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ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

COMMISSIONERS

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

ORIGINAL

Arizona Corporation Commission

DOCKETED

SEP 26 2014

DOCKETED BY

In the matter of:

PATRICK LEONARD SHUDAK, a single man,  
PROMISE LAND PROPERTIES, LLC, an Arizona  
limited liability company,  
and  
PARKER SKYLAR & ASSOCIATES, LLC, an  
Arizona limited liability company,  
Respondents.

DOCKET NO. S-20859A-12-0413

APPLICATION FOR REHEARING

Pursuant to A.R.S. § 44-1974, respondent Patrick Leonard Shudak ("Shudak") respectfully applies to the Arizona Corporation Commission (the "Commission") for a rehearing in the above-captioned matter. As set forth in detail below, the application is based on the following causes that materially affected Shudak's rights: (i) there were irregularities in the proceedings that deprived Shudak of a fair hearing; (ii) there was misconduct by the Commission, in the sense that it did not comply with its own rules of practice and procedure; (iii) the penalties are excessive; (iv) there were errors in the admission of evidence that occurred at the hearing; and (v) the decision is not justified by the evidence and is contrary to well-established law.

## BACKGROUND

1  
2 From its inception through the issuance of the Commission's decision dated September  
3 15, 2014 (the "Decision"), this case appears to be unprecedented. While the evidentiary and  
4 legal defects became apparent during the hearing, the Decision additionally has created due  
5 process violations that underscore the atypical nature of this entire proceeding.

### 6 I. THE FACTS

7 The case began with the Securities Division (the "Division") alleging that Shudak, in his  
8 individual capacity and as a control person of Parker Skylar & Associates, LLC ("Parker  
9 Skylar"), violated the securities registration and securities fraud statutes by offering promissory  
10 notes and membership units in Parker Skylar to 18 investors. Parker Skylar, in turn, was a  
11 member of Cochise County 1900, LLC, which was organized for the purpose of acquiring and  
12 developing approximately 1,900 acres near Bisbee, Arizona (the "Bisbee Property" or "Bisbee  
13 Project"). The Bisbee Project began in 2008 and floundered like so many other real estate  
14 projects in Arizona during the Great Recession. These facts are unremarkable.

15 The story's trajectory changed dramatically in December 2009 – almost *five years ago* –  
16 when the investors in the Bisbee Project, all of whom represented themselves as accredited  
17 investors, took control of the company in charge of the development, removed the principals  
18 (including Shudak), and voted to develop the project themselves instead of selling the land to  
19 recoup their investments. Years later, after the applicable statutes of limitations would have  
20 barred any purported private cause of action, the investors acknowledge that they made a "bad  
21 decision" when they decided to develop the project themselves. This is not the fact-pattern of a  
22 typical enforcement action. However, at least one investor convinced the Division otherwise.

### 23 II. THE HEARING

24 The fragile nature of this action became apparent during the hearing. The Division  
25 introduced testimony from only three of the 18 investors – Martin Schwank, Craig Swandal, and  
26 Steven Berendes, all of whom invested under such vastly different circumstances that no broad  
27 conclusions with respect to the other 15 investors – who did not testify at the hearing – could be  
28 gleaned. The Division also introduced testimony from two staff members – forensic accountant

1 Andrea McDermitt-Fields and investigator Dulance Morin, who conceded that they did not have  
2 evidence necessary to support all of the Division's claims.

3 The most disturbing aspect of the Division's case, and by extension the Decision, is the  
4 often-repeated fabrication that there was any evidence introduced during the hearing concerning  
5 what all the investors believed, expected, knew, relied upon, or were told. That evidence simply  
6 does not exist. To fill-in all the missing evidence, the Division offered nothing more than  
7 conjecture and hypothesis to support its claims relating to the other investors.

8 With respect to the three investors who did testify, the Division failed to prove that any  
9 fraud occurred. Schwank testified that he invested a total of \$361,000. *See* Exh. S-48. He  
10 testified that he "became friendly" with Shudak in 2008. Tr. 25:10-20. At some point in time  
11 after they became friends, the two discussed the Bisbee Project. Tr. 25:25-26:10. Schwank's  
12 understanding was that Shudak was responsible for raising "up to \$2.5 million to finance the  
13 purchase of the land and [to get] the property to plat." Tr. 33:10-13. Schwank's "due diligence"  
14 consisted of reading the operating agreements for Cochise County 1900 and Parker Skylar,  
15 visiting the site, and asking Alan Thome about the project. Tr. 90:3-92:8. Schwank understood  
16 that Thome, not Shudak, was responsible for developing the Bisbee Project. Tr. 91:1-12. After  
17 Schwank made his investment, he also knew that work was being done to get the plat approved.  
18 Tr. 97:7-11.

19 Swandal testified that he invested \$300,000. *See* Exh. S-48. He learned about the Bisbee  
20 Project from his "very close friend" Jim Peterson, an Arizona realtor. Tr. 215:14-25. It was  
21 Peterson, not Shudak, who suggested that Swandal invest in the Bisbee project. Tr. 216:9-16.  
22 Swandal does not recall what information he reviewed on the Bisbee Project before he decided to  
23 invest, and was not provided with "a lot of specifics" about it. Tr. 218:21-219:11, 222:5-11.  
24 Peterson did explain to Swandal that Thome would be developing the project and "vouched for  
25 him," but Peterson did not speak with Thome before making his investment. Tr. 220:3-10,  
26 225:7-13. Swandal "was in the midst of flying all over the world," and admits that  
27 "unfortunately [he] didn't have a lot of time to do the diligence that [he] should have." Tr.  
28 224:11-20. Instead, he relied on his attorney. Tr. 226:21-227:8.

