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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED
AUG 15 2017
DOCKETED BY

COMMISSIONERS

TOM FORESE - Chairman
BOB BURNS
DOUG LITTLE
ANDY TOBIN
BOYD DUNN

In the matter of:

CONCORDIA FINANCING COMPANY, LTD, a/k/a "CONCORDIA FINANCE,"

ER FINANCIAL & ADVISORY SERVICES, L.L.C.,

LANCE MICHAEL BERSCH, and

DAVID JOHN WANZEK and LINDA WANZEK, husband and wife,

Respondents.

DOCKET NO. S-20906A-14-0063

SECURITIES DIVISION'S REPLY BRIEF

The Securities Division ("Securities Division") of the Arizona Corporation Commission ("Commission") hereby submits its Reply to Respondents' Post-hearing Memoranda with respect to the administrative hearing for Concordia Financing Company, LTD, a/k/a "Concordia Finance," ER Financial & Advisory Services, L.L.C., Lance Michael Bersch, David John Wanzek and Linda Wanzek. This Reply to Respondents' Post-Hearing Memoranda is supported by the following Memorandum of Points and Authorities.

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MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

Respondents committed serial violations of the Securities Act over a ten-year period. They raised $26.6 million from 144 investors.[1] 85 of those investors were "net winners,"[2] but they never should have been exposed to Respondents' unlawful investment contracts, which Michael Bersch, David Wanzek and ER Financial sold by fraudulent means. The other 59 investors lost and are owed $2.643 million.[3]

Bersch, Wanzek and ER Financial made over $3.09 million in commissions and custodial fees[4] for selling Concordia's securities through multiple misrepresentations and omissions of material facts.

From 2006, since C. Crowder took over as Concordia's president and Concordia began bleeding high six-figure and seven-figure losses, Concordia has paid him a handsome six-figure salary. He was paid (or effectively paid himself) that handsome six-figure salary even while he and Concordia were threatening investors that Concordia would not return any more of their principal unless the investors agreed to forego 55% of the balance they were owed and to release Respondents of all liability. In fact, not long after Respondents did this to the investors, Crowder raised his six-figure salary by another 40%.

Respondents have no viable defenses to their serial violations of the Act. So instead they falsely accuse the Division of misconduct. They have no other defense options. Respondents' plain liability, however, does not prevent them from denying all responsibility. Even more disturbing, Respondents want to be commended for what they have done.[5] The Securities Act "confirms a broad intent to sanction wrongdoing

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[1] S-194 at page 3 of 3.
[2] S-194 at page 3 of 3.
[3] S-194 at page 3 of 3.
[4] S-194 at pages 1 and 2 of 3.
[5] Concordia Br. at 1:24 ("[Concordia] should be commended....").

in connection with the purchase or sale of securities." *Grand v. Nacchio*, 225 Ariz. 171, 174, ¶ 16 (2010). The Commission should exercise its broad discretion to order Respondents to remedy their violations by ordering full restitution for the investor-victims. The Commission should also impose significant penalties, to be paid only after Respondents have made full restitution, for Respondents' serial violations.

II. RESPONDENTS OFFERED AND SOLD SECURITIES.

A. Concordia Admitted in its Answer that Its Servicing Agreements and Accompanying Custodial Agreements Were Investment Contracts.

Concordia devotes several pages of its Answering Brief to arguing that its Servicing Agreements and accompanying Custodial Agreements were not securities.[6] The Commission should disregard Concordia's arguments on this issue because in its Answer, Concordia admitted that those instruments were investment contracts.

Paragraph 10 of the Amended Notice alleged in relevant part: "To raise capital, Concordia issued ... investment contracts comprised of Sale of Contracts and Servicing Agreements ("Servicing Agreements") and accompanying Custodial Agreements."

Concordia's Amended Answer dated July 17, 2015, stated: "Concordia admits the allegations in paragraph 10." Concordia's original Answer, dated June 8, 2015, to the Amended Notice also identically stated: "Concordia admits the allegations in paragraph 10."

"The law is well settled that an admission in an answer is binding on the party making it, and is conclusive as to the admitted fact. No evidence may be shown to contradict the admitted fact, [and] a finding contrary thereto is erroneous." *Schwartz v. Schwerin*, 85 Ariz. 242, 249 (1959).

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[6] *See* Concordia's Br. at 13:18 to 17:19.

Concordia's admission is binding and conclusive against it as to the admitted fact, namely that Concordia issued investment contracts comprised of Servicing Agreements and accompanying Custodial Agreements. At least as to Concordia, a finding that the Servicing Agreements and accompanying Custodial Agreements were not investment contracts and thus securities would be erroneous. *Schwartz*, 85 Ariz. at 249.

B. Concordia's Servicing Agreements and Accompanying Custodial Agreements Were Investment Contracts and Securities under *Howey*.

Despite its admission to the contrary, Concordia argues that its Servicing Agreements and Custodial Agreements were not investment contracts but merely "sales of debt."[7] Similarly, the ER Respondents describe the investments as non-securities in the form of "'notes secured by a lien on a business or its assets.'"[8] The terms "note," "secured" and "lien" do not appear anywhere in the Servicing Agreements and Custodial Agreements, however.

Throughout their briefs, Concordia and the ER Respondents attempt to re-characterize the investors as "Contract holders"[9] and "lenders."[10] Those terms, however, do not appear anywhere in the Servicing Agreements and Custodial Agreements. Rather, throughout the Servicing Agreements and Custodial Agreements the individual entering those agreements with Concordia is called the "Investor."[11] The same is true for the marketing materials Respondents used, which describe an

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[7] Concordia's Br. at 13:19.
[8] ER Respondents' Br. at 33:9-10 (quoting *MacCollum v. Perkinson*, 185 Ariz. 179, 186-87 (App. 1996)).
[9] Concordia's Br. *passim*.
[10] ER Respondents' Br. *passim*.
[11] *See, e.g.*, S-12(a) *passim*; S-12(b) *passim*.

"Investment Opportunity"[12] in which "Concordia investors receive net 1.0% EACH MONTH in interest for providing necessary capital."[13] Respondents' marketing materials also compared the performance of Concordia's investments to the Dow Jones Industrial Average[14] and touted, "You can lock in guaranteed returns that beat the 20 year stock market average rate of return...."[15]

The legislative purpose of "the securities laws [is] to regulate investments, in whatever form they are made and by whatever name they are called." *Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990). To that end, both Arizona's Legislature and Congress have enacted broad definitions of a "security," sufficient "to encompass virtually any instrument that might be sold as an investment." *Reves*, 494 U.S. at 61. Arizona courts "give a liberal construction to the term 'security.'" *Siporin v. Carrington*, 200 Ariz. 97, 101, ¶ 18 (App. 2001).

The definition of "security" under the Securities Act includes an investment contract.[16] The elements of what constitutes an investment contract have been set forth in *S.E.C. v. W.J. Howey Co.*,[17] adopted as law in Arizona in *Rose v. Dobras*.[18] Under *Howey* and *Rose*, an investment contract will be found in "any situation where (1) individuals are led to invest money (2) in a common enterprise (3) with the expectation that they will earn a profit solely through the efforts of others."[19] This definition "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[20] In applying the *Howey* test,

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[12] S-11(e) - Brochure entitled "Concordia Finance: Investing in Transportation."
[13] S-11(e) - Brochure entitled "Concordia Finance: Investing in Transportation" at ACC004247.
[14] S-11(e) - Brochure entitled "Concordia Finance: Investing in Transportation" at ACC004247.
[15] S-13(h) at ACC004313; S-193 at ACC015234.
[16] A.R.S. § 44-1801(26).
[17] *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946).
[18] *Rose v. Dobras*, 128 Ariz. 209, 211 (App. 1981).
[19] *Rose*, 128 Ariz. at 211.
[20] *Howey*, 328 U.S. at 299.

courts "are mindful of the remedial purpose of the Securities Acts, as well as the Supreme Court's repeated rejection of a narrow and literal reading of the definition of securities."[21]

1. First Element of *Howey* - Investment of Money.

There is no dispute that the investors invested money by purchasing Servicing Agreements and accompanying Custodial Agreements, and in certain instances, Promissory Notes. There is no question that the first element of *Howey* is met.

2. Second Element of *Howey* – Common Enterprise.

"A common enterprise exists when 'the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment of third parties.'"[22] A common enterprise will be found when either horizontal commonality or vertical commonality exists.[23] "Horizontal commonality requires a pooling of funds collectively managed by a promoter or third party," while "[v]ertical commonality requires a direct correlation between the success of the investor and the success of the promoter without a pooling of funds."[24]

a) Horizontal Commonality

Horizontal commonality exists because Concordia pooled investors' funds together in its Chino Bank account or the bank account it had before the Chino Bank

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[21] *Warfield v. Alaniz*, 569 F.3d 1015, 1020 (9th Cir. 2009); *Reves v. Ernst & Young*, 494 U.S. 56, 60 (1990) (noting that, "[i]n defining the scope of the market that it wished to regulate [via the federal securities laws], Congress painted with a broad brush"); *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967) ("[I]n searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality."); *S.E.C. v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943) ("Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a 'security.' ").

[22] *Vairo v. Clayden,* 153 Ariz. 13, 17 (App. 1987) (quoting *S.E.C. v. Glenn W. Turner Enterprises. Inc.,* 474 F.2d 476, 482 n. 7 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973)).

[23] *Vairo,* 153 Ariz. at 17; Fourth Procedural Order dated 8/13/2014 at 13:20-22.

[24] *Foy v. Thorp*, 186 Ariz. 151, 158 (1996); *Vairo,* 153 Ariz. at 17; *Daggett v. Jackie Fine Arts, Inc.*, 152 Ariz. 559, 565-66 (App. 1987); Fourth Procedural Order dated 8/13/2014 at 13:22 to 14:2.

account.[25] *See S.E.C. v. SG Ltd.,* 265 F.3d 42, 50 (9th Cir. 2001) (finding horizontal commonality in part because investors' funds were pooled in a single account); *S.E.C. v. Deyon*, 977 F. Supp. 510, 516-17 (D. Me. 1997) ("Horizontal commonality was present because the investors' money was deposited into a single account ... with each investor to receive 15% or 25% of the principal that he deposited. Thus, a pro rata sharing of the profits was present because each investor would recover an amount in proportion to the principal that he deposited."). Concordia comingled the investors' monies with monies it received from other sources, such as its collections from truckers, sales of repossessed trucks, and insurance claims.[26] Concordia held its profits in its Chino Bank account and commingled those profits with the investors' funds.[27] C. Crowder considered Concordia's Chino Bank account to be a pooled account.[28] Concordia used those pooled funds to purchase Conditional Sales Contracts and to make its interest payments to investors.[29]

If the Conditional Sales Contracts assigned to an investor were not performing, Concordia paid that investor's monthly interest payments from Concordia's other revenue sources.[30] C. Crowder testified, "If it had to come out of [Concordia's] own profits, it came out of [Concordia's] own profits."[31]

In addition, each investor received 10% or 12% annual interest on the principal that he or she invested with Concordia. As in *S.E.C. v. Deyon*, "a pro rata sharing of the profits was present because each investor would recover an amount in proportion to the principal that he deposited." 977 F. Supp. at 516. Likewise, each investor suffered a pro rata loss of 55% of his or her principal when in December 2011

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[25] Vol. I at 88:24 to 89:12 and 98:3-14.
[26] Vol. I at 96:11-23 and 98:3 to 100:1.
[27] Vol. I at 101:19 to 102:1.
[28] S-165 at 52:19-21.
[29] Vol. I at 79:16-18, 81:12-22 and 100:4-14; S-165 at 52:2-4.
[30] Vol. I at 170:24 to 171:9.
[31] Vol. I at 171:6-9.

Concordia imposed the Second Amendment.[32] These facts establish horizontal commonality. *SG Ltd.*, 265 F.3d at 50-51 (finding "horizontal commonality jumps off the screen" because "participants' funds were pooled in a single account" and "each investor was entitled to receive returns directly proportionate to his or her investment stake.").[33]

Respondents argue, "[P]ooling is determined by what the contract says, not by post-contract practices." ER Respondents Br. at 38:17-18. That argument fails, however, because the Servicing Agreements neither provide for nor prohibit Concordia's pooling of investors' funds and its own funds. The Servicing Agreements are silent on the issue of pooling, which C. Crowder testified did occur.[34]

b) Vertical Commonality

Vertical commonality exists because Concordia's ability to make the promised interest payments and return of principal payments to investors depended on its ability to collect, on a global level, on the underlying truck loans.[35] C. Crowder testified:

> Q. So am I correct that the investors' opportunity to receive, first, interest payments and, later, return of principal, depended on Concordia's ability to collect on the underlying truck financing contracts?
>
> A. Yes.[36]

Concordia's ability to collect on the underlying truck loans, in turn, depended in part on the quality of its credit checks for truck loan applicants.[37] It was important for Concordia to do proper credit checks of loan applicants so as not to take on too

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[32] Vol. III at 591:5-21, and 593:3-21.

[33] *See also S.E.C. v. Infinity Group Company*, 212 F.3d 180, 188 (3rd Cir. 2000) (finding horizontal commonality where investors' money was pooled and "the return on investment was to be apportioned according to the amounts committed by the investor."); *Deyon*, 977 F. Supp. at 516-17 (same).

[34] Vol. I at 88:24 to 89:12, 96:11-23 and 98:3 to 100:1.

[35] Vol. I at 116:6-23 and 117:10-15.

[36] Vol. I at 117:10-15.

[37] Vol. I at 116:24 to 117:6.

many borrowers who might default on their loans.[38] If too many borrowers defaulted on their loans, as happened by 2009, Concordia could not afford to make its payments to its investors.[39] Thus, there was a direct correlation between the success of Concordia in evaluating loan applicants and collecting from borrowers, and the success of the investors in receiving returns from Concordia on their investments. The fortunes of the investors were linked with those of Concordia. "[W]here an investor's avoidance of loss depends on the promoter's sound management and continued solvency, a common enterprise exists."[40]

Vertical commonality also exists where, as here, a promoter's "interest does not end upon consummation of the purchase agreement...."[41] Under the Servicing Agreements and Custodial Agreements, Respondents earned ongoing fees. Under the Servicing Agreements, the "Investor ... engages and hires Concordia as its servicing agent for all servicing matters related to the Contracts...."[42] As its fee, Concordia was "entitled to retain, during the entire term of the Contract, (a) all late payment fees, (b) all NSF charges, and (c) all interest and other fees or charges in excess of that amount required to pay Investor a [1.0% or 0.833%] per month return on the then existing balance due under the Contracts."[43] Pursuant to Section 6 of each Custodial Agreement, ER Financial received monthly custodial fees.[44] From 2004 through January 2009, ER Financial's custodial fees totaled $2,529,337.[45]

Since Respondents' interest did not end with the sale of a Servicing Agreement and Custodial Agreement to an investor, "[T]here exists a positive correlation between

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[38] Vol. I at 115:19-22.
[39] Vol. I at 115:23 to 116:2.
[40] *S.E.C. v. Eurobond Exchange, Ltd.*, 13 F.3d 1334, 1340 (9th Cir.1994) (internal quotation and citation omitted).
[41] *Daggett*, 152 Ariz. at 566.
[42] *See, e.g.*, S-12(a) at § 6.1.
[43] *See, e.g.*, S-12(a) at § 6.3.
[44] *See, e.g.*, S-12(b) at § 6.
[45] S-169.

the success of the investor and the success of the promoter. Hence, a common enterprise does exist."[46]

3. Third Element of *Howey* – Expectation of Profits through the Efforts of Others

The third prong of the *Howey* test requires that profits be derived solely from the entrepreneurial or managerial efforts of others.[47] The efforts of others must be those which affect the failure or success of the investment.[48] The efforts of others need not be those of the promoter, but can be that of any third party.[49]

Concordia asserts, "[T]he success depended on truck drivers paying on pledged loans purchased by Concordia."[50] The ER Respondents similarly assert that an "investor's recovery is determined by whether the truckers repay the specific loans...."[51] The record evidence refutes Respondents' argument. Respondents advertised, "Concordia pays whether it collects or not."[52] C. Crowder testified:

> Q. ... Prior to the first amendment, [was] there ever a situation where one investor's contracts were performing far below another's?
>
> A. There could have been, yeah.
>
> Q. And was that investor with the poorer performing truck contracts paid a different interest rate?

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[46] *Daggett*, 152 Ariz. at 566.
[47] *Daggett*, 152 Ariz. at 566.
[48] *Id.* at 566 (citing *S.E.C. v. Glenn W. Turner Enterprises, Inc.* 474 F.2d 476, 482 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973)).
[49] *Daggett*, 152 Ariz. at 566 ("[I]t is not necessary ... that the efforts be those of the promoter."); Fourth Procedural Order at 17:8-9.
[50] Concordia Br. at 13:19-20.
[51] ER Respondents' Br. at 39:21-22.
[52] S-110(h) at ACC011754.

A. No. They would have been paid whatever their sales and service agreement was stated to, either the 10 or 12 percent.

Q. Because those interest payments weren't drawn upon the success or failure of the contracts, truck contracts associated with their portfolio agreement; right?

A. Correct.[53]

If the Conditional Sales Contracts assigned to an investor were not performing, Concordia paid that investor's monthly interest payments from Concordia's other revenue sources.[54] C. Crowder testified, "If it had to come out of [Concordia's] own profits, it came out of [Concordia's] own profits."[55]

In any event, Respondents' assertions about the importance of the third party truckers paying their loans only confirm that the investors were relying in the first instance on the truckers' managerial skills to be able to make their loan payments.[56] This comports with the principle that under the *Howey* test, "[I]t is not necessary … that the efforts be those of the promoter." *Daggett*, 152 Ariz. at 566.

Mainly, however, investors were relying on the managerial skills of Concordia and the ER Respondents. Concordia held itself out as "specializ[ing] in the financial needs of the commercial used truck market."[57] It represented that its personnel included "a former bank vice president who was in charge of truck loans. He reviews and approves each contract considered by Concordia and keeps on top of collections. Typically, 90% of all accounts are paid at least a week ahead of the due date."[58]

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[53] S-165 at 50:23 to 51:11.
[54] Vol. I at 170:24 to 171:9.
[55] Vol. I at 171:6-9.
[56] *See* Fourth Procedural Order at 18:4-6.
[57] S-11(e) at ACC004247.
[58] S-11(e) at ACC004248.

Concordia represented to investors that it "guaranteed"[59] they would receive their monthly interest payments.

