



0000171994

ORIGINAL

RECEIVED
AZ CORP COMMISSION
DOCKET CENTER

2016 JUL 20 P 1:39

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

DOUG LITTLE - Chairman
BOB STUMP
BOB BURNS
TOM FORESE
ANDY TOBIN

In the matter of:
Shadow Beverages and Snacks, LLC, an Arizona
limited liability company,
Lucio George Martinez and Lisa K. Martinez,
husband and wife,
Samuel A. Jones, a married man,
Respondents.

DOCKET NO. S-20948A-15-0422

SECURITIES DIVISION'S POST-HEARING BRIEF

Arizona Corporation Commission
DOCKETED

JUL 20 2016

DOCKETED BY

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

I. PROCEDURAL HISTORY

On December 30, 2015, the Division filed a Notice of Opportunity for Hearing Regarding Proposed Order to Cease and Desist, for Restitution, for Administrative Penalties, and for Other Affirmative Action ("Notice") against Shadow Beverages and Snacks, LLC, Lucio George Martinez and Lisa K. Martinez, husband and wife, and Samuel A. Jones, in which the Division alleged violations of the Arizona Securities Act ("Act") in connection with the offer and sale of securities in the form of promissory notes and investment contracts. Lucio George Martinez, Lisa K. Martinez, and Samuel A. Jones filed Answers to the Notice.

On February 23, 2016, Administrative Law Judge Mark Preny ("ALJ Preny") issued the Third Procedural Order scheduling the hearing to begin on June 6, 2016. On May 13, 2016, the Commission issued an Order to Cease and Desist, Order for Restitution, and Order for Administrative Penalties and Consent to Same against Samuel A. Jones ("Jones Consent Order").

1 The administrative hearing began on June 6, 2016, and ended on June 7, 2016.¹

2 **II. JURISDICTION**

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

5 **III. FACTS**

6 Based on the evidence in the record, the Commission can find the following facts.

7 **A. Respondents**

8 1. Shadow Beverages and Snacks, LLC (“Shadow”) is a limited liability company that has
9 been organized under the laws of the state of Arizona since July 2008.² Shadow has been based in
10 Arizona since it was created.³ Shadow has not been registered by the Commission as a securities
11 salesman or dealer.⁴

12 2. Shadow created and built product brands for the beverage and snack industry,
13 including products such as energy beverages, nutritional supplement beverages, and preserved meat
14 snacks.⁵ It contracted with bottlers to produce products that it sold to retailers.⁶ Shadow sought capital
15 to run the company and produce product.⁷

16 3. Since at least June 1, 2009, Lucio George Martinez (“Martinez”) has been a married man
17 and a resident of the state of Arizona.⁸ Martinez has not been registered by the Commission as a
18 securities salesman or dealer.⁹

19 4. Shadow and Martinez may be referred to collectively as “Respondents.”

20 5. Since at least June 1, 2009, Lisa K. Martinez has been the spouse of Lucio George
21 Martinez (Lisa K. Martinez may be referred to as “Respondent Spouse”).¹⁰ Respondent Spouse is joined

22 ¹ Citations to the hearing transcript are cited a T.[page]. Line numbers are indicated by a colon, e.g. T.101:3–5.
23 Citations to the hearing exhibits are cited as the exhibits numbers, e.g. S-1.

24 ² S-2a

25 ³ S-2a; S-2b; S-2c; S-62 at SHADOW5151

26 ⁴ S-1a

⁵ S-61

⁶ S-61

⁷ S-68 at SHADOW6158; S-69 at SHADOW6170; S-88 p.188:9–12

⁸ S-87 p.7:25–p.8:5, p.26:18–24

⁹ S-1b

¹⁰ S-87 p.26:18–24

1 in this action under A.R.S. § 44-2031(C) solely for purposes of determining the liability of the marital
2 community.

3 6. Martinez co-founded Shadow and has been the President of Shadow since at least
4 January 29, 2010.¹¹ As President of Shadow, Martinez handled day-to-day business, managed the
5 sales and operations teams, oversaw the director of administration, and was in charge of Rick
6 Peterson (“Peterson”), the Senior Vice President of Capital Acquisition.¹² Martinez was also a signer
7 on Shadow’s bank accounts.¹³

8 7. By August 2011, Samuel A. Jones (“Jones”) became the Chief Operating Officer
9 (“COO”) of Shadow and remained so until approximately May 14, 2013.¹⁴ Jones’s responsibilities
10 as COO included business development and operation of the product lines, such as beverage
11 formulation and packaging.¹⁵ When Jones ceased to be COO, Martinez became COO in addition to
12 being President.¹⁶

13 **B. Investors**

14 8. On June 1, 2009, nonresident investor George Karas invested \$50,000 in a Shadow
15 promissory note executed by Martinez.¹⁷ Martinez met with Mr. Karas in Arizona about making this
16 investment.¹⁸ Mr. Karas was a friend, and Martinez spoke to him about investing.¹⁹ The note offered
17 15% annual interest and was due on December 31, 2009.²⁰ Shadow defaulted on this note on that
18 date, and over two years after the maturity date passed, the maturity date was amended to June 30,
19 2012.²¹ This note remained unpaid until August 15, 2012.²²

21 ¹¹ T.179:20–T.180:16; S-61 at ACC48

22 ¹² T.149:19–T.150:22

¹³ S-77 through S-80; S-84 through S-86

¹⁴ S-3 at SHADOW5739, 5752. Jones left Shadow about 5 months after the December 14, 2012, Newtown shooting according to Martinez. See S-87 p.65:13–p.66:13.

¹⁵ S-87 p.112:11–22

¹⁶ S-87 p.111:15–17

¹⁷ S-4

¹⁸ S-88 p.160:9–19

¹⁹ T.162:14–T.163:15

²⁰ S-4

²¹ S-4; S-5

²² S-6

1 9. On February 17, 2010, Arizona investor Brent Tunnel invested \$50,000 in a Shadow
2 promissory note executed by Jones and signed by Martinez as a guarantor.²³ Before investing, Mr.
3 Tunnel was not informed of Shadow's default on Mr. Karas' note.²⁴ The note offered 25% annual
4 interest and was due on August 17, 2010.²⁵ Shadow defaulted on this note on that date.²⁶ Martinez
5 personally guaranteed payment of this note²⁷ but never personally made any payment for this note.²⁸
6 On May 17, 2011, a judgment was entered in the Maricopa Superior Court against Shadow, Martinez,
7 and other defendants in favor of Mr. Tunnel.²⁹ This note was eventually fully paid by Shadow in
8 2011.³⁰

9 10. Mr. Tunnel made a second investment, investing \$200,000 more on March 17, 2010,
10 in a Shadow promissory note executed by Martinez.³¹ In a loan agreement executed by Martinez in
11 connection with the investment, Shadow stated that it was not in default on any indebtedness for
12 borrowed money.³² Actually, Shadow had been in default on Mr. Karas' note since December 31,
13 2009.³³ The note offered 25% annual interest and was due on September 17, 2010.³⁴ Shadow
14 defaulted on this note on that date.³⁵ This note was eventually fully paid by Shadow in 2011.³⁶