1 Berendes testified that he invested \$100,000. *See* Exh. S-48. He was introduced to  
2 Shudak through “a friend of a friend,” John Schnaible. Tr. 272:25-273:3. In return for his  
3 investment, Berendes understood that he would receive a note that would bear 14% interest and  
4 that he would get his interest and principal on the one year anniversary. Tr. 273:10-16.  
5 Berendes has “no idea” if he is still a member of Parker Skylar, and does not “have much interest  
6 in the LLC units.” Tr. 283:13-15, 284:4-16. He said that Shudak gave him “enough paper to  
7 choke a horse,” but he was “only interested in one thing,” which was getting his money back  
8 after one year with a 14% return. Tr. 280:2-10.

9 In sum, the testimony from the three investors reflects that little, or no, due diligence was  
10 done before they made their investments, and there is no evidence that Shudak made the  
11 representations that the Decision concludes he made.

12 The Division did not offer any testimony from the other 15 purported investors (Frank  
13 Lamer, Tim Olp, John Schnaible, John McCardle, Jim Peterson, Craig Thomson, Jack Sandner,  
14 Timothy Banghart, Gary Bates, Mitchell Lane, William Livingston, Frank Moran, Mick Manley,  
15 Jerry Gruetzemacher, and Donald Van Hook). The record is devoid of any evidence of what  
16 these 15 investors knew, or did not know, before they purportedly made their investments.

17 The Division also did not offer any testimony from Shudak. The Division did not ask to  
18 depose or even interview Shudak during its investigation, and did not ask that Shudak appear to  
19 testify at the hearing. There is no record anywhere of what Shudak said, or did not say, to all but  
20 three of the investors. This void alone should have resulted in the dismissal of any claims related  
21 to 15 of the 18 investors.

22 With respect to what documents the investors might have read, the record is similarly  
23 undeveloped. The Decision finds that “[a]lmost all” – meaning *not* all – investors signed  
24 investment purchase agreements, and that at least two investors signed documents that were  
25 “significantly different” from the agreements used with other investors. Decision at ¶46 and fn.  
26 45. Yet, the Decision does not account for these variances in the record.

27 Throughout the hearing, ALJ Mark E. Stern repeatedly indicated his own skepticism  
28 about the Division’s case, at one point telling the parties, “I don’t recall ever seeing something

1 quite like this.” Hearing Transcript (“Tr.”) 332:2-13.

2 **III. THE DECISION**

3 The hearing occurred in June 2013. After waiting for more than a year, a Recommended  
4 Opinion and Order (“ROO”) was filed, but not by ALJ Stern, who presided over the hearing.  
5 Instead, the ROO was filed by ALJ Belinda A. Martin. The Decision adopts ALJ Martin’s ROO  
6 in its entirety.

7 ALJ Martin’s ROO and, therefore, the Decision, contains a number of findings  
8 unsupported by the evidence. Those findings are discussed below. However, more  
9 fundamentally, the Decisions run afoul of the Commission’s own regulations governing practice  
10 and procedure, and violates Shudak’s basic due process rights in at least two respects. The  
11 Commission’s rules require that when a case is heard by a hearing officer, the same hearing  
12 officer shall prepare the recommendation. The wisdom of those rules is illustrated by the due  
13 process violations that occurred here, where the rules were not followed. ALJ Martin did not  
14 have an opportunity to observe and weigh the credibility of the testimony from any of the  
15 witnesses, and – perhaps as a result – the Decision contains findings of fact and conclusions of  
16 law that are based on charges never made by the Division or contested during the hearing. It is  
17 well-settled that these transgressions have resulted in due process violations.

18 **DISCUSSION**

19 **I. THE COMMISSION HAS VIOLATED SHUDAK’S DUE PROCESS RIGHTS**  
20 **AND FAILED TO COMPLY WITH ITS OWN REGULATIONS GOVERNING**  
21 **PRACTICE AND PROCEDURE**

22 Administrative agencies must conduct their hearings “consistently with fundamental  
23 principles which inhere in due process of law.” *Cash v. Indus. Comm’n*, 27 Ariz. App. 526, 532,  
24 556 P.2d 827, 833 (App. 1976) (setting aside an award of the Industrial Commission of Arizona,  
25 where the respondent was not permitted to introduce testimony of his medical expert at the  
26 hearing). The determination of whether due process has been afforded by an administrative  
27 agency “requires analysis of the governmental and private interests that are affected.” *Mathews*  
28 *v. Eldridge*, 424 U.S. 319, 334-35 (1976). At bottom, the parties must have been afforded “the  
opportunity to be heard ‘at a meaningful time and in a meaningful manner.’” *Id.* at 333 (internal

1 citations omitted).

2 Here, the Commission has violated Shudak's due process rights in at least two respects.  
3 First, the underlying ROO was drafted by a different hearing officer than who presided over the  
4 hearing. Swapping ALJs in these proceedings violates well-settled due process laws, and the  
5 Commission's own regulations. Further, as detailed below, ALJ Martin's recommendation  
6 cannot be reconciled with the comments ALJ Stern made during the hearing. Second, illustrating  
7 the inherent prejudice in allowing a different ALJ to recommend findings of fact and conclusions  
8 of law, the Decision improperly contains findings of fact and conclusions of law based on  
9 charges that were never part of the Division's case, never argued at the hearing, and never  
10 discussed in the parties' post-hearing briefs. As a result, Shudak did not have any opportunity to  
11 defend himself against these new charges. These fundamental procedural improprieties violate  
12 Shudak's due process rights.

13 **A. The Commission Has Failed to Comply with its Own Rules of Practice and**  
14 **Procedure**

15 Under A.A.C. R14-3-109(A), every hearing shall be held "before one or more  
16 Commissioners, one or more Hearing Officers, or any combination thereof." In this case, there  
17 was one Hearing Officer, ALJ Stern. The rules of practice require that "[i]n a proceeding heard  
18 by a *Hearing Officer*, the Hearing Officer shall prepare his recommendation which may be in  
19 the form of an opinion and order, unless otherwise directed by the Commissioners. Such  
20 recommendation by the Hearing Officer shall become part of the Docket .... Such proposed  
21 order shall include recommended findings, conclusions, and order, which may be narrative form  
22 at the discretion of the Hearing Officer." A.A.C. R14-3-110(B) (emphasis added). Thus, the  
23 rules unequivocally require that when a hearing is heard by a Hearing Officer, that same Hearing  
24 Officer shall prepare the recommendation.