The ER Respondents touted Bersch's and Wanzek's credentials as Certified Public Accountants.[60] The ER Respondents represented to investors that Concordia reported to them[61] and they monitored Concordia's financial position.[62] The ER Respondents represented they would maintain the collateral, and review monthly reports and payments to the investors.[63]

The terms of the Servicing Agreement confirm the investors' reliance on the Respondents' managerial efforts. In Section 3.6, Concordia warranted to investors that before it purchased a truck loan "from any Dealer, Concordia conducts a credit check of the [truck purchaser] to determine the payment risk."[64] C. Crowder testified that warranting that Concordia had done credit checks was a way to assure investors that although the truck loans were subprime, "there was some level of value" and "we weren't just saying yes to everything."[65]

Under Sections 3.7 and 4.1 of the Servicing Agreement, Concordia agreed to transfer and assign substitute contracts to replace those in default.[66]

Under Section 6.1, the investors agreed that Concordia would act as the servicing agent responsible for "all servicing matters related to the Contracts, including but not limited to sending monthly invoices to Customers for payment, the collection of payments, correspondence and telephone communication with any Customer in default, imposition and collection of late payment fees and NSF check

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[59] S-11(e) at ACC004247.
[60] *See* S-2(e); S-2(f); S-11(f); S-110(g) at ACC011753; S-110(h) at ACC011755.
[61] S-11(f) ("CONCORDIA REPORTS TO ER FINANCIAL").
[62] S-2(f) ("As in the past, we will continue to monitor the financial condition of Concordia.").
[63] S-2(e); S-11(f); S-13(g).
[64] *E.g.*, S-12a at § 3.6.
[65] Vol. I at 114:21 to 115:5.
[66] *E.g.*, S-12a at §§ 3.7 and 4.1.

charges, initiation at Concordia's sole discretion of all collection decisions, actions and activities, including repossession, retention of attorneys or collection agents, making repairs to damaged vehicles, reselling repossessed vehicles and all other matters and decisions relating to the Contracts and the vehicles covered by the Contracts, as if in all respects Concordia remained the owner of the Contracts and had sole authority with respect to the collection and disposition of the Contracts."[67]

Section 8 of the Servicing Agreement required the Investor to acknowledge "the importance of utilizing an experienced servicing agent" to service the truckers' Conditional Sales Contracts and for that reason "the servicing fees to be paid to Concordia ... are fair and reasonable."[68] C. Crowder admitted that Section 8 reflects that the investor was relying on Concordia's efforts and experience as a servicing agent to collect the amounts due on the truck loans.[69]

Under Section 12.1, the investors granted Concordia "an irrevocable power of attorney, coupled with an interest, authorizing and permitting Concordia ... at any time, at Concordia's option, with or without notice to Investor ... to do any and all things Concordia deems necessary and proper to carry out the purpose(s) of this Agreement."[70] C. Crowder testified that through this power of attorney provision, the investors delegated to Concordia all responsibility to service the underlying Conditional Sales Contracts.[71]

Concordia argues that its payment of interest to investors does not qualify as an expectation of profits under the *Howey* test because, according to Concordia, "a static interest payment is not 'profit' directly tied to the success of the business."[72]

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[67] *E.g.*, S-12a at § 6.1.
[68] *E.g.*, S-12a at § 8.
[69] Vol. I at 151:17 to 152:1.
[70] *E.g.*, S-12a at § 12.1(g).
[71] Vol. I at 152:22 to 153:1.
[72] Concordia Br. at 16:10-11.

Concordia's argument is in conflict with directly applicable precedents from the U.S. Supreme Court, the federal Courts of Appeal, and the U.S. District Court for Arizona.

In *S.E.C. v. Edwards*,[73] the Supreme Court was tasked with deciding "whether a moneymaking scheme is excluded from the term 'investment contract' simply because the scheme offered a contractual entitlement to a fixed, rather than variable, return." *Edwards*, 540 U.S. at 391. The Court unanimously held that "an investment scheme promising a fixed rate of return can be an 'investment contract' and thus a 'security' subject to federal securities laws." *Id.* at 397. The Court rejected the same argument Concordia advances here because "unscrupulous marketers of investments could evade the securities laws by picking a rate of return to promise." *Id.* at 394–95. The Court observed that "investments pitched as low-risk (such as those offering a 'guaranteed' fixed return) are particularly attractive to individuals more vulnerable to investment fraud, including older and less sophisticated investors." *Id.* at 394.

The Third and Ninth Circuit Courts of Appeal and the U.S. District Court for Arizona have all rejected the same argument Concordia advances here. *S.E.C. v. Infinity Group Co.*, 212 F.3d 180, 189 (3rd Cir. 2000) ("[T]he definition of security does not turn on whether the investor receives a variable or fixed rate of return."); *Warfield v. Alaniz*, 569 F.3d 1015, 1024 (9th Cir. 2009) ("After *Edwards*, it is clear that fixed periodic payments of the sort promised in the present case may constitute 'profits' for purposes of the *Howey* test."), *affirming* 453 F. Supp.2d 1118, 1123 (D. Ariz. 2006) ("Despite the Defendants' assertions to the contrary, there is no reason to distinguish between promises of fixed returns and promises of variable returns for purposes of the test.") (Internal quotation omitted). Applying *Edwards*, *Infinity Group* and *Warfield*, the Commission should reject Concordia's argument.

[73] *S.E.C. v. Edwards*, 540 U.S. 389, 394-96 (2004).

4. The Cases Respondents Cite Are Inapposite.

The cases Respondents cite are distinguishable from the facts of this case. Several cases they cite involved commercial loans or loan participations made by banks or savings and loans.[74] In contrast, the transactions at issue here involved individual investors with no experience making commercial truck loans.[75] The Commission has previously found cases primarily involving transactions between two or more commercial banks to be distinguishable and unpersuasive in addressing investments by individual investors.[76] The Commission should do the same here because unlike sophisticated commercial banks, individual investors need the protections of securities laws.

Respondents' reliance on *Foy v. Thorp*[77] is misplaced for three reasons. First, in *Foy*, the real estate transaction "involved no pooling of [the investor's] funds with those of [the defendant] or other investors" so "there [was] no horizontal

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[74] *First Citizens Fed. Sav. & Loan Ass'n v. Worthen Bank & Trust Co.*, 919 F.2d 510, 512 (9th Cir. 1990) ("First Citizens Federal Savings and Loan Association ('First Citizens'), Worthen Bank and Trust Company ('Worthen'), and 20 other savings and loan institutions entered into a loan participation agreement ('Agreement') in connection with a real estate development."); *Union Nat'l Bank of Little Rock v. Farmers Bank*, 786 F.2d 881, 885 (8th Cir. 1986) ("This case involves a transaction between two banks related to participation in a note."); *Kansas State Bank in Holton v. Citizens Bank of Windsor*, 737 F.2d 1490, 1495 (8th Cir. 1984) (a bank's purchase of a loan participation certificate from another bank was not a security); *United American Bank v. Gunter*, 620 F.2d 1108, 1118 (5th Cir. 1981) (bank's participation in another bank's fully collateralized loan was not a security, but "a routine commercial financing agreement between two banks."); *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1260 (9th Cir. 1976) (note of a corporation given to a bank in exchange for a 10-month renewable line of credit was not a security); *In re Epic Mortgage Insurance Litigation*, 701 F. Supp. 1192, 1247 (E.D. Va. 1988) (defendants sold certificates of participation in mortgage loan pools to "sophisticated, federally regulated lending institutions."), *rev'd on other grounds by Foremost Guar. Corp. v. Meritor Sav. Bank*, 910 F.2d 118 (4th Cir. 1990).

[75] Vol. II at 213:13-21 [Luhr]; Vol. II at 278:24 to 279:1 [LeMay]; Vol. III at 501:9-17 [Dennison]; Vol. IV at 710:9-17 [Patricola].

[76] *See In the Matter of Radical Bunny, LLC*, Arizona Corporation Commission Decision No. 73768, 2013 WL 1209432 at *156 (3/21/2013) (distinguishing and not following *Gunter* and *Kansas State Bank*).

[77] *Foy v. Thorp*, 186 Ariz. 151 (App. 1996).

commonality."[78] In contrast, here Concordia pooled investors' funds together and with its own funds in the Chino Bank account.[79]

Second, in *Foy*, vertical commonality did not exist "because there [was] no direct correlation between the success of [the investor] and that of [the defendant]."[80] Here, however, there was a direct correlation between the success of Concordia in evaluating loan applicants and collecting from borrowers, and the success of the investors in receiving returns from Concordia on their investments.

Third, in *Foy*, "If at any time, [the investor] became dissatisfied with her choice of property managers [i.e. the defendant], she had the power to fire that manager and hire a replacement. The purchase of Broadriver Plaza was not inextricably linked to the management contract."[81]

In contrast, Section 6.3 of the Servicing Agreement provided that Concordia's appointment as the servicing agent was "irrevocable" unless (1) Concordia defaulted and failed to cure, or (2) Concordia consented to modify its appointment as the servicing agent, "which consent may be withheld by Concordia for any reason whatsoever without regard to any standard of reasonableness."[82] Thus, absent a default or Concordia's consent, which it did not have to give, an investor was obligated to use Concordia as the servicing agent.[83] Further, Section 8 expressly required that "Concordia be retained as the servicing agent during the entire term of the Contracts...."[84] Unlike the real estate that was purchased in *Foy*, the assigned truck loans were inextricably linked to Concordia's engagement as the servicing agent.

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[78] *Foy*, 186 Ariz. at 158.
[79] Vol. I at 96:11-23 and 98:3 to 100:1; S-163 [K. Crowder EUO] at 79:1-13; S-165 at 52:19-21; S-180 at 27:16 to 28:4, and 43:3-12.
[80] *Foy*, 186 Ariz. at 158.
[81] *Foy*, 186 at 158.
[82] *E.g.* S-12a at § 6.3.
[83] *E.g.* S-12a at § 6.3; Vol. I at 135:10 to 136:1.
[84] *E.g.* S-12a at § 8.

Concordia argues that investors "were at all times at liberty to withdraw [from the Servicing Agreements] … [and] manage their dedicated truck loans."[85] In support of that argument, Concordia quotes C. Crowder's inaccurate testimony that "Concordia could not stop them from doing that."[86] But Sections 6.3 and 8 of the Servicing Agreements expressly empowered Concordia to prevent investors from withdrawing and collecting on their own absent a default by Concordia or its consent, which it reserved the right to refuse "without regard to any standard of reasonableness."[87] Mr. Crowder's testimony on this issue, and Concordia's argument, should be rejected because they are contrary to the plain terms of the Servicing Agreements. Most likely because the Servicing Agreements expressly prevented investors from withdrawing and collecting on their own absent a default or consent, no investor ever asked to do so.[88]

C. Concordia's Servicing Agreements and Custodial Agreements were also Securities under *Reves* and *MacCollum*.

Respondents argue that the *Howey* test should not apply and instead the Commission should analyze the Servicing Agreements and Custodial Agreements using the "family resemblance" test articulated in *Reves v. Ernst & Young*[89] for whether a "note" is a security. Respondents' argument rests on their assertion, "The Concordia truck loan contracts are fully secured by a title lien on the big rig trucks."[90]

There are several problems and inaccuracies with Respondents' assertion. First, the use of the term "Concordia truck loan contracts" conflates Concordia's Servicing

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[85] Concordia Br. at 15:17-18.
[86] Vol. I at 104:15-16.
[87] *E.g.* S-12a at § 6.3.
[88] Vol. I at 124:23 to 125:3.
[89] *Reves v. Ernst & Young*, 494 U.S. 56 (1990).
[90] ER Respondents' Br. at 33:10-11.

Agreements with the underlying truck loan contracts (the conditional sales contracts). But they were distinct agreements. The truck loan contracts were between Concordia and the truckers. The Servicing Agreements were between Concordia and the investors. The truckers were not parties to the Servicing Agreements, and the investors were not parties to the truck loans. Conflating the Servicing Agreements with the truck loan contracts is Respondents' attempt to obscure that investors invested because Concordia, not the truckers, guaranteed it would pay them 10% or 12% annual interest.[91]

To the extent that Respondents assert that the Servicing Agreements were "fully secured"[92] by title liens, and "at the time of sale, there was 100% collateral,"[93] those assertions are contrary to the evidence. Ken Crowder testified in his EUO that sometimes Concordia did not have enough truck loans to assign so as to cover an investor's entire investment:

> Q. If I invest $100,000 with Concordia, what is done with that money?
>
> A. He signed a sales and service agreement, acknowledges the $100,000. And then Concordia goes through its inventory of contracts and comes as close as possible to 100,000 and assigns those to the investor.
>
> Q. This inventory, are they contracts that have already been purchased by Concordia?
>
> A. Correct. If there is a shortfall, then it is noted as cash waiting for investment.

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[91] *See, e.g.*, S-110(h) (advertising, "Concordia pays whether it collects or not."); S-11(e) (advertising, "Concordia: 12% Guaranteed.").

[92] ER Respondents' Br. at 33:10-11.

[93] ER Respondents' Br. at 35:20-21.

Q. And what was done with that shortfall?

A. It was kept as a record until it could be replaced with a contract.[94]

Thus, because there were "shortfalls," there was not 100% collateral and investors were not fully secured.

Investors were also not fully secured because the vehicle title liens were never in their names:

> Q. So were the trucks then titled in the investor's name?
>
> A. It's a long explanation.... The titles were – Concordia was placed as the lienholder in order to maintain collection ability on it. The titles were signed on the back so that the customer, the investor, could then go down to their custodian, take all his titles, take them down to DMV, put them in their name, and they could start collecting....[95]

Thus, the vehicle title liens were in Concordia's name. Concordia was secured. The investor, while potentially able to become the lienholder, never actually was secured.

Reves' "family resemblance" test was adopted as law in Arizona in *MacCollum v. Perkinson*[96] to determine whether a note is a security for the purposes of the antifraud provisions of the Securities Act. The test begins with the presumption that every note is a security.[97] This presumption may be rebutted only if Respondents show that the note bears a strong resemblance, determined by examining four specified factors, to one of a judicially-crafted list of instruments that are not securities, or if those factors

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[94] S-163 at 75:11-25.
[95] S-180 at 29:17 to 30:4.
[96] *MacCollum v. Perkinson*, 185 Ariz. 179 (App. 1996).
[97] *Reves*, 494 U.S. at 65.

establish a new category of instrument that should be added to the list.[98] This list of notes "that are not securities includes ... the short-term note secured by a lien on a small business or some of its assets...."[99]

Respondents assert that the Concordia investments were "'notes secured by a lien on a business or its assets.'" ER Answering Br. at 33:9-10 (quoting *MacCollum*, 185 Ariz. at 186-87). In referencing "notes secured by a lien on a business or its assets" as an example of non-securities, *MacCollum* was quoting from a footnote in *State v. Tober*, 173 Ariz. 211, 212 n.3 (1990). *Tober* in turn was paraphrasing *Reves*, 494 U.S. at 65.

As recited above, the actual quote from *Reves* as to an example of a note that is not a security is a "***short-term*** note secured by a lien on a small business or some of its assets." 494 U.S. at 65 (emphasis added). Even if Concordia's investments are considered to be notes, they were not short-term notes. The underlying truck loans were of a three-year term.[100] The Servicing Agreements went on indefinitely until Concordia imposed the First Amendment in 2009. Thus, Respondents' argument that Concordia's investments were not securities fails because the investments do not fit the "short-term note" exception from *Reves*.

In addition, none of *Reves*' four factors militates in favor of finding the investments to be non-securities. The first *Reves* factor assesses the motivations of the buyer and seller to enter into the transaction at issue. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments, and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a security.[101]

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[98] *Reves*, 494 U.S. at 65. Since both inquiries involve application of the same four-factor test, they "essentially collapse into a single inquiry." *S.E.C. v. Wallenbrock*, 313 F.3d 532, 537 (9th Cir. 2002).

[99] *Reves*, 494 U.S. at 65.

[100] S-110(g) at ACC011750; S-193 at ACC015216.

[101] *Reves*, 494 U.S. at 66-67.

Concordia was in the business of purchasing truck loans from used big rig dealers and collecting the payments.[102] Concordia sought capital from investors to purchase more truck loans and service them.[103] Investors wanted to generate a stream of income and profit.[104] This first factor weighs heavily in favor of finding Concordia's investments to be securities.

Respondents assert, "[T]he proceeds were not used for Concordia's general business purposes, but to fund specific loans to truckers."[105] That assertion is contrary to the evidence. C. Crowder testified that Concordia used the investors' principal to operate its business, purchase additional loans and pay its overhead.[106]

Further, contrary to Respondents' assertion, an investor's money was not used to fund specific loans to truckers. Rather, Concordia assigned truck loans to investors from Concordia's existing inventory of such loans.[107] Kenneth Crowder testified:

> Q. The investor invests 100,000 with Concordia.... [D]oes Concordia then take that 100,000 and go to the dealer and say, "I want to buy some contracts that get me as close to 100,000 as possible"?
>
> A. No.
>
> Q. Those contracts are already in Concordia's portfolio?
>
> A. Correct.[108]

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[102] Amended Notice at ¶ 10 and Concordia's Answer dated 7/17/2015 at ¶ 10; S-11(e); Vol. I at 70:8-20.

[103] Amended Notice at ¶ 10 and Concordia's Answer dated 7/17/2015 at ¶ 10; S-163 at 26:20-27:5; S-11(e).

[104] Vol. II at 214:3-5 [Luhr]; Vol. II at 279:17 to 280:1 [LeMay]; Vol. III at 453:18 to 454:1 [Hatch]; Vol. III at 501:25 to 502:7 [Dennison]; Vol. IV at 710:22 to 711:7 [Patricola].

[105] ER Respondents' Br. at 34:5-6.

[106] S-165 at 71:2-11; Vol. I at 158:25 to 159:9

[107] S-163 at 75:11-20 and 80:8-18; S-110(h) ("Concordia Finance buys conditional sales contracts. These are then packaged and sold to the investor under a Sales and Service Agreement.").

[108] S-163 at 80:8-18.

Thus, Concordia had already fully funded the truck loans before an investor invested.

The second *Reves* factor examines the plan of distribution to determine if the "note" is an instrument in which there is "common trading for speculation or investment."[109] "Offering and selling to a broad segment of the public is all that is required to establish the requisite 'common trading' in an instrument."[110] "If notes are sold to a wide range of unsophisticated people, as opposed to a handful of institutional investors, the notes are more likely to be securities." *S.E.C. v. Zada*, 787 F.3d 375, 381 (6th Cir. 2015) (finding notes were securities when defendant sold them "to about 60 people in two states."). However, the number of investors is not dispositive, but must be weighed against the purchasers' need for the protection of the securities laws.[111] Courts find common trading when individuals, as opposed to financial institutions, were solicited.[112]

Here, Respondents sold 132 investments comprised of a Servicing Agreement and an accompanying Custodial Agreement.[113] The sales were to individual investors, not sophisticated financial institutions. Most investors resided in Arizona, but twenty investors had addresses in Colorado, Hawaii, North Carolina, California, Oregon, Washington, Georgia, Arkansas, New Mexico or Texas.[114] The investors included a retired deputy sheriff,[115] a retired respiratory therapist,[116] a retired firefighter,[117] and a

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[109] *Reves*, 494 U.S. at 68-69.

[110] *MacCollum*, 185 Ariz. at 187 (quoting *Reves*, 494 U.S. at 68 and citing *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 694 (1985) (stock of closely held corporation not traded on any exchange held to be a security)).

[111] *McNabb v. S.E.C.*, 298 F.3d 1126, 1132 (9th Cir. 2002).

