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Arizona Corporation Commission

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APR 20 2015 BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
DOCKET CONTROL

In the matter of:

MICHELLE LEE WAGNER (CRD No. 2403647),

Respondent.

DOCKET NO. S-20916A-14-0328

SECURITIES DIVISION'S POST-HEARING BRIEF

Hearing Date: March 4, 2015

Assigned to Administrative Law Judge Mark Preny

The Securities Division ("Division") of the Arizona Corporation Commission ("Commission") submits its Post-Hearing Brief ("Brief") with respect to the administrative hearing held on March 4, 2015. This Brief is supported by the following Memorandum of Points and Authorities.

MEMORADUM OF POINTS AND AUTHORITIES

I. Jurisdiction

The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona Constitution and the Securities Act. As stated in A.R.S. § 44-2032, the Commission has jurisdiction when it appears to the Commission that any person has engaged in any act, practice or transaction that constitutes a violation of the Securities Act or any rule or order of the Commission.

II. Overview and Facts

A. Overview

This case involves Ms. Wagner's violation of A.R.S. § 44-1962(10), which prohibits dishonest and unethical practices by a salesman in the securities industry. Commission Rule 14-4-

1 130(A)(15) defines the unethical practice at issue: "Borrowing of money or securities by a salesman
2 from a customer, except when the customer is a relative of the salesman or a person in the business
3 of lending funds." As stated in the preamble to Title 14 of the AAC, all persons who seek
4 registration as a salesman must comply with the Commission Rules in Title 14.

5 Rule R14-4-130(A)(15) keeps customer funds managed by the salesman separate from the
6 salesman's funds. It also avoids conflicts of interest created by the salesman touting his or her own
7 investment opportunity and offering to become an income stream to the customer.¹ This case
8 highlights the need to enforce the standards of honesty and ethical practices governing registered
9 securities salesmen. Here, Mr. Lawrence Pritchard, a customer of Ms. Wagner's acting through a
10 trust he controlled, decided to invest in real estate, the income from which would be generated by
11 Ms. Wagner and her business. His investment funds came partly from funds managed by Ms.
12 Wagner. And his decision to invest was influenced and advised by Wagner.

13 B. Facts

14 The Division and Respondent Michelle L. Wagner have stipulated to most of the relevant
15 facts.² Ms. Wagner reviewed those stipulations with her attorney and authorized him to sign on her
16 behalf.³ These stipulated facts support the allegations in the Division's Notice.⁴

17 Ms. Wagner has been an Arizona resident at all relevant times, i.e. from November 21,
18 2003 to the present.⁵

19 From 1998 to the present, Ms. Wagner, CRD No. 2403647, has been registered as a
20 securities salesman in Arizona.⁶ From July 2003 through at least January 2015, Ms. Wagner

23 ¹ See, e.g., North American Securities Administrators Association, Inc. 2/13/04 letter comment to SEC regarding
24 NASD Rule 2370 (which puts a similar restriction on brokers obtaining loans from clients) at
http://www.nasaa.org/wp-content/uploads/2011/07/69-Lending_Comment.38032-37763.pdf

25 ² Joint Fact Stipulations filed 4/2/15 ("Fact Stip.").

25 ³ Hearing Transcript pp. 7:15 – 8:5 & 54:6–15.

26 ⁴ Notice of Opportunity for Hearing Regarding Proposed Order of Revocation/Suspension, to Cease and Desist, for
Restitution, and for Administrative Penalties, filed 9/11/14.

⁵ Fact Stip. ¶ 1.

⁶ Fact Stip. ¶ 2; Ex. S-2.

1 registered as a securities salesman with the Commission in association with the registered
2 broker/dealer Crown Capital Securities.⁷

3 Beginning in November 2003, Lawrence Pritchard (“LP”), an Arizona resident, became a
4 customer of Ms. Wagner’s.⁸ LP continued to be Wagner’s customer through 2012.⁹ With LP as her
5 customer, Ms. Wagner managed a portion of LP’s accounts, LP’s retirement accounts, and
6 accounts and investments of LP’s charitable remainder trust (the “Trust”).¹⁰ LP was the sole trustee
7 of the Trust and acted on its behalf.¹¹

8 In May 2005, Wagner, dba Creative Consulting, borrowed \$400,000 from the Trust.¹² A
9 portion of the funds for the loan came from selling investment capital managed by Wagner.¹³

10 At the time, neither LP nor the Trust is or was in the business of lending money.¹⁴ LP is not
11 a relative of Wagner’s.¹⁵