25 The Commission's rules conform with the basic precepts of administrative law. For  
26 example, it is well-established, particularly in a case like this one where witness testimony is at  
27 issue, that "a hearing examiner making a recommendation to a reviewing board, agency or court  
28 must actually hear and observe the witnesses." *Adams v. Indus. Comm'n of Ariz.*, 147 Ariz. 418,

1 420, 710 P.2d 1073, 1075 (App. 1985) (setting aside award of the Industrial Commission of  
2 Arizona where administrative law judge who did not preside over hearing made findings); *see*  
3 *also Ohlmaier v. Indus. Comm'n*, 161 Ariz. 113, 118, 776 P.2d 791, 796 (1989) (“In order to  
4 give impartial and complete credence to evidence, the one who decides the issue should be the  
5 one who hears the evidence.”). This rule exists because “the predicate upon which our deference  
6 is given to the finder of fact is the assumption that he has indeed had the opportunity to look the  
7 witness in the eye and reach a conclusion with respect to his veracity or lack thereof.” *Id.*

8 When witness testimony is an issue, a “substitute” hearing officer who did not preside  
9 over the hearing should not be the one making findings or a recommendation. *See Adams*, 147  
10 Ariz. at 420, 710 P.2d at 1075. Indeed, the general rule has been stated as follows:

11 [T]he principle which should govern substitution of hearing officers is the simple  
12 one that demeanor of witnesses should not be lost from the case. Whoever  
13 observes the demeanor must report it to the decision makers. If demeanor is  
unimportant because *all* the crucial evidence is documentary, no such report is  
needed.

14 *Id.* (emphasis added) (quoting K. Davis, *Administrative Law Treatise* § 17:17 (2d ed. 1980)). If  
15 a recommendation is permitted to be made based on “the cold record,” then “the integrity of the  
16 legal process not only falters, it fails.” *Id.* “[T]he conflict [must] be resolved by something more  
17 personal than a sterile resort to pages of hearing transcripts.” *Id.*

18 Here, the Division clearly did not rely solely upon a “cold record” in presenting its case.  
19 It relied heavily on its witnesses to attempt to connect threads of incomplete documentary  
20 evidence. ALJ Stern presided over the entire three-day proceeding, heard the evidence, cross-  
21 examined witnesses, directed questions to counsel, and ruled on numerous evidentiary  
22 objections. Perhaps most importantly, as discussed below, ALJ Stern also repeatedly questioned  
23 on the record the credibility of witness testimony. ALJ Martin, who did not hear the evidence,  
24 cross-examine any witnesses, direct any questions to counsel, or rule on any evidentiary  
25 objections, has authored recommendations simply based on the “cold record.” ALJ Martin’s  
26 recommendations cannot be reconciled with ALJ Stern’s comments at the hearing, let alone the  
27 evidence. As a result, the Decision violates the Commission’s own rules, and violates Shudak’s  
28

1 rights to due process.<sup>1</sup>

2 **B. The Decision Improperly Contains Findings of Fact and Conclusions of Law**  
3 **Based on New Charges**

4 The Decision also violates Shudak's due process rights, because it adopts new charges  
5 raised by ALJ Martin that were neither identified in the Notice nor argued by the parties during  
6 the hearing. "The essence of due process is the requirement that a person in jeopardy of serious  
7 loss (be given) notice of the case against him and opportunity to meet it." *Mathews*, 424 U.S. at  
8 348 (1976) (internal citations omitted). Thus, where a hearing officer finds violations "based on  
9 grounds not alleged in [the agency's] notice," it is a violation of due process. *See Carlson v.*  
10 *Arizona State Pers. Bd.*, 214 Ariz. 426, 432, 153 P.3d 1055, 1061 (App. 2007) (vacating and  
11 remanding trial court judgment affirming decision of the Arizona State Personnel Board, where  
12 the hearing officer's findings were "based on conduct never alleged" in the Arizona Department  
13 of Environmental Quality's notice).

14 The courts have long held that in administrative proceedings "no person may lose  
15 substantial rights because of wrongdoing shown by the evidence, but not charged." *Murray v.*  
16 *Murphy*, 24 N.Y. 2d 150, 157, 247 N.E. 2d 143, 147 (1969); *see also Carlson*, 214 Ariz. at 432,  
17 153 P.3d at 1061 (collecting cases). A respondent to an administrative proceeding has a due  
18 process right "to assume that the hearing will be limited to the charges made." *Id.* "His lawyer  
19 is likewise entitled to prepare for the hearing in reliance that, after the hearing is concluded the  
20 charges will not be switched." *Id.* "[I]n such a 'switching' situation, prejudice is presumed,"  
21 and due process will be deemed to have been violated. *Carlson*, 214 Ariz. at 432, 153 P.3d at

22 <sup>1</sup> At the open meeting during which the ROO was discussed, the Commission's staff cited to  
23 *Pine-Strawberry Improvement Assoc. v. Arizona Corp. Comm'n*, 152 Ariz. 339, 732 P.2d 230  
24 (App. 1986), for the proposition that the Commission has the inherent authority to allow a non-  
25 presiding ALJ to prepare the recommendation. The *Pine-Strawberry* case is easily  
26 distinguishable. First, it was a utility rate case, not a securities enforcement case. There is no  
27 indication in the *Pine-Strawberry* opinion as to the evidence presented at hearing, the issues in  
28 contention, whether there was any live testimony, or any other matters that might draw a fair  
analogy to the securities enforcement proceedings that occurred here. Second, the case  
concerned the ministerial act of "docketing a proposed order," not recommending findings of  
fact and conclusions of law consuming 50 pages of analyses. Third, in *Pine-Strawberry*, the  
court found that the Commission "directed" the non-presiding ALJ to prepare the proposed order, but no  
such direction occurred in this case, and in any event, the direction would have to come from the  
Commissioners.