15 11. On September 1, 2010, nonresident investor Scott Jarus invested \$75,000 in a Shadow
16 promissory note executed by Martinez.³⁷ Martinez met with Mr. Jarus in Arizona about making this
17 investment.³⁸ Before investing, Mr. Jarus was not informed of Martinez's failure to perform on a
18 previous personal guaranty for a Shadow note.³⁹ The note offered 15% annual interest and was due

19 ²³ S-7; S-8

20 ²⁴ S-4; S-88 p.173:24-p.174:1

21 ²⁵ S-7

22 ²⁶ S-13 at ACC325 ¶ 18-19; S-16

23 ²⁷ S-9

24 ²⁸ S-88 p.178:20-24, p.181:2-9

25 ²⁹ S-15

26 ³⁰ S-16; S-17

³¹ S-11; S-12; S-13 at ACC324 ¶ 11

³² S-14 at SHADOW7310

³³ S-4; S-5

³⁴ S-11

³⁵ S-11; S-13 at ACC326 ¶ 23-24; S-16

³⁶ S-16; S-17

³⁷ S-18; S-19

³⁸ S-88 p.187:21-p.188:14

³⁹ S-88 p.191:13-16

1 on December 31, 2010.⁴⁰ Shadow defaulted on this note on that date.⁴¹ Martinez personally
 2 guaranteed this note⁴² but never personally made any payments for this note.⁴³ This note was
 3 eventually fully paid by Shadow in 2011.⁴⁴

4 12. On January 3, 2011, Arizona investor Ronald Barrett invested \$125,000 in a Shadow
 5 promissory note executed by Martinez.⁴⁵ Martinez met with Mr. Barrett in Arizona about making
 6 this investment.⁴⁶ Before investing, Mr. Barrett was not informed of Shadow's defaults on previous
 7 notes.⁴⁷ The note offered 10% annual interest and was due on March 1, 2011.⁴⁸ Shadow defaulted on
 8 this note on that date.⁴⁹ This note was eventually fully paid by Shadow in 2011.⁵⁰

9 13. On January 13, 2011, Arizona investors Gary and Michelle Van Kilsdonk invested
 10 \$50,000 in a Shadow promissory note executed by Martinez, and on January 14, 2011, Arizona
 11 investors Robert and Stacey Gervasi also invested \$50,000 in the same note.⁵¹ Although the \$100,000
 12 note is only in Mrs. Gervasi's name, this was actually a joint investment by the two families.⁵² Before
 13 investing, Mrs. Gervasi spoke to Martinez but was not informed of Shadow's defaults on previous
 14 notes.⁵³ Mrs. Van Kilsdonk was a Shadow employee who had basic administrative duties for the
 15 product sales team.⁵⁴ Mr. and Mrs. Gervasi were not accredited investors when they invested.⁵⁵ The
 16 note offered 10% annual interest and was due on December 31, 2011.⁵⁶ To date, Shadow has made
 17 payments for the note totaling \$5,000.⁵⁷

18
 19 ⁴⁰ S-18

⁴¹ S-88 p.192:7-17

⁴² S-20

⁴³ S-88 p.192:1-6

⁴⁴ S-21

⁴⁵ S-22; S-23; S-88 p.198:16-21

⁴⁶ T.168:8-10; S-88 p.198:16-p.199:6

⁴⁷ S-88 p.199:14-16

⁴⁸ S-18

⁴⁹ S-88 p.197:16-p.198:6

⁵⁰ S-88 p.197:16-p.198:15

⁵¹ S-24 at SHADOW6342; S-90

⁵² S-24; S-88 p.200:6-14; S-90; T.83:13-22

⁵³ S-88 p.201:18-20; T.84:19-21; T.85:16-18

⁵⁴ T.131:13-T.132:2

⁵⁵ T.85:6-15

⁵⁶ S-24

⁵⁷ T.85:19-21

1 14. On October 15, 2012, Shadow executed a \$1,000,000 factoring agreement with a
2 bank.⁵⁸ In the agreement, Shadow granted the bank a security interest in collateral that included all
3 present and future accounts receivable and proceeds of Shadow's inventory,⁵⁹ which the bank
4 recorded.⁶⁰ The bank continued to hold this security interest until October 29, 2014.⁶¹

5 15. On March 7, 2013, nonresident investor David Kelly, through his entity Canis Major
6 Development, invested \$500,000 in a Shadow promissory note executed by Martinez.⁶² Martinez met
7 with Mr. Kelly in Arizona about making this investment.⁶³ Mr. Kelly also received a security interest
8 in Shadow's product inventory and accounts receivable.⁶⁴ Before investing, Mr. Kelly was not
9 informed of Martinez's failure to perform on previous personal guaranties for Shadow notes or the
10 existing security interests in Shadow's product inventory and accounts receivable.⁶⁵ The note offered
11 interest of \$25,000 every 30 days and was due on May 6, 2013.⁶⁶ Shadow defaulted on this note on
12 April 5, 2013, when it failed to make the first interest payment that was due.⁶⁷ Martinez personally
13 guaranteed this note⁶⁸ but never personally made any payments for this note.⁶⁹ Shadow has never
14 made any payments for this note.⁷⁰

15 16. On April 5, 2013, nonresident investor Rick Andersen invested \$250,000 in a Shadow
16 promissory note executed by Martinez.⁷¹ Mr. Andersen also received a security interest in Shadow's
17 product inventory and accounts receivable.⁷² Mr. Andersen is Martinez's cousin, and Martinez
18 communicated with Mr. Andersen about making this investment.⁷³ Before investing, Mr. Andersen
19

20 ⁵⁸ S-25

⁵⁹ S-25 at ACC843 ¶ 11.1

⁶⁰ S-26

⁶¹ S-27

⁶² S-28; S-29; S-30; S-88 p.223:4-9

⁶³ S-88 p.223:24-p.224:5

⁶⁴ S-31

⁶⁵ S-88 p.226:4-11; T.153:4-T.154:11

⁶⁶ S-28

⁶⁷ S-28; S-88 p.224:11-14

⁶⁸ S-32

⁶⁹ S-88 p.227:5-9

⁷⁰ S-74

⁷¹ S-34; S-35; S-88 p.233:9-10

⁷² S-36

⁷³ S-88 p.233:9-16

1 was not informed of Shadow's defaults on previous notes or the existing security interests in
 2 Shadow's product inventory and accounts receivable.⁷⁴ The note offered 12% annual interest and
 3 was due on April 5, 2014.⁷⁵ Shadow defaulted on this note on that date.⁷⁶ Shadow has never made
 4 any payments for this note.⁷⁷

5 17. Mr. Andersen invested a second time, investing \$250,000 on April 17, 2014, in the
 6 name of his limited liability company, in a Shadow promissory note executed by Martinez.⁷⁸ Before
 7 investing, Mr. Andersen was not informed of Shadow's defaults on other investors' notes or a recent
 8 \$1,400,000 judgment against Shadow.⁷⁹ The note offered a fixed sum of \$20,000 in interest and was
 9 due on May 19, 2014.⁸⁰ Shadow defaulted on this note on that date.⁸¹ Shadow has never made any
 10 payments for this note.⁸²