12 The \$400,000 loan was for the purchase and tenant improvements of an office
13 condominium in Scottsdale.¹⁶

14 Ms. Wagner purchased the office in May 2005. Title to the office condominium was in the
15 name of Ms. Wagner. Ms. Wagner caused the tenant improvements to be built in the office and
16 used it as her place of business until 2013.¹⁷

17 The loan is evidenced by a Note Secured by Deed of Trust and a Deed of Trust and
18 Assignment of Rents. Both documents are dated May 16, 2005. Under the terms of the note,
19 Wagner was to pay the Trust annual interest of 4%. The office condominium is the collateral
20 securing Wagner’s obligations under the 2005 note. This deed of trust was not recorded.¹⁸

21 _____
⁷ Ex. S-2; H.T. pp. 13:14 – 14:18 & 30:9–23.

22 ⁸ Fact Stip. ¶ 3; Exs. S-3 & S-4; H.T. p. 15:2–22.

23 ⁹ Fact Stip. ¶ 4; H.T. p. 43:17 – 44:4.

24 ¹⁰ Fact Stip. ¶ 5; Exs. S-3 & S-4; H.T. p. 15:2–17.

25 ¹¹ Fact Stip. ¶ 7.

26 ¹² Fact Stip. ¶ 9; Exs. S-7, H.T. 16:12–19.

¹³ Exs. S-5 & S-6; H.T. p. 24:7–13.

¹⁴ Fact Stip. ¶ 10; H.T. p. 25:9–15.

¹⁵ Fact Stip. ¶ 8; H.T. p. 23:15–21.

¹⁶ Fact Stip. ¶ 11; H.T. p. 24:2–6.

¹⁷ Fact Stip. ¶ 12.

¹⁸ Fact Stip. ¶ 13; Ex. S-7; H.T. pp. 17:22 – 18:16.

1 A second Promissory Note and a second Deed of Trust, both dated June 1, 2008, replaced
2 the first Promissory Note and first Deed of Trust. Ms. Wagner was solely and personally liable for
3 repayment of the Promissory Note. Creative Consulting was not a party to the second Promissory
4 Note and second Deed of Trust. Under the terms of this note, Ms. Wagner would pay the Trust
5 \$1,500 per month for 24 months. At the end of that period all unpaid interest and principal would
6 be due. This deed of trust also has the office condominium as the collateral securing Ms. Wagner's
7 obligations under the 2008 note. This deed of trust was recorded with the Maricopa County
8 Recorder at Instrument No. 2008-0529403 on June 1, 2008.¹⁹

9 The parties agreed to a third modification to the notes and deeds of trust on or around
10 August 1, 2011. At this time, the Trust and Ms. Wagner personally executed a document titled
11 "Extension of Real Estate Note and Deed of Trust Lien." Under this document, Ms. Wagner would
12 pay the Trust \$1,500 a month through December 30, 2012.²⁰

13 LP did not offer to renew or extend the loan past December 30, 2012. The Trust demanded
14 that the entire principal amount, \$400,000, be paid on the due date.²¹

15 On April 30, 2013, the Trust conducted a Trustee Sale on the property that was the security
16 in the 2008 Deed of Trust. The sale price at the Trustee Sale was \$152,000.²²

17 Prior to the Trustee Sale, Ms. Wagner paid the Trust interest on the loan pursuant to the
18 terms of the notes. Prior to demanding full payment of principal around December 2012, the Trust
19 did not request and Ms. Wagner did not pay the Trust any principal.²³

20 On 9/23/13, the Trust sold the property for a sale price of \$180,000.²⁴

21 On 11/14/13 Ms. Wagner filed for Chapter 7 bankruptcy protection in Arizona.²⁵ On
22 2/14/14, the Trust filed a bankruptcy adversary proceeding against Ms. Wagner.²⁶ The adversary
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24 ¹⁹ Fact Stip. ¶ 14; Exs. S-8 & S-9.

²⁰ Fact Stip. ¶ 15; Ex. S-10.

²¹ Fact Stip. ¶ 16.

²² Fact Stip. ¶ 17; Ex. S-11.

²³ Fact Stip. ¶ 18.

²⁴ Ex. R-12.

²⁵ Bankruptcy Petition #: 2:13-bk-19796-MCW

²⁶ Adversary Proceeding #: 2:14-ap-00149-MCW

1 proceeding involves collecting the deficiency on the loan described in this administrative
2 proceeding. The adversary proceeding is ongoing. The most recent event in the proceeding was a
3 4/15/15 jointly-stipulated scheduling order.