1 1061.

2 Here, the Division's fraud claim always has been based on four grounds: (i) the alleged  
3 oversubscription of membership units; (ii) the alleged misuse of investor funds, which were to be  
4 used for the development of the Bisbee Project; (iii) the alleged failure to disclose to investors a  
5 loan and security interest from a private lender; and (iv) the alleged misrepresentation by Shudak  
6 that he had the expertise and experience to raise sufficient capital to fund CC 1900's operations  
7 while failing to disclose "to several" investors that Shudak had been sued by several creditors.  
8 *See* Notice at ¶57. Those four grounds were identified in the Notice, litigated during the hearing,  
9 and then further debated in the parties' post-hearing briefs. *See* Division's Post-Hearing Reply  
10 Brief at 10 ("The Division Brief discusses four distinct frauds ...."). While the parties disagreed  
11 about the evidence, they never disagreed over what the alleged "four distinct frauds" were.  
12 Inexplicably, although the Decision acknowledges "the four different fraudulent acts," Decision  
13 at ¶137, the Decision strays from these bases, and introduces new charges that were not included  
14 in the Division's Notice, and that neither side had the opportunity to contest:

15 First, ALJ Martin correctly acknowledges that the Division failed to prove that Shudak  
16 misused investor funds. *See, e.g.*, Decision at ¶82 ("There is no evidence demonstrating for what  
17 purposes Mr. Shudak used the PSA funds ..."), and Decision at ¶149 ("The Division did not  
18 submit any direct evidence that the funds were used for impermissible purposes after they were  
19 transferred."). These findings should have ended the analysis in favor of Shudak on this charge.

20 Instead of concluding the analysis, the Decision *switches* the analysis, and finds that  
21 Shudak committed securities fraud by adding a co-signatory to the PSA's bank account, and by  
22 commingling investor funds with non-investor funds. Decision at ¶¶151-58. Neither of these  
23 charges is found in the Division's Notice. The latter argument is particularly perplexing, because  
24 the Decision acknowledges elsewhere that the record concerning the movement of funds "is not  
25 substantiated or supported, and is, therefore, unreliable ...." Decision at ¶84. To compound  
26 matters, the Decision falsely finds that Shudak "fail[ed] to advise investors that the PSA account  
27 and investor funds were being handled in a manner contrary to that represented to investors  
28 under the Operating Agreement ...." Decision at ¶158. The record is devoid of evidence

1 supporting that finding. None of the witnesses were asked about signatories on the account or  
2 the alleged commingling of funds, because that was not a basis for the Division's securities fraud  
3 claim. The findings of fact and conclusions of law relating to this new charge for fraud should  
4 be stricken from any order.

5 Second, the Decision recasts the Division's claim pertaining to Shudak's ability to raise  
6 capital for the Bisbee Project into a materially different claim. The Decision finds that Shudak  
7 misrepresented to investors that "he also had the financial wherewithal to bear the total risk of  
8 economic loss if the Project failed." Decision at ¶165. There is no evidence in the record  
9 concerning Shudak's financial wherewithal or any commitment that he would "bear the total risk  
10 of economic loss if the Project failed." These fact issues were never part of the Division's case.

11 The Division's claim always has been that Shudak represented that he had the  
12 qualifications to raise capital sufficient to fund CC 1900's operations. See Notice at ¶57. On  
13 that claim, as discussed below, there is no evidence that Shudak made the representation to all of  
14 the investors; and, even if he had, the record demonstrates that he could raise capital sufficient to  
15 fund CC 1900's operations. This part of the Division's fraud claim should have been denied.

16 These due process violations alone warrant a rehearing. But there are additional grounds  
17 warranting rehearing.

## 18 II. THE DIVISION'S FRAUD CLAIMS FAIL

19 As discussed, the Decision mischaracterizes, sometimes blatantly, the Division's fraud  
20 charges. The analysis should track the allegations raised in the Division's Notice. If the  
21 Commission stays within the scope defined therein, the evidence and law simply fail to support  
22 the findings of fact and conclusions of law.

### 23 A. Allegation: Shudak sold at least 29% of Parker Skylar membership interests 24 to investors after 100% of Parker Skylar membership interests had been assigned.

25 The evidence does not support the allegation that Shudak sold more than 100% of Parker  
26 Skylar's membership interests. See Notice at ¶57(a). The Decision's analysis also illustrates  
27 why it is a violation of due process to allow an ALJ who did not preside over the hearing to make  
28 the recommended order.

1 The evidence concerning the alleged oversubscription was, if nothing else, confusing and  
2 incomplete. During the hearing, ALJ Stern aptly characterized the Division's evidence on this  
3 issue as "pretty questionable" and "really roughshod." Tr. 413:13-14, 414:2-4. In stark contrast  
4 to ALJ Stern's contemporaneous remarks on the testimony and documentary evidence, ALJ  
5 Martin has concluded that "the Division presented more than sufficient evidence demonstrating  
6 that Mr. Shudak oversubscribed the offering." Decision at ¶142. It is impossible to reconcile  
7 these two opinions expressed by two different hearing officers.

8 According to the Division's own records, Shudak only sold 88 membership units in  
9 Parker Skylar. *See* Exh. S-48. There is no evidence that any consideration was paid for the other  
10 45 units that are part of the Division's calculation. *See id.* Indeed, Morin, the Division's  
11 investigator, testified that "[a]fter several interviews" the Division found that Schnaible, Lamer,  
12 McCardle, and Peterson did not invest any cash in Parker Skylar. Tr. 399:12-401:7. The  
13 Division attributes 35 of the "133" membership units to those four individuals. *See* Exh. S-48.  
14 Thus, based on the Division's own admissions, once those 35 units are deducted from the total,  
15 the number of units sold is under 100.

