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AZ CORP COMMISSION
DOCKET CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

In re:

MICHELLE LEE WAGNER,

(CRD No. 2403647),

Respondent.

DOCKET NO. S-20916A-14-0328

**RESPONDENT'S POST-HEARING
BRIEF AND RESPONSE TO
SECURITIES DIVISION'S POST-
HEARING BRIEF**

(Assigned to Administrative Law Judge Mark
Preney)

Respondent, Michelle Lee Wagner ("Wagner"), through her undersigned counsel, submits her Post-Hearing Brief ("Respondent's Brief") with respect to the administrative hearing held on March 4, 2015 and her response to the Arizona Securities Division's ("AZSD") Post-Hearing Brief (Post-Hearing Brief). Respondent requests that the Court recommend a sanction commensurate with the violation committed and to defer an award of restitution to the United States Bankruptcy Court for the reasons detailed in the attached Memorandum of Points and Authorities.

MEMORANDUM OF POINTS AND AUTHORITIES

I. Introduction.

This case was initiated by the AZSD following receipt of a complaint by Lawrence Pritchard ("Pritchard"). Pritchard is a disgruntled, vengeful ex-client of Wagner committed to causing Wagner personal and professional embarrassment and harm. Pritchard's complaint was not based on any fraudulent actions by Wagner but rather on a personal disagreement with Wagner regarding her alliance with a former friend of Pritchard. The AZSD filed the instant proceeding against Wagner based on a 10 year old technical violation by Wagner of a Commission Rule prohibiting a salesman from entering into a loan relationship with a non-relative or person not involved in the business of making loans. R-14-4-130(A)(15). Although the violation was not a fraudulent act; was not entered into for Wagner's sole benefit; was extremely remote in time and was a single isolated event, Wagner acknowledged and admitted to the technical violation. Given the circumstances surrounding the entire event, Wagner seeks a recommendation from the Court to the Arizona Corporation Commission ("Commission") commensurate with the scope and nature of the technical violation.

II. Jurisdictional Statement

Wagner agrees with the jurisdictional statement stated in AZSD Post-Hearing Brief.

III. Relevant Facts.

As stated by the AZSD in its Post-Hearing Brief, the parties stipulated to relevant facts prior to the hearing and submitted a written stipulation. Wagner agrees with the statement of relevant facts as stated by the AZSD and will not repeat the stipulated fact statement.

1 However, the stipulated statement of facts addresses the “elements” of the
2 technical violation only. It does nothing to illuminate the events leading to the
3 violation or the motivations of the parties in bringing the complaint or review the
4 testimony of the witnesses from the hearing. For those reasons, Wagner believes an
5 overall understanding of the events is necessary when the Court considers the
6 sanctions appropriate for the violation.

7 The following is a list of pertinent facts describing the events in full. Although
8 the AZSD did not stipulate to these facts, the testimony given by witnesses at the
9 hearing attesting to these facts was uncontested.

10 1. While Wagner was not a “relative” of Pritchard, she had a long term
11 relationship with Pritchard’s family. Wagner was considered by Pritchard to be a
12 family member since 1991, long before the loan arrangement between Pritchard and
13 Wagner.

14 2. When Wagner agreed to become Pritchard’s financial advisor,
15 Pritchard’s investment goals included obtaining investments which would produce a
16 stream of income.

17 3. Wagner did not “solicit” or request the loan from Pritchard. Pritchard
18 offered to make the loan to Wagner as a financial investment for the benefit of his
19 personal Trust.

20 4. The loan from Pritchard to Wagner was consistent with Pritchard’s
21 investment goals and Wagner believed the loan was in Pritchard’s best interests.

22 5. At the time the loan was made, Wagner was unaware such a loan
transaction violated A.R.S. § 44-1962(10) and Arizona Administrative Code (“AAC”) Rule R14-4-130(A)(15).

1 6. Wagner did not receive any money or personal benefit from the loan.
2 All funds from the loan were used exclusively for the purchase and subsequent build
3 out of an office condo to be used as Wagner's primary place of business.

4 7. For more than 7 years Wagner paid Pritchard all payments pursuant to
5 the loan documents. In December 2012 Pritchard unilaterally refused to extend the
6 loan due date. Over the 7 year period, Wagner paid Pritchard more than \$121,333.24.

7 8. On December 31, 2012, Pritchard demanded the entire principal balance
8 in the amount of \$400,000.00 from Wagner.

9 9. Wagner attempted to refinance the loan or obtain a new loan on the
10 office condo. She was unable to do so due to loss of value of the property during the
11 collapse of the real estate market occurring at the time Pritchard called the note due.

12 10. Wagner was not responsible for the loss of market value of the
13 property.

14 11. Four months after foreclosing on the property, Pritchard resold the
15 property for \$180,000.00.

16 12. Pritchard "loaned" the purchase price to the subsequent buyers of the
17 office condo through a "seller carryback" arrangement.

