at 1042.

1 A primary violation of A.R.S. § 44-1991(A) can be either direct or indirect.¹⁷⁰ It is now well
 2 settled the Act is not to be narrowly interpreted.¹⁷¹ Accordingly, the courts will look at a broad range
 3 of conduct and levels of participation to determine if a person¹⁷² violated A.R.S. § 44-1991(A).

4 In this case, HAGEMAN, DELUGE and HYDROTHERM misrepresented to offerees and
 5 investors that they would receive 100% return on investment within three to five years when, in fact,
 6 RESPONDENTS had been selling stock in DELUGE and HYDROTHERM since at least 1998 and
 7 no investor have received any return on their investment.¹⁷³ Further, RESPONDENTS failed to inform
 8 offerees that both DELUGE and HYDROTHERM were no longer recognized corporations in either
 9 Delaware or Arizona.¹⁷⁴ In addition, RESPONDENTS failed to disclose to offerees and investors that
 10 the only source of income for HAGEMAN was investor funds through “shareholder loans” that were
 11 neither documented by the entities nor recorded on the books and records of the companies.¹⁷⁵ Any
 12 one of these actions would violate A.R.S. §44-1991(A).¹⁷⁶ Taken together, they show HAGEMAN,
 13 DELUGE and HYDROTHERM violated the antifraud provisions of Act.

14 **F. HAGEMAN Directly Or Indirectly Controls The Activities Of The DELUGE**
 15 **And HYDROTHERM And Is Responsible For Any Violations Of A.R.S. § 44-**
 16 **1991 By DELUGE And HYDROTHERM.**

17 The Act imposes presumptive secondary liability on a “controlling person” to the same
 18 extent as it does to any person that commits a primary violation of A.R.S. § 44-1991:

19 B. Every person who, directly or indirectly, controls any person liable for a violation
 20 of section 44-1991 or 44-1992 is liable jointly and severally with and to the same
 extent as the controlled person to any person to whom the controlled person is liable
 unless the controlling person acted in good faith and did not directly or indirectly

21 ¹⁷⁰ See e.g. *Barnes v. Vozack*, 113 Ariz. 269, 273, 550 P.2d 1070, 1074 (1976)(Officers of company could be liable
 under A.R.S. § 44-1991 for the fraudulent statements of a salesman of the security.)

22 ¹⁷¹ See *Grand v. Nacchio*, 225 Ariz. 171, 174, 236 P.3d 398, 401 (2010).

23 ¹⁷² “Person” under the Act means “an individual, corporation, partnership, association, joint stock company or trust,
 limited liability company, government or governmental subdivision or agency or any other unincorporated
 organization.” A.R.S. § 44-1801(16).

24 ¹⁷³ See Hearing Exhibit S-10, Bates No. ACC000030; Hearing Exhibit S-12, page 18, lines 20 – 23; Hearing
 Transcript, Volume I, page 82, lines 16 – 23; page 119, lines 9 - 12.

25 ¹⁷⁴ See Hearing Exhibits S-4; S-5a and S-5f; Hearing Transcript, Volume I, page 82, lines 6 – 9; page 83, lines 4 -13;
 page 121, lines 17 – 25; page 118, lines 4 – 9.

26 ¹⁷⁵ See Hearing Exhibit S-16, page 73, lines 17 -20; page 75, lines 7 – page 78, lines 14; page 93, lines 6 – 14; Hearing
 Transcript, Volume I, page 121, lines 17 - 25.

¹⁷⁶ See *Hernandez*, 179 Ariz. at 521, 88 P.2d at 741.

