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BEFORE THE ARIZONA CORPORATION COMMISSION

In the Matter of Shadow Beverages and Snacks, LLC

Case No: S-20948A-15-0422

Lucio George Martinez and Lisa K. Martinez,

Post Hearing Brief

Arizona Corporation Commission

Samuel A. Jones,

DOCKETED

SEP 15 2016

Respondents

DOCKETED BY *JA*

Lucio George Martinez and Lisa Kay Martinez submit their 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 against Shadow Beverages LLC, Lucio George Martinez and Lisa Kay Martinez and Samuel Jones in which the Securities Division alleged violations of the Arizona Securities Act in connection with the offer and sale of securities in the form of promissory notes and investment contracts. Answers to the notice were filed by the respondents.

On February 23, 2016, Administrative Law Judge Mark Preny issued the Third Procedural Order scheduling a hearing to begin on June 6, 2016. On May 13, 2016, the Commission issued an Order to Cease and Desist, Order of Restitution, and Order for Administrative Penalties and Consent to the Same for Samuel A. Jones. The administrative hearing began on June 6 and was completed on June 7. Both Lisa Kay Martinez and Lucio George Martinez were at the hearing and answered questions and

1 presented additional facts to the Judge. A Post-Hearing Brief was filed by Paul Kitchin,
2 attorney for the Securities Division on July 20, 2016. On August 18, 2016 Lucio George
3 Martinez and Lisa Kay Smith filed an extension for time to reply to the Commission
4 based on family matters. The Commission granted the extension.

5 **II. FACTS**

6 **A) Based on the evidence presented during the hearing and records reviewed by** 7 **the Investigator of the Commission, the following facts are of record.**

- 8 1. Lucio George Martinez (“Martinez”) and Samuel A. Jones founded the
9 company of Shadow Beverages and Snacks LLC (“Shadow”) in 2008. The
10 company was registered in Arizona and as of the date of this filing, it is in good
11 standing with the State of Arizona.
- 12 2. Lisa Kay Martinez is the wife of Lucio George, and has been employed by
13 Hospice of the Valley prior to the founding of Shadow. She is a full time
14 employee and has been for 10+ years working 50 hours per week. Lisa Kay
15 was never involved and did not participate in the operation of Shadow nor had
16 any decision making at the company. She was fully employed by Hospice of
17 the Valley and would not have had the time to be a part of the company. She
18 was unaware of Martinez’s day-to-day activities related to the matters
19 complained of in this proceeding. She received no benefit from Shadow,
20 monetary or otherwise.
- 21 3. During his time at Shadow, Martinez did not receive a steady salary, bonus, or
22 monetary consideration for his work and efforts. Only for a period of 6 months
23 out of the 6 years he was involved with did Martinez receive a paycheck from
24 Shadow, fact that were established by the investigation of bank records and the
25 company accounting records done by the Commission.
- 26 4. The investigation by the Commission found that there was no monetary gain for
27 Martinez or Lisa Kay from Shadow since the company was founded.
28

1 5. Shadow was governed by a Board of Directors during its time of operation.
2 Martinez was not the sole decision maker for the company or the company's
3 financial affairs. Copies of the board minutes and board members were given
4 to the Commission for review. While working for Shadow, Martinez held
5 many roles and Shadow had three other CEO's since the company was founded.
6 Martinez was the only founder that lived in Arizona and therefore oversaw the
7 day-to-day operations and office functions.

8 6. Shadow ceased operations as of April 1, 2016 due to a sale to Mix1 Beverages
9 for a transaction amount of \$12.2 million dollars in cash and stock. The sale
10 included the No Fear brand that was developed by Shadow and its distribution
11 system that supported the sales revenue of the No Fear brand.

12 **B) INVESTORS: as listed in the post-hearing brief from Paul Kitchin**

13 8) George Karas was a co-worker at the Pelican Group and Martinez had
14 known him 2 to 3 years. During a family BBQ George asked Martinez if he
15 could invest in Shadow as a mutual friend, Richard Scherer, had been a
16 founding partner and George wanted to be a part of the new venture. No
17 business plan or formal presentation was made to George, he wanted to put
18 some money in place that he could help grow the company. He was treated
19 for cancer 6 months later and passed away shortly after. His note was paid
20 in full to his family. The note was due when he was ill and it was agreed to
21 extend and handle the note once George was in better health.