16 There is evidence that the total number of units sold should be reduced even further. The  
17 Division introduced evidence showing that one of the investors, Tim Olp, invested money with  
18 Parker Skylar and purportedly received eight membership units, but he also received money back  
19 on several occasions. *See* Exhs. S-36, S-38, and S-48. ALJ Stern asked Morin if he knew how  
20 McCardle, Schnaible, Lamer, Peterson, or Olp got their membership units, and Morin confessed  
21 that he did not know. Tr. 406:17-407:20. Morin conceded that he was unable to confirm how  
22 much money was invested and paid to Parker Skylar, and he could not confirm whether any  
23 consideration was paid for the purported membership interests in Parker Skylar:

24 Q. And you don't know if there was any consideration paid for any of these  
25 purported investors if you don't have evidence of monies being received by  
Parker Skylar, correct?

26 A. That's correct.

27 Tr. 392:3-7; *see also* Tr. 390:23-392:7; Exh. S-48. So, while the Division alleged that Shudak  
28 assigned 133 out of a possible 100 membership units in Parker Skylar, the record is devoid of

1 evidence establishing the number of membership units actually sold. ALJ Stern commented on  
2 that void. *See* Tr. 413:13-14, 414:2-4. The Decision glosses over it.

3 **B. Allegation: Shudak represented to investors that all investor funds would be**  
4 **transferred to Cochise County 1900 to be used for the purchase of the Bisbee**  
5 **Property and expenses related to obtaining a final plat for the Bisbee Project,**  
6 **when in fact, on several occasions, the money was not transferred to or used**  
7 **for the benefit of Cochise County 1900.**

8 Once again, the Decision's analysis illustrates how Shudak's due process rights have  
9 been violated when a different ALJ is tasked with making recommendations based on a hearing  
10 the ALJ did not preside over. During the hearing, ALJ Stern offered the most accurate  
11 description of the evidence on how investor funds were used, when he observed: "There's a lot  
12 of money came in here and lot of money went different places, it doesn't always – you can't  
13 tell." Tr. 338:10-14. As alluded to above, the Decision reaches the same conclusion, but then  
14 veers the analysis in a completely different – and improper – direction.

15 Of the 18 alleged Parker Skylar investors, the record is devoid of any evidence of what  
16 Shudak said, or did not say, to 15 of them. Similarly, the record is devoid of any evidence of  
17 what those same 15 investors knew, or did not know, before they purportedly made their  
18 investments.

19 Even assuming Shudak did make the alleged representations, there is no evidence that  
20 any such representations were false. The Division failed to prove that any of the investor funds  
21 were misdirected or used for anything other than expenses related to the Bisbee Project.  
22 McDermitt-Fields, the Division's forensic accountant, did not do any analysis on how the money  
23 raised was used. Tr. 334:6-11. She purported to trace only two of the investments, but even with  
24 respect to those two investments, she did not know if any of the money was redirected to cover  
25 expenses unrelated to the project. Tr. 334:6-341:1. In fact, when asked if all the funds could  
26 have been used for legitimate purposes related to the Bisbee Project, McDermitt-Fields  
27 acknowledged that she just did not know. Tr. 340:20-341:1.

28 Similarly, Schwank acknowledged that: (i) Parker Skylar could have paid development  
expenses directly; (ii) he does not know how much money was spent on the Bisbee Project; and  
(iii) he cannot account for all the money deposited, or not deposited, in the Cochise County

1 account. Tr. 126:5-129:2. The record is silent on this issue.

2 **C. Allegation: Shudak did not disclose that a private lender had taken steps to**  
3 **perfect its security interest in all of Parker Skylar's assets and that the lender**  
4 **considered Parker Skylar in default of its obligations to the lender.**

5 The evidence does not support the allegation that Shudak failed to disclose that a private  
6 lender had taken steps to perfect its security interest in all of Parker Skylar's assets and that the  
7 lender considered Parker Skylar in default of its obligations to the lender. *See* Notice at ¶57(c).  
8 This allegation, which concerns an apparent loan that Nascent Investments, LLC ("Nascent")  
9 made on May 22, 2008, has several fundamental evidentiary and factual deficiencies. *See* Exh.  
10 S-50.

11 First, as discussed, the record is devoid of any evidence of what Shudak said, or did not  
12 say, to 15 of the Parker Skylar investors. Similarly, the record is devoid of any evidence of what  
13 those same 15 investors knew, or did not know, before they purportedly made their investments.  
14 The Decision simply ignores this void in the record, and concludes in summary fashion that  
15 "[i]nvestors should have been advised of the perfected security interest prior to making their  
16 investments ...." Decision at ¶164.

17 Second, the Parker Skylar Operating Agreement fully disclosed that Shudak, as Manager,  
18 had the authority to borrow money on behalf of the company. Under paragraph 6.3 of the Parker  
19 Skylar Operating Agreement, the Manager "has the power, on behalf of the Company, without  
20 further authorization from the Members, to do all things necessary or convenient to carry out the  
21 business and affairs of the Company, including, without limitation ... (d) entering into contracts  
22 and guarantees; incurring of liabilities; borrowing money, issuance of notes, bonds, and other  
23 obligations, and the securing of any of its obligations by mortgage or pledge of any of its  
24 Property or income." *See* Exh. S-56 at p. 8, ¶6.3.

25 Third, the record is devoid of any evidence showing: (i) when Nascent took steps to  
26 perfect its security interest in Parker Skylar's assets; (ii) when, if at all, Shudak knew that  
27 Nascent took steps to perfect its security interest in Parker Skylar's assets; (iii) when Nascent  
28 considered Parker Skylar in default; and (iv) when, if at all, Shudak knew that Nascent  
considered Parker Skylar in default. *See Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569

1 (9th Cir. 1990) (finding that “the danger of misleading buyers must be actually known or so  
2 obvious [to the seller] that any reasonable man would be legally bound as knowing, and the  
3 omission must derive from something more egregious than even ‘white heart/empty head’ good  
4 faith”) (internal quotations omitted); *Golden Rule Ins. Co. v. Montgomery*, 435 F. Supp. 2d 980,  
5 983 (D. Ariz. 2006) (recognizing that there can be “no fraud where the omitted information was  
6 not within the [defendant’s] personal knowledge”); *In re MicroStrategy, Inc. Secs. Litig.*, 148 F.  
7 Supp. 2d 654, 665-66 (E.D. Va. 2001) (stating that for securities fraud liability, plaintiffs must  
8 demonstrate that “defendants knowingly or recklessly misstated or omitted the alleged material  
9 facts”).