18 13. Pritchard continues to receive monthly payments on the resale of the
19 office condo which continues to provide a stream of in come to Pritchard on his
20 investment.

21 14. At no time did Wagner intend for Pritchard to suffer harm.

22 15. It is impossible to calculate the final return on Pritchard's investment
because he continues to receive income from the investment.

1 16. On June 26, 2013, Pritchard commenced litigation against Wagner and
2 her business, Creative Consulting, in the Maricopa County Superior Court for
3 “Breach of Contract: Deficiency Action (A.R.S. § 33-814).”

4 17. Wagner was unable to financially support an aggressive defense to
5 Pritchard’s Superior Court proceeding or to pay the deficiency claim. Wagner was
6 forced to file for bankruptcy protection on November 14, 2013.

7 18. Wagner received a discharge of her debts, including any “debt” owed
8 to Pritchard on February 27, 2014.

9 19. Pritchard has filed a request in the bankruptcy proceeding to have any
10 alleged “debt” owed by Wagner declared non-dischargeable. The bankruptcy
11 proceeding is currently pending.

12 20. Wagner has never made any other violation of any statute, rule or
13 regulation in the 17 years she has been a registered securities salesman in Arizona.

14 **IV. Legal Argument**

15 **A. Any Discipline Against Wagner Should Be Minimal Given the Facts** 16 **of the Case.**

17 Wagner acknowledges and admits that she obtained a personal loan secured
18 by a Deed of Trust from a non-relative not in the business of making loans. Wagner
19 believes that any sanctions by the Commission against her for misconduct should be
20 tailored to fit the offense she committed.

21 Pursuant to Arizona statutes and Administrative Rules, Wagner’s
22 transgression is an *unethical* act but is not a *fraudulent* act. Rule R14-4-130 interacts
with A.R.S. § 14-1962(10) to define conduct considered to be dishonest and unethical.
Fraudulent conduct is addressed by A.R.S. §§ 44-1991 *et. seq.* No allegation has been
made that Wagner’s conduct rose to the level of being fraudulent. Any sanctions

1 against her must not be based on fraudulent conduct but rather unethical conduct.

2 There is a distinct difference between fraudulent actions and unethical actions.

3 The action upon which AZSD has brought the instant proceeding against
4 Wagner is based on R14-4-130 (A)(15) which states:

5 A. For purposes of A.R.S. §§ 44-1961(A)(13) and 44-1962(10), dishonest or
6 unethical practices in the securities industry shall include but not be limited
7 to the following:

8 15. Borrowing of money or securities by a salesman from a customer,
9 except when the customer is a relative of the salesman or a person in
10 the business of lending funds.

11 The Rule provides that borrowing money from a customer is neither
12 fraudulent nor prohibited *per se*. A salesman may enter into a loan arrangement with
13 a customer if the customer either is a "relative" or is in the business of lending funds.
14 In the instant matter, while Pritchard was not, "in the business of lending funds" the
15 uncontroverted testimony at the hearing was that Pritchard has made similar loans
16 backed by security interests in real property. Such repeated actions by Pritchard
17 demonstrates his level of confidence in such transactions. The fact that Pritchard
18 entered into similar transactions with third parties *after* the transaction with Wagner
19 further demonstrates his continued commitment to using such transactions as an
20 investment tool.

21 The uncontroverted testimony of Wagner at the hearing established that,
22 Pritchard was not a "relative," but Pritchard considered Wagner to be as close as a
family member. Wagner was a friend of Pritchard's family for many years having
been best friends and roommates with Pritchard's daughter while in college. Wagner
enjoyed dinner at the Pritchard residence on at least a weekly basis. When Wagner
moved out of state, she often stayed with Pritchard's family during return visits.
Pritchard felt so comfortable with Wagner that he requested she become his financial

1 advisor when the brokerage firm he was with requested he find a replacement
2 financial representative.

3 Wagner's uncontroverted testimony also established that when she entered
4 into the loan agreement with Pritchard, she was unaware such a transaction
5 constituted unethical misconduct. Pritchard approached Wagner and offered to lend
6 her the money because he knew she was looking to purchase an office condo to serve
7 as her place of business. After careful consideration, Wagner believed the loan
8 arrangement to be in Pritchard's best interests because it fit perfectly with his stated
9 investment goals; i.e. to make investments that would provide a stream of income.

10 It was also Wagner's uncontroverted testimony at the hearing that she did not
11 personally gain anything from the loan transaction with Pritchard. All of the funds
12 provided by Pritchard were used in the purchase and build out of the office condo.
13 None of the loan funds were retained by Wagner for her personal benefit. While
14 Wagner benefitted from using the office condo as her place of business for many
15 years, Pritchard was fully compensated for that benefit through the mortgage
16 payments made by Wagner every month in accordance with the Promissory Note
17 and Deed of Trust. Pritchard received the full benefit of the bargain with regard to
18 the loan agreement. Moreover, Pritchard could have continued to receive benefits
19 from the loan had he decided to extend the terms until such time as the real estate
20 market rebounded and Wagner was able to refinance the loan. It was Pritchard who
21 unilaterally created a situation whereby he knew Wagner was sure to default.