11 18. On December 6, 2013, Arizona investors Catherine Leyen and Don Johnson invested
 12 \$25,000 in a loan agreement with Shadow executed by Martinez ("Loan Agreement").⁸³ Ms. Leyen
 13 testified that she considered it to be an investment and invested for the promised interest.⁸⁴ Martinez
 14 told her Shadow needed the money for a production run and she would be paid back immediately
 15 afterward, and she gave him the check for the investment.⁸⁵ Neither Ms. Leyen nor Mr. Johnson ever
 16 had any management role at Shadow.⁸⁶ Before investing, they were not informed of Shadow's
 17 previous defaults on its notes.⁸⁷ Interest for the Loan Agreement was \$5,000 to be paid based on the
 18 rate of Shadow's product sales.⁸⁸ When they invested, neither Ms. Leyen nor Mr. Johnson had a net
 19

20 ⁷⁴ S-88 p.234:2-10

21 ⁷⁵ S-34

22 ⁷⁶ S-88 p.233:4-7

23 ⁷⁷ S-74

24 ⁷⁸ S-37; S-38; S-89 p.281:7-17

25 ⁷⁹ S-89 p.282:25-p.283:6

26 ⁸⁰ S-37

⁸¹ S-89 p.281:18-19

⁸² S-74

⁸³ S-39; S-40

⁸⁴ T.34:11-13; T.38:15-17; S-88 p.248-249

⁸⁵ T.37:21-T.38:23

⁸⁶ S-88 p.248:5-9

⁸⁷ T.52:12-15; S-88 p.250:5-13

⁸⁸ S-39

1 worth over \$1,000,000 or an annual income over \$200,000.⁸⁹ At the time, Ms. Leyen had nominal
 2 investing experience, Mr. Johnson had minimal investing experience, and neither of them had
 3 invested in something like Shadow before.⁹⁰ The Loan Agreement did not have a fixed maturity date,
 4 but payments based on product sales were due beginning two weeks after the first receipt of sale
 5 proceeds from products funded by the investment. Shadow defaulted on the Loan Agreement on the
 6 date that payments were first due, which was approximately March 6, 2014.⁹¹ Shadow made a single
 7 \$1,250 payment for the Loan Agreement.⁹²

8 19. Ms. Leyen and Mr. Johnson invested a second time, investing \$50,000 on May 9,
 9 2014, in the name of their limited liability company.⁹³ They invested in a Shadow promissory note
 10 executed by Martinez.⁹⁴ She considered it to be an investment.⁹⁵ Martinez spoke to Ms. Leyen in
 11 Phoenix before their second investment and told her Shadow was growing and expected to have a lot
 12 of revenue.⁹⁶ Ms. Leyen invested despite Shadow's failure to repay the Loan Agreement on time
 13 because she believed in Shadow and believed she would still be paid.⁹⁷ Before investing, Ms. Leyen
 14 and Mr. Johnson were not informed of Shadow's defaults on previous notes or a recent \$1,400,000
 15 judgment against Shadow.⁹⁸ The note offered a fixed sum of \$10,000 in interest and was due on
 16 September 8, 2014.⁹⁹ Shadow defaulted on this note on that date.¹⁰⁰ Shadow has never made any
 17 payments for this note.¹⁰¹ The loss of their investments caused Ms. Leyen and Mr. Johnson financial
 18 hardship and resulted in several very lean months for them.¹⁰²

21 ⁸⁹ T.43:21–T.44:2

22 ⁹⁰ T.44:3–12

23 ⁹¹ S-39 at SHADOW6897 ¶ 4; S-88 p.248:10–13, p.248:25–p.249:14

24 ⁹² T.51:18–T.52:11; S-74

25 ⁹³ S-41; S-42; T.48:10–18

26 ⁹⁴ S-41

⁹⁵ T.47:22

⁹⁶ T.49:12–17; T.50:3–8

⁹⁷ T.48:23–T.49:4

⁹⁸ S-89 p.286:15–23; T.45:8–11; T.52:12–15

⁹⁹ S-39

¹⁰⁰ S-89 p.284:20–p.285:12

¹⁰¹ S-45; S-74

¹⁰² T.52:25–T.53:20

1 20. On January 12, 2014, General Nutrition Corporation (“GNC”) was awarded a
2 \$1,400,000 default judgment against Shadow (“GNC Judgment”) that has not been paid.¹⁰³

3 21. On January 13, 2014, nonresident investor James Stephensen invested \$30,000 in a
4 Shadow promissory note executed by Martinez.¹⁰⁴ Martinez spoke to Mr. Stephensen about making
5 this investment.¹⁰⁵ Before investing, Mr. Stephensen was not informed of Shadow’s defaults on
6 previous notes.¹⁰⁶ The note offered a fixed sum of \$2,500 in interest and was due on April 13, 2014.¹⁰⁷
7 Shadow defaulted on this note on that date.¹⁰⁸ Shadow has never made any payments for this note.¹⁰⁹

8 22. On January 15, 2014, married Arizona investors Jason and Robbyn Salganick invested
9 \$50,000 in a Shadow promissory note executed by Martinez.¹¹⁰ Before investing, these investors
10 were not informed of Shadow’s defaults on previous notes, Martinez’s failure to perform on prior
11 personal guaranties, or the GNC Judgment.¹¹¹ The note offered a fixed sum of \$7,500 in interest and
12 was due on July 15, 2014.¹¹² Shadow defaulted on this note on that date.¹¹³ Martinez personally
13 guaranteed payment of this note.¹¹⁴ Shadow has never made any payments for this note.¹¹⁵

14 23. On February 24, 2014, Darrel DeMello invested \$135,000 in a Shadow Beverages
15 promissory note.¹¹⁶ The note offered a fixed sum of \$22,500 in interest and had a three-month term.¹¹⁷
16 Mr. DeMello had a company called Market Access India that was a contractor for Shadow with a
17 finder’s fee agreement to help Shadow financially through networking.¹¹⁸ Ms. Leyen worked with
18 Mr. DeMello and Market Access India as a subcontractor.¹¹⁹ Martinez spoke to Mr. DeMello about

19 _____
¹⁰³ S-43; S-89 p.265:4–266:5

20 ¹⁰⁴ S-44 at SHADOW7259

¹⁰⁵ S-89 p.267:9–11

21 ¹⁰⁶ S-89 p.268:9–11

¹⁰⁷ S-44

22 ¹⁰⁸ S-89 p.267:3–5

¹⁰⁹ S-74

¹¹⁰ S-46; S-47

23 ¹¹¹ S-89 p.269:21–p.270:6

¹¹² S-46

24 ¹¹³ S-89 p.268:25–p.269:2

¹¹⁴ S-48

25 ¹¹⁵ S-74

¹¹⁶ T.135:3–T.136:13

26 ¹¹⁷ T.135:3–T.136:13

¹¹⁸ T.35:6–T.37:4; T.55:3–13

¹¹⁹ T.55:16–21

1 finding capital and Shadow's need for capital before Mr. DeMello invested.¹²⁰ Mr. DeMello has
 2 received only a single payment of \$1,250.¹²¹ The loss of Mr. DeMello's investment has caused him
 3 financial hardship, and his home is now in foreclosure.¹²² The Commission can infer that Martinez
 4 executed Mr. DeMello's note because Martinez executed all of the other notes too, except for one
 5 note executed by Jones, who no longer worked for Shadow when Mr. DeMello invested.¹²³