10 Fourth, according to the Division’s calculations, three of the investors (Frank Lamer, Tim  
11 Olp, and Craig Swandal) invested *before* the loan was made, so there was nothing to disclose  
12 with respect to those investments. *See* Exh. S-48. The Decision acknowledges this fact, but  
13 falsely argues that a covenant in the Assignments that membership interests were free and clear  
14 of liens and encumbrances somehow includes a covenant about the potential for future  
15 encumbrances. *See* Decision at ¶162. The Assignments contain no such covenants.

16 Fifth, the investors all represented that they had access to whatever information they  
17 deemed necessary and that they conducted their own due diligence. *See* Exhs. S-16 through S-  
18 33. There was no evidence concerning the due diligence conducted by 15 of the 18 investors. On  
19 June 6, 2008, Nascent recorded a UCC Financing Statement, listing Parker Skylar as the debtor  
20 and reflecting that the financing statement covered all of Parker Skylar’s assets. *See* Exh. S-15.  
21 The Division’s fraud claim cannot rest upon the publicly disclosed loan. *See In re Progress*  
22 *Energy, Inc.*, 371 F. Supp. 2d 548, 552-53 (S.D. N.Y. 2005) (recognizing that it is “well-  
23 established law that securities laws do not require disclosure of information that is publicly  
24 known”); *see also Drobbin v. Nicolet Instrument Corp.*, 631 F. Supp. 860, 891 (S.D. N.Y. 1986)  
25 (stating that “securities laws were not enacted to protect sophisticated [investors] from their own  
26 errors of judgment,” and finding that where an investor fails to conduct a background check on  
27 seller, investor could not blame seller for failure to disclose his criminal convictions and  
28 involvement in litigation).

1           **D. Allegation: Shudak represented that he was qualified and had expertise and**  
2           **experience to raise capital sufficient to fund Cochise County 1900's**  
3           **operations, and failed to disclose to several investors that several of Shudak's**  
4           **creditors had sued Shudak.**

5           The evidence does not support the allegation that Shudak represented that he was  
6           qualified and had expertise and experience to raise capital sufficient to Cochise County 1900's  
7           operations, or that he failed to disclose to several investors that several of Shudak's creditors had  
8           sued him. *See* Notice at ¶57(d).

9           Again, the record is devoid of any evidence of what Shudak said, or did not say, to 15 of  
10          the Parker Skylar investors. The Decision simply cites to language in the CC1900 Operating  
11          Agreement. Decision at ¶169. The investors were not members of CC1900, and there is no  
12          evidence that the investors received or relied upon the CC1900 Operating Agreement. Similarly,  
13          the record is devoid of any evidence of what 15 investors knew, or did not know, before they  
14          purportedly made their investments. Of the three investors who did testify, *none* of them  
15          testified that Shudak represented himself as "qualified" or that he "had expertise and experience  
16          to raise capital sufficient to fund Cochise County 1900's operations."

17          Since the Division chose to bring its case without questioning Shudak, there also is no  
18          record of whether Shudak knew that he had been sued by any of his creditors. *See Hollinger*,  
19          914 F.2d at 1569 (finding that "the danger of misleading buyers must be actually known or so  
20          obvious [to the seller] that any reasonable man would be legally bound as knowing, and the  
21          omission must derive from something more egregious than even 'white heart/empty head' good  
22          faith") (internal quotations omitted); *Golden Rule Ins. Co.*, 435 F. Supp. 2d at 983 (recognizing  
23          that there can be "no fraud where the omitted information was not within the [defendant's]  
24          personal knowledge"); *In re MicroStrategy, Inc. Secs. Litig.*, 148 F. Supp. 2d at 665-66 (stating  
25          that for securities fraud liability, plaintiffs must demonstrate that "defendants knowingly or  
26          recklessly misstated or omitted the alleged material facts"). The cases against Shudak all  
27          resulted in default judgments, which were entered on December 23, 2008, February 24, 2009,  
28          March 6, 2009, June 10, 2009, well after most of the alleged investments were made. *See* Exhs.  
S-40a, S-41a, S-42a, S-43a.

1 As discussed above, the Decision implicitly acknowledges this void in the evidence, but  
2 then recommends findings that go beyond the scope of the Notice.

3 **E. Allegation: Shudak induced an Arizona couple to purchase a note in the**  
4 **principal amount of \$200,000 by using a security agreement granting a**  
5 **security interest in Parker Skylar for 50% of Parker Skylar, when at the**  
6 **time, Shudak had transferred 132.5% of Parker Skylar.**

7 The evidence does not support the allegation that Shudak induced an Arizona couple, the  
8 Van Hooks, to purchase a note in the principal amount of \$200,000 by using a security  
9 agreement granting a security interest in Parker Skylar for 50% of Parker Skylar, when at the  
10 time, Shudak had transferred 132.5% of Parker Skylar. See Notice at ¶57(e).

11 The Division presented virtually no evidence concerning the Van Hooks' note. The *only*  
12 testimony cited by the Decision is from Morin, who simply testified that Mr. Van Hook told him  
13 that he understood that the loan would "go towards the land development," that he made the  
14 \$200,000 loan, and he did not receive any payments in return. See Decision at ¶70; Tr. at 382-  
15 383. There was no questions asked, and no answers given, about what, if anything, Shudak  
16 represented to the Van Hooks or what they relied upon before making their loan.