4 **III. Legal Argument**

5 The Division established at hearing that during the years 2004 – 2013, Respondent engaged
6 in unethical and dishonest practice in the securities industry in violation of A.R.S. § 44-
7 1962(A)(10) and A.C.C. R14-4-130(15). Ms. Wagner’s conduct is grounds to revoke her salesman
8 registration, order her to cease and desist from further violations, assess penalties, and order
9 restitution.²⁷

10 **A. The loan from LP satisfies all elements of a 1962(A)(10) violation and no exemption**
11 **applies.**

12 The Securities Act prohibits a salesman from engaging in dishonest or unethical practices in
13 the securities industry.²⁸ Commission Rule R14-4-130 states that dishonest or unethical practices in
14 the securities industry includes “Borrowing of money for securities by a salesman form a customer,
15 except when the customer is a relative of the salesman or a person in the business of lending
16 funds.” The Division established the elements of this rule through the stipulated facts and during
17 the hearing:

- 18 • Ms. Wagner was a registered salesman residing and operating in Arizona at the time the
19 loan was made;
- 20 • LP/the Trust was a customer of Ms. Wagner’s;
- 21 • LP/the Trust lent Ms. Wagner \$400,000 to purchase an office condominium and build the
22 tenant improvements of this office;
- 23 • The loan is evidenced by a note and unrecorded deed of trust; it was later renewed and
24 modified with additional documentation showing the changes;

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²⁷ A.R.S. § 44-1962(B).

²⁸ A.R.S. § 44-1962(A)(10).

- 1 • LP and the Trust were not a relative of Wagner's and were not in the business of making
2 loans.

3 **B. The Commission should revoke Ms. Wagner's securities salesman registration, issue**
4 **penalties, and order restitution as authorized by statute.**

5 The Securities Act states that the Commission may enter an order revoking the registration
6 of a salesman if the Commission finds that the salesman has engaged in dishonest or unethical
7 practices in the securities industry.²⁹ In similar cases, the Commission has revoked, rather than
8 suspended, the salesman's registration.³⁰ In addition to suspension or revocation, the Commission
9 may assess administrative penalties, order the salesman to cease and desist from violating the
10 Securities Act, and order restitution.³¹

11 The amount of restitution to be ordered is cash equal to the fair market value of the
12 consideration paid, determined as of the date of such payment together with (b) interest from the
13 date of the purchase payment.³² Here, LP made a \$400,000 loan payment to Ms. Wagner on May
14 16, 2005. This principal amount was renewed in subsequent loans, the most recent being on or
15 around August 1, 2011. Since the amount was paid in cash, this \$400,000 is the fair market value of
16 the consideration. The rule militates that this value be used to determine restitution using a later
17 value of the property or a subsequent sale, would be inappropriate.

18 As specified in the rule, the restitution amount will be offset by principal, interest, or other
19 distributions. Ms. Wagner did not pay any principal to LP. She did pay interest as prescribed by the
20 notes. These payments totaled \$123,333.24.³³ Because R14-4-308(C) specifically lists interest
21 payments, this \$123,333.24 should be an offset to the amount of restitution ordered. Additionally,
22 LP obtained the collateral for his loan at a trustee sale.³⁴ LP was later able to sell the property for

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²⁹ A.R.S. § 44-1962(A).

24 ³⁰ See, e.g., *In re Anthony Ray Stacy*, Docket No. S-20909A-14-226, Decision #74849 issued on 12/18/2014; *In re Britt*
25 *M. Lachemann*, Docket No. S-20894A-13-0351, Decision #74239 issued on 1/7/2014; *In re Lynn R. Goldney*, Docket
26 No. S-20880A-13-0088, Decision #73766 issued on 5/8/2013; and *In re Attila Toth*, Docket No. S-20782A-11-0019,
27 Decision #72507 issued on 8/3/2011.

³¹ A.R.S. § 44-1962(B).

³² R14-4-308(C)(1)(a) & (b).

³³ Ex. R-13.

³⁴ Ex. R-12.

1 \$180,000.³⁵ The rule allows for “other distributions received on the security[.]”³⁶ The \$180,000 sale
 2 could reasonably be considered such “other distribution” and would be an offset to the restitution
 3 owed.