[112] *Stoiber v. S.E.C.*, 161 F.3d 745, 751 (D.C. Cir. 1998); *S.E.C. v. Global Telecom Services, L.L.C.*, 325 F. Supp. 2d 94 (D. Conn. 2004) (the plan of distribution factor was met where notes were sold to five individuals).

[113] *See* Stipulation for Admission of Certain Securities Division Exhibits.

[114] Stipulation No. 2, filed 12/9/2017.

[115] Vol. II at 201:14-17 [Luhr].

[116] Vol. II at 265:16-17 [LeMay].

[117] Vol. III at 444:23-25 [Hatch].

retired mechanical salesman.[118] The protections of securities laws would have benefitted the investors in this case.[119] As a result, the second *Reves* factor supports finding that the Servicing Agreements and Custodial Agreements are securities.

The third *Reves* factor examines the reasonable expectations of the investing public.[120] This factor, which is "closely related" to the first factor,[121] accounts for "whether a reasonable member of the investing public would consider these notes as investments."[122] Respondents promoted Concordia's Servicing Agreements and Custodial Agreements as investments. For example, Respondents distributed a brochure titled "Concordia Finance: Investing in Transportation," which described the "Investment Opportunity,"[123] not a commercial loan. Respondents' marketing materials also compared the performance of Concordia's investments to the Dow Jones Industrial Average[124] and touted, "You can lock in guaranteed returns that beat the 20 year stock market average rate of return...."[125] The Servicing Agreements and Custodial Agreements defined the individual entering those agreements with Concordia as the "Investor."[126]

When promoters characterize instruments as "investments" it is "reasonable for a prospective purchaser to take [the promoters] at [their] word."[127] The third *Reves* factor strongly supports finding that the Servicing Agreements and Custodial Agreements are securities.

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[118] Vol. III at 496:8-10 [Dennison].
[119] *See In the Matter of Shadow Beverages*, Arizona Corporation Commission Decision No. 76155 dated 6/22/2017, 2017 WL 2797400 at *28.
[120] *Reves*, 494 U.S. at 68.
[121] *S.E.C v. J.T. Wallenbrock & Associates*, 313 F.3d 532, 539 (9th Cir. 2002).
[122] *McNabb*, 298 F.3d at 1132.
[123] S-11(e); S-13(f); S-110(e); S-189.
[124] S-11(e); S-13(f); S-110(e); S-189. *See also* S-193 at ACC015231 (comparing returns on Concordia's Servicing Agreements to the stock market).
[125] S-13(h) at ACC004313; S-193 at ACC015234.
[126] *See, e.g.,* S-12(a) *passim*; S-12(b) *passim*.
[127] *Reves*, 494 U.S. at 69.

The fourth and final factor is whether there are risk-reducing factors that would diminish the need for protection under the Securities Act, such as the presence of other regulatory schemes or collateral.[128] There was no regulatory scheme that would significantly reduce the risk of Concordia's investments and thereby render the application of the securities laws unnecessary.

Respondents argue that investors' risk was reduced because the title liens on the big rig trucks served as collateral, and because of the substitute contract provision in Section 3.7 of the Servicing Agreements. As detailed above, however, the vehicle title liens were in Concordia's name, not the investors'.[129] Concordia was collateralized, but the investors never actually were.

Moreover, the title liens and the substitute contract provision did nothing to protect the investors when Concordia eliminated their interest payments and later wrote off 55% of the investors' principal. Indeed, in November 2010, Concordia instructed ER Financial to return the vehicle titles to it, notwithstanding that Section 4.3 of the Servicing Agreement prohibited ER Financial from doing so without the investors' written authorization, which it did not have.[130] Wanzek sent the titles back to Concordia anyway.[131] At that point, the investors' purported collateral was gone.[132] Accordingly, neither the title liens nor the substitute contract provision can be seen as alleviating the need for protection under the Act.[133]

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[128] *Reves*, 494 U.S. at 67; *see also McNabb*, 298 F.3d at 1132-33 ("[T]his factor weighs in favor of finding that the promissory notes at issue in this case were actually securities because without such a classification there is the potential that the lender may be left open to significant risk.).

[129] S-180 at 29:17 to 30:4.

[130] Vol. III at 600:12-15.

[131] S-161 at ¶ 4.

[132] Vol. IX at 1697:2-8.

[133] *See In the Matter of Shadow Beverages*, Arizona Corporation Commission Decision No. 76155 dated 6/22/2017, 2017 WL 2797400 at *30 (respondent's personal guaranties did little to protect the purchasers from default or to enforce repayment).

If, as Respondents argue, Concordia's investments should be considered notes, under Arizona law they are presumed to be securities. Applying the family resemblances test under *Reves*, the investments do not resemble instruments on the *Reves* list, and the evidence does not establish that they should be added to that list. Accordingly, the Commission should find that the Servicing Agreements and Custodial Agreements Respondents sold are subject to the antifraud provisions of the Act.

D. The Promissory Notes Concordia Sold Were Securities.

The ER Respondents' argument that Concordia's investments were not securities but instead "notes secured by a lien"[134] does not apply to the seven (7) Promissory Notes Concordia sold.[135] Those Promissory Notes do not reference any lien or collateral.[136] Nothing secured them.

The Division's Opening Brief explained why Concordia's Promissory Notes were securities under Arizona law for registration purposes.[137] Notes are included within the statutory definition of a security and the Arizona Supreme Court has held that notes are therefore subject to registration requirements unless exempted by statute.[138]

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[134] ER Respondents' Br. at 33:9-10.

[135] The Division does not allege that the ER Respondents offered or sold Concordia's Promissory Notes or that the ER Respondents have any liability for them. Concordia is solely liable for its sales of the seven Promissory Notes.

[136] *See* S-35(e) [Edmonds Note for $42,000 dated 2/28/2007]; S-35(f) [Edmonds Note for $208,000 dated 1/10/2007]; S-87(e) [Santy Note dated 9/16/2002]; S-103(a) [Guest Note dated 11/6/2006 for $225,000]; S-105(a) [Kollars Two Year Note dated 11/6/2006 for $53,109]; S-115e [Ferris-Spence Note dated 3/7/2001 for $200,000]; and S-115f [Ferris-Spence Note dated 5/7/2005 for $200,000].

[137] *See* Division's Opening Br. at 55:16 to 56:18.

[138] *State v. Tober*, 173 Ariz. 211, 213 (1992).

In its Answering Brief, Concordia did not respond to or otherwise address the Division's argument. "Failure to respond in an answering brief to a debatable issue constitutes confession of error." *Chalpin v. Synder*, 220 Ariz. 413, 423, ¶ 40 n.7 (App. 2008); *Hecla Min. Co. v. Indus. Comm'n*, 119 Ariz. 313, 314 (App. 1978) (same). Thus, Concordia has effectively conceded that the Promissory Notes it sold were securities under Arizona law.

Moreover, Concordia presented no evidence at the hearing that any exemption would apply to its Notes. Accordingly, the Notes are securities for purposes of the registration provisions of the Securities Act.

III. NO EXEMPTIONS FROM REGISTRATION APPLY

A. A.R.S. § 44-1843(A)(10)'s Exemption for Notes Secured by Mortgages or Deeds of Trust on Chattel Does Not Apply.

It is the Respondents' burden to prove any exemption from registration. A.R.S. § 44-2033. Because of the vital public policies underlying the Act's registration requirements, all exemption requirements must be strictly complied with. *State v. Baumann*, 125 Ariz. 404, 411 (1980) ("[T]he statutes requiring registration of securities and dealers are designed to make the possibility of fraud even more remote.").

A.R.S. § 44-1843(A)(10) exempts from the Securities Act's registration requirements "Notes ... secured by a mortgage or deed of trust on ... chattels, or a contract or agreement for the sale of ... chattels, if the entire mortgage, contract or agreement together with all notes ... secured thereby is sold or offered for sale as a unit." Respondents argue this exemption applies to what they call "Concordia's truck loan contracts."[139] Respondents are wrong for several reasons.

[139] ER Respondents' Br. at 43:3.

First, as explained above, Respondents' use of the term "Concordia's truck loan contracts" improperly conflates Concordia's Servicing Agreements with the underlying truck loan contracts. They were not the same.

Second, the Servicing Agreements did not contain the words "note," "chattel," "secured", "mortgage" or "deed of trust." Rather, the Servicing Agreements used the term "Investor" throughout. Respondents' marketing materials described an "Investment Opportunity"[140] and compared and contrasted the projected investment returns to the Dow Jones Industrial Average[141] and stock market.[142] At the hearing, no investor testified that he or she thought they were buying notes secured by mortgages or deeds of trust on chattel.

Respondents inaccurately assert, "Here, each [Servicing Agreement] applied to specific truck loans, each with a fully secured title loan [*sic*]."[143] Both parts of that statement are unsupported by the evidence. The "Exhibit A"s to all of the Servicing Agreements, which were supposed to list the assigned truck loans, are blank. Respondents did not introduce, and do not point to, any evidence of which truck loans were assigned under any of the Servicing Agreements.

The evidence also contradicts Respondents' assertion that each Servicing Agreement was fully secured. As noted above, Ken Crowder testified in his EUO that sometimes Concordia did not have enough truck loans to assign so as to cover an investor's entire investment, so there were "shortfalls."[144] Thus, the Servicing Agreements were not always fully secured.

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[140] S-11(e) - Brochure entitled "Concordia Finance: Investing in Transportation."
[141] S-11(e) - Brochure entitled "Concordia Finance: Investing in Transportation" at ACC004247.
[142] S-13(h) at ACC004313; S-193 at ACC015234.
[143] ER Respondents' Br. at 43:18-19. Presumably Respondents intended "lien" and not "loan."
[144] S-163 at 75:11-25.

Moreover, under the Servicing Agreements, the vehicle title liens were in Concordia's name, not the investor's name.[145] The investor, while potentially able to become the lienholder, never actually was secured. This fact distinguishes this case from *Blute v. Terrazas*,[146] which Respondents cite. In that case, the note purchaser received a security interest in inventory.[147] Here, the investors never actually were secured because the vehicle title liens were in Concordia's name.

Finally, Concordia's Servicing Agreements were not "sold or offered for sale as a unit"[148] with the underlying truck loans. Rather, the truck loans were not assigned until after an investor had already purchased the Servicing Agreement. Ken Crowder testified in his EUO regarding the timing of the investor's investment and the assignment of the truck loans:

> Q. If I invest $100,000 with Concordia, what is done with that money?
>
> A. He signed a sales and service agreement, acknowledges the $100,000. And then Concordia goes through its inventory of contracts and comes as close as possible to 100,000 and assigns those to the investor.[149]

If Concordia did not have enough truck loans to assign to cover the entire amount an investor invested through a Servicing Agreement, Concordia noted the shortfall "as cash waiting for investment"[150] and kept a record of it until it could assign another truck loan to cover the shortfall.[151]

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[145] Vol. I at 103:1-11; S-180 at 29:17 to 30:4.
[146] *Blute v. Terrazas*, 166 Ariz. 111 (App. 1990).
[147] *Blute*, 166 Ariz. at 112 ("The notes issued to Dr. Blute were secured by a financing statement in inventory.").
[148] A.R.S. § 44-1843(A)(10).
[149] S-163 at 75:11-17.
[150] S-163 at 75:20-21.
[151] S-163 at 75:22-24.

Similarly, C. Crowder testified the truck loans were not assigned until after an investor had already invested:

> Q. Okay. So Investor Joe Schmoe sends his money in, and Concordia selects which truck titles and truck financing contracts are going to be pledged to that investor's account, correct?
>
> A. Correct. But –
>
> Q. And the investor doesn't have – the investor didn't have any input as to what contracts were assigned to his portfolio?
>
> A. No.[152]

Thus, Concordia's Servicing Agreements were not "sold or offered for sale as a unit"[153] with the underlying truck loans. The exemption from registration in A.R.S. § 44-1843(A)(10) does not apply.

B. Concordia's Securities Were Not Exempt from Registration Based on Regulation D or R14-4-126.

Respondents have failed to prove that Concordia's securities were exempt from registration pursuant to Regulation D, Rule 505[154] ("Rule 505"), Regulation D, Rule 506[155] ("Rule 506"), or A.A.C. R14-4-126 because they have failed to prove several requirements that are shared by some or all of the relevant exemptions.

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[152] S-180 at 40:10-18.

[153] A.R.S. § 44-1843(A)(10).

[154] 17 C.F.R. § 230.505

[155] All references to Rule 506 refer to 17 C.F.R. § 230.506(b) because 17 C.F.R. § 230.506(c) was not in effect until July 24, 2013, after the relevant timeframe. *See* 78 FR 44770.

1. Concordia's securities did not satisfy the prohibitions against general solicitation and general advertising for Rule 505, Rule 506, and R14-4-126

Respondents have not proven that Concordia's securities were sold without any general solicitation or general advertising. One of the general conditions of Rule 505, Rule 506, and A.A.C. R14-4-126 is that the securities may not be offered or sold by any form of general solicitation or general advertising by the issuer or anyone acting on its behalf. 17 C.F.R. § 230.502(c); A.A.C. R14-4-126(C)(3).

"One of the benchmarks of a general solicitation is contacting potential investors with no previous relationship to the issuer or persons promoting the offering." Thomas Lee Hazen, 1 *The Law of Securities Regulation* § 4:77 (May 2017 Update). Advertisements and other generally directed offers to sell clearly constitute a general solicitation. *Id.* Similarly, contacting a wide variety of potential purchasers without regard to their wealth or investment sophistication will be a general solicitation. *Id.*

Substantial evidence demonstrates that Respondents used general solicitation and general advertising to offer and sell Concordia's investments. For example, Concordia's "Investing In Transportation" brochure advertised that Concordia "Has Contracts Available for Purchase Now," without any restrictions as to which investors from the general public were eligible to invest. S-11(e); S-13(f); S-110(e); S-189. Accordingly, Concordia's "Investing In Transportation" brochure was a general solicitation.

Another advertising flyer titled "Fixed Base Income at 12% - Guaranteed!" described one way in which Bersch and Concordia advertised the investment to a wide variety of potential purchasers without regard to their wealth or investment sophistication:

> Michael Bersch, CPA, is a club member and also on the board of Concordia Finance. He saw the "FELLOW CLUB MEMBERS: SHOW US WHAT YOU'VE GOT!" request in our newsletter and contacted Stephen Seal. As a result, Concordia Finance was an exhibitor at the December meeting in Palm Springs and many of our oxford club members expressed interest and wanted to know more about this opportunity.[156]

The flyer continued: "Concordia invites interested investors to contact them for more information.... Investor relations is handled by the office in Lake Havasu City, Arizona. You may wish to contact either Michael Bersch, CPA or David Wanzek, CPA...." S-110(h) at ACC011755. *See also* S-110(g), which is another advertisement inviting "interested investors" to contact Concordia without regard to the potential investors' wealth or sophistication.

There is no evidence that these advertisements were intended to or did reach only potential investors who had a pre-existing relationship with Concordia. Wanzek testified that some people contacted him and invested without having any prior relationship with him.[157]

No one at Concordia ever requested to review the marketing materials and sales pitches Bersch, Wanzek or ER Financial were using.[158] Concordia did not supervise the marketing of its investments by Bersch, Wanzek or ER Financial.[159] Neither C. Crowder nor anyone else at Concordia ever asked Bersch, Wanzek or ER Financial what they were telling investors.[160] C. Crowder did not have any interest in knowing what Bersch, Wanzek and ER Financial were telling investors.[161]

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[156] S-110(h) at ACC011754.
[157] Vol. IX at 1602:12-20.
[158] Vol. I at 93:17-21.
[159] Vol. I at 129:1-12.
[160] Vol. I at 93:22-25.
[161] Vol. I at 94:15-18 and 130:8-10.

Concordia did not do anything to determine if an investor had the financial wherewithal to invest.[162] Concordia did not receive any questionnaires or other materials to determine whether an investor was an accredited investor.[163]

Respondents engaged in general advertising and solicitation. *See In the Matter of Prendergast*, Complaint No. C3A960033, 1999 WL 1022140 at *20 (N.A.S.D.R. 7/8/1999) ("Here, the advertisement invited the general public to attend Prism's seminar to learn how to invest in hedge funds. There is no evidence that the advertisement was intended to or did reach only potential investors who had a pre-existing relationship with Prism. Accordingly, we find that Prism's advertisement constitutes a 'general solicitation.'").

2. Concordia did not meet the limitations on resale requirements of Rule 505, Rule 506, and R14-4-126

Respondents have not proven that Concordia took the necessary steps to prevent resale of its securities. Rule 505, Rule 506, and A.A.C. R14-4-126 all require that an issuer exercise reasonable care to assure that its securities are not purchased by underwriters. 17 C.F.R. § 230.502(d); R14-4-126(C)(4). Respondents have not argued that Concordia took such reasonable care, and, in fact, it did not. There are three non-exclusive ways to demonstrate reasonable care: 1) reasonable inquiry about whether investors are buying the securities for others instead of for themselves, 2) written disclosure to investors that the securities cannot be resold without registration or an exemption, and 3) placing a legend on the securities stating that they are not registered and referring to limits on transferability of the securities. 17 C.F.R. § 230.502(d)(1), (2), (3); A.A.C. R14-4-126(C)(4)(a), (b), (c). There is no evidence that Concordia took any of these steps, nor any similar steps.

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[162] Vol. I at 96:24 to 97:2.
[163] Vol. I at 97:3-9.

On the contrary, Concordia's Servicing Agreements expressly contemplated that investors could resell the securities to others.[164] By failing to use reasonable care to limit resale of the securities, Respondents have failed to prove that these exemptions apply.

3. Concordia's securities did not meet the information requirements of Rule 505, Rule 506, and R14-4-126

Respondents have not proven that the non-accredited investors in Concordia's securities received required financial information before investing. Rule 505, Rule 506, and R14-4-126 require that all non-accredited investors receive financial information about the issuer before investing. 17 C.F.R. § 230.502(b)(2)(i)(B); A.A.C. R14-4-126(C)(2)(b).

Seeking to avoid the exemption's information requirements, Respondents' analysis parses out the investments over ten years to minimize the sales as being on average "about $2.56 million per year."[165] The investments, however, were part of an integrated offering by Concordia. *See* 17 C.F.R. § 230.502(a); A.A.C. R14-4-126(C)(1)(c). The factors to be considered in determining whether offers and sales should be integrated for purposes of the exemptions under Regulation D and A.A.C. R14-4-126 are:

(a) Whether the sales are part of a single plan of financing;

(b) Whether the sales involve issuance of the same class of securities;

[164] *See*, e.g., S-12a at Section 7.
[165] ER Respondents' Br. at 45:3-4.