22 9) Martinez never knew Brent Tunnel, who was brought to the company by
23 another founding partner, Joe Dunnigan. It was explained to the executive
24 team that Tunnel had sold a company and wanted to re-invest the funds so
25 he did not have a tax liability. Shortly after Tunnel's investment, the sale of
26 his company was cancelled, and Tunnel retook control of that business,
27 needing his investment to operate. Shadow had another partner that was
28 talking to Spyglass Capital, and it was agreed that once Shadow received

1 funds from Spyglass Capital, Tunnel would be repaid in full. Tunnel was
2 repaid in full and returned his equity in Shadow at no cost so Shadow could
3 finish the Spyglass Capital agreement. Tunnel was not informed of the
4 situation with George Karas and the note not being paid as written because
5 George was dying at the time

6 10) This investment was just part two of the original agreement with Brent
7 Tunnel and was also paid in full.

8 11) Scott Jarus was the CFO of Ironclad Performance Gloves in CA. Shadow
9 entered into a licensing agreement to build an energy drink for Ironclad and
10 begin distribution. Scott came to Arizona to discuss a business partnership
11 and how Shadow was building a marketing campaign for his licensed brand.
12 He did not come to AZ to discuss an investment opportunity with Martinez,
13 and only spoke to Sam Jones on making the investment after the meeting.
14 During the marketing discussion and the need to find additional capital to
15 support the marketing of the Ironclad brand, Scott agreed to support the
16 marketing needs by looking for folks to invest in Shadow. At the time Scott
17 was leading a financial re-structuring of Ironclad and wanted to show
18 investors that a marketing plan was in place to grow his brand through the
19 marketing of beverages. Scott's loan was paid in full and he knew the
20 company's financial situation when he agreed to fund the marketing
21 program and that Shadow had a loan to repay to Tunnel and that Shadow
22 was repaying that loan with the Spyglass Capital agreement. Scott made the
23 investment so his brand could keep moving as Shadow discussed other
24 options to financing the company.

25 12) Ron Barrett is a personal family friend of Martinez, who lives in Arizona.
26 Martinez did not meet Martinez for an investment meeting. During a family
27 function Martinez discussed the needs for Shadow as it was finalizing the
28 Spyglass Capital agreement. Ron was not interviewed for the statements in

1 the post-hearing brief and facts that are claimed. Ron will speak to the fact
2 that he knew that Shadow had notes due and that his investment was a
3 bridge to help close the Spyglass Capital agreement. Ron was paid in full
4 for this loan.

5 13) Stacey Gervasi is the daughter of George Karas. She knew that her father
6 and Martinez were co-workers and friends. When her father past away, she
7 came in to Shadow's office to discuss her father's investment and that her
8 and her siblings needed to finalize his financial affairs and divide the
9 inheritance. She wanted to take her inheritance and re-invest into Shadow.
10 She knew her father's note was due and had not been paid. Shadow paid the
11 note and she re-invested it once her inheritance was closed. Martinez did
12 not know Gary or Michelle Van Kilsdonk, Stacey brought them to the office
13 because she wanted to bring them into her investment. They had made other
14 investments together over time. The investment was made together
15 (Martinez never had any documentation on who invested what amount) and
16 Stacey made the payment. They later changed the ownership to an Arizona
17 limited liability company that they started. Michelle later came to Martinez
18 looking for employment after she retired from the police department. She
19 was a sales administrative support person and participated in company
20 meetings in which the financial status of the company was discussed.

21 14) The factoring agreement with First Community Financial was an
22 agreement that was up to a limit of \$1,000,000, only if the invoices factored
23 were approved. The collateral was not all receivables and inventory; it was
24 just the amount outstanding at the time. Shadow never had a balance due
25 greater than \$200,000. Shadow did not factor all receivables with them so
26 they only had rights to what was factored. Shadow's balance sheet showed
27 that there was inventory and receivables well over \$1,000,000 on a constant
28 basis.

1 15) Dave Kelly is a resident of Arizona. His investment was made on behalf
2 of Rick Peterson. Martinez only met Dave once when he came in the office
3 to hear about the business model. Rick Peterson presented Shadow's
4 standard company overview to Dave Kelly. He received a copy of
5 Shadow's balance sheet and was explained that the notes due had been paid
6 through the Spyglass Capital agreement.