4 **C. The Commission’s proceedings are not affected by Ms. Wagner’s bankruptcy and any**
 5 **Commission order would not be dischargeable in Bankruptcy.**

6 While Ms. Wagner did not petition to stay the Commission’s proceedings, it is instructive to
 7 note that the proceedings are not subject to the automatic stay and can proceed through and including
 8 entry of an order by the Commission and transcript of judgment, pursuant to A.R.S. § 44-2036(C).
 9 Section 326(4) of the bankruptcy code excludes certain exercises of regulatory authority and police
 10 power from the automatic stay.³⁷ In *In re Knoell*, the Arizona District Court specifically held that the
 11 Commission is exercising a legitimate police power when enforcing the Securities Act.³⁸

12 In a previous Commission administrative action regarding A. Cooper and L. Cooper, Docket
 13 No. S-03550A-04, the Coopers filed a bankruptcy petition in the Bankruptcy Court of Arizona, Case
 14 No. 2-05-26746-RJH. The Coopers argued that their administrative hearing was stayed. By request of
 15 Administrative Law Judge Stern and pursuant to a procedural order dated November 2, 2005, the
 16 Division on behalf of the Commission filed a motion for relief from the automatic stay on November
 17 4, 2005. On January 26, 2006, Judge Haines granted the Division relief from the automatic stay and
 18 found as follows:

- 19 1) The Arizona Corporation Commission is a governmental agency enforcing its police
 20 and regulatory power;

22 ³⁵ Ex. R-12.

23 ³⁶ R14-4-308(C)(1)(c).

24 ³⁷ 11 U.S.C.A. § 362(b)(4); *In re Universal Life Church, Inc.*, 128 F.3d 1294, 1297 (9th Cir. 1997), *citing* 3 COLLIER
 25 ON BANKRUPTCY § 362.05(5)(b), at 362-58 (15th ed. 1996) (To prevent bankruptcy from becoming “a haven for
 26 wrongdoers,” the automatic stay should not prevent governmental regulatory, police and criminal actions from
 proceeding.); see also *S.E.C. v. Brennan*, 230 F.2d 65, 71 (2d. Cir. 2000) (“[W]here a governmental unit is suing a
 debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or
 regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under
 the automatic stay.”)

³⁸ *In re Knoell*, 160 B.R. 825, 826 (D. Ariz. 1993) (Holding that the automatic stay does not preclude an investigation
 by the Commission regarding possible violations of the Securities Act of Arizona because actions of the Commission
 are pursuant to the Commission’s police and regulatory power.).

1 2) Pursuant to 11 U.S.C. § 362(b)(4), police and regulatory actions commenced by the
2 Arizona Corporation Commission are not stayed by these bankruptcy proceedings; and,
3 3) The Arizona Corporation Commission may proceed with their investigation, and also
4 proceed to exercise their regulatory powers as provided by law.

5 Specifically, the [Bankruptcy] Court recognizes the authority of the Arizona Corporation
6 Commission to enter Orders in administrative and civil proceedings, including but not
7 limited to, those that provide for injunctive relief, for penalties, for restitution and for the
8 revocation of licenses as provided by law; however, the Arizona Corporation Commission
9 may not attempt to execute upon the monetary judgment so long as the Bankruptcy Court
10 has jurisdiction over the debtor.

11 As this case and *Knoell* show, the Commission's proceedings are not subject to the automatic stay;
12 Commission proceedings continue all the way through entering an order, independently of the
13 bankruptcy.

14 Section 523(a)(19) of the bankruptcy code makes administrative orders for the violations of
15 State securities laws non-dischargeable in bankruptcy. This statute describes orders for violations of
16 State securities law as a "debt" that is created by the administrative proceeding.³⁹ Since the debt is
17 created by the violation of securities laws—laws that all citizens must follow—not discharging the
18 debt does not create an obligation that did not already exist. A Pennsylvania bankruptcy case states:
19 "Nor will § 523(a)(19) impose any new duties on Mr. Lewandowski with regard to conduct
20 associated with transactions he has already completed. Section 523(a)(19) 'does not make unlawful
21 conduct that was lawful when it occurred.' [citation omitted] The conduct which violated the security
22 laws of the State of New Jersey was already unlawful and subject to monetary liability when his
23 bankruptcy petition was filed."⁴⁰ Thus a Commission order is a distinct debt, independent of other
24 creditors' disputes with the bankruptcy debtor.

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³⁹ 11 U.S.C.A. § 523(a)(19).