22 The loan transaction occurred 10 years prior to Pritchard filing a complaint
with the AZSD. It is ironic that if Wagner's conduct had risen to the level of being
fraudulent, the AZSD could not pursue any action against Wagner. Prosecution for
fraudulent conduct is barred after 2 years from the date the event occurred pursuant
to A.R.S. § 44-2004. Had Wagner intended to harm Pritchard, steal his money or

1 acted in total disregard to his interests, she would not be facing a disciplinary
2 proceeding today.

3 Wagner's conduct in entering into the loan arrangement with Pritchard was
4 not fraudulent in nature; was not a knowing violation of the statute; occurred many
5 years ago; was not intended to harm Pritchard in any manner; was consistent with
6 Pritchard's investment goals and did not benefit Wagner personally. Taken together,
7 these facts demonstrate that no purpose would be served by punishing Wagner
8 whatsoever. She has been a licensed salesman for 17 years with only one
9 transgression which occurred 10 years ago. She has acknowledged her transgression
10 and clearly it will never occur again. Pritchard received the full benefit of his
11 investment and continues to receive additional benefits through a seller carryback of
12 the mortgage for the subsequent buyer. If the Court believes that a sanction is
13 warranted, Wagner contends it should be limited to entry of a Cease and Desist
14 Order prohibiting her from engaging in similar conduct in the future.

15 **B. The Facts Do Not Warrant the Imposition of Restitution.**

16 The Financial Industry Regulatory Authority ("FINRA") is a not-for-profit
17 organization authorized by Congress to protect America's investors by making sure
18 the securities industry operates fairly and honestly. FINRA's mission is to safeguard
19 the investing public against fraud and bad practices. *See generally* the FINRA website
20 at <http://www.finra.org>. FINRA provides model codes of conduct for securities
21 salespersons and securities brokers. The National Adjudicatory Council ("NAC") has
22 developed FINRA Sanction Guidelines for use by various bodies adjudicating
disciplinary decisions and determining appropriate remedial sanctions. *FINRA
Sanction Guidelines*, March 2015. Comparing sanctions from case to case is
notoriously difficult because each case presents unique facts particularly with regard
to restitution and disgorgement of ill-gotten gains by securities law violators.

1 Pertinent FINRA recommendations to be considered in conjunction with the
2 imposition of sanctions for violations of the type involved in the instant proceeding
3 include the following:

- 4 1. Disciplinary sanctions are remedial in nature and should be
5 designed to deter future misconduct and to improve overall
6 business standards.
- 7 2. Disciplinary sanctions should be more severe for recidivists.
- 8 3. Adjudicators should tailor sanctions to respond to the
9 misconduct at issue.
- 10 4. Where appropriate to remediate misconduct, Adjudicators should
11 order restitution and/or rescission. Restitution is a traditional
12 remedy used to restore the status quo ante where a victim
13 otherwise would unjustly suffer loss.
- 14 5. To remediate misconduct, Adjudicators should consider a
15 respondent's ill-gotten gain when determining an appropriate
16 remedy
- 17 6. When raised by a respondent, Adjudicators are required to
18 consider ability to pay in connection with the imposition,
19 reduction or waiver of a fine or restitution.
- 20 7. Whether an individual or member firm respondent accepted
21 responsibility for and acknowledged the misconduct.
- 22 8. Whether the respondent engaged in numerous acts and/or a
pattern of misconduct.
9. Whether the respondent engaged in the misconduct over an
extended period of time.
10. Whether the respondent attempted to conceal his or her
misconduct.
11. The level of sophistication of the injured or affected customer.

12 Application of the foregoing FINRA recommendations to the instant
13 proceeding show that any sanctions against Wagner should be limited in scope and
14 should not include an order of restitution. The actions by Wagner giving rise to the
15 complaint were remote in time; did not result in any "ill-gotten gain" for Wagner;
16 involved an isolated incident with a very sophisticated customer accustomed to
17 actively managing his investments who even engaged in "churning" of his
18 investments. Additionally, Wagner is not a recidivist; has acknowledged and

1 accepted responsibility for her actions; never attempted to conceal any aspects of the
2 loan transaction and, as evidenced by her recent Chapter 7 bankruptcy filing, does
3 not have the financial ability to pay fines and restitution, even if warranted.