6 24. On March 21, 2014, Arizona investor Reed Hatkoff invested \$100,000 in a Shadow
 7 promissory note executed by Martinez.¹²⁴ The \$115,000 amount of his note reflects his \$100,000
 8 investment¹²⁵ plus a fixed sum of \$15,000 in interest.¹²⁶ Mr. Hatkoff received a security interest in
 9 Shadow's accounts receivable and some of its product inventory.¹²⁷ Mr. Hatkoff testified that he
 10 spoke to Martinez by phone from his home office and told Martinez he wanted a financial statement,
 11 which Martinez agreed to and eventually did provide.¹²⁸ The personal financial statement that
 12 Martinez provided misrepresented that Martinez was not a guarantor for any company and
 13 misrepresented that no judgment had ever been entered against him.¹²⁹ Mr. Hatkoff invested because
 14 of the very favorable interest terms.¹³⁰ Before investing, Mr. Hatkoff was not informed of Shadow's
 15 defaults on previous notes, the existing security interests in Shadow's accounts receivable and
 16 product inventory, or the GNC Judgment.¹³¹ The note offered additional interest of up to \$10,000
 17 based on the volume of Shadow's product sales within a specific timeframe, and the note was due on
 18
 19
 20

21 ¹²⁰ T.137:13-24

22 ¹²¹ T.51:18-T.52:11; T.136:23-T.137:6

23 ¹²² T.53:18-T.54:11

24 ¹²³ S-4; S-7; S-11; S-18; S-22; S-24; S-28; S-34; S-38; S-39; S-41; S-44; S-46; S-49; S-53; S-56; S-87 p.65:13-p.66:13;
 25 T.135:3-T.136:13

26 ¹²⁴ S-49; S-50

¹²⁵ Mr. Hatkoff considered it to be a hard money loan, but "investment" is used to simplify the terminology. See
 T.60:8-11.

¹²⁶ S-49; T.66:66-T.67:1

¹²⁷ S-51

¹²⁸ T.61:21-T.62:23

¹²⁹ T.70:4-14; S-52 at ACC403

¹³⁰ T.64:15-22

¹³¹ T.63:17-24; T.68:2-8; T.73:15-20; S-89 p.277:17-p.279:20

1 September 21, 2014.¹³² Shadow defaulted on this note on that date.¹³³ To date, Mr. Hatkoff has
 2 received payments totaling \$45,000 for the note.¹³⁴

3 25. On July 18, 2014, Michael Crane and Debra Martin invested \$50,000 in a Shadow
 4 promissory note executed by Martinez.¹³⁵ Before investing, Mr. Crane was not informed of Shadow's
 5 defaults on previous notes, Martinez's failure to perform on prior personal guaranties, or the GNC
 6 Judgment.¹³⁶ The note offered a fixed sum of \$7,500 in interest and was due on October 18, 2014.¹³⁷
 7 Shadow defaulted on this note on that date.¹³⁸ Martinez personally guaranteed payment of this
 8 note.¹³⁹ Shadow has never made any payments for this note.¹⁴⁰

9 26. On July 18, 2014, nonresident investor Kurt Moore invested \$100,000 in a Shadow
 10 promissory note executed by Martinez.¹⁴¹ Before investing, Mr. Moore was not informed of
 11 Shadow's defaults on previous notes, Martinez's failure to perform on prior personal guaranties, or
 12 the GNC Judgment.¹⁴² He invested because the promised return was good.¹⁴³ The note offered a fixed
 13 sum of \$15,000 in interest and was due on October 17, 2014.¹⁴⁴ Shadow defaulted on this note on
 14 that date.¹⁴⁵ Martinez personally guaranteed payment of this note.¹⁴⁶ Shadow has never made any
 15 payments for this note.¹⁴⁷ The loss of Moore's investment was a significant loss to him.¹⁴⁸

19 ¹³² S-49

20 ¹³³ S-89 p.274:15-24

21 ¹³⁴ T.72:15-25. The S-74 entry reflecting only \$40,000 paid to Mr. Hatkoff is incorrect. See S-74.

22 ¹³⁵ S-53; S-54

23 ¹³⁶ S-89 p.290:18-291:3

24 ¹³⁷ S-53

25 ¹³⁸ S-89 p.289:14-25

26 ¹³⁹ S-55

¹⁴⁰ S-74

¹⁴¹ S-56; S-57

¹⁴² T.88:1-12; S-89 p.292:16-p.293:1

¹⁴³ T.87:24-25

¹⁴⁴ S-56

¹⁴⁵ S-89 p.291:14-p.292:1

¹⁴⁶ S-58

¹⁴⁷ S-74

¹⁴⁸ T.88:16-20

1 27. Shadow raised a total of \$2,140,000 from the investors above, and Shadow and
2 Martinez have paid back approximately \$552,500 to the investors.¹⁴⁹ In connection with the Jones
3 Consent Order, Jones has also paid the full \$95,000 principal balance of the Gervasi-Van Kilsdonk
4 note.¹⁵⁰ After Jones' payment, the principal balance still due to the investors above is \$1,492,500.

5 **C. Rick Peterson and Securities Sales Efforts**

6 28. Peterson was a significant source for finding new investors.¹⁵¹ Shadow eventually
7 gave him the title of Senior Vice President of Capital Acquisition.¹⁵² Shadow had a finder's fee
8 agreement with Peterson that entitled him to a 5% commission on all capital received by Shadow
9 from a source introduced by Peterson.¹⁵³ Peterson's efforts included asking his contacts to suggest
10 potential investors to him from among their contacts.¹⁵⁴ Martinez believed, incorrectly, that Peterson
11 was a licensed investment advisor, but Martinez never verified his licensure.¹⁵⁵ Shadow did not give
12 Peterson any limits or guidelines on how he was allowed to find investors.¹⁵⁶ Martinez never
13 instructed Peterson that he was required to disclose the GNC Judgment to potential investors.¹⁵⁷

14 29. The investors found by Peterson include Mr. Kelly, Ms. Leyen, Mr. DeMello, Mr. and
15 Mrs. Salganick, Mr. Hatkoff, Mr. Crane, and Mr. Moore.¹⁵⁸ Mr. Hatkoff had no previous relationship
16 with Peterson when Peterson approached him about investing in a Shadow note.¹⁵⁹

17 30. Some investors were not asked whether their net worth or income qualified them as
18 accredited investors. Shadow did not ask these questions of Mrs. Gervasi, Ms. Leyen, Mr. Hatkoff, or
19 Mr. Moore.¹⁶⁰

20 ¹⁴⁹ These amounts reflect the figures in S-74 and also Mr. DeMello's \$135,000 investment, the \$1,250 payment to Mr.
21 DeMello, and the additional \$5,000 paid to Mr. Hatkoff. See S-74; T.51:18-T.52:11; T.72:15-25; T.135:3-T.136:13;
T.136:23-T.137:6.