(c) Whether the sales have been made at or about the same time;

(d) Whether the same type of consideration is being received; and

(e) Whether the sales are made for the same general purpose.[166]

Except for the third factor, each of these factors demonstrates an integrated offering by Concordia. Concordia sold its investment contracts as part of a single plan of financing. The sales involved issuance of the same class of securities, namely investment contracts comprised of Servicing Agreements and Custodial Agreements.[167] All of Concordia's Servicing Agreements and Custodial Agreements were substantially identical to each other except for the name of the investor, the amount of the investment, the date and the interest rate, which was either 10% or 12% annually.[168] Concordia received the same type of consideration, cash, from investors via checks or wire transfers.[169] The sales were made for the same general purpose: for Concordia to purchase additional truck loans, pay its overhead and operate its business.[170]

Because Concordia's securities offering was over $7.5 million, Concordia was required to provide all non-accredited investors with the financial statements that would be required in a registration statement, namely, a balance sheet and a profit and

[166] 17 C.F.R. § 230.502(a); A.A.C. R14-4-126(C)(1)(c).
[167] Amended Notice at ¶ 10 and Concordia's Answer dated 7/17/2015 at ¶ 10; Vol. I at 77:9-23.
[168] Vol. X at 1908:17 to 1909:4; Vol. I at 147:4-7.
[169] Vol. I at 96:11-16.
[170] S-165 at 71:2-11; Vol. I at 158:25 to 159:9

loss statement, both certified by an independent CPA or public accountant. 17 C.F.R. § 230.502(b)(2)(i)(B)(3); R14-4-126(C)(2)(b)(iv)[171]. *See* 15 U.S.C. § 77aa(25), (26). There is no evidence that all, or any, of Concordia's non-accredited investors received such documents as required by these exemptions.

4. Respondents have failed to prove that all non-accredited Concordia investors were sophisticated as required by Rule 506 and R14-4-126

Respondents have not proven that each Concordia investor was either an accredited investor or a sufficiently sophisticated investor. Rule 506 and the corresponding provision of R14-4-126 require that each investor who is not an accredited investor have "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment," or that the issuer reasonably believes that to be true. 17 C.F.R. § 230.506(b)(2)(ii); R14-4-126(F)(2)(b).

Respondents cannot prove that Concordia met this requirement for each non-accredited investor for two reasons. First, there is no evidence that Concordia did anything to determine an investor's sophistication. Concordia did not receive any questionnaires or other materials regarding an investor's qualifications.[172] Because it did nothing to determine investors' sophistication, Concordia could not have reasonably believed all its non-accredited investors were sophisticated.

Second, Respondents do not even claim to know who all of the non-accredited investors are. Respondents speculate, "[I]t is more likely than not that no more than 35 non-accredited investors purchased the truck loan contracts."[173] This effectively

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[171] This provision was numbered R14-4-126(C)(2)(b)(i)(2)(c) prior to September 28, 1999.

[172] *See* Vol. I at 97:3-9 (Concordia did not receive any questionnaires or other materials to determine whether an investor was an accredited investor).

[173] ER Respondents' Br. at 45:8-9.

concedes that the Respondents cannot prove exactly how many non-accredited Concordia investors there are, which means they cannot prove the identity and sophistication of each non-accredited investor to meet the requirement. *See Johnston v. Bumba*, 764 F. Supp. 1263, 1276 (N.D. Ill. 1991) (issuer failed to prove investors' sophistication where issuer presented evidence as to some, but not all, investors).

Even among the non-accredited investors that Respondents do identify, not all of them were sufficiently sophisticated to be capable of evaluating the merits and risks of the Concordia investment, as required by Rule 506 and R14-4-126. For example, Gerald Hoffort, despite having some business knowledge and experience, was not able to correctly evaluate the liquidity risks of his Concordia investment. Mr. Hoffort testified that his understanding was that Concordia would repay his investment at any time if he asked, but, in fact, Concordia was under no obligation to repay Mr. Hoffort's investment upon demand and was not even required to repay him by a fixed maturity date.[174]

Investor Wesley Luhr also lacked the knowledge and experience in financial and business matters needed to evaluate the merits and risks of his Concordia investment. Before investing, Mr. Luhr had no experience with any business like Concordia.[175] He had some investing experience but was not very successful at it, and he invested in Concordia based on his trust in Bersch.[176] Mr. Luhr understood generally that higher interest rates indicate higher risks.[177] However, he did not have enough investment experience to understand that the 10% interest rate on his Concordia investment indicated a high degree of risk, and he instead mistakenly believed that his investment involved "very, very little risk."[178] Mr. Luhr also

[174] Vol. XI at 2091:25 to 2092:7; S-152a
[175] Vol. II at 212:17-20
[176] Vol. II at 212:7-15
[177] Vol. II at 236:23-25
[178] Vol. II at 208:23 to 209:5

mistakenly believed that his Concordia investment was "very liquid" and that he could get his principal back at any time.[179]

C. The Non-Public Offering Exemption Does Not Apply to Respondents' Sales of Concordia's Investment Contracts.

Nor were any of Respondents' securities sales exempt as "transactions by an issuer not involving any public offering" ("Non-Public Offering") pursuant to the Act. *See* A.R.S. § 44-1844(A)(1). Although there is no Arizona authority on the meaning of A.R.S. § 44-1844(A)(1), it is identical to Section 4(a)(2) of the federal Securities Act of 1933. *See* 15 U.S.C. § 77d(a)(2). Therefore authorities on Section 4(a)(2) should be used as an interpretive guide for the Non-Public Offering provision of the Act. *See* Laws 1996, Ch. 197, § 11(C) (Legislature intends that court interpretations of substantially similar federal securities provisions be used as interpretive guide for the Act).

The federal Non-Public Offering provision only exempts offerings in which the offerees can "fend for themselves" and do not need the protection of a securities registration statute, such as the executive officers of the issuer. *See S.E.C. v. Ralston Purina Co.*, 346 U.S. 119, 125-26 (1953). "A court may only conclude that the investors do not need the protection of the [Securities Act of 1933] if all of the offerees have relationships with the issuer affording them access to or the disclosure of the sort of information about the issuer that registration reveals." *S.E.C. v. Murphy*, 626 F.2d 633, 647 (9th Cir. 1980). The information required is "quite extensive." *Id.* at 645. The test for the federal Non-Public Offering exemption is based on, 1) the number of

[179] Vol. II at 205:8–14

offerees, 2) the sophistication of the offerees,[180] 3) the size and manner of the offering, and 4) the relationship of the offerees to the issuer. *Id.* at 644–645.

In the present case, however, it is not necessary to analyze these factors because Respondents cannot prove that the Non-Public Offering exemption applies based on the hearing record. "The party claiming the exemption must show that it is met not only with respect to each purchaser, but also with respect to each offeree." *Murphy*, 626 F.2d at 645. This proof "must be 'explicit, exact and not built on conclusory statements'" of Respondents. *Bumba*, 764 F. Supp. at 1273 (*quoting S.E.C. v. Continental Tobacco Co.*, 463 F.2d 137, 156 (5th Cir. 1972)). Therefore "... the exact number and identity of all offerees must be produced." *Western Fed. Corp. v. Erickson*, 739 F.2d 1439, 1442 (9th Cir. 1984).

The hearing record does not establish the identity of all of Concordia's offerees or even the number of offerees. There is no evidence in the record about the identity or sophistication of each offeree or their relationship to Concordia.

Because they have not proved the exact number, identity and sophistication of all of the offerees, Respondents have failed to prove the Non-Public Offering exemption applies. *See Western Fed. Corp.*, 739 F.2d at 1442 (private offering exemption did not apply because investment promoters failed to prove the exact number and identity of all offerees); *Murphy*, 626 F.2d at 645 (without introducing evidence on the number of offerees, defendant could not establish private offering exemption); *Bumba*, 764 F. Supp. at 1279 (holding that private offering exemption did not apply because court "simply did not learn enough about the entire class of purchasers and offerees so as to conclude that they did not need the protections of the Act.").

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[180] Sophistication is a factor, but it is "not a substitute for 'access to the kind of information which registration would disclose.'" *U.S. v. Custer Channel Wing Corp.*, 376 F.2d 675, 678 (4th Cir. 1967) (quoting *Ralston Purina*, 346 U.S. at 127).

IV. BERSCH, WANZEK AND ER FINANCIAL COMMITTED SECURITIES FRAUD IN VIOLATION OF A.R.S. § 44-1991(A).

The ER Respondents are correct that the Division has withdrawn its theories that Bersch, Wanzek and ER Financial violated § 44-1991(A) by misrepresenting that they were Concordia's "investor relations office" and that a third-party insurer had approved the sale of Concordia's investments. In addition, although the ER Respondents' argument is not well taken, in order to reduce the issues on which these Respondents will inevitably appeal, the Division will agree to withdraw its assertion that they also committed fraud by: (i) misrepresenting to investors that the investments offered "low risk" and "safety of principal"; and (ii) failing to disclose Concordia's losses and rapidly deteriorating financial condition to Mrs. Patricola before she invested $150,000 in 2008.

That being said, Bersch, Wanzek and ER Financial made over $3.09 million in commissions and custodial fees[181] for selling Concordia's securities through multiple misrepresentations and omissions of material facts.

A. "Liquid"

Bersch and Wanzek sold Concordia's securities by misrepresenting that the investor's investment in Concordia would be liquid and/or the investor could get his or her money out.[182] For example, presentations Respondents gave investors represented:

- "Servicing Agreements provide safety of principal and ***100% liquidity*** in the event of emergency need;" and

[181] S-194 at pages 1 and 2 of 3.

[182] Luhr - Vol. II at 205:8-14; LeMay - Vol. II at 419:20 to 420:19; Hatch - Vol. III at 448:17 to 449:9; Dennison - Vol. III at 498:11-20; Patricola - Vol. IV at 707:12-17 and 763:21-24; Fuhrman - Vol. VII at 1350:15 to 1351:3; Hospice - Vol. VII at 1351:17 to 1352:1; Pike - S-13h at ACC004312; S-193 at ACC015233.

- "Higher guaranteed yield to offset inflation, safety of principal backed by collateral and ***100% liquidity*** has made Concordia Servicing Agreements the preferred fixed income investment for many of our clients."[183]

Specifically, Bersch sold Concordia's securities to the following investors by misrepresenting their investment would be liquid and/or the investor could get his or her money out if necessary:

Investor	**Transcript and/or Exhibit**	**Servicing Agreement**	**Custodial Agreement**	**Date**
Luhr	Vol. II at 205:8-14 ("it was very liquid").	S-11a	S-11b	5/11/2004
LeMay	Vol. II at 419:20 to 420:19.	S-2a	S-2b	4/30/2002
Dennison	Vol. III at 498:11-20.	S-17a	S-17b	3/30/2000
Patricola	Vol. IV at 707:12-17 and 763:21-24	S-18a	S-18b	4/1/2008 and 11/6/2008 (S-190 at ACC004727)
Fuhrman	Vol. VII at 1340:16-20; S-193 at ACC015233	S-110a	S-110b	11/25/2005
Hospice of	Vol. VII at	S-111a	S-111b	12/1/2005

[183] S-13(h) at ACC004312 and S-193 at ACC015233 (emphases added).

Havasu	1340:21 to 1341:13			

Wanzek sold Concordia's securities to the following investors by misrepresenting their investment would be liquid and/or the investor could get his or her money out if necessary:

Investor	**Transcript**	**Servicing Agreement**	**Custodial Agreement**	**Date**
Hatch	Vol. III at 448:17 to 449:9 ("it was, you know, basically liquid")	S-108a	S-108b	12/1/2005
McCowan	Vol. VII at 1350:15 to 1351:3.	S-88a	S-88b	11/1/2002
Martin	Vol. VII at 1351:17 to S-1352:1	S-54a	S-54b	2/17/2004
Roth	Vol. VII at 1352:8-14	S-57a	S-57b	3/6/2004
Bronsart	Vol. VII at 1353:3-10.	S-50a	S-50b	9/1/2004
Peters	Vol. VII at 1354:14-19; Vol. XII at 2300:18-25.	S-109a	S-109b	12/5/2005

Bersch's and Wanzek's misrepresentations regarding "100% liquidity" and the ability of investors to get their money out were false when they made them, as C. Crowder's EUO testimony confirms. At his first EUO, C. Crowder testified:

> Q. … Through 2007, could an investor come to Concordia and withdraw 100 percent of their investment principal?
>
> A. Efforts would be made, you know to do that. But it wasn't -- - if she'd asked me March 1st, I couldn't necessarily --- I may not be able to, you know, do that on March 1st. What she could do is go to her custodian, take the contracts and the titles, and she could perfect them in her own name and then start collecting on those….[184]

The California attorney representing C. Crowder at that EUO, Steven Gourley, then interjected: "I think what's not being said here, and please let [the Division's counsel] know if it is otherwise, this is clearly not a liquid investment."[185] C. Crowder answered, "No."[186]

The EUO continued with respect to the illiquid nature of the investments:

> Q. And you did not intend it to be a liquid investment.
>
> A. No.
>
> Q. Because you needed the principal to do your business: Purchase truck contracts?
>
> A. Right.
>
> Q. Service these agreements?
>
> A. Right.
>
> Q. Pay for overhead?

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[184] S-165 at 70:3-12.
[185] S-165 at 70:21-23.
[186] S-165 at 70:24.

A. Right.[187]

In his second EUO, C. Crowder testified that Bersch and Wanzek knew Concordia's investments were not liquid:

Q.: Mr. Crowder, in your testimony in California in 2013, do you recall being asked about the liquidity of the investments in the sale of contracts and servicing agreements by my predecessor, Mr. Womack? Do you recall, in particular, testifying that they were not liquid; they were never intended to be liquid?

A. Yes.

Q. Did Mr. Bersch -- do you know whether Mr. Bersch knew that the investments in Concordia were not liquid?

A. He understood the process that I told you; that the investors could take and perfect their titles and collect them on their own, and that was it.

Q. The same question with respect to Mr. Wanzek. Did Mr. Wanzek understand that the investments were not liquid, in the sense that an investor couldn't call up and say, "Hey, I've got an emergency. I need my $100,000 back"?

A. Yes, and it's the same answer that I gave for Mr. Bersch. They understood that it was -- they could perfect those, those titles, and take. That's the only thing they definitely could do.

Q. And it would be up to the investor to perfect the title and to–

A. Start collecting.

[187] S-165 at 71:2-11.

Q. And start collecting from the trucker, or if the trucker went into default, to repo the truck and then sell it on the secondary market, right?

A. Correct.

Q. And you wouldn't characterize that process for the investor to recoup their money as liquid, would you?

A. No.[188]

Section 7.1 of the Servicing Agreements provides additional evidence of the illiquid nature of investments. Section 7.1 restricted the investor's ability to liquidate the investment by selling or assigning the assigned truck loans to a third party.[189] An investor who needed cash and wanted to sell or assign the loans to a third party had to first offer to sell them back to Concordia for only 95% of the then existing principal balance due under the loans, and give Concordia 90 days to accept or reject the offer.[190]

Thus, Bersch and Wanzek knowingly misrepresented to investors that Concordia's investments offered "100% liquidity," when that was untrue. With respect to each investor identified above, Bersch, Wanzek and ER Financial violated § 44-1991(A).

B. Failure to Disclose Commissions

In selling the Concordia investments to at least five investors – Wesley Luhr,[191] Suellen LeMay,[192] Stephen Dennison,[193] Theresa Patricola[194] and Kathy Hodel[195] --

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[188] S-180 at 70:15 to 71:22.
[189] *See, e.g.*, S-12a at § 7.1.
[190] *See, e.g.*, S-12a at § 7.1.
[191] Vol. II at 207:6-25 and 247:2-20.
[192] Vol. II at 272:22 to 273:4.
[193] Vol. III at 499:13 to 500:1.
[194] Vol. IV at 708:11-13.
[195] Vol. VI at 951:13-15.

Bersch failed to disclose that Concordia would pay him or ER Financial a commission if they invested. Similarly, Wanzek did not disclose to Mr. Hatch that Concordia would pay him or ER Financial a commission if Mr. Hatch invested.[196]

Bersch and Wanzek had a duty to disclose the commissions Concordia would pay them for recruiting these investors. Bersch was the CPA for Mr. Luhr,[197] Ms. LeMay,[198] Mr. Dennison,[199] and Mr. and Mrs. Hodel.[200] Wanzek was Mr. Hatch's CPA.[201] "As a matter of public policy, attorneys, accountants, and other professionals owe special duties to their clients...." *Barmat v. John and Jane Doe Partners A-D*, 155 Ariz. 519, 523 (1993).

Arizona law governing accountants imposes an affirmative duty on a CPA to disclose in writing that he will receive a commission for recommending a product or service, like Concordia's investments. A.A.C. R4-1-455(B)(2)(e) requires a CPA who will receive a commission to make a written disclosure "to any person or entity to which the certified public accountant, public accountant, or firm recommends or refers a product or service to which the commission relates."[202] This regulation demonstrates both the duty to disclose and the materiality of the commissions.

The duty to disclose financial self-interest in recommending investments is not unique to CPAs. "When recommending a security to a customer, a salesman has a duty to disclose material adverse facts of which he is aware such as economic self-interest because such facts could influence the salesman's recommendation."[203] Investors "must be permitted to evaluate overlapping motivations through appropriate

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[196] Vol. III at 451:10-13.
[197] Vol. II at 202:4-10, and 204:1-4.
[198] Vol. II at 266:6-21.
[199] Vol. III at 497:2-14.
[200] Vol. VI at 944:9-12.
[201] Vol. III at 452:5-6.
[202] A.A.C. R4-1-455(B)(2)(e)
[203] *In re McGee*, Exchange Act Release No. 80314, 2017 WL 1132115, at *7 (Mar. 37, 2017); *In re Scholander*, Exchange Act Release No. 34-77492, 2016 WL 1255596, at *5 (Mar. 31, 2016).

disclosures, especially where one motivation is economic self-interest." *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1172 (2d Cir. 1970) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 196 (1963)). It was incumbent on Bersch and Wanzek to disclose that they would receive commissions so that the investors could evaluate the extent to which their recommendations of Concordia's investments were based on the fact that they would receive commissions versus the purported benefits of the investments themselves.

As to the materiality of the omissions, under the basic test of materiality -- whether there is a substantial likelihood that a reasonable investor would have considered the fact important in making an investment decision[204] -- the commissions were a material fact in the context of Bersch's and Wanzek's affirmative recommendations that their CPA clients buy Concordia's investments. There is a substantial likelihood that a reasonable investor would have considered Concordia's substantial commission payments - $565,424 between 2004 and 2008 alone -- important to an evaluation of Bersch's and Wanzek's recommendation to buy the investments, and, ultimately, to an investment decision. At a minimum, the commissions from Concordia had the potential to influence Bersch's and Wanzek's recommendation of its investments. Bersch's and Wanzek's undisclosed commissions cast doubt on the sincerity of their recommendations.

The failure to disclose the payment of commissions "constitutes a violation of the antifraud provisions, since such a payment, especially to persons who have a fiduciary relationship with the purchaser, is a material fact that the purchaser will want to consider."[205] *See In re McGee*, Exchange Act Release No. 80314, 2017 WL

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[204] *Hirsch v. Arizona Corp. Comm'n*, 237 Ariz. 456, 463, ¶ 27 (App. 2015).

[205] Joseph C. Long *et al.*, 12 *Blue Sky Law* § 7:105 n. 3 (2016 Update) (citing *DuPont v. Brady*, 646 F. Supp. 1067, 1072 (S.D.N.Y. 1986) (failure to disclose commission paid by issuer to attorney upon investment by his client in a security was a material omission), *rev'd on other grounds*, 828 F.2d 75 (2d Cir. 1987)).