1 induce the act underlying the action.¹⁷⁷

2 The Arizona Appellate Court has interpreted this provision to impose presumptive
3 secondary liability “on those persons who have the *power* to directly or indirectly control the
4 activities of those persons or entities liable as primary violators of A.R.S. § 44-1991.”¹⁷⁸

5 In *Eastern Vanguard*, the issue of how controlling person liability under A.R.S. § 44-1999
6 was to be interpreted was one of first impression.¹⁷⁹ In reaching its decision, the court followed the
7 legislature’s direction that the Act be “liberally construed to effect its remedial purpose of
8 protecting the public interest,” upholding the finding by the Commission of controlling person
9 liability.¹⁸⁰ The court (1) rejected the argument by the control appellees that “their mere status as
10 controlling shareholders and officers or directors of the corporate entity was insufficient to
11 establish their liability” as controlling persons “because no evidence was presented that they
12 actually participated in any violation of § 44-1991(A) by directing anyone to make false and
13 misleading statements;” and (2) held that “actual participation” as a required element of liability
14 would be “too restrictive to guard the public interest a directed by our state legislature.”¹⁸¹

15 Specifically, first, the *Eastern Vanguard* court held that the plain language of the statute
16 does not support the actual participation requirement, stating

17 Indeed, the SEC has long defined “control” as meaning “the possession, direct or
18 indirect, of the *power to direct or cause the direction of the management and*
19 *policies of a person*, whether through the ownership of voting securities, by
20 contract, or otherwise.” 7 C.F.R. § 230.05 (1995) (emphasis added). The SEC’s
21 broad definition is consistent with legislative history leading to the passage of §
22 20(a). “In this section ... when reference is made to ‘control,’ the term is intended
23 to include actual control as well as what has been called legally enforceable
24 control.” (citations omitted).¹⁸²

25 ¹⁷⁷ A.R.S. § 44-1999(B).

26 ¹⁷⁸ *Eastern Vanguard Forex Ltd. v. Arizona Corp. Comm’n*, 206 Ariz. 399, 412, 79 P.3d 86, 89 (App. 2003) (emphasis in original).

¹⁷⁹ *Eastern Vanguard*, 206 Ariz. at 410, 79 P.3d at 97.

¹⁸⁰ *Id.*, citing 1951 Ariz. Sess. Laws, ch. 18, § 20.

¹⁸¹ *Id.*

¹⁸² *Eastern Vanguard*, 206 Ariz. at 412, 79 P.3d at 99; see also *Id.* at FN21 (“See A.R.S. §10-801(B) (Supp.2002), which generally requires that ‘[a]ll corporate powers shall be exercised by or under the authority of and the business and affairs of the corporation shall be managed under the direction of its board of directors...’”).

1 Second, the court held that requiring evidence that a controlling person actually participated in the
 2 fraudulent would “frustrate the intent behind the creation of controlling person liability” under the
 3 Act.¹⁸³

4 In this case, as the president, chief executive officer (“CEO”), HAGEMAN not only had
 5 the power to control, but actually controlled and managed the day-to-day affairs of DELUGE and
 6 HYDROTHERM.¹⁸⁴ Further, HAGEMAN stated that he is the only person that made the offer
 7 and sale of shares.¹⁸⁵ Accordingly, the Division established control person liability for
 8 HAGEMAN as it relates to DELUGE and HYDROTHERM, such that HAGEMAN is jointly and
 9 severally liable with DELUGE and HYDROTHERM for these entities violations of A.R.S. § 44-
 10 1991(A), pursuant to A.R.S. § 44-1999(B).

11 **V. RESTITUTION**

12 The Securities Division established, based upon its witnesses, evidence and documents
 13 provided by HAGEMAN, the total amount raised by DELUGE and HYDROTHERM was
 14 \$11,243,754.89.¹⁸⁶ Based upon testimony and documents provided by Mrs. Killibrew, she and her
 15 husband invested \$37,500 and received \$50,000 from the sale of some of their stock.¹⁸⁷ Although
 16 the Killibrews received \$50,000, the restitution list should be reduced by the amount the
 17 Killibrews invested - \$37,500. Therefore, the new total principal amount due to investors is
 18 \$11,206,254.89.