22 ¹⁵⁰ May 13, 2016, Order to Cease and Desist, Order for Restitution, and Order for Administrative Penalties and
Consent to Same

23 ¹⁵¹ S-87 p.62:10-18

24 ¹⁵² S-87 p.144:10-p.145:5

25 ¹⁵³ S-72

26 ¹⁵⁴ S-87 p.81:15-p.82:12

¹⁵⁵ S-87 p.53:17-p.55:2

¹⁵⁶ S-87 p.82:13-22, p.129:2-13

¹⁵⁷ T.146:12-T.147:23

¹⁵⁸ T.34:3-8; T.141:21-T.142:3; T.150:23-T.151:15

¹⁵⁹ T.60:4-16

¹⁶⁰ T.57:22-T.58:3; T.76:10-13; T.91:16-20; T.91:21-T.92:3

1 notes.¹⁶⁹ However, these investors were not informed before they invested about Martinez's failure to
 2 perform on previous personal guaranties for Shadow notes.¹⁷⁰

3 Existing Security Interests

4 35. Martinez and Shadow stated to Mr. Kelly, Mr. Andersen, and Mr. Hatkoff that Shadow
 5 would grant them security interests in its product inventory and accounts receivable.¹⁷¹ However,
 6 Shadow had already granted a bank a \$1,000,000 security interest in all present and future accounts
 7 receivable and proceeds of Shadow's inventory.¹⁷² These investors were not informed before they
 8 invested of this prior security interest in the same collateral.¹⁷³ If Mr. Hatkoff had known about the
 9 prior security interest, it would have been significant to his decision whether to invest.¹⁷⁴

10 GNC Judgment

11 36. Through the notes that Martinez executed, Martinez and Shadow stated to Mr. Andersen
 12 for his second note, to Ms. Leyen and Mr. Johnson for their note, and to Mr. and Mrs. Salganick, Mr.
 13 Hatkoff, Mr. Crane, and Mr. Moore that Shadow would repay them by a particular date.¹⁷⁵ However,
 14 these investors were not informed before they invested about the \$1,400,000 GNC Judgment against
 15 Shadow.¹⁷⁶ If Ms. Leyen and Mr. Hatkoff had known about the GNC Judgment, it would have been
 16 significant to their decisions whether to invest.¹⁷⁷

17 E. Misrepresentations

18 37. Martinez and Shadow misrepresented to Mr. Tunnel in connection with his March 17,
 19 2010, second note that Shadow was not in default on any debt.¹⁷⁸ However, Shadow was in default on
 20
 21

22 ¹⁶⁹ S-20; S-32; S-48; S-55; S-58

¹⁷⁰ S-88 p.191:13-16, p.226:4-7; S-89 p.270:3-6, p.290:25-p.291:3, p.292:22-p.293:1; T.88:5-8; T.153:4-7

¹⁷¹ S-31; S-36; S-51

¹⁷² S-25 at ACC843 ¶ 11.1

¹⁷³ S-88 p.226:8-11, p.234:8-10; S-89 p.279:10-20; T.68:2-8; T.154:5-11

¹⁷⁴ T.68:19-T.69:1

¹⁷⁵ S-37; S-41; S-46; S-49; S-53; S-56

¹⁷⁶ S-89 p.269:25-p.270:2, p.277:21-p.278:1, p.283:4-6, p.286:21-23, p.290:22-24, p.292:19-21; T.45:8-11;
 T.63:17-24; T.88:9-12

¹⁷⁷ T.45:8-17; T.63:25-T.64:5

¹⁷⁸ S-11; S-13 at ACC324 ¶ 11; S-14 at SHADOW7310 ¶ 3.1(n)

1 Mr. Karas' note, which was due on December 31, 2009, but which Shadow did not pay until August 15,
2 2012.¹⁷⁹

3 38. Martinez and Shadow misrepresented to Mr. Hatkoff in Martinez's personal financial
4 statement that he was not a guarantor for any company.¹⁸⁰ However, Martinez was a guarantor at the
5 time due to his personal guaranty of Mr. Jarus' unpaid note.¹⁸¹ This misrepresentation was significant
6 to Mr. Hatkoff's decision whether to invest.¹⁸²

7 39. Martinez and Shadow misrepresented to Mr. Hatkoff in Martinez's personal financial
8 statement that no judgment had ever been entered against him.¹⁸³ However, Mr. Tunnel's judgment had
9 previously been entered against him.¹⁸⁴ This misrepresentation was significant to Mr. Hatkoff's decision
10 whether to invest.¹⁸⁵

11 40. Martinez and Shadow misrepresented to Mr. Hatkoff in a March 21, 2014, security
12 agreement that no person other than Shadow had any interest in specific accounts receivable or product
13 inventory.¹⁸⁶ However, Shadow's factoring bank and two previous investors all had security interests in
14 the same collateral.¹⁸⁷

15 IV. ARGUMENT

16 A. Conforming the Notice to the Evidence

17 41. The Division moved during the hearing to conform its notice to the evidence,
18 particularly regarding Mr. DeMello's investment in Shadow.¹⁸⁸ Rule 15(b) of the Arizona Rules of
19 Civil Procedure allows conforming if issues not raised in the notice are tried by express or implied
20
21

22 ¹⁷⁹ S-4; S-5

23 ¹⁸⁰ T.70:4-14; S-52 at ACC403

24 ¹⁸¹ T.156:12-21.

25 ¹⁸² T.71:4-15

26 ¹⁸³ T.70:4-14; S-52 at ACC403

¹⁸⁴ S-15; T.157:4-T.160:13

¹⁸⁵ T.71:4-14

¹⁸⁶ S-51 at ACC8984, 8987

¹⁸⁷ S-25; S-31; S-36

¹⁸⁸ T.697:24-T.698:5

1 consent of the parties. See Ariz. R. Civ. P. 15(b).¹⁸⁹ Such issues are then treated as if they had been
2 raised in the pleadings. See id.

3 42. A motion to conform the notice to the evidence is within the discretion of the hearing
4 officer, and such amendments should be liberally allowed in the interests of justice. See Continental
5 National Bank v. Evans, 107 Ariz. 378, 381 (1971) The purposes of the rule are to permit cases to be
6 tried on the merits and to promote judicial economy by allowing all relief the parties are entitled to in
7 a single trial. See id.

8 43. The issue of Mr. DeMello's investment was tried by implied consent of the parties. See
9 Ariz. R. Civ. P. 15(b). Mr. DeMello's investment was raised without objection during Mr. Leyen's direct
10 examination and cross-examination and during Martinez's direct examination and cross-examination.¹⁹⁰
11 This evidence of Mr. DeMello's investment without objection shows that the issue was tried with the
12 implied consent of the parties. See Beckwith v. Clevenger, 89 Ariz. 238, 240 (1961) (issue was tried by
13 consent of the parties because issue was brought out on cross-examination of two witnesses without
14 objection).

15 44. The Division's motion should be allowed because Martinez was neither surprised nor
16 prejudiced. See Beckwith 89 Ariz. at 240-241 (motion to conform should have been allowed where
17 neither party was surprised or prejudiced). Martinez did not object to the motion on the basis that he was
18 surprised by the issue of Mr. DeMello but instead on the basis that it would contradict the Division's
19 investor list summary exhibit.¹⁹¹ See id. (objection to motion to conform did not assert surprise). In fact,
20 Martinez was prepared to testify about Mr. DeMello and did so during his direct examination.¹⁹²
21 Martinez also had with him a list of investors that he had submitted to Shadow's bankruptcy court, and
22 the list reflected the amount, date, and terms of Mr. DeMello's investment.¹⁹³

23
24 ¹⁸⁹ Rule 15(b) of Arizona Rules of Civil Procedure is the applicable rule because no procedure for conforming
25 pleadings to the evidence is set forth by law, the Commission's Rules of Practice and Procedure, Commission
26 regulation, or Commission order. See A.A.C. R14-3-101(A).