7 16) Rick Anderson is a family member, cousin. During a family get together
8 he asked if he could invest into Shadow. He had a cash surplus from his
9 business and was buying gold bars and putting them in a vault. He was
10 never shown any documentation on Shadow and funded his investment
11 based on only a couple of discussions with Martinez.

12 17) Same investor as number 16.

13 18) Catherine Leyen was a broker for Shadow. At the hearing she testified that
14 she had an agreement in place with Shadow and her business partner Darrell
15 Demello to bring investors and utilize their export company, India Access,
16 to grow their business. They had a fee schedule in place to get paid for any
17 funds that they guided into Shadow. Part of their strategy for their other
18 investors was to show the investors that they had their own money invested.
19 Both Catherine and Darrell made investment in hopes that their investor
20 groups would place as much as \$10 million into the Shadow business
21 model. They also traveled to Dubai to meet their investors and they
22 believed their investors would place money into Shadow and they would get
23 their money back at a high interest rate plus a 5% fee for bringing the
24 investors. The record shows that during her testimony she did not want to
25 discuss this and asked if she could not respond to the question that was
26 asked of her being a broker for Shadow.

27 19) This investment was Catherine Leyen's mother. She would not discuss her
28 involvement as a broker for Shadow at the hearing, she brought her mother

1 to Martinez asking if she could invest and support Shadow because she and
2 Darrell were working on closing a larger investments that would pay off
3 these investments with high interest and they would receive their fee as
4 broker.

5 20) GNC was awarded a judgement against Shadow. Martinez had numerous
6 discussions with executive management on this and Shadow was in the
7 process of selling GNC the formulas and bottle molds for the judgement.
8 Shadow let the PA court system file this as it did not have the funds to find
9 an attorney in PA and Shadow's board did not want to take any investment
10 dollars and spend in attorney fees. The judgement was put in place for GNC
11 to take the formulas and bottle molds that Shadow had created. Shadow had
12 a licensing agreement to create GNC beverages and it did so. The brand
13 need more marketing funding, but a new CEO was put in place at GNC who
14 decided that he did not want any attention to this brand project and he need
15 his organization focused on fixing their retail business. Their stock price
16 had dropped dramatically and he had no interest in this brand project with
17 Shadow. Their corporate attorneys found a clause in the agreement that if
18 they cancelled the agreement they would still be able to hold us liable for
19 the licensing fees for the length of the agreement. Shadow fought the issue
20 but did not have the funds to defend the lawsuit.

21 21) James Stephensen was an Off Road race truck driver that Shadow
22 sponsored for three years with the Ironclad and No Fear brands. He was
23 very close to the business and knew our financial situation. Martinez did
24 not speak to him regarding his investment. Because Shadow had supported
25 his racing career that ended in 2014, he wanted to support the company
26 through our sale to Mix1 Beverages.

1 22) Jason and Robin Salganick were brought to Shadow through Rick Peterson
2 and they are neighbors. Martinez never spoke to them regarding an
3 investment.

4 23) Darrell Demello is the CEO of India Access and was working in the same
5 capacity as Catherine Leyen. He had a broker agreement with Shadow and
6 was working on bringing in Capital firms to support the company. He
7 would have been paid 5% of anything he brought to the company and used
8 his investment as a selling tool to others that he had his own money in the
9 company and believed Shadow had the right business model to grow.
10 Darrell like Catherine new the company financials very well and were using
11 them to discuss investment with Capital Firms.

12 24) Reed Hatkoff did not speak to Martinez regarding an investment into
13 Shadow. The Commission post-hearing brief notes on line 14-16 of page 12
14 that Reed was a group of investors that spoke to Rick Peterson about an
15 investment. Reed Hatkoff did receive a \$45,000 payment when the
16 company sold to Mix1. The Sale transaction with Mix1 included
17 \$1,000,000 in cash for No Fear expenses, which most of these loan
18 agreements were for as Shadow used the funds for production,
19 transportation, selling expenses, and payroll to employees.

20 25) Michael Crane did not speak to Martinez regarding an investment into
21 Shadow. The Commission post-hearing brief notes on line 14-16 of page 12
22 that Michael Crane was a group of investors that spoke to Rick Peterson
23 about an investment.