4 "Restitution" is defined by Google as, "1. the restoration of something lost or stolen
5 to its proper owner. 2. recompense for injury or loss." In this instance, Pritchard neither lost
6 anything nor had anything stolen from him. Pritchard entered into an "arms-length"
7 transaction pursuant to normal business terms. Pritchard knew the investment in the
8 office condo would carry the same risk of loss that any similar investment in real
9 estate would carry. His involvement in the loan transaction with Wagner was willing
10 and intentional on Pritchard's part. Additionally, Pritchard has not suffered an injury
11 or loss due to Wagner's actions. Wagner was not personally responsible for the
12 collapse of real estate values in the community. Moreover, Wagner did not call the
13 note due at a time when Wagner could not realistically refinance the property and
14 satisfy the Note in its entirety. It was Pritchard's decision to do so thereby creating a
15 paper "loss" (deficiency) in order to pursue Wagner further. Lastly, Pritchard
16 continues to reap the benefits of the loan transaction by entering into a seller
17 carryback and financing the purchase of the office condo by the subsequent buyer.
18 These are not the conditions under which an award of restitution is warranted.

19 **C. Restitution is Discretionary, Not Mandatory**

20 A recommendation of imposition of restitution by this Court is discretionary,
21 not mandatory. *See* Rule R14-4-308(A). While the AZSD urges the Court to
22 recommend restitution, it provides little justification for doing so. As noted above,
the factual differences between cases of this type make it impossible to apply a
blanket restitution sanction on every case based solely on the fact that the elements
constituting a violation have been met. Not every case involving fraud warrants a

1 restitution order. Not every case involving a loan transaction between a salesman
2 and her customer does either.

3 In its Post-Hearing Brief, the AZSD states, "In addition to suspension or
4 revocation, the Commission **may** assess administrative penalties,
5 order the salesman to cease and desist from violating the Securities
6 Act, and order restitution." (Emphasis supplied.) The Securities Act does not
7 *require* the Commission to assess *any* sanctions against a salesperson including
8 restitution. Imposition of sanctions is solely within the discretion of the Court and
9 Commission based on the facts and circumstances particular to each individual case.

10 In support of its argument for imposition of sanctions, the AZSD cites a
11 variety of cases arguing each is "similar" to the case at bar. However, the facts of
12 each cited case are markedly different from the instant case and demonstrate that a
13 "cookie cutter" approach to imposing sanctions cannot be relied on in cases involving
14 violations of the same statute or rule.

15 In *In re Anthony Ray Stacy*, Docket No. S-20909A-14-226, Decision #74849
16 issued on 12/18/2014, the Respondent entered into a loan arrangement with a client.
17 Mr. Stacy misrepresented to the client that the loan funds would be used as an
18 investment in a restaurant owned by Mr. Stacy. The loan was based on a Promissory
19 Note only and the Note was unsecured. Mr. Stacy did not use the loan funds to invest
20 in the restaurant. Mr. Stacy used the funds to pay personal obligations and expenses.
21 Mr. Stacy waived all of his rights in the disciplinary matter, did not contest the
22 charges against him, did not request a hearing and did not contest the imposition of
sanctions against him.

Unlike the *Stacy* case, in the instant matter Wagner did not misrepresent the
purpose of the loan; Wagner used the loan for its stated purpose; the Promissory
Note was fully secured; Wagner did not use the loan proceeds for personal expenses

1 or receive any direct personal benefit from the loan and Wagner strongly contests the
2 imposition of sanctions against her.

3 In *In re Britt M Lachemann*, Docket No. S-20894A-13-0351, Decision #74239
4 issued on 1/7/2014, Mr. Lachemann solicited loans from his customers. Mr.
5 Lachemann obtained 3 separate loans from his customers. Mr. Lachemann waived all
6 of his rights in the disciplinary matter, did not contest the charges against him, did
7 not request a hearing and did not contest the imposition of sanctions against him.
8 The written Order does not detail what Mr. Lachemann did with the loan proceeds.

9 Unlike the *Lachemann* case, Wagner received only 1 loan from 1 customer; did
10 not waive any of her rights herein and strongly opposes the imposition of sanctions
11 against her.

12 In *In re Lynn R. Goldney*, Docket No. S-20880A-13-0088, Decision #73766
13 issued on 5/8/2013, Ms. Goldney obtained 45 separate and distinct loans from 26
14 customers through her various companies and LLCs. Ms. Goldney elect to
15 permanently waive any right to a hearing and appeal, did not contest the charges
16 against her, did not request a hearing and did not contest the imposition of sanctions
17 against her.

18 Unlike the *Goldney* case, Wagner received only 1 loan from 1 customer; did
19 not waive any of her rights herein and strongly opposes the imposition of sanctions
20 against her.