1132115, at *6 (Mar. 37, 2017) ("McGee violated Exchange Act Section 10(b) and Exchange Act Rule 10b-5 because his compensation from [the issuer] was a material fact that he had a duty to disclose."); *In re Scholander*, Exchange Act Release No. 34-77492, 2016 WL 1255596, at *5 (Mar. 31, 2016) (affirming order barring salesmen from associating with FINRA member firms in any capacity; "The failure to disclose the $350,000 payment is, on its own, sufficient to support FINRA's finding of fraud."); *In re DuBois*, Exchange Act Release No. 48332, 2003 WL 21946858, at *3 (8/13/2003) (finding antifraud violations where a broker recommended securities but failed to disclose that he was being compensated by the promoter of the stock).

The ER Respondents falsely assert that the $565,424 Concordia paid them were not commissions or finder's fees, but "was for filling out paperwork."[206] Ken Crowder's EUO testimony exposes the falsity of that assertion. He testified:

> Q. … What were those finder's fees paid for?
>
> A. The first time a new investor was brought in, or if that investor, portfolio investor added additional significant, significant amounts of money, the finder's fee was paid for the person, to the person who brought them to the company.[207]

Thus, Concordia did not pay the ER Respondents $565,424 "for filling out paperwork."[208] Concordia paid them to recruit new investors and raise more money for Concordia to use.[209]

Finally, the ER Respondents cite two federal court cases[210] to argue they had no duty to disclose their commissions. Neither case involved a situation like this one

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[206] ER Respondents' Br. at 54:19-20.
[207] S-163 at 42:24 to 43:5.
[208] ER Respondents' Br. at 54:19-20.
[209] S-163 at 42:24 to 43:5.
[210] *U.S. v. Skelly*, 442 F.3d 94 (2d Cir. 2006) (affirming convictions for securities fraud); *S.E.C. v. Mapp*, 2016 WL 5870576 (E.D. Tex. 2016).

where state law imposed an affirmative duty on the defendants to disclose commissions, as A.A.C. R4-1-455(B)(2)(e) does for CPAs.

In any event, Arizona courts "will not defer to federal case law when, by doing so, we would be taking a position inconsistent with the policies embraced by our own legislature." *Siporin v. Carrington*, 200 Ariz. 97, 103, ¶ 28 (App. 2001). "We will depart from those federal decisions that do not advance the Arizona policy of protecting the public from unscrupulous investment promoters." *Id.* at 103, ¶ 28. The two federal court cases the ER Respondents cite on the failure to disclose commissions for recommending an investment "do not advance the Arizona policy of protecting the public from unscrupulous investment promoters." *Id.* at 103, ¶ 28. The Commission should reject them.

C. Bersch and Wanzek Misled Investors by Misrepresenting They Monitored Concordia's Financial Position.

In soliciting further investments, Bersch and Wanzek represented to at least two investors, Mr. Dennison and Ms. LeMay, that they monitored Concordia's financial position for the investors.[211] In a form letter addressed to "Our Portfolio Investors," in which Bersch and Wanzek sought "additional funds to invest,"[212] they wrote: "As in the past, we will also monitor the financial position of Concordia."[213]

Bersch testified, however, that he does not recall receiving any financial information about Concordia.[214] Therefore, Bersch could not have been monitoring Concordia's financial position.

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[211] Vol. III at 510:13-19; S-2f; S-17e; *see also* S-2h.
[212] S-2f; S-17e.
[213] S-2f; S-17e.
[214] Vol. X at 1903:9-11 and 1904:9-14.

Wanzek testified that he did not always receive Concordia's financial statements.[215] Because Wanzek was not consistently receiving Concordia's financial statements, it was misleading for him to represent that he was he was monitoring Concordia's financial position.

The ER Respondents assert that this fraud theory was not alleged in the Amended Notice of Opportunity and the Division only raised it for the first time in its Opening Brief, which is true. The reason for that, however, is that the hearing presented the first opportunity the Division had to determine whether or not Bersch or Wanzek monitored Concordia's financial position as they represented they did. Throughout his EUO, Bersch asserted his privilege against self-incrimination, so the Division could not ask him about whether he monitored Concordia's financial position until Bersch testified at the hearing.

Similarly, the Division attempted to take an EUO of Wanzek, but he refused to appear. *See* Objection to Subpoenas filed 3/27/2015. So the Division could not ask Wanzek if he monitored Concordia's financial position until Wanzek testified at the hearing.

The Amended Notice provided ample notice that the Division alleged Bersch or Wanzek violated A.R.S. 44-1991(A) in multiple ways. Only at the hearing did the Division learn that Bersch's and Wanzek's written representations to investors that they monitored Concordia's financial position were untrue. Thus, the Division could not have alleged this fraud theory before the hearing.

Bersch and Wanzek should not get free passes for this fraud violation based on Bersch's invocation of his privilege against self-incrimination at his EUO and Wanzek's refusal to appear for an EUO. Giving Bersch and Wanzek free passes for this fraud violation would be contrary to the Legislature's directive that the Securities

[215] Vol. IX at 1637:25 to 1638:3, and 1639:13 to 1640:16.

Act "shall be liberally construed as a remedial measure" to advance "the prosecution of persons engaged in fraudulent or deceptive practices in the sale or purchase of securities" and "the protection of the public."[216] The Act "confirms a broad intent to sanction wrongdoing in connection with the purchase or sale of securities." *Grand v. Nacchio*, 225 Ariz. 171, 174, ¶ 16 (2010).

D. Failure To Disclose ER Financial Was Operating As An Unlicensed Escrow Business.

The Division's Opening Brief detailed why the ER Respondents operated as an unlicensed escrow business and escrow agents,[217] and as such were subject to being shut down at any time.[218] The failure to disclose to investors that ER Financial was engaged in the conduct of an unlicensed escrow business was a material omission. A reasonable investor would want to know that the Custodian holding the truck loan contracts and title liens collateralizing the investment "[was] not even licensed to be engaged in that type of a business activity." *S.E.C. v. Levine*, 671 F. Supp.2d 14, 28-29 (D.D.C. 2009) (investment promoters violated the anti-fraud provisions in § 17(a) of the Securities Act of 1933 and § 10(b) of the Exchange Act of 1934 "by engaging in an illegal escrow business in connection with the offer or sale of securities."); *S.E.C. v. Randy*, 38 F. Supp.2d 657, 669 (N.D. Ill. 1999) (fact that bank whose securities were being sold was not legally licensed was material). The Division reiterates the Opening Brief's analysis regarding why the ER Respondents' unlicensed escrow activities

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[216] 1951 Ariz. Sess. Laws Ch. 18, § 20; *Shorey v. Arizona Corporation Comm'n*, 238 Ariz. 253, 257, ¶ 12 (App. 2015) (Securities Act is "designed to protect the public from fraud and deceit arising in securities transactions") (internal quotation omitted).

[217] A.R.S. § 6-801(4), (5) & (7).

[218] A.R.S. § 6-840(A) (providing that when the Arizona Department of Financial Institutions ascertains that an escrow agent's "affairs are in an unsafe condition, [ADFI] may immediately take possession of all the property, business and assets of the agent....").

violated A.R.S. § 44-1991(A) in connection with the offer or sale of Concordia's securities.

The ER Respondents' argument that the Division did not prove they were unlicensed escrow agents is spurious. Bersch and Wanzek both testified that neither of them had ever applied to be licensed as escrow agents, and ER Financial was never licensed as an escrow business. Vol. IX at 1703:2-17; Vol. X at 1928:15-21.

The ER Respondents argue they acted not as escrow agents but more like a dry cleaner or a parking valet. Those analogies miss the mark and their argument fails. When one drops their clothes at a dry cleaner or valets their car, they are not doing so "in connection with the sale, transfer, encumbrance or lease of … personal property" within the meaning of A.R.S. § 6-801(4) defining an escrow. There is no "sale, transfer, [or] encumbrance" of the clothes or car. The person owns those items. Absent the person failing to pay the cleaner or the valet, there is no "contingent happening or nonhappening of a specified event or performance or nonperformance of a prescribed act," A.R.S. § 6-801(4), that will trigger whether the person gets their clothes or car back.

Unlike a dry cleaner or a parking valet, ER Financial was holding personal property, the truck loan contracts and title liens, "in connection with the sale, transfer, [or] encumbrance … of … personal property," namely the trucks. Further unlike a dry cleaner or a parking valet, whether ER Financial returned a truck loan contract and title lien to Concordia was contingent on the trucker paying off the loan or the trucker defaulting, in which case Concordia needed to provide a substitute contract.[219] Whether ER Financial delivered the truck loan contract and title lien to an investor was contingent

[219] *See, e.g.*, S-12(a) at §§ 1.10 and 4.1.

on whether Concordia defaulted or consented for ER to do so.[220] "This is the very essence of escrow...." *U.S. Life Title Co. v. Bliss*, 150 Ariz. 188, 190 (App. 1986).

The ER Respondents argue that no investor expressed concern that they operated an unlicensed escrow business, so it could not have been a material fact.[221] This argument is erroneous and irrelevant. It is erroneous because materiality is based on an objective standard. *Hirsch*, 237 Ariz. at 463, ¶ 27. "'Under this test, there is no need to investigate whether an omission or misstatement was actually significant to a particular buyer.'" *Id.* at 464, ¶ 27 (quoting *Trimble v. American Savings Life Insurance Company*, 152 Ariz. 548, 553 (App. 1986)).

The ER Respondents' argument is also irrelevant. The fact that they were never shut down and no investor was harmed thereby is irrelevant. If a person drives drunk but does not get into an accident, he still endangered the public and broke the law.

Finally, the ER Respondents' argument that the Commission's powers "do not include jurisdiction over escrow issues"[222] is misplaced and should be rejected. The Division is seeking to enforce the anti-fraud provisions of the Securities Act, not the escrow laws. In *Levine*, the S.E.C. was not deemed to be attempting to enforce Nevada's escrow licensing laws. Similarly, in *Randy*, the S.E.C. was not deemed to be attempting to enforce bank licensing laws. Rather, the securities fraud in those cases, as here, resulted from the defendants' failure to inform investors of the unlicensed and therefore unlawful business activity they were conducting.

Adjudicating the ER Respondents' material omissions is squarely within the Commission's jurisdiction and will not in any way intrude on the jurisdiction of the Arizona Department of Financial Institutions. As the Administrative Law Judge ruled in denying the ER Respondents' prior motion to dismiss the unlicensed escrow

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[220] *See, e.g.*, S-12(a) at §§ 4.2, 4.3 and 7.
[221] ER Respondents' Br. at 58:7-9.
[222] ER Respondents Br. at 59:13-14.

allegation, "An allegation of fraud in connection with the offer or sale of securities is within the jurisdiction of the Commission, not the Department of Financial Institutions."[223] The ER Respondents have failed to establish a jurisdictional basis for not adjudicating this violation of the Act's anti-fraud provision.

V. THE LEGISLATURE HAS NOT IMPOSED A STATUTE OF LIMITATIONS AND NEITHER SHOULD THE COMMISSION.

The Securities Act does not impose a time limit within which the Division must bring an enforcement action. *Bersch v. State*, 2016 WL 3101789 (Ariz. App. 6/2/2016), review denied Dec. 13, 2016; *Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548, 555-56 (App. 1986) (state agencies are "immune from the statute of limitations defense" in A.R.S. § 44-2004 when they pursue an action in the public interest).

The Commission should reject Respondents' invitation to err by imposing a limitations period when the Legislature has not done so. "The legislature has the exclusive power to declare what the law shall be." *State ex rel. Woods v. Block*, 189 Ariz. 269, 275 (1997) (internal quotation and citation omitted). "Whether statutes of limitations governing prosecution of ... offenses should be adopted at all is a matter solely for the legislature." *Story v. State*, 721 P.2d 1020, 1028-29 (Wyo. 1986) *cert. denied*, 479 U.S. 962 (1986); *Agbanc, Ltd v. United States*, 707 F. Supp. 423, 426 (D. Ariz. 1988) ("To create a limitations period in this particular situation where one does not exist is not the province of this Court but rather that of the Congress."). "If the law is to be changed the responsibility rests with the legislative department of government...." *State Tax Comm'n v. Quebedeaux Chevrolet*, 71 Ariz. 280, 289 (1951), superseded by statute as stated in *People of Faith Inc. v. Ariz. Dep't of Revenue*,

[223] Fifteenth Procedural Order dated 7/7/2015 at 14:17-19.

161 Ariz. 514, 519 n.3 (T. C. 1989). Imposing a limitations period would usurp the Legislature's authority to legislate. *See Bowslaugh v. Bowslaugh*, 126 Ariz. 517, 519 (1979) (adding phrase to statute by "judicial fiat," despite benevolent intent, "would be an infringement upon the province of the legislature").

The absence of a limitations period for enforcement actions is fully consistent with Arizona law and public policy. "Arizona case law has consistently recognized the common law doctrine 'nullum tempus occurrit regi'—time does not run against the king." *City of Phoenix v. Glenayre Elecs.*, Inc., — Ariz. ——, ——, 393 P.3d 919, 922, ¶ 10 (2017) (citing *Kerby v. State ex rel. Frohmiller*, 62 Ariz. 294, 307 (1945) (noting the established rule that statutes of limitations "do not run or operate against the state"); and *City of Bisbee v. Cochise County*, 52 Ariz. 1, 9 (1938) (finding "ample justification for the rule, stated in the ancient maxim and confirmed by our Legislature from time to time, that statutes of limitations which govern between private individuals do not apply in proceedings on behalf of the state")). It is Arizona's public policy[224] that statutes of limitation do not run against the state "unless the Legislature has expressly and definitely declared that they do."[225] *City of Bisbee*, 52 Ariz. at 10.

"The nullum tempus doctrine is based on the premise that, although time limitations apply to private parties so as to prevent fraudulent, stale claims, time stands still, as it were, for the state because '[t]he officers who are charged with the active duty of enforcing [the] rights [of the state] have no personal profit to gain thereby, and therefore no inducement for the bringing of false and unwarranted actions.'" *Glenayre*

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[224] Arizona's constitution, statutes and judicial decisions embody its public policy. *CSA 13-101 Loop, LLC v. Loop 101, LLC*, 236 Ariz. 410 412, ¶ 8, 341 P.3d 452, 454 (2014); *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, 378, 710 P.2d 1025, 1033 (1985) ("[O]ur state's constitution and statutes embody the public conscience of the people of this state.").

[225] *See also Defenders of Wildlife v. Hull*, 199 Ariz. 411, 415, ¶ 2, 18 P.3d 722, 726 (App. 2001) (73-year dormancy did not affect the validity of the state's claims because "[n]either doctrines of laches nor statutes of limitations ... can be allowed to defeat the state's sovereign title to trust lands.").

Elecs., 393 P.3d at 922, ¶ 10 (quoting *City of Bisbee*, 52 Ariz. at 9). Although the doctrine was originally established as a royal prerogative similar to sovereign immunity, its role under modern law is "to protect the public" and ensure "its rights to redress against wrongdoers." *Tucson Unified School Dist. v. Owens-Corning Fiberglass Corp.*, 174 Ariz. 336, 337, 849 P.2d 790, 791 (1993).

Although Respondents attack the nullum tempus doctrine as "outdated,"[226] in May 2017 the Arizona Supreme Court reaffirmed its applicability. *See Glenayre Elecs.*, 393 P.3d at 921, 926 & 928, ¶¶ 4, 27 & 36 (holding that City of Phoenix was not time-barred from bringing indemnity claims against developers for conduct that occurred between 17 and 40 years earlier). The court reaffirmed that "statutes of limitations do not and should not apply to the state, in the absence of an express declaration to the contrary by the Legislature, that is, unless the Legislature has expressly and definitely declared that they do." 393 P.3d at 923, ¶ 14 (internal quotations and citation omitted).

Respondents' reliance on *Gabelli v. S.E.C.*[227] and *Kokesh v. S.E.C.*,[228] which construed 28 U.S.C. § 2462, is misplaced. 28 U.S.C. § 2462[229] is statute of general applicability that "requires that any [federal] administrative action aimed at imposing a civil penalty must be brought within five years of the alleged violation." *3M Co v. Browner*, 17 F.3d 1453, 1455-56 (D.C. Cir. 1994) (internal quotation and citation omitted).

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[226] ER Respondents' Br. at 64:9-10.

[227] *Gabelli v. S.E.C.*, --- U.S. ---, 133 S. Ct. 1216 (2013)

[228] *Kokesh v. S.E.C.*, --- U.S. ---, 137 S. Ct. 1635 (2017).

[229] 28 U.S.C. § 2462 provides:

> Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

"[F]ederal law is persuasive in interpretation of Arizona securities laws only where [the] provisions and underlying policies are similar." *Hirsch v. Arizona Corporation Comm'n*, 237 Ariz. 456, 466, ¶ 41 (App. 2015) In interpreting a state statutory scheme such as the Securities Act, "[Arizona Courts] will give less weight and not necessarily defer to federal case law that construes a parallel federal statute when the state and federal statutory provisions or their underlying policies materially differ." *Sell v. Gama*, 231 Ariz. 323, 327, ¶ 18 (2013).

28 U.S.C. § 2462 has no counterpart in Arizona law. § 2462 is not a parallel federal statute to § 44-2004 or any other provision in the Securities Act. § 2462 is not even specific to securities law. "[I]t governs many penalty provisions throughout the U.S. Code." *Gabelli*, 133 S. Ct. at 1219. That federal law contains a provision with no counterpart under Arizona law "gives us 'good reason to depart from that authority.'" *Hirsch*, 237 Ariz. at 466, ¶ 41 (quoting *Sell*, 231 Ariz. at 327, ¶ 18).[230] For this reason, *Gabelli* and *Kokesh*, which construed § 2462, are wholly inapposite.

Imposing a limitations period on enforcement actions would undermine the Commission's ability to remedy violations of the Act by limiting the time available to investigate and develop securities fraud claims. Steps typically include: (1) reviewing investor complaints, which the Securities Division may not receive until several years after the date of investment; (2) interviewing investors; (3) investigating the business, which may include an undercover investigation that takes months to develop; (4) collecting evidence using document subpoenas and examinations under oath; (5) interacting with the business in an attempt to reach a negotiated resolution; and (6) if necessary, filing an enforcement action.

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[230] *See also Siporin v. Carrington*, 200 Ariz. 97, 103, ¶ 28 (App. 2001) ("[W]e will not defer to federal case law when, by doing so, we would be taking a position inconsistent with the policies embraced by our own legislature. We will depart from those federal decisions that do not advance the Arizona policy of protecting the public from unscrupulous investment promoters.").

Imposing a statute of limitations would compress this timeline and might force the Division to race the clock to vindicate investors' rights, especially because it would often be difficult to ascertain when the clock began to run. This result would be bad for investors and worse for businesses that would no longer benefit from the Division's ability to take the necessary time to carefully investigate and resolve investor complaints of alleged violations, often without any adverse action or litigation.

Securities violations often extend for several years before they come to light. Under a limitations period, a violator could only be held accountable for recent conduct, the Division's available evidence would be limited, and some defrauded investors would be left without any claim to receive restitution. Imposing a limitation period would frustrate the Act's legislative purposes.