19 HAGEMAN, in his questioning of Securities Division witness Sean Callahan, implied that
 20 the funds provided by his father on Hearing Exhibit S-24a were personal loans not
 21 investments.¹⁸⁸ Although no testimony or evidence was provided from HAGEMAN or his father,
 22 the Securities Division would allow a further reduction in the principal amount of restitution by

23 ¹⁸³ *Id.*, citing Loftus C. Carson, II, *The Liability of Controlling Persons under the Federal Securities Act*, 72 NOTRE
 24 DAME L. REV. 263, 268 -69 (1997) (“[I]f participation was required, ... ‘dummies,’ and other proxies could immunize
 themselves [sic] from liability.”).

25 ¹⁸⁴ See Hearing Exhibit S-16, page 7, lines 1 – 8.

26 ¹⁸⁵ See Hearing Exhibit S-16, page 66, lines 14 -16. See Hearing Transcript, Volume I, page 117, lines 17 – 23.

¹⁸⁶ See Hearing Exhibits S-24a, 24b and 24c.

¹⁸⁷ See Hearing Exhibit S-27.

¹⁸⁸ See Hearing Transcript, Volume II, page 230, lines 19 – page 234, lines 21.

1 \$64,500, which sum represents the amount of money HAGEMAN's father provided to
2 HAGEMAN as personal loans.¹⁸⁹ The Securities Division seeks an Order of Restitution in the
3 principal amount of \$11,141,754.89.

4 **VI. ADMINISTRATIVE PENALTY**

5 Pursuant to A.R.S. §44-2036(A), a violation of the Act may be assessed an administrative
6 penalty in an amount not to exceed five thousand dollars. In this case, RESPONDENTS offered
7 and sold securities in the form of stock to over 700 investors, over, at least, a fifteen year period.
8 In addition to violating the registration provisions of the Act, RESPONDENTS also violated the
9 anti-fraud provisions of the Act by making misrepresentations or omissions of material fact to
10 offerees and investors.

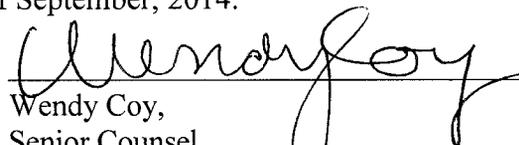
11 The Securities Division seeks an administrative penalty against HAGEMAN, DELUGE
12 and HYDROTHERM, jointly and severally, in the amount of \$250,000.

13 **VII. CONCLUSION**

14 Based upon the evidence presented, the Division respectfully requests this tribunal to:

- 15 A. Order Respondents to cease and desist from further violations of the Act pursuant
- 16 to A.R.S. §44-2032;
- 17 B. Order Respondents to pay an administrative penalty of not less than \$250,000
- 18 pursuant to A.R.S. §44-2036(A);
- 19 C. Order Respondents to pay restitution in the principal amount of \$11,141,754.89
- 20 pursuant to A.R.S. §44-2032(1) and A.A.C. R14-4-308(C); and
- 21 D. Order any other relief this tribunal deems appropriate or just.

22 Respectfully submitted this 5th day of September, 2014.

23 
 24 Wendy Coy,
 25 Senior Counsel
 26 For the Securities Division

¹⁸⁹ See Hearing Exhibit S-24a.

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SERVICE LIST FOR: BRIAN C. HAGEMAN, DELUGE, INC. and HYDROTHERM
POWER CORPORATION

ORIGINAL and 8 copies of the foregoing
filed this 5th day of September, 2014, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

COPY of the foregoing hand-delivered
this 5th day of September, 2014, to:

The Honorable Marc E. Stern
Administrative Law Judge
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

COPY of the foregoing mailed/mailed
this 5th day of September, 2014, to:

BRIAN C. HAGEMAN
18832 N. 95th Street
Scottsdale, Arizona 85255

DELUGE, INC.
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HYDROTHERM POWER CORPORATION
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