21 In *In re Attila Toth*, Docket No. S-20782A-11-0019, Decision #72507 issued on
22 8/3/2011, Mr. Toth contacted his client by telephone to solicit a short-term loan. Mr.
Toth represented to his client that funds would be used to provide a short term loan
to a company unrelated to Mr. Toth. However, \$52,500.00 of the loan funds were not
distributed to the company as promised by Mr. Toth. Instead, the monies remained

1 in Mr. Toth's personal bank account and were used by Mr. Toth for personal
2 expenses, including, but not limited to, medical and real estate expenses. An internal
3 investigation conducted by Mr. Toth's broker dealer, Workman. Workman concluded
4 that, "through an investigation the firm reached the opinion that the representative used client
5 funds for personal reasons without the client's authority." Mr. Toth was terminated from
6 Workman's employ. Mr. Toth elected to permanently waive any right to a hearing
7 and appeal under Articles 11 and 12 of the Securities Act of Arizona, A.R.S. §§ 44-
8 1801 et seq. Mr. Toth violated A.R.S. § 44-1991 by (a) employing a device, scheme, or
9 artifice to defraud, (b) making untrue statements or misleading omissions of material
10 facts, or (c) engaging in transactions, practices, or courses of business that operate or
11 would operate as a fraud or deceit. Mr. Toth did not contest the imposition of
12 sanctions against him.

13 Unlike the *Toth* case, In the instant proceeding, Wagner did not misrepresent
14 the purpose of the loan; used the loan for its stated purpose; did not use the loan
15 proceeds for personal expenses or receive any direct personal benefit from the loan;
16 did not engage in any fraudulent behavior; was not charged with violations of A.R.S.
17 §§ 44-1801 et seq.; did not violate A.R.S. § 44-1991 and strongly opposes the
18 imposition of sanctions against her.

19 Additionally, it is important to note that, as in *Toth*, Wagner's broker dealer,
20 Crown Capital Securities, LP ("CC"), conducted an independent, extensive and
21 thorough investigation into the events surrounding the loan agreement. CC
22 investigated formation of the loan agreement, performance of the agreement, the
results of Pritchard's calling the Note due; and the actions and motivations of both
Wagner and Pritchard. Following the investigation, CC declined to impose any
sanctions whatsoever against Wagner. She remains a productive and trusted
salesperson of CC backed products.

1 The "similar" cases cited by the AZSD are easily distinguished from the
instant proceeding. Given the specific facts and circumstances involved in *this* case,
2 Wagner requests that the Court recommendation to the Commission contain no
3 suspension or revocation of her license and, most certainly, no order for restitution.

4 **D. The "Debt" to Pritchard Was Discharged In Bankruptcy Before the**
5 **Filing of the Instant Matter.**

6 Following the foreclosure proceeding on the office condo, Pritchard filed suit
7 against Wagner in Maricopa County Superior Court seeking a judgment for a
"deficiency" between the amount of the loan and the ultimate "sale" price paid by
8 Pritchard through a credit bid at the foreclosure sale. Wagner did not enjoy the
9 protection of Arizona's "anti-deficiency" statute, A.R.S. § 33-814(G) as the foreclosed
10 property was used for commercial, not residential purposes. It is telling that, in the
11 Superior Court lawsuit, Pritchard never alleged Wagner engaged in fraudulent
12 behavior, that Pritchard had been duped or that Wagner had violated any securities
13 monetary damages suffered by Pritchard related to the foreclosure proceeding.

14 From the outset of the Superior Court lawsuit Pritchard and his counsel
15 embarked on a very aggressive campaign designed to harass Wagner and cause her
16 to incur a large amount of debt responding to numerous discovery requests and
17 pretrial motions. With rapidly mounting debts and no prospect of prevailing in a
18 defense to the deficiency claim, Wagner made the agonizing decision to file for
19 protection and relief pursuant to Chapter 7 of the U.S. Bankruptcy Code. Wagner's
bankruptcy proceeding was filed on November 14, 2014.

20 While the Superior Court litigation was immediately stayed by 11 U.S.C. § 362
21 when the bankruptcy petition was filed, Pritchard and his counsel moved their
22 aggressive tactics from the Superior Court to the Bankruptcy Court. A real estate

1 deficiency claim or judgment is an unsecured, non-priority debt completely
2 dischargeable in a Chapter 7 proceeding. It was only *after* Wagner initiated the
3 bankruptcy case and Pritchard's claim was in jeopardy of outright discharge did
4 Pritchard allege that Wagner had engaged in fraudulent conduct and duped him into
5 making the loan to purchase the office condo. Wagner received her Chapter 7
6 discharge on February 27, 2014. All of her debts and claims against her, including
7 Pritchard's, were discharged at that time. Prior to entry of Wagner's discharge,
8 Pritchard filed an Adversary Proceeding, Case # 2-14-ap-00149-MCW. Pritchard is
9 seeking to have the claim against Wagner excepted to the Discharge Order on the
10 grounds of fraud or defalcation by a fiduciary pursuant to 11 U.S.C. § 523(a)(2), (a)(4)
11 and (a)(6).¹ The Adversary Proceeding has not tried or considered by the Court. A
12 pretrial conference in the matter has been set for October 20 2015. Pritchard's claim
13 remains subject to the Discharge Order pending resolution of the Adversary
14 Proceeding.