As for Respondents' complaints about the ability of businesses to raise funds and destroy records, *Trimble* has been the law in Arizona for 31 years. There is no evidence in the record that the Commission's ability to enforce the Act without a time limitation has hindered business growth in Arizona.

In any event, arguments as to the wisdom of imposing a limitations period on enforcement actions are appropriately directed to the legislature, not to the Commission. To the extent that imposing a limitations period would benefit violators like Respondents by providing finality for them, the Legislature is the appropriate body to weigh those private benefits against the costs to public rights.

Ultimately what Respondents advocate for is a rule that would permit fraudsters to know that if they can only avoid detection of their violations for long enough, they will go scot-free. That is not the law in Arizona. Nor should it be the outcome in this case.

VI. RESPONDENTS' LACHES DEFENSE FAILS.

Respondents seek to preclude the Division from responding to their arguments that this action is barred by the doctrine of laches. They argue that because the Division did not address laches in its Opening Brief, the Division has waived its right to respond to Respondents' laches arguments.[231]

The doctrine of laches is an affirmative defense. At all times, it is Respondents' burden to raise and prove it. The Division had no obligation to address any of Respondents' affirmative defenses in its Opening Brief. Respondents cite no authority for their absurd argument, which if accepted, would be patently unfair. The Commission should reject Respondents' effort to preclude the Division from responding on the merits, or lack thereof, to their laches defense.

Laches does not apply to this case for several reasons. First, "the doctrine of laches does not apply against the State or its agencies in matters affecting the public interest absent a statute expressly allowing such a defense." *State ex rel. Darwin v. Arnett*, 235 Ariz. 239, 245, ¶ 33 (App. 2014); *Kerby v. State ex rel. Frohmiller*, 62 Ariz. 294, 307-08 (1945) (13-year delay by state auditor before bringing suit to recover unauthorized expenditures by Secretary of State; "when the public interest is concerned, neither laches nor the statute of limitations applies against the state, in the absence of a statute expressly allowing such defenses.").[232] Respondents have not identified any statute expressly allowing a laches defense against a securities enforcement action, and there is none.

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[231] ER Respondents' Br. at 67:10-11.

[232] *See also Defenders of Wildlife v. Hull*, 199 Ariz. 411, 415, ¶ 2, 18 P.3d 722, 726 (App. 2001) (73-year dormancy did not affect the validity of the state's claims because "[n]either doctrines of laches nor statutes of limitations … can be allowed to defeat the state's sovereign title to trust lands."); *State v. Durham*, 860 S.W.2d 63, 67 (Tex. 1993) ("[T]he principal argument of the dissenting Justices is that it just is not fair to be litigating events that occurred almost sixty years ago. However, the State in its sovereign capacity, unlike ordinary litigants, is not subject to the defenses of limitations, laches, or estoppel.").

Respondents assert that at the oral argument at the Court of Appeals, "the Division conceded that laches would apply to this proceeding."[233] That assertion is incomplete and therefore inaccurate. The relevant exchange at the Court of Appeals was as follows:

> Hon. Kent Cattani: Assuming there is not a statute of limitations, is there anything that would prevent the parties from alleging that in this case the length of time that they waited to bring an action was simply unreasonable … because we are unable to bring in evidence we could have brought in earlier? Are they precluded from ever making any kind of equitable argument like that?
>
> Division's Counsel: No they are not your Honor, because they have a due process claim. But the due process claim or the laches claim or the estoppel claim would involve unreasonable delay. In fact, due process would involve intentional delay by the government. Same with laches and estoppel. Laches and estoppel require unreasonable delay and you'll see that in some of the cases they have cited….[234]

The Division then went on to distinguish the *Tucson Electric Power*,[235] *Valencia Energy*[236] and *State v. Garcia*[237] cases. In those cases laches or estoppel was applied against the government. In *Garcia*, laches barred a child support arrearage case because the mother and the Department of Economic Security (DES) made no attempt to determine paternity for 16 years and DES purged relevant records in the interim, prejudicing the father.[238] In *Valencia Energy* and *Tucson Electric Power* the

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[233] Concordia Br. at 32:15; ER Respondents' Br. at 67:1-2.
[234] The oral argument at the Court of Appeals is available on You Tube by searching under "CR1 5 10 2016 CV150340". The excerpt quoted above begins at 23 minutes and 22 seconds into the video.
[235] *Tucson Electric Power Co. v. Arizona Dep't of Revenue*, 174 Ariz. 507 (App. 1992).
[236] *Valencia Energy Co. v. Arizona Dep't of Revenue*, 191 Ariz. 565 (1998).
[237] *State v. Garcia*, 187 Ariz. 527 (App. 1996).
[238] *Garcia*, 187 Ariz. at 529.

Department of Revenue gave companies assurances on tax issues, but later reversed its positions and sought to assess back taxes.[239]

In concluding the answer to Judge Cattani's question quoted above, the Division's counsel stated: "Yes, there is a remedy for a litigant who can establish that the government knew about the conduct and then unreasonably delayed or intentionally delayed in order to gain some sort of a tactical advantage. There is no evidence in the record of anything like that here." Respondents' assertion that the Division conceded that laches applies here mischaracterizes the exchange between Judge Cattani and counsel.

"Laches is an equitable defense that prevents a plaintiff, who 'with full knowledge of the facts, acquiesces in a transaction and sleeps upon his rights.'" *Danjaq LLC v. Sony Corp.*, 263 F.3d 942, 950-51 (9th Cir. 2001) (quoting *Southern Pac. Co. v. Bogert*, 250 U.S. 483, 500 (1919) (McReynolds, J. dissenting)). As stated at the Court of Appeals, a necessary element of laches is unreasonable delay. *League of Ariz. Cities & Towns v. Martin*, 219 Ariz. 556, 558, ¶ 6 (2009). Delay alone is not sufficient to establish a laches defense; it has to have been unreasonable. *Id.* at 558, ¶ 6; *Harris v. Purcell*, 193 Ariz. 409, 412, ¶ 16 (1998). In determining whether the delay was unreasonable, courts "examine the justification for delay, including the extent of plaintiff's advance knowledge of the basis for challenge." *Harris*, 193 Ariz. at 412, ¶ 16. For laches to apply, "'[T]he delay must come after the party against whom the defense is asserted becomes aware of or has knowledge of ... his right.'" *Flynn v. Rogers*, 172 Ariz. 62, 66 (1992) (quoting *Jerger v. Rubin*, 106 Ariz. 114, 117 (1970)).

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[239] *Valencia Energy*, 191 Ariz. at 569, ¶¶ 4-5 (estoppel applied where taxpayer sought and relied on position of Department of Revenue, which wrote 3 separate letters saying tax would not apply, and then reversed its position and assessed taxes four year later); *Tucson Electric Power*, 174 Ariz. at 514-16 (utility conferred with audit supervisor for the Department of Revenue regarding whether pollution certifications from New Mexico would qualify for amortization purposes on its Arizona tax return and was told they would; years later, the Department of Revenue reversed its position and assessed back taxes).

"[L]aches penalizes inexcusable dilatory behavior; if the plaintiff legitimately was unaware of the defendant's conduct, laches is no bar to suit." *Jarrow Formulas, Inc. v. Nutrition Now, Inc.*, 304 F.3d 829, 838 (9th Cir. 2002). Absent prior knowledge of Respondents' violations, the Division cannot be deemed to have delayed taking enforcement action.

The evidence demonstrates that the Division did not have any knowledge of Respondents' activities until July 2012, when an investor, Sue Ellen LeMay, submitted a complaint.[240] The Division promptly commenced an investigation.[241] In August 2012, Gary Clapper was assigned as the investigator.[242] The Division filed this enforcement action eighteen (18) months later. In the interim, the Division had to work through Respondents' efforts to obstruct the investigation. Respondents' obstructionist tactics included:

- Concordia refused to honor the Division's subpoena duces tecum.[243] The Division then had to work with the California Corporations Commissioner[244] to subpoena Concordia's documents and the testimony of K. Crowder,[245] A. Dekmejian[246] and C. Crowder.[247]
- Bersch and Wanzek refused to produce any of ER Financial's responsive documents in response to the Division's investigative subpoena. First, however, Bersch and Wanzek obtained two extensions from the Division so they could supposedly prepare ER Financial's response to the

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[240] Vol. VII at 1209:5-12.
[241] Vol. VII at 1209:3-8.
[242] Vol. VII at 1209:3-8.
[243] Vol. VII at 1221:5-14.
[244] Vol. VII at 1221:5-20 and 1222:4-24.
[245] *See* S-163.
[246] *See* S-164.
[247] *See* S-165.

subpoena.[248] Instead, Bersch and Wanzek dissolved ER Financial[249] and then claimed that because it no longer existed, they did not have to produce any of its records.[250]

There was no delay, let alone unreasonable delay, by the Division.

The lapse of time and purported prejudice Respondents complain about are self-inflicted wounds caused by Respondents' failures to register with the Commission as A.R.S. §§ 44-1841 and 44-1842 require, and not a result of any conduct by the Division. "[T]he statutes requiring registration of securities and dealers are designed to make the possibility of fraud even more remote." *State v. Baumann*, 125 Ariz. 404, 411, 610 P.2d 38, 45 (1980) (citing A.R.S. §§ 44-1841 and 44-1842). By failing to register the securities or themselves, Respondents evaded the Division's review of their activities. The Division could not act on violations of which it was unaware.

Turning their obligation to register under A.R.S. §§ 44-1841 and 1842 on its head, Respondents argue that the Division should have discovered their violations sooner because their sales of Concordia's securities were "open and notorious."[251] The phrase "open and notorious" is a term of art applicable to the doctrine of adverse possession. *See Lewis v. Pleasant Country Ltd.*, 173 Ariz. 186, 189 (App. 1992). "[A]dverse possession cannot run against the State." *Ziggy's Opportunities, Inc. v. I-10 Indus. Park Developers*, 152 Ariz. 104, 107 (App. 1986). Respondents' argument fails.

Arnett[252] illustrates that laches does not apply to bar this action. In *Arnett*, in 1988 and 1990, an underground storage tank leaked gasoline.[253] By February 1990,

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[248] S-185; S-186; Vol. VII at 1228:7 to 1229:18.
[249] S-168.
[250] Vol. VII at 1235:20-25; S-160; S-174.
[251] Concordia Br. at 34:17; see also ER Respondents' Br. at 69:14-15.
[252] *Arnett*, 235 Ariz. at 245, ¶¶ 33-35.
[253] *Arnett*, 235 Ariz. at 241, ¶¶ 4-5.

the Tucson Fire Department and the Arizona Department of Environmental Quality (ADEQ) were aware of the contamination.[254] In February 2005, ADEQ learned the identity of the owner of underground storage tank.[255] Five-and-a-half years later, in September 2010, ADEQ sued the owner for the cost of cleanup and civil penalties.[256] The superior court rejected the owner's laches defense, and the Court of Appeals affirmed. The courts rejected the owner's argument that, because he recorded a deed in 1982 reflecting that he was the owner of the land on which the underground storage tank was located, ADEQ should have identified him and brought the action sooner.[257] The Court of Appeals held: "Because the statute of limitations does not apply to this type of litigation, and because applying laches to bar ADEQ's action in the instant case would adversely affect ADEQ's ability to regulate USTs and would harm the public's interest in safe water, the superior court properly rejected Arnett's laches defense."[258]

In contrast to *Arnett* where ADEQ waited five-and-a-half years to bring its enforcement action from when it learned who owned the leaky tank, here the Division brought this enforcement action within eighteen (18) months of first learning of Respondents' activities. As in *Arnett*, no statute of limitations applies to this litigation. Applying laches to bar this enforcement action would adversely affect the Division's ability to remedy securities violations and would harm the public interest. Enforcement actions like this one are "brought for the public benefit...." *Trimble*, 152 Ariz. at 56, 733 P.2d. at 1139. Accordingly, the Commission should reject Respondents' laches defense.

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[254] *Id.* at 241, ¶ 5.
[255] *Id.* at 241, ¶ 13.
[256] *Id.* at 241, ¶ 14.
[257] Id. at 240-41 & 243-44, ¶¶ 2 & 24-26.
[258] *Id.* at 245, ¶ 35.

Finally, Respondents cite several cases for the proposition that when a plaintiff files suit in equity or admiralty outside the limitations period that would apply to an analogous action at law, laches presumptively applies. Those cases are inapposite. All but two of them involved suits solely between private litigants.[259] In one of the two cases that involved government entities, the court held the private litigant's claim was barred by laches.[260] In the other case that involved a government agency, the court held that laches did not bar the agency's efforts in 1996 to collect overpayments it made to a hospital in 1981.[261]

In any event, Respondents' attempt to impose laches against the Division based on the analogous limitation periods in A.R.S. § 44-2004 for private litigants fails. Arizona law is clear that "when the public interest is concerned, neither laches nor the statute of limitations applies against the state, in the absence of a statute expressly allowing such defenses." *Kerby*, 62 Ariz. at 307-08.

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[259] *Jarrow Formulas, Inc. v. Nutrition Now, Inc.*, 304 F.3d 829, 838-39 (9th Cir. 2002) (private litigant knew of its Lanham Act cause of action in 1993 but waited until 2000 to file suit without offering any legitimate excuse for the delay); *Danjaq LLC v. Sony Corp.*, 263 F.3d 942 (9th Cir. 2001) (private litigant waited between 19 and 36 years from when he knew of defendant's alleged copyright infringement before he brought suit); *Tandy Corp. v. Malone & Hyde, Inc.*, 769 F.2d 362 (6th Cir. 1985) (laches did not bar trademark infringement when plaintiff brought suit 32 months after learning of defendant's conduct); *Brown v. Kayler*, 273 F.2d 588, 591 (9th Cir. 1959) (in admiralty action for personal injury, laches applied because the plaintiff did not bring suit within analogous 2-year statute of limitation and did not present a valid excuse for the delay); *Wilson v. Northwest Marine Iron Works*, 212 F.2d 510, 511 (9th Cir. 1954) (same); *Costello v. Muheim*, 9 Ariz. 422 (1906) (laches did not bar quiet title action between private litigants); *Patchett v. DiVito*, 3 Ariz. App. 72 (1966) (laches applied to claim and counterclaim between private litigants).

[260] *Lavin v. Board of Education*, 447 A.2d 516, 520 (N.J. 1982) (teacher's claim against school board for retroactive salary increase based on military service was barred by laches; teacher did not bring her claim until 9 years after she began employment and 23 years after military service).

[261] *Robert F. Kennedy Medical Center v. Dep't of Health Services*, 61 Cal. App. 4th 1357, 1359-60 (1998).

VII. RESPONDENTS DO NOT HAVE RIGHT TO A JURY TRIAL

Respondents argue they are entitled to jury trial on the Division's requests for restitution and civil penalties. Respondents are mistaken.[262]

A. Controlling Arizona Precedent Defeats Respondents' "Right to a Jury Trial" Argument.

Article 2, Section 23 of the Arizona Constitution provides in relevant part: "The right of trial by jury shall remain inviolate." This constitutional provision "*preserves* a right to a jury trial in only those actions that existed at common law when the Arizona Constitution was adopted in 1910." *Life Investors Ins. Co. of Am. v. Horizon Resources Bethany, Ltd.*, 182 Ariz. 529, 532 (App. 1995).

Controlling Arizona precedents hold, "Unless expressly provided for by statute, 'there is no right to a jury trial on statutory claims that did not exist at common law prior to statehood.'" *State ex rel. Darwin v. Arnett*, 235 Ariz. 239, 245, ¶ 36 (App. 2014) (Article 2, Section 23 of the Arizona Constitution did not provide a right to jury trial in enforcement action by state agency to recover damages to remediate environmental contamination and civil penalties) (quoting *In re Estate of Newman*, 219 Ariz. 260, 272, ¶ 45 (App. 2008), *review denied* 10/28/2008); *Life Investors*, 182 Ariz. at 532 (no right to jury in deficiency judgement action; "Since the deed of trust statute was enacted in 1971, there was no provision for this type of statutory action in 1910, and, hence, no issue exists regarding preservation of a nonexistent right.").

Applying the holdings of *Arnett*, *Estate of Newman* and *Life Investors*, Respondents do not have a right to a jury trial on the Division's requested statutory remedies of restitution and administrative penalties. The Division is bringing this administrative enforcement action pursuant to the Securities Act, which was enacted

[262] The Division incorporates and adopts the analysis of the Administrative Law Judge regarding the jury trial issue set forth in the Twenty-Ninth Procedural Order dated 11/28/2016 at 20:3 to 21:5.

in 1951. *See* Laws 1951, Ch. 18. In Article 16 of the Act, the Legislature expressly authorized the Commission to "take appropriate affirmative action … to correct the conditions resulting from the [violation] including, without limitation, a requirement to provide restitution as prescribed by the rules of the [C]ommission." A.R.S. § 44-2032(1).

Pursuant to this express statutory authorization to require restitution and its general statutory rule-making authority, the Commission promulgated A.A.C. R14-4-308 ("Commission Rule 14-4-308"). *See* A.R.S. §§ 44-1821 and 44-2032(1), and A.A.C. R14-4-308. Commission Rule 14-4-308 provides, in relevant part:

> A. When a person or persons have violated the Securities Act or the IM Act, or any rule or order of the Commission, the Commission may require the person or persons to make rescission and/or restitution as provided herein.
>
> …
>
> C. If restitution is ordered by the Commission,
>
> 1. The amount payable as damages to each purchaser shall include:
>
> a. Cash equal to the fair market value of the consideration paid, determined as of the date such payment was originally paid by the buyer; together with
>
> b. Interest at a rate pursuant to A.R.S. § 44-1201 for the period from the date of the purchase payment to the date of repayment; less
>
> c. The amount of any principal, interest, or other distributions received on the security for the period from the date of purchase payment to the date of repayment.[263]

The Legislature has also expressly authorized the Commission to assess administrative penalties, after a hearing.[264] By statute, the Commission may not

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[263] A.A.C. R14-4-308(A) and (C).

[264] A.R.S. § 44-2036(A) ("A person who, in an administrative action, is found to have violated any provision of this chapter or any rule or order of the commission may be assessed an administrative penalty by the commission, after a hearing, in an amount of not to exceed five thousand dollars for each violation.").

order restitution or penalties prior to providing a respondent with notice of a hearing or a notice of an opportunity for a hearing, and the Commission shall provide a hearing when requested.[265]

As in *Arnett*, *Estate of Newman* and *Life Investors*, the statutory causes of action and statutory remedies at issue did not exist when the Arizona Constitution was adopted in 1910. Because "Article II, Section 23 *preserves* a right to a jury trial in only those actions that existed at common law when the Arizona Constitution was adopted," *Life Investors,* 182 Ariz. at 531, Respondents do not have a right to a jury trial on any issue in this action, including the requested statutory remedies of restitution and administrative penalties. *See Arnett*, 235 Ariz. at 245, ¶ 36 (Article 2, Section 23 of the Arizona Constitution did not provide a right to jury trial in ADEQ's action to recover damages and civil penalties.)