⁴⁰ *In re Lewandowski*, 325 B.R. 700, 707-08 (Bankr. M.D. Pa. 2005).

1 After the Commission issues an order, collection on that order can be determined by the
2 bankruptcy court.⁴¹ Debts created by administrative orders for violations of State securities laws are
3 non-dischargeable. Section 523(a)(19) states that the debtor cannot discharge any “debt” that is for the
4 violation any of the State securities laws, or any regulation or order issued under such State securities
5 laws that results, before, on, or after the date on which the petition was filed, from any judgment,
6 order, consent order, or decree entered in any State judicial or administrative proceeding; or any court
7 or administrative order for any penalty, restitutionary payment, disgorgement payment, or other
8 payment owed by the debtor.⁴²

9 The statute explicitly allows bringing an action “before, on, or after the date on which the
10 petition was filed.”⁴³ The Georgia Bankruptcy Court has noted that this provision allows non-
11 bankruptcy forums to determine liability: “Section 523(a)(19) expressly contemplates a postpetition
12 determination of liability by a nonbankruptcy forum for debts resulting from securities law violations
13 as well as common law fraud, deceit, or manipulation in connection with the purchase or sale of a
14 security.”⁴⁴

15 Because the Division is exercising a valid police power that would create an obligation for the
16 violation of State securities laws (LP is not a party in this action and the Division is not enforcing
17 LP’s contract with Ms. Wagner), this administrative matter proceeds independent of Wagner’s
18 bankruptcy through the issuing of an order. After an order is issued, the case is a collection matter,
19 outside of the scope of this administrative action. In such collections, the Commission’s order of
20 restitution in this case would create a separate “debt” that is non-dischargeable in bankruptcy.

21 CONCLUSION

22 The evidence produced at hearing establishes that Ms. Wagner violated A.R.S. § 44-1062
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24 ⁴¹ 11 U.S.C.A. § 362(b)(4); *S.E.C. v. Brennan*, 230 F.2d 65, 71 (2d. Cir. 2000); see also *In re Jafari*, 401 B.R. 494,
25 499–500, (Bankr. D. Colo. 2009) (Section 523(a)(19)(B) still requires that “the liability determination occur outside of
26 the bankruptcy forum, whether it occurs pre- or post-bankruptcy. Once liability has been imposed, then either a
bankruptcy court or a non-bankruptcy court may determine the application of this nondischargeability statute.”).

⁴² 11 U.S.C.A. § 523(a)(19).

⁴³ 11 U.S.C.A. § 523(a)(19).

⁴⁴ *In re Zimmerman*, 341 B.R. 77, 80 (Bankr. N.D. Ga. 2006)

1 by taking a \$400,000 loan from LP, a customer who was not her relative and not in the business of
2 making loans.

3 Based upon the evidence admitted during the administrative hearing, the Division
4 respectfully requests this tribunal to:

- 5 1. Revoke Respondent's salesman registration with the Commission;
- 6 2. Order Respondent to pay restitution in the amount of \$96,666.76 (\$400,000 less
7 \$123,333.34 in interest payments and \$180,000 from the sale of the property), plus interest from
8 the date judgment is entered in this matter to the date of repayment (interest rate to be calculated at
9 the time of judgment under A.R.S. § 44-1201);
- 10 3. Order Respondent to pay an administrative penalty of not more than \$5,000 for her
11 violation of the Securities Act, as the Court deems just and proper, pursuant to A.R.S. § 44-
12 2036(A).
- 13 4. Order Respondent to cease and desist from further violations of the Act pursuant to
14 A.R.S. § 44-2032.
- 15 5. Order any other relief this tribunal deems appropriate or just.

16
17 RESPECTFULLY SUBMITTED April 20, 2015

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19 Ryan J. Millicam
20 Attorney for the Securities Division of the
21 Arizona Corporation Commission
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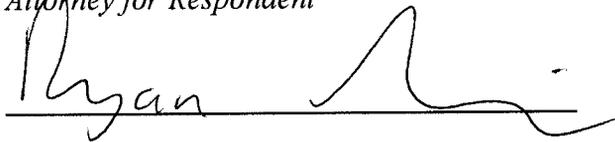
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5 1200 W. Washington St.
6 Phoenix, AZ 85007

7 COPY of the foregoing mailed
8 on April 20, 2015, to:

9 J. Murray Zeigler
10 229 W. La Vieve Ln.
11 Tempe, AZ 85284-3022
12 *Attorney for Respondent*

13 By:

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