17 As a threshold matter, the Van Hooks' note is not a security under Arizona law. See  
18 *State v. Tober*, 173 Ariz. 211, 841 P.2d 206 (1992). In *Tober*, the Arizona Supreme Court held  
19 that for purposes of determining whether a note is a "security" under the registration  
20 requirements of A.R.S. §§ 44-1841 and 44-1842, the courts must look to A.R.S. §§ 44-1843, 44-  
21 1843.01, and 44-1844, which describe exempt notes and exempt transactions in notes. *Tober*,  
22 173 Ariz. at 213, 841 P.2d at 208. There is no evidence that the Van Hooks' note was anything  
23 other than a single, private transaction that was not part of any public offering. Therefore, the  
24 note qualifies as an exempt transaction under A.R.S. § 44-1844, and is not a security under  
25 *Tober*.

26 Second, even if the note is a security under Arizona law, there is no evidence of fraud.  
27 The Van Hooks did not testify at the hearing, no testimony from them was introduced at the  
28 hearing, and the record is devoid of any evidence of what Shudak said, or did not say, to the Van  
Hooks. Similarly, the record is devoid of any evidence of what the Van Hooks knew, or did not

1 know, before they purportedly made their loan. Again, the Decision makes findings in this  
2 regard that are unsupported by the record.

3 **III. THE DIVISION'S REGISTRATION CLAIM FAILS**

4 The Decision's analysis of the Division's registration claims fails for the same reasons  
5 that its fraud analysis fails. The due process violations cover all the charges, and the same voids  
6 in record exist.

7 The Decision's analysis also fails, because the evidence does not support the Division's  
8 allegations that Shudak violated the registration requirements of A.R.S. §§ 44-1841 and 44-1842.  
9 The investments were part of a private offering and, therefore, exempt from registration under  
10 A.R.S. § 44-1844(A)(1). In determining whether investments are part of a private offering and,  
11 therefore, exempt from the registration requirements, courts consider the following factors: (1)  
12 the number of offerees; (2) the sophistication of the offerees; (3) the size and manner of the  
13 offering; and (4) the relationship of the offerees to the issuer. *See Mary S. Krech Trust v. The*  
14 *Lakes Apartments*, 642 F.2d 98, 101 (5th Cir. 1981). Here, each of these factors reflects that the  
15 investments were part of a private offering:

16 **A. The Number of Offerees**

17 There is no rigid limit to the number of offerees to whom an issuer could make a private  
18 offering. *See SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953). While the number of  
19 offerees, itself, is not decisive, *Doran v. Petroleum Mgmt. Corp.*, 545 F.2d 893, 901 (5th Cir.  
20 1977), "the more offerees, the more likelihood that the offering is public." *See Hill York Corp. v.*  
21 *Am. Intern. Franchises, Inc.*, 448 F.2d 680, 688 (5th Cir. 1971). Here, the evidence shows that  
22 there were only 17 investors, and then an entirely separate loan involving Mr. Van Hook. This  
23 evidence supports the finding that the investments were part of a private offering and, therefore,  
24 exempt from registration. *See Krech Trust*, 642 F.2d at 102-103 (finding offering to be private  
25 where there were 15 offerees); *see also Doran*, 545 F.2d at 901 (recognizing that the difference  
26 between one and eight offerees is "relatively unimportant" to the private offering analysis).

27  
28

1           **B.     The Sophistication of the Offerees**

2           The Division introduced evidence showing that the offerees signed Investor Suitability  
3 Questionnaires indicating that they were all accredited investors, and represented in the  
4 Investment Purchase Agreements that they, among other things: (i) received and reviewed the  
5 information provided to them; (ii) had a reasonable opportunity to ask questions and all questions  
6 were answered to their satisfaction; (iii) conducted whatever investigation they deemed  
7 necessary; (iv) evaluated the merits and risks of the investment; and (v) understood that the  
8 investment was speculative and involved certain risks. *See* Exhs. S-16 through S-33. Thus,  
9 based on their own admissions, the offerees were all sophisticated. This same evidence also  
10 supports the finding that the investments were part of a private offering and, therefore, exempt  
11 from registration. *See Krech Trust*, 642 F.2d at 102-103 (finding offering to be private where  
12 investors completed questionnaires stating their “net worth and financial sophistication”).

13           **C.     The Size and Manner of the Offering**

14           If an offering is small and is made directly to the offerees “rather than through the  
15 facilities of public distribution such as investment bankers or the securities exchanges,” a court is  
16 more likely to find that it is private. *See Hill York Corp.*, 448 F.2d at 689. Here, each of the  
17 offerees acknowledged in their Investment Purchase Agreement that the solicitation was  
18 “directly communicated to me and any Advisors ..., [and] [a]t no time was I presented with or  
19 solicited by or through any leaflet, public promotional meeting, circular, newspaper or magazine  
20 article, radio or television advertisement or any other form of general advertising ....” *See* Exhs.  
21 S-16 through S-33 (Investment Purchase Agreement, Additional Terms and Conditions, ¶1(i)).  
22 Given the relatively small nature of the offering, and the private manner of the solicitations, this  
23 factor further supports the finding that the investments were part of a private offering and,  
24 therefore, exempt from registration. *See Krech Trust*, 642 F.2d at 102-103 (finding offering to  
25 be private where offering was made through brokers who directly communicated with only a  
26 select group of investors).

1           **D.     The Relationship Between the Issuer and the Offerees**

2           As discussed above, each of the offerees acknowledged that they were given access to  
3 whatever information about the issuer they deemed necessary. *See supra* pp. 15-16. Therefore,  
4 this factor supports the finding that the investments were part of a private offering and, therefore,  
5 exempt from registration. *See Krech Trust*, 642 F.2d at 102-103 (finding offering to be private  
6 where offerees were given the opportunity to ask questions and review relevant documents).  
7 Because each of the above factors reflects that the investments were part of a private offering,  
8 the investments were exempt from registration under A.R.S. § 44-1844(A)(1). The Division's  
9 registration claim, therefore, fails.