Respondents fixate on Commission Rule 14-4-308(C)'s use of the word "damages" in describing how to calculate the amount a respondent must pay to each purchaser "[i]f restitution is ordered by the Commission." Commission Rule 14-4-308(C)'s use of the word "damages" does not change the foregoing analysis, however. In *Arnett* and *Estate of Newman*, the defendants did not have a right to a jury trial under the Arizona Constitution despite the fact that they were defending against claims seeking damages. *See Arnett*, 235 Ariz. at 241, ¶ 15; *Estate of Newman*, 219 Ariz. at 264, ¶ 6. The same result applies to Respondents.

Because the Securities Act was enacted in 1951, there was no provision for this type of statutory action when the Arizona Constitution was adopted in 1910. Therefore, Article 2, Section 23 did not preserve a jury trial for statutory claims that did not exist in 1910. *Arnett*, *In re Estate of Newman* and *Life Investors* are controlling and dispose of Respondents' arguments concerning a purported jury trial right.

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[265] *See* A.R.S. § 44-1972(C), (E); Twenty-Ninth Procedural Order dated 11/28/2016 at 20:10-12.

B. When a Proceeding Implicates Public Rights, and the Legislature has Provided a Proper Administrative Forum for Adjudicating the Action, the Right to a Jury Trial is Inapplicable.

The United States Supreme Court has held that the Seventh Amendment right to a jury trial does not apply to administrative proceedings. *Atlas Roofing Co. v. Occupational Safety and Health Review Comm'n*, 430 U.S. 442, 455 (1977); *Tull v. United States*, 481 U.S. 412, 418, n.4 (1987) ("[T]he Seventh Amendment is not applicable to administrative proceedings."). Legislatures can assign to administrative agencies the power to enforce certain laws, or adjudicate certain "public rights." *Atlas Roofing*, 430 U.S. at 450. These are situations in which the government acts in its sovereign capacity to enforce public rights under a statute. *Simpson v. Office of Thrift Supervision*, 29 F.3d 1418, 1423 (9th Cir. 1994) (citing *Atlas Roofing*, 430 U.S. at 450).

Respondents argue that the restitution the Division seeks under A.R.S. § 44-2032(1) and A.A.C. R14-4-308 (C) is the same as the damages an investor bringing a private cause of action could seek under A.R.S. § 44-2001(A). Respondents argue that this makes the Division's request for restitution a private right, to which a jury trial should apply, instead of a public right. Disregarding the plain language of A.R.S. § 44-2032(1), Respondents further argue that the remedy of restitution is "not integral to a regulatory scheme."[266]

Respondents' argument is contrary to Arizona law. Enforcement actions the Securities Division brings, such as the one here, are "brought for the public benefit...." *Trimble*, 152 Ariz. at 556. The corrective actions taken by the Commission "benefit the public as a whole. The public interest is served by the cessation of illegal and fraudulent acts." *Id.* at 555-56. Requiring persons who violate the Securities Act "to

[266] Concordia Br. at 39:10.

make restitution to the victims has a deterrent effect, which also serves the public interest." *Id.* at 556. "The fact that the action in its present status is directed toward remedies for individuals does not diminish the public interest nature of the proceeding." *Id.* at 556.

When a proceeding implicates public rights, as this one does, and the legislature has provided a proper administrative forum for adjudicating the action, the right to a jury trial is inapplicable. *See Simpson*, 29 F.3d at 1424; *see also Atlas Roofing*, 430 U.S. at 455 (Seventh Amendment does not prevent Congress from committing litigation to administrative agencies with special competence in the relevant field). Respondents are not entitled to jury trial on the Division's requests for the statutory remedies of restitution and penalties.

C. Respondents Rely on Inapposite Cases.

Respondents cite eight Arizona cases concerning jury trial rights, but none involve statutory causes of action or administrative enforcement proceedings.[267] They are inapposite. Most stand for the unremarkable proposition that the right to a jury

[267] *Derendal v. Griffith*, 209 Ariz. 416, 418, ¶ 2 (2009) (criminal misdemeanor prosecution for drag racing); *Brown v. Greer*, 16 Ariz. 215, 216 (1914) (action for an accounting and settlement of copartnership's affairs), *superseded by statute as stated in Hoyle v. Superior Court in and for Maricopa County*, 161 Ariz. 224, 229 (App. 1989); *Fisher v. Edgerton*, 236 Ariz. 71, 73, ¶ 2 (App. 2014) (trial de novo to jury following appeal of compulsory arbitration of claims arising from auto accident); *Orme School v. Reeves*, 166 Ariz. 301, 303 (1990) (indemnity claim by school defending a claim of salmonella poisoning by former student); *Dombey v. Phoenix Newspapers, Inc.*, 150 Ariz. 476, 565 (1986) (libel action); *Perkins v. Komarnyckyj*, 172 Ariz. 115, 116 (medical malpractice action; trial judge erred by (1) communicating with jurors without notifying counsel and (2) instructing jurors that those voting against liability should not participate in determining damages); *Chartone, Inc. v. Bernini*, 207 Ariz. 162, 164, ¶ 1 (App. 2004) (action for breach of an implied contract; trial judge erred by bifurcating trial into separate phases for liability and damages and then, while jury was deliberating on liability, vacating bifurcation order an appointing a special master to determine damages); and *Moses v. Daru*, 4 Ariz. App. 385, 387, 391 (1966) (plaintiff/counterdefendant was entitled to have jury decide his liability and the amount of damages on defendant's counterclaim for defamation).

trial is preserved in those common law actions for which there was a right to jury trial when the Arizona Constitution was adopted. *See Fisher* 236 Ariz. at 73, ¶ 2 (claims, presumably negligence, arose from auto accident); *Chartone*, 207 Ariz. at 164, ¶ 1 (breach of an implied contract); *Perkins*; 172 Ariz. at 116 (medical malpractice action); *Dombey*, 150 Ariz. at 565 (libel action); *Moses*, 4 Ariz. App. at 387 (counterclaim for defamation).

Respondents' reliance on *Del Monte Dunes*,[268] *Feltner*[269] and *Granfinanciera*[270] is misplaced. Those cases hold that the Seventh Amendment's preservation of a right to a jury trial "applies not only to common-law causes of action but also to statutory causes of action 'analogous to common-law causes of action ordinarily decided in English law courts in the late 18th century, as opposed to those customarily heard by courts of equity or admiralty.'"[271] In the 18th century before the Seventh Amendment was adopted, there was no common-law cause of action analogous to a securities enforcement action. Thus, this holding of *Del Monte Dunes*, *Feltner* and *Granfinanciera* does not apply.

Tull v. United States[272] undermines, rather than supports, Respondents' arguments. *Tull* was a Clean Water Act enforcement action the government brought in federal district court, not in an administrative agency.[273] 481 U.S. at 415. Thus,

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[268] *City of Monterey v. Del Monte Dunes at Monterey*, Ltd., 526 U.S. 687 (1999) (Section 1983 action).

[269] *Feltner v. Columbia Pictures Television, Inc.*, 523 U.S. 340, 348 (1998) (copyright infringement action)

[270] *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989) (bankruptcy trustee's action to void fraudulent transfers).

[271] *Del Monte Dunes*, 526 U.S. at 708-09 (quoting *Feltner*, 523 U.S. at 348 (internal quotation omitted)); *Granfinanciera*, 492 U.S. at 42.

[272] *Tull v. United States*, 481 U.S. 412 (1987).

[273] The statute under which the government brought its enforcement action in *Tull* requires that any enforcement action "be brought in the district court of the United States for the district in which the defendant is located or resides or is doing business, and such court shall have jurisdiction...." 33 U.S.C. § 1319(b).

unlike this proceeding, the dispute in *Tull* was not an adjudication before an administrative tribunal, but was in a forum - federal court - that provided a procedure for a trial by jury. Therefore, *Tull* is neither analogous nor relevant, except that the Supreme Court reaffirmed that "the Seventh Amendment is not applicable to administrative proceedings." *Id.* at 418, n. 4 (citing *Atlas Roofing Co. v. Occupational Safety and Health Review Comm'n*, 430 U.S. 442 (1977)).

Finally, *Great-West Life Annuity Ins. Co. v. Knudson*[274] did not involve a jury trial issue and it does not help Respondents. In *Great-West Life*, the insurer to an ERISA plan sued a beneficiary who was injured in an auto accident and whose personal injury settlement recovered some of the medical expenses the insurer and plan had paid. The insurer sought to enforce the plan's reimbursement provision giving it the right to recover from a beneficiary any payment for benefits paid by the plan that the beneficiary was entitled to recover from a third-party. 534 U.S. at 207. The issue was whether the insurer could proceed under a federal statute that authorizes a civil action "to enjoin any act or practice which violates the terms of the plan, or ... to obtain other appropriate equitable relief...." 29 U.S.C. § 1132(a)(3). The Court held the suit could not proceed under that statute because the insurer was not seeking equitable relief but legal relief instead. *Id.* at 221. The insurer sought "in essence, to impose personal liability on [the plan's beneficiary] for a contractual obligation [under the plan] to pay money...." *Id.* at 210. The Court reasoned, "A claim for money due and owing under a contract is quintessentially an action at law." *Id.* at 210 (internal quotations and citation omitted).

In contrast to the insurer's claim in *Great-West Life*, the Division is not seeking to enforce the investment contracts between Respondents and their investors. The Division does not seek to impose contractual liability on Respondents, nor could it.

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[274] *Great-West Life Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002).

Neither the Division nor the Commission is a party to the investment contracts. Rather, the Division seeks to impose statutory liability on Respondents to pay restitution and penalties pursuant to A.R.S. §§ 44-2032(1) and 44-2036 because they violated the Securities Act.

In short, the authorities Respondents rely upon are inapposite. They do not provide a basis on which to conclude that Respondents are entitled to a jury trial on the Division's request relief of restitution and administrative penalties.

VIII. THE RECORD AND THE LAW REFUTE RESPONDENTS' FALSE ACCUSATIONS AGAINST THE DIVISION.

Having no real defense to their serial violations of the Securities Act, Respondents attack the Division's integrity. They assert, "the Division presented false testimony and withheld exculpatory evidence."[275] Neither the record nor the law supports Respondents' false accusations.

Respondents provided several investors with flowcharts that stated, "PRODUCT APPROVED BY KANSAS CITY LIFE INC., BROKER: SUNSET FINANCIAL."[276] The Division alleged that Kansas City Life Insurance Company never approved the investments in Concordia.[277]

On March 12, 2015, the Division provided Respondents with its preliminary Lists of Witnesses and Exhibits. The exhibits included the flowcharts. The list of witnesses included A. Craig Mason, Jr. of Kansas City Life Insurance Company.

On December 6, 2016, the Division called Mr. Mason to testify. He is a senior vice president, general counsel and secretary of Kansas City Life Insurance

[275] Concordia Br. at 5:22-23.
[276] S-2(e); S-11(f); S-13(g); S-24(l); S-110(f).
[277] *See* Amended Notice at ¶¶ 61 & 72(c).

Company.[278] He is also the secretary of Sunset Financial Services, Inc.,[279] which is Kansas City Life's wholly owned subsidiary.[280] Despite that ownership, Sunset Financial is separate legal entity from Kansas City Life.[281]

Mr. Mason testified that Kansas City Life "had no record of this or knowledge of this [Concordia] product whatsoever,"[282] and had never approved it.[283]

Mr. Mason also testified that Sunset Financial had records concerning Concordia investments that one of its registered representatives, Randolph Albers, had sold to three clients.[284] Mr. Mason further testified that although Mr. Albers had sold those investments, Sunset did not approve them for sale.[285] Mr. Mason testified that Sunset learned of the Concordia investments when Mr. Albers reported them on his annual compliance questionnaire.[286] After that, Sunset required Mr. Albers to report the investments through the firm so as to monitor his outside business activities.[287]

Mr. Mason testified that Sunset sent a binder of whatever documents it had found concerning Concordia to the Division.[288] Concordia moved that both Sunset and the Division be ordered to produce any such documents.[289] After conferring with Chief Investigator Gary Clapper, the Division's counsel stated his then existing belief, which was erroneous, that "the Division, in fact, did not receive any binder from

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[278] Vol. V at 792:24 to 793:1.
[279] Vol. V at 792:24 to 793:1.
[280] Vol. V at 793:13-16.
[281] Vol. V at 793:17-20.
[282] Vol. V at 796:5-7.
[283] Vol. V at 796:21-24; 797:15-21; 819:5-13.
[284] Vol. V at 796:8-16; 798:19-24.
[285] Vol. V: at 796:17-20; 818:25 to 819:4.
[286] Vol. V at 812:14-17.
[287] Vol. V at 812:12-13; 829:16-21.
[288] Vol. V at 832:11-15; 833:10-17.
[289] Vol. V at 833:2-9.

Sunset Financial."[290] The Division's counsel continued, "And that being said, if Mr. Mason is willing to provide a copy of that binder, we have no objection to that...."[291]

During the colloquy that ensued, the Division's paralegal, Karen Houle, checked the Division's electronic file, which indicated that the Division probably did have documents sent from Sunset. The Division's counsel immediately stated: "We may well have that binder that I just stated we didn't – I didn't think we had. If we do, we will produce it...."[292]

After a short recess, the Administrative Law Judge asked: "Mr. Burgess, have you had an opportunity to find out anything more about the binder that was mentioned by the prior witness?"[293] The Division's counsel responded:

> Yes. As I discussed with Mr. Baskin over the break, there is a substantial number of documents. Over the lunch hour or the lunch break ... I will look at what the documents are and determine the extent that we may need to redact them. And then we'll begin processing them for production as quickly as we can. Without looking at it, I mentioned to Mr. Baskin that we might be able to get them to the respondents as early as tomorrow, but either way, I will give them an update on what it is and when they can expect it.[294]

Respondents falsely assert that the Division made "efforts to bury that information [received from Sunset]."[295] To the contrary, when the Division's counsel did not believe the Division had any documents from Sunset, he stated that the Division had no objection if Mr. Mason produced the documents he had described.[296] When moments later it appeared that the Division had received documents from Sunset

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[290] Vol. V at 23-25.
[291] Vol. V at 833:25 to 834:2.
[292] Vol. V at 837:10-16.
[293] Vol. V at 840:24 to 841:2.
[294] Vol. V at 841:3-15.
[295] Concordia Br. at 44:2-3.
[296] Vol. V at 833:25 to 834:2.

in July 2013, ***the Division's counsel volunteered to produce them*** to Respondents.[297] The record belies Respondents' false accusation.

Nor did the Division "withhold" or "conceal" the Sunset documents as Respondents assert. Respondents' accusation incorrectly presumes the Division had an obligation to disclose the Sunset documents sooner than it volunteered to do. But no such obligation existed.

The Administrative Procedures Act (APA) and the Commission's Rules provide for limited discovery by subpoenas and depositions, upon a showing of reasonable need, and allow for the exchange of exhibits prior to a hearing.[298] The APA and the Commission's Rules do not require the parties to disclose documents they do not intend to use as exhibits at the hearing. This is as true for the Division as it is for the Respondents.

The Division did not intend to use the Sunset documents at the hearing. The Division's counsel was unaware they even existed until the middle of Mr. Mason's testimony.[299] The Division did not have any obligation to disclose the Sunset documents before it volunteered to produce them. To the contrary, even if counsel had been aware of the Sunset documents, absent authorization or the documents becoming "a matter of public record,"[300] the Securities Act's confidentiality statute[301]

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[297] Vol. V at 837:10-16.

[298] A.R.S. § 41-1062(A)(4); A.A.C. R14-3-108(A); A.A.C. R14-3-109(L); A.A.C. R14-3-109(O); A.A.C. R14-3-109(P).

[299] Vol. V at 837:10-16.

[300] A.R.S. § 44-2042(A)

[301] A.R.S. § 44-2042(A), provides in relevant part:

> The names of complainants and all information or documents obtained by any officer, employee or agent of the commission ... in the course of any examination or investigation are confidential unless the names, information or documents are made a matter of public record. An officer, employee or agent of the commission shall not make the confidential names, information or documents available to anyone other than a member of the commission, another officer or employee of the commission, an agent who is designated by the commission or director, the attorney general or law

required that the Division keep them confidential, as did Ethical Rule 1.6. *See* ER 1.6, cmt. [3] ("The confidentiality rule ... applies not only to matters communicated in confidence, but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law.").

Respondents cite no authority for their contention that the Division had an obligation to disclose what they characterize as exculpatory evidence. Their contention is contrary to the law.

The state has an obligation to disclose exculpatory evidence to defendants in criminal cases. *Brady v. Maryland*, 373 U.S. 83 (1963). That obligation does not extend to civil enforcement actions like this one. "*Brady* is limited to the criminal context and has never been applied in a civil or administrative setting." *Ellsworth v. Baltimore Police Dep't*, 89 A.3d 1183, 1192 (Md. 2014) (*Brady*'s disclosure obligations did not apply to police disciplinary hearing); *Culver v. Culver*, 360 S.W.3d 526, 536 (Tex. App. 2011) (wife "has not provided this Court with any authority that *Brady* is applicable to a protective order proceeding – a civil proceeding – and we are not aware of any."); *Alexander v. New York State Div. of Parole*, 654 N.Y.S.2d 835, 836 (App. 1997) ("The right of a criminal defendant to discover exculpatory material does not apply in the context of parole revocation proceedings."); *Smigelski v. Dubois*, 100 A.3d 954, 967 (Conn. App. 2014) (rejecting attorney's due process claim that the state bar's disciplinary counsel "had any obligation to correct [a witness'] testimony or to provide [the attorney] with any evidence favorable to his case.").

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enforcement or regulatory officials, except pursuant to any rule of the commission or unless the commission or the director authorizes the disclosure of the names, information or documents as not contrary to the public interest.

As one court recently ruled: "Our case law amply demonstrates that *Brady* applies only to defendants in criminal prosecutions.... This case is not a criminal action, but rather a civil enforcement action and, thus, the requirements of *Brady* do not apply."[302] In short, the Division had no obligation to disclose the Sunset documents.

Nothing prevented Respondents from contacting Sunset to request its documents concerning Concordia. Respondents knew as early as March 12, 2015, that the Division intended to call Mr. Mason to testify. Yet Respondents never contacted him or Sunset to determine if potentially relevant documents existed. If Sunset had been unwilling to provide its documents, pursuant to the APA and the Commission's Rules,[303] Respondents could have applied for a subpoena to Sunset to obtain the documents.

Nor were the Sunset documents exculpatory. Nowhere did they state that Kansas City Life had ever approved Concordia's investments. What they showed was that Mr. Albers reported to Sunset in his annual compliance questionnaires that he had sold three Concordia's investments, and he told Sunset it had approved the sales.[304] There is a difference, however, between Mr. Albers' telling Sunset it had approved those investments and Sunset actually approving them. The documents also showed that Concordia paid commissions to Sunset and Mr. Albers.[305]

After the Division produced the Sunset documents, it invited Respondents to recall Mr. Mason to testify again so they could examine him about the documents: "Mr. Sabo is free to – the respondents are free to recall Mr. Mason if they want to

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[302] *Gonzalez v. State Elections Enforcement Comm'n*, 77 A.3d 790, 802 (Conn. App. 2013).
[303] A.R.S. § 41-1062(A)(4); A.A.C. R14-3-109(O).
[304] *See* ER-15 at ACC011521 to ACC011525.
[305] ER-15 at ACC011527 to ACC011543.

recall him."[306] The Division then offered to arrange Mr. Mason's further testimony,[307] which it did.