15 In its Post-Hearing Brief, the AZSD states, "Section 326(4) of the
16 bankruptcy code excludes certain exercises of regulatory authority
17 and police power from the automatic stay," and "[T]he Commission's
18 proceedings. . . can proceed through and including entry of an order
19 by the Commission and transcript of judgment, pursuant to A.R.S. §

20 ¹ 11 U.S. Code § 523 - Exceptions to discharge
21 (a) A discharge under section 727, 1141, 1228 (a), 1228 (b), or 1328 (b) of this title does not discharge an
22 individual debtor from any debt—

...
23 (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the
24 extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement
respecting the debtor's or an insider's financial condition;

...
25 (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

...
26 (6) for willful and malicious injury by the debtor to another entity or to the property of
another entity;

1 44-2036(C).” Although the AZSD notes, “While Ms. Wagner did not petition
2 to stay the Commission’s proceedings,” it then waxes for a page and a half
3 citing Arizona District Court cases, Commission administrative cases and Arizona
4 Bankruptcy Court cases all holding the automatic stay of 11 U.S.C. § 362 does not
5 apply to bar Commission proceedings such as the instant proceeding. Wagner is
6 clearly cognizant of that fact. That is exactly the reason why Wagner did not petition
7 to stay the instant proceeding.

8 **E. There Is No Debt Upon Which to Base a Restitution Order**

9 It is axiomatic that before an award of restitution may be entered, a debt or
10 claim by one party against another must exist. As defined above, “restitution”
11 restores an injured party to a prior position based on the debt or claim owed to the
12 injured party. Restitution cannot be given to a party where no debt or claim exists.

13 This logic applied to the instant matter makes clear no basis exists to award
14 Pritchard restitution against Wagner because Wagner owes no debt to Pritchard. Any
15 debt Wagner may have owed to Pritchard was discharged in bankruptcy. While it is
16 true that same debt may be excepted from discharge, that event has yet to occur.
17 Moreover, a determination of whether a debt may be excepted from discharge lies
18 within the exclusive province of the Bankruptcy Court.

19 **F. The Continued Dischargeability of the Alleged Debt Will Be
20 Determined By the Bankruptcy Court.**

21 As properly noted by the AZSD in its Post-Hearing Brief, “Section 523(a)(19) of
22 the bankruptcy code makes administrative orders for the violations of State securities
laws non-dischargeable in bankruptcy.”² In the instant case, any fine or penalty

² (a) A discharge under section 727, 1141, 1228 (a), 1228 (b), or 1328 (b) of this title does not discharge an individual debtor from any debt—

...

1 ordered against Wagner by the Commission would not be dischargeable in her
2 bankruptcy proceeding not only under § 523(a)(19) but also due to the fact that the
3 “debt” (imposition of the fine) occurred after the filing of the bankruptcy (a post-
petition debt).

4 While the Bankruptcy Code states *what* is dischargeable and what is not, it
5 remains the exclusive province of the Bankruptcy Court to determine *if* the law
6 applies in any given situation. The AZSD cites *In re Zimmerman*, 341 B.R. 77, 80
7 (Bankr. N.D. Ga. 2006) which discusses the competing considerations of bankruptcy
8 and non-bankruptcy forums in making determinations of liability for debts and the
dischargeability of those debts.

9 In *Zimmerman*, a creditor/customer sought to enforce a mandatory arbitration
10 clause in a contract dispute to determine liability of a securities salesman and his
11 broker for fraudulent advice concerning an investment. Zimmerman, the securities
12 salesman, filed a Chapter 7 bankruptcy. The customer filed an adversary proceeding
13 seeking to have the debt excepted from discharge. The customer also sought
14 modification of the automatic stay to allow the arbitration proceedings to move
15 forward. Zimmerman objected to the stay modification request. Following a hearing,

16 (19) that—

(A) is for—

17 (i) the violation of any of the Federal securities laws (as that term is defined in
18 section 3(a)(47) of the Securities Exchange Act of 1934), any of the State
securities laws, or any regulation or order issued under such Federal or State
securities laws; or

19 (ii) common law fraud, deceit, or manipulation in connection with the
purchase or sale of any security; and

20 (B) results, before, on, or after the date on which the petition was filed, from—

(i) any judgment, order, consent order, or decree entered in any Federal or
21 State judicial or administrative proceeding;

(ii) any settlement agreement entered into by the debtor; or

22 (iii) any court or administrative order for any damages, fine, penalty, citation,
restitutionary payment, disgorgement payment, attorney fee, cost, or other
payment owed by the debtor.

1 the customer amended his complaint to allege the debt owed by Zimmerman was
2 also non-dischargeable pursuant to § 523(a)(19).