¹⁹⁰ T.52:2-5; T.53:23-11; T.115:22-T.116:12; T.132:25-T.149:12

¹⁹¹ T.182:23-T.185:23

¹⁹² T.115:22-T.116:12

¹⁹³ T.134:13-T.136:13

1 Ariz. Corp. Comm'n, 194 Ariz. 104, 108 ¶ 16–17 (Ct. App. 1999) (citing S.E.C. v. W.J. Howey
 2 Co., 328 U.S. 293 (1946)). The Loan Agreement is a security if it involves an investment of money
 3 in a common enterprise with the expectation of profits from the managerial efforts of others. See
 4 Nutek, 194 Ariz. at 108 ¶ 17–18. A common enterprise exists between the investor and promoter
 5 when the investor's success is correlated to the promoter's success. Dagget v. Jackie Fine Arts, 152
 6 Ariz. 559, 565 (Ct. App. 1986)

7 50. The Loan Agreement meets this test. Ms. Leyen and Mr. Johnson invested money and
 8 expected profits as promised in the Loan Agreement.¹⁹⁷ The Loan Agreement was a common
 9 enterprise between the investors and Shadow because their success was correlated to Shadow's
 10 success. The amount of profits Ms. Leyen and Mr. Johnson were entitled to was based on the rate of
 11 Shadow's successful production and sale of product.¹⁹⁸ They relied on Martinez's managerial efforts
 12 because they had no management role at Shadow.¹⁹⁹ Accordingly, the Loan Agreement is an
 13 investment contract security.

14 **C. Martinez and Shadow Sold the Securities Within and From Arizona**

15 51. An offer to sell a security means any attempt to offer or dispose of a security. A.R.S.
 16 § 44-1801(15). A sale of a security means any sale or disposition of a security for value or a contract
 17 to make such a sale. A.R.S. § 44-1801(21). All of Shadow's securities were sold from Arizona
 18 because it is an Arizona company located in Arizona and with a President residing in Arizona.²⁰⁰
 19 There is also evidence that many of the offers and sales occurred within Arizona and to Arizona
 20 residents.²⁰¹

21 52. Except for Mr. Tunnel's first note, Martinez and Shadow offered and sold all of the
 22 Notes and the Loan Agreement by Martinez executing them on behalf of Shadow.²⁰² Martinez offered
 23 Mr. Tunnel's first note by attempting to dispose of it with his personal guaranty of the note, which

24 ¹⁹⁷ T.34:11–13; S-39

25 ¹⁹⁸ S-39

26 ¹⁹⁹ S-88 p.248:5–9

²⁰⁰ S-2a; S-2b; S-2c; S-87 p.7:25–p.8:5; T.179:20–T.180:16

²⁰¹ S-10; S-39; S-47; S-49; S-88 p.160:9–19, p.187:21–p.188:14, p.198:16–21; S-90

²⁰² S-4; S-11; S-18; S-22; S-24; S-28; S-34; S-38; S-39; S-41; S-44; S-46; S-49; S-53; S-56

1 would have reduced the apparent risk of the note to Mr. Tunnel.²⁰³ Shadow also made all of the offers
 2 and sales made by Martinez because Martinez was an agent of Shadow working on its behalf and
 3 because Shadow was the issuer of the Notes and the Loan Agreement.²⁰⁴

4 **D. Martinez, Shadow, and the Securities Were Neither Registered Nor Exempt From**
 5 **Registration**

6 53. Martinez and Shadow were not registered by the Commission as securities salesmen
 7 or dealers.²⁰⁵ Shadow's securities have not been registered by the Commission.²⁰⁶

8 54. It is the Respondents' burden to prove any exemption from registration. A.R.S. § 44-
 9 2033. Because of the vital public policies underlying the Act's registration requirements, all
 10 exemption requirements must be strictly complied with. State v. Baumann, 125 Ariz. 404, 411
 11 (1980).

12 55. The Respondents have failed to prove that any exemption from registration applies to
 13 them or to the securities. Most importantly, there is no evidence that Shadow has ever made a Form
 14 D notice filing with the Commission, which is a requirement after making a securities sale for several
 15 exemption grounds.²⁰⁷

16 56. Other exemptions require that the issuer not engage in general solicitation, but Shadow
 17 has.²⁰⁸ Whether general solicitation has occurred is based on whether there is a relationship between
 18 the offeror and offeree, and whether that relationship is substantive and pre-existing. See Johnston v.
 19 Bumba, 764 F.Supp. 1263, 1274–1275 (N.D. Ill. 1991); Woodtrails-Seattle, Ltd., SEC No-Action
 20 Letter, 1982 WL 29366 (Aug. 9, 1982); E.F. Hutton Co., SEC No-Action Letter, 1985 WL 55680
 21 (Dec. 3, 1985).

22 57. Shadow did not give Peterson any limits or guidelines on how he was allowed to
 23 find investors, for example by limiting him to investors with whom he had a substantive pre-

24 ²⁰³ S-7; S-9

²⁰⁴ S-4; S-7; S-11; S-18; S-22; S-24; S-28; S-34; S-38; S-39; S-41; S-44; S-46; S-49; S-53; S-56

25 ²⁰⁵ S-1a; S-1b

²⁰⁶ S-1a

26 ²⁰⁷ See, e.g., R14-4-126(D); R14-4-140(L)

²⁰⁸ See, e.g., 17 C.F.R. §230.502(c); R14-4-126(C)(3)

1 existing relationship.²⁰⁹ Peterson did not limit his sales efforts to his own contacts, and instead also
 2 sought investors among his contacts' contacts.²¹⁰ For example, Peterson approached Mr. Hatkoff
 3 about investing in a Shadow note despite having no pre-existing relationship with Mr. Hatkoff at all.²¹¹
 4 Without a pre-existing relationship with potential investors, Peterson and Shadow were engaged in
 5 general solicitation.

6 58. Shadow also failed to satisfy the requirements of any exemption limited to accredited
 7 or sophisticated investors. Ms. Leyen and Mr. Johnson were not accredited investors because they had
 8 neither a net worth over \$1,000,000 nor an annual income over \$200,000.²¹² They also lacked the
 9 investment experience to be able to evaluate the risks and merits of the investment.²¹³ Mr. and Mrs.
 10 Gervasi were also not accredited investors when they invested.²¹⁴ Shadow also lacked a reasonable
 11 belief that Mrs. Gervasi, Ms. Leyen, Mr. Hatkoff, and Mr. Moore were accredited investors because
 12 it did not ask them.²¹⁵

13 **E. Martinez and Shadow Violated the Anti-Fraud Provisions of the Act**

14 59. Martinez and Shadow engaged in multiple violations of A.R.S. § 44-1991(A), the
 15 antifraud provisions of the Securities Act.