10           **IV.    THE DIVISION IS NOT ENTITLED TO A RESTITUTION AWARD**

11           Because the Division failed to prove that there was a misuse of funds and that Shudak  
12 improperly received any funds, the Division's claim for restitution is inherently flawed.

13           The Decision's restitution award illustrates, yet again, the due process issues created by  
14 replacing the ALJ after the hearing. During the hearing, ALJ Stern described the obvious  
15 problem with the Division's restitution calculations as follows:

16           I just still find it somewhat – I don't know what a good term would be. Usually  
17 when you want to order an amount to be paid in restitution, you have a dollar  
18 amount that you know is valid and it's been proven. Here we have claims of  
19 investments, but no track of the money. ... So, we're not entirely sure if, in fact,  
20 the monies were invested. ... I don't know, I don't recall ever seeing something  
21 quite like this.

22           Tr. 332:2-13. Despite ALJ Stern's acknowledged concerns regarding the Division's proposed  
23 restitution calculations, ALJ Martin, who was not present to weigh the credibility of the  
24 Division's witnesses called to testify about the restitution calculations, adopted the Division's  
25 proposed amount, with a reduction of \$90,500 because of insufficient evidence for one of the  
26 investments. Decision at ¶185. ALJ Martin's analysis cannot be reconciled with ALJ Stern's  
27 comments on the record.

28           The restitution award also fails to comply with Arizona law. Section 44-2032 of the  
Arizona Securities Act (the "Act") provides that where a party has violated the Act, the ACC  
may require the party to "provide restitution." *See* A.R.S. § 44-2032. The ACC must determine

1 the necessity for, and amount of, such restitution consistent with the well-defined meaning of  
2 restitution under Arizona law. *See McIntyre v. Mohave Cnty.*, 127 Ariz. 317, 318 620 P.2d 696,  
3 698 (1980) (recognizing that where it does not appear from the context that a different meaning  
4 is intended, “[w]ords and phrases in statutes shall be given their ordinary meaning”).

5 Under Arizona law, restitution is awarded where “it would be inequitable or unjust” for a  
6 party to retain a “benefit” from another without compensation. *See Murdock-Bryant Constr.,*  
7 *Inc. v. Pearson*, 146 Ariz. 48, 54, 703 P.2d 1197, 1203 (1985). The “mere receipt of a benefit is  
8 insufficient” to justify restitution. *See id.* The purpose of restitution in circumstances such as  
9 these is to “eliminate profit from wrongdoing, while avoiding, so far as possible, the imposition  
10 of a penalty.” *See* Restatement (Third) of Restitution and Unjust Enrichment § 51(4); *see also*  
11 *Webster v. Culbertson*, 158 Ariz. 159, 162, 761 P.2d 1063, 1066 (App. 1996) (recognizing that in  
12 the absence of law to the contrary, Arizona follows the Restatement). Therefore, where, as here,  
13 “restitution is intended to strip [a party] of a wrongful gain,” restitution is calculated by  
14 determining “the amount of the profit wrongfully obtained.” *See* Restatement (Third) of  
15 Restitution and Unjust Enrichment § 49(4); *see also Amerco v. Shoen*, 184 Ariz. 150, 155, 907  
16 P.2d 536, 541 (App. 1995) (finding the restitution due to be the amount of improper gains). The  
17 party seeking restitution has the “burden of producing evidence permitting at least a reasonable  
18 approximation of the amount of the wrongful gain.” *See* Restatement (Third) of Restitution and  
19 Unjust Enrichment § 51(5)(d).

20 The record is devoid of any evidence that Shudak benefitted – let alone wrongfully  
21 obtained profits – from the investments. As the Decision concedes, there is no evidence that any  
22 of the funds paid by the investors: (i) were received by Shudak (or Parker Skylar); (ii) failed to  
23 go towards the Bisbee Project; or (iii) were used by Shudak (or Parker Skyler) for anything other  
24 than expenses related to the Bisbee Project. Moreover, even if the ACC finds that Shudak has  
25 benefitted in some way, the Division still is not entitled to restitution in the amount that it  
26 apparently seeks. The Division’s recovery in restitution is limited to “the amount of profit  
27 [Shudak has] wrongfully obtained.” *See* Restatement (Third) of Restitution and Unjust  
28 Enrichment § 49(4); *see also Amerco*, 184 Ariz. at 155, 907 P.2d at 541. The Division has not

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1 produced any evidence permitting even a "reasonable approximation" of wrongfully obtained  
2 profit.

3 **V. THE COMMISSION LACKS GROUNDS TO IMPOSE ADMINISTRATIVE**  
4 **PENALTIES**

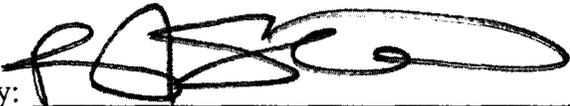
5 The Decision proposes an administrative penalty in the amount of \$150,000. Decision at  
6 ¶187. For the reasons discussed herein, the record does not support the imposition of any  
7 penalties. Most certainly, there is no evidence that Shudak committed 30 different violations (30  
8 x \$5,000 = \$150,000).

9 **CONCLUSION**

10 For the foregoing reasons, Shudak respectfully requests that the Commission grant his  
11 application for a rehearing.

12 DATED this 26th day of September, 2014.

13 GREENBERG TRAUIG, LLP

14   
15 By: \_\_\_\_\_  
16 BRIAN J. SCHULMAN  
17 Attorneys for Respondent Patrick Leonard Shudak

18 ORIGINAL and 13 copies of  
19 the foregoing hand-delivered on this  
20 26th day of September, 2014 to:

21 Docket Control  
22 Arizona Corporation Commission  
23 1200 W. Washington Street  
24 Phoenix, AZ 85007

25 COPY of the foregoing mailed  
26 on this 26th day of September, 2014 to:

27 Matthew J. Neubert  
28 Ryan Millecam  
Arizona Corporation Commission  
Securities Division  
1300 West Washington Street, 3<sup>rd</sup> Floor  
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