3 The Bankruptcy Court in *Zimmerman* recognized that, “[D]etermination of
4 dischargeability of a debt is a core proceeding that is of critical importance to the “fresh start”
5 that the Bankruptcy Code promises to the honest but unfortunate debtor.” The Court went on
6 to state;

7 Because the discharge is a critical, if not the central, objective of an
8 individual's bankruptcy filing, arbitration of issues relating to dischargeability
9 inherently conflicts with bankruptcy law that expressly provides for, and in some
10 instances requires, the bankruptcy courts to make dischargeability determinations
11 and necessarily jeopardizes the Debtor's interests in having dischargeability and
12 other issues relating to the “fresh start” determined in one forum with
13 particularized expertise to do so. *Zimmerman* at 80

14 The Court also recognized that a determination of liability for debts that may
15 fall under § 523(a)(19) did not conflict with the unique duties tasked to a bankruptcy
16 court. As such, it was appropriate for a non-bankruptcy forum to determine liability
17 for violations pertaining to securities laws. However, when determining
18 dischargeability relating to fraud, fraudulent practices, defalcation, misrepresentation
19 and other issues under § 523(a)(2), (4), or (6), such determinations are within the
20 exclusive determination of the bankruptcy court as a bankruptcy “core” proceeding.

21 The AZSD also cites *In re Lewandowski*, 325 B.R. 700, (Bankr. M.D. Pa. 2005)
22 in support of its argument that § 523(a)(19) makes any debt or sanction for violations
of securities laws automatically nondischargeable. Wagner disagrees with that
assumption and the *Lewandowski* case specifically addresses the type of violations
Congress attempted to make nondischargeable when enacting the current version of
§ 523(a)(19). Regarding the enactment of § 523(a)(19) the Court in *Lewandowski*
stated:

Congress added § 523(a)(19) to the Code on July 30, 2002 as part of
Title VIII of the Sarbanes-Oxley Act 2002, commonly referred to as the
Corporate and Criminal Fraud Accountability Act of 2002. See Pub.L. No.

1 107-204, 116 Stat. 745 (2002). Through the Sarbanes-Oxley Act, Congress
2 sought "to protect investors by improving the accuracy and reliability of
3 corporate disclosures made pursuant to the securities laws, and for other
4 purposes." See *id.* Congress' inclusion of § 523(a)(19) was "meant to prevent
5 wrongdoers from using the bankruptcy laws as a shield and to allow
6 **defrauded** investors to recover as much as possible." See Legislative History
7 of Title VIII of HR 2673: The Sarbanes-Oxley Act of 2002, 148 Cong. Rec.
8 S7418 (July 26, 2002). (Emphasis supplied.) *Lewandowski* at 704.

9 Clearly Congressional intent behind enactment of § 523(a)(19) was to make
10 dischargeable debts procured through fraudulent conduct and any sanctions, fines
11 and remedial actions levied as a result of such conduct. It is uncontroverted that
12 Wagner did no engage in fraudulent conduct. Thus it is reasonable to believe any
13 restitution order issued by the Commission may still be held to be dischargeable in
14 bankruptcy in spite of § 523(a)(19).

15 It is also important to note that in the *Lewandowski* case, the debtor/securities
16 salesman never argued against the application of § 523(a)(19) to the facts of his case.
17 Rather Lewandowski argued that the law in existence prior to the enactment of §
18 523(a)(19) should ultimately control the outcome of this proceeding therefore §
19 523(a)(19) was completely inapplicable to his case. Mr. Lewandowski lost that
20 argument and the Court ruled in favor of the New Jersey Bureau of Securities on a
21 summary judgment motion.

22 Even if Wagner owed a Pritchard a "debt" or claim which could form the basis
for a restitution award, such an award is not appropriate in this case. All other
bankruptcy cases cited by the AZSD all address the situation whereby a debtor filed a
bankruptcy and attempted to discharge debts assessed against the debtor prior to
entry of a discharge. In those cases, the "debt" still existed. In the instant case, no
debt currently exists. It will be up to the bankruptcy court to determine if the debt
should be revived and if relief should be awarded to Pritchard.

1 **G. An Award of Restitution Could Lead to a Double Payment for**
2 **Pritchard**

3 Since the hearing in this matter, another event has occurred dictating restraint
4 on the part of this Court regarding a recommendation of restitution. Following the
5 hearing in this matter, Pritchard served a demand for arbitration against Wagner's
6 broker, Crown Capital. In addition to seeking remuneration for alleged damages
7 against Wagner, Pritchard is now seeking monetary damages against Crown Capital
8 for the exact same alleged improper conduct. This carries the possibility of Pritchard
9 receiving a windfall from these events, no matter how remote. Steps should be taken
10 to insure this does not occur.