16 60. Under A.R.S. § 44-1991(A)(2) it is unlawful to make untrue statements of material
 17 fact or to omit to state a material fact necessary in order to make the statements made, in light of the
 18 circumstances under which they were made, not misleading. A.R.S. § 44-1991(A)(2). A statement is
 19 misleading if it misleads potential investors in any way. See Trimble v. Am. Sav. Life Ins. Co., 152
 20 Ariz. 548, 553 (Ct. App. 1986) (the Act places a heavy burden upon the offeror not to mislead
 21 potential investors in any way). A statement with misleading implications is also misleading. See
 22 State v. Schwenke, 222 P.3d 768, 773 (Utah Ct. App. 2009) (statement was misleading based on

23
 24 ²⁰⁹ S-87 p.82:13–22, p.129:2–13

²¹⁰ S-87 p.81:15–p.82:12

²¹¹ T.60:4–16

²¹² T.43:21–T.44:2

²¹³ T.445:13–20; See, e.g., 17 C.F.R. §230.506(b)(ii); R14-4-126(F)(2)(b)

²¹⁴ T.85:6–15

²¹⁵ T.57:22–T.58:3; T.76:10–13; T.91:16–20; T.91:21–T.92:3

1 what it lead one to believe). Statements made to create confidence in a transaction can be misleading
 2 if omitted facts would undermine that confidence. See State v. Johnson, 224 P.3d 720, 731 (Utah Ct.
 3 App. 2009). Investors are not required to investigate or perform due diligence. Trimble, 152 Ariz.
 4 at 553. It is the offeror who bears the burden not to mislead potential investors. Id. A fact is material
 5 if there is a substantial likelihood that, under all of the circumstances, the fact would have assumed
 6 actual significance in the deliberations of a reasonable investor. Caruthers v. Underhill, 230 Ariz.
 7 513, 524 ¶ 43 (App. 2012). Materiality does not require evidence that investors would have decided
 8 not to invest. See id.

9 **Prior Defaults**

10 61. Martinez and Shadow stated to all of the investors that Shadow would repay them by a
 11 particular date.²¹⁶ They omitted to many investors²¹⁷ that Shadow had defaulted on all of the Notes.²¹⁸

12 62. This omission was misleading because stating that Shadow would repay the investors by
 13 a particular date implied that Shadow had the means to do so, and the history of defaults would have
 14 shown that this implication was false. See Schwenke, 222 P.3d at 773. The fact that this would have
 15 been significant to Ms. Leyen and Mr. Hatkoff's decisions whether to invest shows that it would have
 16 been material to a reasonable investor.²¹⁹

17 **Failure to Perform on Personal Guaranties**

18 63. Martinez and Shadow stated to Mr. Jarus, Mr. Kelly, Mr. and Mrs. Salganick, Mr. Crane,
 19 and Mr. Moore that Martinez personally guaranteed their notes.²²⁰ They omitted²²¹ that Martinez had
 20 failed to perform on other personal guaranties for Shadow notes.²²²

21
 22 ²¹⁶ S-7; S-11; S-18; S-22; S-24; S-28; S-34; S-38; S-39; S-41; S-44; S-46; S-49; S-53; S-56

23 ²¹⁷ S-88 p.173:24–p.174:1, p.199:14–16, p.201:18–20, p.234:2–4, p.250:5–13; S-89 p.268:9–11, p.269:21–24,
 p.277:17–20, p.282:25–p.283:3, p.286:15–20, p.290:18–21, p.292:16–18; T.52:12–15; T.73:15–20; T.85:16–18;
 T.88:1–4

24 ²¹⁸ S-4; S-5; S-11; S-13 at ACC325 ¶ 18–19; S-16; S-24; S-88 p.192:7–17, p.197:16–p.198:6, p.224:11–14, p.233:4–7,
 p.248:10–13; S-89 p.267:3–5, p.268:25–p.269:2, p.274:15–24, p.281:18–19, p.284:20–p.285:12, p.289:14–25,
 p.291:14–p.292:1; T.85:19–21; T.135:3–T.136:13; T.136:23–T.137:6

25 ²¹⁹ T.52:12–24; T.73:15–T.74:2

26 ²²⁰ S-20; S-32; S-48; S-55; S-58

²²¹ S-88 p.191:13–16, p.226:4–7; S-89 p.270:3–6, p.290:25–p.291:3, p.292:22–p.293:1; T.88:5–8; T.153:4–7

²²² S-9; S-13 at ACC325 ¶ 18–19; S-16; S-18; S-88 p.178:20–24, p.181:2–9, S-88, p.192:1–17, p.224:11–14, p.227:5–9

1 collateral.²⁴⁰ This prior, competing security interest would clearly have been significant to a
2 reasonable investor because it undermined the value of the new security interest.

3 **F. Martinez was a Controlling Person of Shadow and Is Liable for Its Anti-Fraud**
4 **Violations**

5 73. Martinez is also liable as a control person for the violations of the antifraud provisions
6 committed by Shadow. A.R.S. § 44-1999(B) imposes presumptive liability “on those persons who
7 have the power to directly or indirectly control the activities of those persons or entities liable as
8 primary violators of A.R.S. § 44-1991.” Eastern Vanguard Forex Ltd. v. Ariz. Corp. Comm’n, 206
9 Ariz. 399, 412 ¶ 42 (Ct. App. 2003). See also A.R.S. § 44-1999(B). Control includes both actual
10 control and legally enforceable control. See Eastern Vanguard, 206 Ariz. at 412 ¶ 41.

11 **Martinez Had the Power to Control Shadow**

12 74. Martinez had actual control over Shadow. Martinez was a co-founder of Shadow and
13 its President.²⁴¹ He was a signer on Shadow’s bank accounts, handled day-to-day business, managed
14 the sales and operations teams, oversaw the director of administration, and was in charge of
15 Peterson, the Senior Vice President of Capital Acquisition.²⁴²

16 **Martinez Has Not Proven Good Faith or Lack of Inducement**

17 75. An affirmative defense is available to control persons who acted in good faith and did
18 not induce the violations, but it is the controlling person's burden to prove those circumstances.
19 Eastern Vanguard, 206 Ariz. at 413 ¶ 46. See A.R.S. § 44-1999(B). The good faith element requires
20 at a minimum that the control person exercised due care by taking reasonable steps to maintain and
21 enforce a reasonable and proper system of supervision and internal controls. Eastern Vanguard, 206
22 Ariz. at 414 ¶ 50. Martinez has not met this burden.

23
24
25 ²⁴⁰ S-25

26 ²⁴¹ T.179:20–T.180:16; S-61 at ACC48; S-61 at ACC48. Although Martinez was not the President at the time of Mr. Karas’ June 1, 2009, investment, Shadow has no anti-fraud liability with respect to Mr. Karas, so there is no control person liability for that timeframe.

²⁴² S-77 through S-80; S-84 through S-86; T.149:19–T.150:22

1 76. Martinez did not supervise or control Shadow's salesman, Peterson. He did not
2 control how Peterson found investors.²⁴³ He did not require Peterson to disclose the GNC Judgment
3 to potential investors.²⁴⁴ He did not even confirm whether Peterson was actually a licensed
4 investment advisor, as he claimed.²⁴⁵

5 77. Martinez also failed to confirm the supposed legality of Peterson's sales efforts. Peterson
6 told Martinez that he had discussed securities sales methods with an attorney, but Martinez never spoke
7 with the attorney himself to confirm what the attorney's advice was.²⁴⁶

8 78. Martinez also directly induced the acts underlying the fraud violations because his acts
9 were part of the fraud violations. See A.R.S. § 44-1999(B). As described above in Section E.,
10 Shadow's fraud violations were based on Martinez's misleading omissions and misrepresentations.