24 26) Kurt Moore did not speak to Martinez regarding an investment into
25 Shadow. The Commission post-hearing brief notes on line 14-16 of page 12
26 that Kurt Moore was a group of investors that spoke to Rick Peterson about
27 an investment.

28 **C. Rick Peterson and his Security Sales Efforts**

1 28) Rick Peterson was a co-worker at PepsiCo when Martinez was also
2 employed by PepsiCo. He first came into Shadow's office with a Scottsdale
3 Investment Firm when Shadow had contracted with Carl Marks (an
4 Investment Firm from New York that Shadow paid to help fund the
5 company for growth). Rick came in with the firm as the beverage expert.
6 He left the office very impressed with Shadow's business model. The firm
7 ultimately did not make an investment due to the amount of money Shadow
8 needed was too small for them. A few months later Rick called and said he
9 was moving to Arizona from Texas due to his father's health and he was
10 looking for consulting work. He explained that after his beverage career he
11 had spent the past 3 years working in the financial industry raising money
12 for beverage companies. He asked if Shadow would hire him to do the
13 capital raising. Martinez told him executives at Shadow did not earn a
14 salary, and that the company would need to raise capital for growth and get
15 to a point Shadow could pay executives. Martinez offered him an office and
16 office support and shares of the company if he wanted to help Shadow grow
17 and that he could continue with his other business as needed. He explained
18 that he normally receives a 5% fee for raising capital. This discussion led
19 Martinez to believe Peterson was licensed and was experienced in raising
20 capital because when he first met with Martinez he presented himself as a
21 beverage expert that was working with capital firms to find good
22 management teams to build business. With all the executive experience
23 Shadow had, this was very attractive to investors, including the fact Shadow
24 was not using the investors funds pay the executives was also important.
25 Peterson misrepresented his experience and expertise and that he was
26 licensed to do this work to Martinez.

27 29) Martinez took Peterson's offer to work for Shadow as the SVP of Capital
28 Acquisition to the board for approval and it was approved.

1 30) As presented in the hearing, an email as evidence that during a board
2 meeting a member brought up the question if Shadow needed a filing or
3 license to raise the money through Peterson. Martinez submitted the email
4 evidence that he asked Peterson if Shadow need any license or filing.
5 Peterson responded that he had checked with an attorney friend of his on
6 this topic and nothing was required, and that Shadow was in accordance
7 with the law. Because Peterson was a SVP, Martinez did not feel that I
8 would have to call and verify with the attorney what Peterson represented to
9 the board.

10 **D. Omissions**

11 31) The Commission reports that Shadow or Martinez purposely omitted
12 important information to investors that would have affected their investment
13 decision. The Karas delinquency was due to George's illness and timing of
14 his death. George and Martinez had discussed and planned to write an
15 extension to the agreement, but his health was an issue and he was not
16 concerned with our agreement. Shadow did not discuss the Tunnel
17 judgement with other investors because Shadow entered into an agreement
18 with Tunnel that he would remove the default once the loan was paid by a
19 certain date. Shadow paid the loan off, Tunnel gave the equity back and an
20 order to not execute the judgement was filed. Shadow was advised by
21 counsel that once Shadow paid amounts due and filed the order to not
22 execute the judgment; it was as if the judgment never happened. The Board
23 acted on that advice and paid the loan amount off understanding that a
24 judgement had not occurred. This evidence of the filing was presented at
25 the hearing.

26 32) The Commission is representing that Shadow pledged collateral for loans
27 over what Shadow actually had in collateral, which is not correct. Shadow's
28 factor agreement with the bank allowed Shadow to factor invoices up to \$1

1 million. Shadow did this because it was in discussions with Wal-Mart on
2 supplying them with No Fear, but Shadow could not make the cash flow
3 proposition work without factoring what was sold. Shadow's financial
4 records show the inventory and receivables never extended over what was
5 granted to Mr. Kelly, Mr. Anderson, and Mr. Hatkoff. Included in the
6 security agreements were Shadows assets, including brands and licenses.
7 The fact that Shadow sold the No Fear brand alone for \$12.2 million
8 demonstrates that Shadow's collateral was not over extended to lenders.

9 **Arguments and Conclusion:**

10 33) Lisa Kay Martinez had no involvement with Shadow and should not be liable
11 for any acts of Shadow for investments sold. She had no knowledge or
12 participation in her husband's wrongdoing, if any. Furthermore, the community
13 did not benefit from Shadow from any investment because the community was not
14 being compensated for Martinez's actions complained of herein.