11 **IV. Conclusion**

12 In 2005, Wagner entered into a secured loan contract with her customer
13 Pritchard. Pritchard was a close friend but not a relative and was not in the business
14 of making loans. Pritchard was a sophisticated, experienced investor in charge of
15 multiple investment vehicles. Pritchard approached Wagner regarding the loan on
16 the basis that the loan would provide financing to purchase and build an office condo
17 for Wagner to use as her office and would provide Pritchard a stream of income
18 fitting in with his current investment strategy. The office condo was purchased and
19 Wagner commenced her payments to Pritchard in accordance with the security
20 documents.

21 Wagner continued making payments to Pritchard for more than 7 years. In
22 2012, Pritchard called the Note due as a result of a disagreement with Wagner.
Pritchard knew at the time Wagner would not be able to refinance the loan due to
market factors existing at the time. Pritchard foreclosed on the office condo in
January 2013. Several months later, Pritchard resold the property for a \$30,000.00
profit. Additionally, Pritchard financed the sale to the subsequent purchaser through

1 a seller carryback arrangement. In essence, Pritchard financed the subsequent
2 purchaser in the same manner he originally financed Wagner. Pritchard continues to
3 receive a stream of payments on the original investment today.

4 Following the foreclosure, Pritchard instituted a Superior Court action against
5 Wagner for a "deficiency" in the resale of the office condo. Due to financial
6 considerations, Wagner was unable to mount a defense to Pritchard's lawsuit and
7 filed for Chapter 7 bankruptcy.

8 Facing a complete discharge of his deficiency claim in the bankruptcy,
9 Pritchard instead changed his claim to one for damages alleging fraudulent conduct
10 on Wagner's part relating to the original loan some 8 years before. Pritchard brought
11 a non-dischargeability action against Wagner in bankruptcy court. That proceeding
12 remains unresolved today.

13 Almost a year after the bankruptcy was filed and 9 years after the original loan
14 was made, Pritchard filed the instant complaint with the AZSD. Wagner admitted
15 she made a technical violation of an AAC Rule defining and prohibiting "unethical"
16 conduct even though she did not know her conduct was an infraction at the time.
17 Wagner has chosen not to contest reasonable and appropriate sanctions being levied
18 against her as long as such sanctions are commensurate with the infractions which
19 occurred.

20 Wagner strongly denies that restitution to Pritchard is either warranted or
21 available to Pritchard as a sanction in this proceeding. Pritchard is not entitled to
22 restitution because he received the full benefit of his bargain with Wagner and any
loss he may suffer was not the result of Wagner's actions. No return on any
investment is ever guaranteed to a customer. To award Pritchard restitution in this
matter would grant him a windfall other investors with similar investments would

1 neither expect nor enjoy. Moreover, no debt or claim remains upon which an award
2 of restitution could be based.

3 Any debt or claim Wagner may have owed to Pritchard at any time was
4 discharged in Wagner's bankruptcy prior to institution of these proceedings against
5 her. Even if Wagner's actions had risen to the level of being "fraudulent," the
6 limitations period for instituting proceedings against her by the AZSD would long
7 since have expired. Although Pritchard has requested that the Bankruptcy Court
8 declare nondischargeable any debt allegedly owed him by Wagner, the issue remains
9 unresolved and any debt or claim by Pritchard remains subject to the bankruptcy
10 discharge at this time.

11 The bankruptcy court is the proper forum for a determination of the
12 nondischargeability proceeding brought by Pritchard. Not only are the
13 nondischargeability statutes upon which Pritchard relies based on federal law,
14 nondischargeability actions are "core" proceedings exclusively vested in the
15 jurisdiction of the bankruptcy court. Thus, even if a cognizable claim were to exist
16 upon which to base a restitution award, the Commission should refrain from
17 imposing such an award and leave the ultimate determination up to the bankruptcy
18 court as required by law.

19 For all the stated reasons herein, Wagner requests that the Court recommend
20 imposition of sanctions against her that are reasonable or fit the offense she
21 committed. Wagner asserts such sanctions consist of entry of a Cease and Desist
22 Order prohibiting her from engaging in similar conduct in the future. Wagner further
23 requests that the Court recommend to the Commission that no order of restitution be
24 levied for the reasons such an order is both unwarranted and contrary to law.

25 ...

1 Dated: May 20, 2015.

2 ZEIGLER LAW GROUP, PLC

3 
4 /s/ J. Murray Zeigler

5 J. Murray Zeigler
6 Attorney for Respondent

7 I hereby certify that I have this day served the foregoing document on all parties of record in
8 this proceeding by mailing a copy thereof, properly addressed with first class postage prepaid to the
9 following:

10 DOCKET CONTROL
11 ARIZONA CORPORATION COMMISSION
12 1200 W. WASHINGTON
13 PHOENIX, AZ 85007-2927
14 (Original + 8 copies)

15 I hereby certify that I have this day served the foregoing document on the following via email
16 at the listed email address:

17 Ryan J. Millecam
18 RMillecam@azcc.gov

19 Dated at Tempe, Arizona, this 20th day of May 2015.

20 /s/ J. Murray Zeigler

21 J. Murray Zeigler

22 