11 **G. Martinez's Marital Community Is Liable Under the Act**

12 79. All property acquired by either husband or wife during marriage is the community
13 property of the husband and wife except for several narrow exceptions that are not relevant here. See
14 A.R.S. § 25-211. During marriage, "the spouses have equal management, control and disposition
15 rights over their community property and have equal power to bind the community." A.R.S. § 25-
16 214(B). Either spouse may contract debts and otherwise act for the benefit of the community. A.R.S.
17 § 25-215(D). "(T)he presumption of law is, in the absence of the contrary showing, that all property
18 acquired and all business done and transacted during coverture, by either spouse, is for the
19 community." Johnson v. Johnson, 131 Ariz. 38, 45 (1981). Furthermore, a debt is incurred at the
20 time of the actions that give rise to the debt. Arab Monetary Fund v. Hashim, 219 Ariz. 108, 111
21 (Ct. App. 2008). Here, the actions giving rise to the debt occurred while Martinez and Respondent
22 Spouse were married. Therefore, the debt was incurred during marriage and is presumed to be a
23 community debt.

24
25 ²⁴³ S-87 p.82:13-22, p.129:2-13

26 ²⁴⁴ T.146:12-T.147:23

²⁴⁵ S-87 p.53:17-p.55:2

²⁴⁶ M-5: T.132:12-24

1 80. Martinez and Respondent Spouse failed to rebut the presumption that a debt incurred
2 during marriage is a community obligation. A party contesting the presumptively community nature
3 of a debt bears the burden of overcoming that presumption by clear and convincing evidence. Hrudka
4 v. Hrudka, 186 Ariz. 84, 91 (Ct. App. 1995). The presumption of intent is enough to bind the
5 community regardless of Respondent Spouse's knowledge or participation. See Ellsworth v.
6 Ellsworth, 5 Ariz. App. 89, 92 (Ct. App. 1967). Since Martinez and Respondent Spouse failed to
7 overcome this presumption, the debt remains a liability of the marital community. Therefore, the
8 marital community of Martinez and Respondent Spouse is subject to any order of restitution,
9 administrative penalties, or other appropriate affirmative action.

10 81. It does not matter that only Martinez and not Respondent Spouse signed some of
11 the personal guaranties to investors.²⁴⁷ A community is not bound by a guaranty not signed by both
12 spouses. Rackmaster Sys., Inc. v. Maderia, 219 Ariz. 60, 63 ¶ 15 (Ct. App. 2008). See A.R.S. §
13 25-214(C)(2). However, the Division is not attempting to enforce the terms of the guaranties. The
14 Division is enforcing a statute that prohibits misleading omissions in connection with the sale of
15 securities. See A.R.S. 44-1991(A)(2).²⁴⁸

16 82. The community's protection against liability for single-spouse guaranties does not
17 protect it from other sources of liability for the same transaction. See Chase Bank of Arizona v.
18 Acosta, 179 Ariz. 563, 571 (Ct. App. 1994). But see First Interstate Bank of Arizona v. Tatum and
19 Bell Center Assoc., 170 Ariz. 99, 104 (Ct. App. 1991). In the Acosta case, a partnership accepted
20 a loan from a bank, and a general partner signed a guaranty for payment of the loan, but the general
21 partner's wife did not sign the guaranty. Id. at 565–566. The bank eventually sued the marital
22 community for the partnership's loan. Id. at 567. Regardless of the community's protection against
23 guaranties, the community was still liable for the partnership's loan on the basis of the community's
24 general partner interest in the partnership. Id. at 571.

25 _____
²⁴⁷ S-20; S-32; S-48; S-55; S-58

26 ²⁴⁸ Also, even if the marital community was not liable for the misleading omissions regarding the guaranties, it would still be liable for Martinez' other anti-fraud and/or registration violations for each of the relevant investors.

1 83. Like the Acosta case, Martinez's marital community is liable not on the basis that the
2 guarantee is enforceable, but instead on another basis. See Acosta at 571. Regardless of the
3 enforceability of Martinez's guaranties, Martinez and the community are liable because, in
4 connection with a securities offer, Martinez made statements that were misleading because of
5 material facts that he omitted. See A.R.S. § 44-1991(A)(2).

6 **V. CONCLUSION**

7 84. Based on the evidence admitted at the hearing, the Division respectfully requests that
8 the Commission make the following conclusions of law.

9 85. Martinez and Shadow violated A.R.S. § 44-1841 by the offer or sale of unregistered
10 securities within or from Arizona.

11 86. Martinez and Shadow violated A.R.S. § 44-1842 by the offer or sale of securities
12 within or from Arizona while not registered as a securities salesman or dealer.

13 87. Martinez and Shadow violated A.R.S. § 44-1991(A)(2) by making untrue statements
14 of material fact or materially misleading omissions in connection with an offer to sell securities within
15 or from Arizona.

16 88. Martinez controlled Shadow within the meaning of A.R.S. § 44-1999, so that he is
17 jointly and severally liable under A.R.S. § 44-1999 to the same extent as Shadow for its violations of
18 A.R.S. § 44-1991.

19 89. The Division respectfully requests that the Commission grant the following relief.

20 90. Order Martinez and Shadow to jointly and severally pay restitution in the amount of
21 \$1,492,500, plus pre-judgment interest from the date of each investor's investment as set forth in
22 Exhibit S-74 and from the February 24, 2014, date of Mr. DeMello's investment (interest rate to be
23 calculated at the time of judgment under A.R.S. § 44-1201).

24 91. Order Martinez and Shadow to pay administrative penalties of not more than five
25 thousand dollars (\$5,000) for each violation of the Act, as the Commission deems just and proper,
26 pursuant to A.R.S. § 44-2036(A). The Division recommends that Martinez be ordered to pay an

1 administrative penalty in the amount of \$75,000 and that Shadow be ordered to pay an administrative
2 penalty in the amount of \$75,000.

3 92. Order Martinez and Shadow to cease and desist from further violations of the Act,
4 pursuant to A.R.S. § 44-2032.

5 93. Order that the marital community of Martinez and Respondent Spouse be subject to
6 any order of restitution, rescission, administrative penalties, or other appropriate affirmative action
7 pursuant to A.R.S. § 25-215; and

8 94. Order any other relief the Commission deems appropriate or just.

9
10 RESPECTFULLY SUBMITTED this 20th day of July, 2016.

11
12 ARIZONA CORPORATION COMMISSION

13
14 By:  _____
15 Paul Kitchin
16 Attorney for the Securities Division of the
17 Arizona Corporation Commission
18
19
20
21
22
23
24
25
26

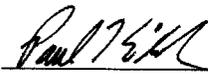
1 ORIGINAL AND SIX (6) COPIES of the foregoing
2 filed this 20th day of July, 2016, with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 W. Washington St.
6 Phoenix, AZ 85007

7 COPY of the foregoing mailed/delivered
8 this 20th day of July, 2016, to:

9 Mr. Mark Preny
10 Administrative Law Judge
11 Arizona Corporation Commission/Hearing Division
12 1200 W. Washington St.
13 Phoenix, AZ 85007

14 Lucio George Martinez
15 Lisa K. Martinez
16 1772 S Comanche Dr.
17 Chandler Arizona 85286
18 Respondents

19 
20 _____