15 In this matter, the claims against Martinez may be considered quasi-criminal
16 as they are asserted by a regulatory body, and are akin to an intentional tort.
17 Arizona law provides that as to intentional torts, the community is not liable for
18 one spouse's malicious acts unless it is specifically shown that the other spouse
19 consented to the act or that the community benefited from it. *Shaw v. Greer*, 67
20 Ariz. 223, 194 P.2d 430 (1948). The community is not liable without proof of the
21 non-tortfeasor spouse's knowledge of, consent to, or ratification of the other
22 spouse's wrong. *Selby v. Savard*, 134 Ariz. 222, 229, 655 P.2d 342, 349 (1982).

23 Here, any judgment rendered against Martinez will be based upon findings
24 of his own wrongful acts, of which Lisa Kay did not have knowledge of, consent
25 to, or ratification. There has been no evidence presented that Lisa Kay was a
26 participant in the actions complained of, or that she was involved with Shadow in
27 the operations of Shadow in any way. Accordingly, she cannot be held liable for
28 the acts complained of herein.

1 Any judgment rendered in this matter must therefore exclude Lisa Kay and
2 the her marital community. If Lisa Kay and the community are not excluded from
3 the judgment, her wages will be subject to garnishment and any bank account held
4 by Lisa or the community could be seized, all despite Lisa Kay's innocence.

5 In the alternative, any judgment against Martinez which includes his marital
6 community must explicitly exclude any contribution to the community by Lisa
7 Kay. By entering a judgment in this manner, Martinez would be unable to shield
8 his liability asserting community property, but Lisa Kay's sole and separate earning
9 remains excluded from any efforts to enforce the judgment, as they should be due
10 to her non-involvement in Shadow and lack of culpability in this matter. If Lisa
11 Kay is not explicitly excluded from any judgment, then it is likely that as long is
12 married to Martinez, she will be burdened with a judgment for the rest of her life as
13 she likely could not even discharge this debt in bankruptcy. This is not an
14 equitable outcome.

15 Based on the testimony in this matter, it is clear that Lisa Kay has no
16 culpability for any wrongdoing, and therefore any judgment entered must be
17 considered as to its impact on this innocent party.

18 34) The Anti-fraud Act is not applicable. There is no evidence that untrue
19 statements where made or implied. Omissions of the facts presented were
20 circumstantial, a health issue with Mr. Karas, an order filed to "Not execute the
21 Judgement" with Mr. Tunnel.

22 35) Martinez was in charge of the running of the operations, but did not have sole
23 decision-making powers of the company. A board of directors were in place and
24 minutes taken on a monthly basis. Decisions were all approved by the board.

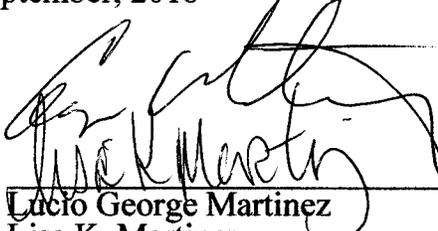
25 36) Martinez was misled by Rick Peterson and his misrepresentation of what he
26 was licensed to do. Martinez sought advice and asked for legal opinion when
27 needed. No intent of wrongdoing is evident and Martinez was not involved in most
28 of the investment decisions between Rick Peterson and investors.

1 37) Respondents Lisa Kay Martinez and Lucio George Martinez respectfully
2 request that the Commission grant the following relief to this investor group –

3 38) Order Shadow to pay restitution through the bankruptcy process with its
4 current assets and receivables.

5 39) Order Shadow to cease and desist operating as a company.

6 DATED this 15th day of September, 2016

7
8 
9
10 _____
11 Lucio George Martinez
12 Lisa K. Martinez

13 **COPY** of the foregoing emailed
14 this 15th day of September 2016, to:

15 pkitchin@azcc.gov

16 wcoy@azcc.gov

17 kh@azcc.gov

18 ORIGINAL AND SIX (6) COPIES of the foregoing filed this 15th day of September 2016,
19 with:

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21 Arizona Corporation Commission
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24 Copy of the foregoing delivered this 15th day of September 2016 to:
25 Mr. Mark Preny
26 Administrative Law Judge
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