On December 13, 2016, Mr. Mason testified again. Mr. Mason did not waiver from his prior testimony that Sunset did not approve Mr. Albers' sale of the Concordia's investments: "[H]e did not sell it through the firm, but our treatment would be as if it had been sold by a different firm. We never did an initial suitability review of this; we never took in initial paperwork of the sales. It was treated as if the product had been sold privately and then brought to us."[308]

With respect to the first commission payment dated October 30, 2000, Mr. Mason testified that Sunset accepted that check, even though it did not have a selling agreement for Concordia's investments, because "we didn't have good procedures in place."[309] Sunset was subsequently disciplined by FINRA in two different Acceptance, Waiver and Consent (AWC) agreements for its supervisory and due diligence deficiencies.[310] Mr. Mason testified that starting in 2003, as a result of the first AWC, for investments like Concordia's for which Sunset did not have a selling agreement, Sunset required its representatives to report them and run their commissions through the firm.[311] Sunset then took a share of any monies that flowed through the firm.[312]

Whatever this evidence reflects about whether Sunset actually ever approved Concordia's investments, it does not show that Kansas City Life ever approved them. That, however, is what Respondents' flowcharts misrepresented.

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[306] Vol. VII at 1192:9-11.
[307] Vol. VII at 1199:25 to 1200:1.
[308] Vol. X at 1798:1-7.
[309] Vol. X at 6-9.
[310] C-31; Vol. X at 1794:24 to 1795:6, and 1811:23.
[311] Vol X at 1811:21 to 1812:3.
[312] Vol. X at 1809:13-14.

Respondents accuse the Division of misconduct by seeking to impeach C. Crowder with a portion of the Sunset documents. This accusation is unwarranted and hypocritical. In its List of Witnesses and Exhibits dated October 28, 2012, Concordia itself reserved "the right to use documents not identified above in cross-examination or rebuttal." Thus, Concordia reserved the right to use undisclosed documents for impeachment, but contends the Division had no similar right. The Commission should reject Respondents' double standard.

Moreover, impeaching Concordia's president with offering documents he and Concordia's C.F.O. created in 2010 was entirely appropriate. The documents undermined Concordia's representation in its opening statement that in 2008 it "voluntarily ceased" attempting to raise investor money.[313] And the documents directly contradicted C. Crowder's testimony.

C. Crowder testified it would have been irresponsible for Concordia to take on more investor money in 2009, 2010, 2011 and 2012[314] because Concordia has been on the brink of bankruptcy since 2009.[315] Echoing what Concordia represented in its opening statement, C. Crowder testified that Concordia has not sought to raise money from investors since 2008:

> Q. You and Concordia have not sought to raise new investor money since 2008, correct?
>
> A. Concordia has not, no.
>
> Q. Okay. Concordia has not sought funds from investors since 2009 to fund its operations?
>
> A. Not that I know of.[316]

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[313] Vol. I at 41:10-11.
[314] Vol. VI at 1155:2-12.
[315] Vol. VI at 1155:13-20.
[316] Vol. VI at 1155:21 to 1156:2.

C. Crowder further testified, however, that in July 2010, he and Armen Dekmejian discussed creating another company to raise money from investors but "it wasn't for Concordia."[317] C. Crowder further testified:

> Q. It wasn't for Concordia?
>
> A. No.
>
> Q. The money would not be used for Concordia?
>
> A. No.
>
> Q. And by "Concordia" you mean Concordia Finance?
>
> A. Correct.[318]

Within the Sunset documents were emails dated between July and September 2010 in which C. Crowder and Dekmejian attempted to solicit interest from Sunset Financial in a securities offering to be issued by a new company, "Concordia Funding I, LLC."[319] An offering memorandum that C. Crowder and Dekmejian sent to Sunset Financial stated: "Concordia through Concordia Funding I, LLC, is currently seeking to raise up to $10 million in senior secured financing … to fund the opportunities in the pre-owned truck finance business over the next two years."[320] The offering memorandum further stated, "Concordia Finance Co. Ltd. will be the manager of Concordia Funding I, LLC."[321] The LLC would be "used only to acquire and hold the Conditional Installment Sales Contracts ('Sales Contracts') originated and serviced by Concordia Finance, Inc."[322] Thus, contrary to C. Crowder's testimony, Concordia tried to use the LLC as a shell to raise money to fund Concordia's operations.

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[317] Vol. VI at 1157:19-23.
[318] Vol. VI at 1557:24 to 1158:4.
[319] ER-15 at ACC011545 to ACC011571.
[320] ER-15 at ACC011559.
[321] ER-15 at ACC011568.
[322] ER-15 at ACC011555.

A term sheet for the offering further contradicted C. Crowder's testimony. It stated, "Investment Purpose: Concordia Finance, Inc. ('Concordia') intends to use the net proceeds to purchase class 8 truck Sales Contracts...."[323] Thus, Concordia intended to use the money raised to purchase more truck loans.

These offering materials demonstrate that C. Crowder testified falsely when he stated:

> Q. Okay. Concordia has not sought funds from investors since 2009 to fund its operations?
>
> A. Not that I know of.[324]
>
> ...
>
> Q. The money would not be used for Concordia?
>
> A. No.[325]

Further, the documents demonstrate that the offering documents Concordia prepared contained material misrepresentations and omissions. The offering memorandum represented that one of the strengths of the offering was that Concordia then currently had "a portfolio with stellar performance."[326] This was contrary to C. Crowder's testimony characterizing the performance of Concordia's truck loan portfolio since 2009 as first being "in dramatic freefall" and then slowly going "sideways."[327] The offering memorandum contained a section disclosing certain risks of the investment, but nowhere did it disclose that Concordia was on the brink of bankruptcy.[328]

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[323] ER-15 at ACC011555.
[324] Vol. VI at 1155:21 to 1156:2.
[325] Vol. VI at 1557:24 to 1158:2.
[326] ER-15 at ACC011566 (emphasis added).
[327] Vol. VI at 1156:3-6.
[328] *See* ACC011566 to ACC011567.

Concordia's opening statement and C. Crowder's testimony introduced the issues of whether Concordia sought to raise money from investors after 2008 and what its financial condition was. Concordia should not be heard to complain that the Sunset documents its counsel insisted be produced turned out to contain offering materials Mr. Crowder prepared in 2010, which exposed a misrepresentation in Concordia's opening statement and impeached Mr. Crowder.

IX. RESPONDENTS' MISCELLANEOUS ARGUMENTS FAIL.

A. The Division Fully Complied with the Applicable Discovery Standards Under the APA and the Commission's Rules.

The ER Respondents again complain that they were denied discovery under the Arizona Rules of Civil Procedure.[329] For the reasons detailed in the Motion to Quash filed January 5, 2015, and the Reply filed February 3, 2015, the Arizona Rules of Civil Procedure do not apply to this proceeding. The discovery provisions in the Administrative Procedures Act and the Commission's Rules apply.[330] The Division also incorporates the reasoning at pages 5 and 6 of the Twelfth Procedural Order dated July 19, 2017, in *WMF Management, LLC et al.*, A.C.C. Docket No. S-20988A-16-0354.

B. Linda Wanzek

The ER Respondents again argue the Commission does not have jurisdiction to proceed against Linda Wanzek because she moved to Florida in 2010, and Florida is

[329] ER Respondents Br. at 80:5-6.

[330] A.R.S. § 41-1062(A)(4); A.A.C. R14-3-108(A); A.A.C. R14-3-109(L); A.A.C. R14-3-109(O); A.A.C. R14-3-109(P).

not a community property state. The Administrative Law Judge properly rejected this argument in the Fourth Procedural Order filed August 13, 2014. The Division adopts the reasoning and authorities set forth at pages 25 through 27 of the Fourth Procedural Order.

The ER Respondents also argue Linda Wanzek was denied due process because the Commission did not provide her a reasonable accommodation under the Americans With Disabilities Act. Specifically, the ER Respondents assert the Commission did not "set up a secure web feed"[331] so she could monitor the proceedings from her home.

The ER Respondents never requested a reasonable accommodation for Mrs. Wanzek or a "secure web feed." Instead, they requested the Commission to publicly broadcast the hearing. *See* Letter from Jodi Jerich to Timothy Sabo dated 11/22/2016. The Commission's Executive Director acted well within her discretion in denying the ER Respondents' request for a public broadcast.

Further, the ER Respondents' request for a public broadcast merely stated that Mrs. Wanzek would be unable to travel due to health issues, not that she was disabled.[332] The request did not mention the Americans With Disabilities Act or the term "reasonable accommodation."[333]

In any event, an allegation of an ADA violation is not a defense to the Wanzeks' liability in this action. *See In re Doe*, 60 P.3d 285, 291 (Hawaii 2002) (allegations of an ADA violation were not a defense to a parental rights termination proceeding "because any purported violation may be remedied only in a separate proceeding brought under the provisions of the ADA.").

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[331] ER Respondents' Br. at 74:24-25.

[332] *See* Letter from Jodi Jerich to Timothy Sabo dated 11/22/2016 reciting the reasons stated in the ER Respondents' request.

[333] *See id.*

C. A Cease and Desist Order is Appropriate.

Concordia argues there is no reason for a cease and desist order because in 2008 it ceased trying to raise money from investors.[334] The argument is factually incorrect. As set forth above and in the Division's Opening Brief, in 2010 Concordia attempted to raise $10 million from investors[335] by misrepresenting it had "a portfolio with stellar performance."[336]

Cease and desist orders are properly entered when defendants have violated the securities laws. *See Black Diamond Fund, LLLP v. Joseph*, 211 P.3d 727, 738 (Colo. App. 2009) ("Compliance with the [Colorado Securities Act] is necessarily in the public interest.... We also find nothing arbitrary or capricious in the terms of a cease and desist order that mandates compliance with those laws."); *S.E.C. v. Alexander*, 115 F.Supp.3d 1071, 1085-86 (N.D. Cal. 2015) (permanent injunction was warranted against future violations of securities laws because defendants' actions were not isolated incidents, they never publicly acknowledged wrongfulness of their conduct, and they provided no assurances against future violations); *S.E.C. v. Deyon*, 977 F. Supp. 510, 518-19 (D. Me. 1997) (permanent injunction was warranted against future violations because defendants would not admit wrongful conduct).

As in *Alexander*, Respondents' violations were not isolated incidents. Respondents sold 132 of Concordia's unlawful investment contracts over ten years. Concordia and the ER Respondents refuse to acknowledge the wrongfulness of their conduct. To the contrary, Concordia brazenly asserts "it should be commended"[337] for its unlawful conduct. Accordingly, a cease and desist order is appropriate.

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[334] Concordia Br. at 18:9-10.
[335] ER-15 at ACC011559.
[336] ER-15 at ACC011566 (emphasis added).
[337] Concordia Br. at 1:24.

X. THE COMMISSION SHOULD ORDER FULL RESTITUTION FOR THE INVESTORS AND SIGNIFICANT PENALTIES.

The Commission has broad authority to order Respondents to remedy their violations of the Securities Act, "including, without limitation, a requirement to provide restitution as prescribed by rules of the commission." A.R.S. § 44-2032(1); A.A.C. R14-4-308(A) & (C). Ordering persons who violate the Act to make their victims whole by paying restitution advances the Act's remedial purposes as well as investor protection. "Requiring the [violators] to make restitution to the victims has a deterrent effect, which … serves the public interest." *Trimble*, 152 Ariz. at 555-56

A. By Concordia's Own Admission, Respondents Owe $2.296 Million to Investors.

Concordia introduced its exhibit, C-24, which purported to rebut the Division's financial data summary, S-194, showing the $2.643 million of net principal still owed to 59 investors. The ER Respondents did not object to Concordia's introduction of C-24.[338] Concordia's witness who prepared C-24 admitted it contained several mistakes and inaccuracies.[339] But even according to Concordia's own exhibit, investors are owed net principal of $2,296,185.15.[340] Pursuant to A.R.S. § 44-2032(1) and A.A.C. R14-4-308 (C), the Commission should order Respondents to pay restitution of at least $2,296,185.15.

The Division's forensic accountant, Avi Beliak, C.P.A, prepared S-194, which accurately summarizes the investment documents, ledgers and spreadsheets Concordia

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[338] *See* Vol. XIV at 2411:14 to 2422:14.
[339] Vol. XIV at 2413:17 to 2414:19, 2415:11-12, 2417:16-20, and 2420:19 to 2421:9.
[340] C-24 at C002031.

produced in response to the State of California's subpoena duces tecum.[341] Mr. Beliak determined the amounts Concordia repaid investors by examining Concordia's account ledgers and spreadsheets.[342] When Concordia's account ledgers and spreadsheets covered concurrent dates, they sometimes contained conflicting information.[343] The ledgers documented the dates, check numbers and amounts of payments Concordia sent to investors.[344] The spreadsheets did not list any check numbers, but rather amounts that appeared to be repayments or accruals of interest.[345] So for the time periods for which Concordia produced its ledgers, Mr. Beliak used the ledgers as the best available evidence of repayments.[346] For the periods for which ledgers were not available, Mr. Beliak used Concordia's spreadsheets to give Respondents credits for what appeared to be payments to investors.[347]

In many instances, Mr. Beliak determined that investors are owed less net principal than Concordia calculates.[348] In an effort to reconcile the differences between S-194 and C-24, the Division requested information from Concordia, but Concordia did not provide it.[349]

Mr. Beliak credited, and S-194 accurately reflects as of the date it was prepared, all payments to investors shown on the documents Concordia produced. The Division and the State of California subpoenaed and tried to obtain evidence of all repayments to investors, including any monthly interest payments Concordia made between 1998 and 2003. *See* S-162 at Request No. 21 requesting Concordia to produce "records of

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[341] S-181; S-182; Vol. VII at 1224:2 to 1225:3; Vol. VI at 1028:12-14, 1033:7 to 1034:1, and 1140:22-25.
[342] Vol. VI at 1033:16-1034:1, 1077:2-20, 1107:11-21 and 1123:23 to 1125:6.
[343] Vol. VI at 1107:9-14.
[344] Vol. VI at 1033:16-1034:1.
[345] Vol. VI at 1124:8 to 1125:8.
[346] Vol. VI at 1107:11-21.
[347] Vol. VI at 1107:15 to 1108:4.
[348] S-194 at Tab 1A; Vol. VI at 1038:7-24.
[349] Vol. VI at 1118:10-13.

all payments" to investors, ACC011997; S-184 at Request No. 26 requesting ER Financial to produce "The amounts and dates of any interest, earnings, distributions, dividends, ... refund, or any other form of returns" to investors. The ER Respondents produced no evidence of any repayments to investors. Concordia only provided the ledgers and spreadsheets for some of the time period at issue.

S-194 does not purport to credit repayments for which Respondents provided no evidence. For this reason, the Division did not choose "to omit ... monthly interest payments to Contract holders from prior to 2004 and as far back to 1998," as Respondents erroneously contend.[350] The Division used the same consistent approach as with the rest of the time period at issue. The Division credited Respondents with repayments as long the ledgers and/or spreadsheets Concordia produced documented those payments.

Respondents' assertion that the Division "simply made judgment calls"[351] about what amounts to credit is untrue. As Mr. Beliak testified, the Division relied on the evidence Concordia produced to determine the repayment amounts.[352] The Division did not estimate or assume that payments were made to investors where Respondents provided no documents supporting such payments. Because payment is an affirmative defense, the burden is on Respondents to prove any payments they made. *See B & R Materials, Inc. v. United States Fidelity & Guaranty Co.,* 132 Ariz. 122, 124 (App. 1982).

It is Respondents' problem, not the Division's, that Respondents failed to keep records of some of the payments they may have made to investors. Respondents' poor record-keeping is no reason to harm the investors by reducing the restitution Respondents owe them.

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[350] Concordia Br. at 12:6-10.

[351] Concordia Br. at 24:16-17.

[352] Vol. VI at 1033:16-1034:1, 1077:2-20, 1107:11-21 and 1123:23 to 1125:6.

Moreover, the Division is not refusing to account for payments made to investors from 1998 through 2003, as Respondents contend.[353] To the contrary, pursuant to A.A.C. R14-4-308(C)(4), Respondents are entitled to be credited for any payments they can verify they made. But it is incumbent on Respondents that they do so.

Respondents complain that the Division's request for restitution does not take into account the Second Amendments that Concordia imposed in December 2011. The Second Amendments purported to reduce the principal amounts owed to investors by 55%, and to release Concordia and its agents from all liability.

The Second Amendments are void and of no effect, however. The Securities Act's anti-waiver statute, A.R.S. § 44-2000, expressly prohibits and voids agreements that purport to waive the applicability of the Act: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with this chapter or chapter 13 of this title or of the rules of the commission is void."[354] The Legislature enacted § 44-2000 to prevent sellers of securities from using contractual waivers to narrow the protection for investors at which the Arizona Securities Act is aimed. *R & L Limited Investments, Inc. v. Cabot Investment Properties, LLC*, 729 F. Supp.2d 1110, 1113 (D. Ariz. 2010) (§ 44-2000 voided provision for Georgia law to govern an investment contract sold to an Arizona resident; contractual provision could not displace applicability of Arizona Securities Act).

§ 44-2000 prohibits Respondents from using the Second Amendments to contract their way out of their obligation to pay full restitution pursuant to the Act and the Commission's Rules.[355] Pursuant to § 44-2000, the Second Amendments are void. Giving effect to them "would undercut Arizona's public policy objectives of

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[353] Concordia Br. at 27:9.

[354] A.R.S. § 44-2000.

[355] A.R.S. § 44-2032(1); R14-4-308(A) & (C).

protecting investors from ... provisions created by those peddling investments and designed to evade the substantive safeguards that Arizona's legislators have crafted to protect its investing citizenry." *R & L Limited*, 729 F. Supp.2d at 1114.

Thus, contrary to Respondents' contentions, the Second Amendments did not extinguish or even alter their restitution obligations. The Second Amendments did not impact the Commission's statutory authority under § 44-2032(1) to order Respondents to repay the investors the full amounts they entrusted to Respondents.

Respondents also complain that the Division's request for restitution does not take into account the "tax benefits" Respondents contend the investors received because of their investment losses with Concordia. Investment losses, however, are not "tax benefits." They are losses. Respondents do not cite any authority for their contention that the purported tax benefits should offset the restitution owed. In any event, the Commission's Rule governing restitution does not provide for a respondent to be credited with any tax benefits an investor may have received. *See* A.A.C. R14-4-308(C).

Respondents also complain that the Division is seeking restitution for some investors who do not want it.[356] This is not an issue. The Commission's standard procedure is to order that "Any restitution funds that the Commission cannot disburse because an investor refuses to accept such payment ... shall be disbursed on a *pro rata* basis to the remaining investors shown on the records of the Commission."[357]

Respondents also complain that S-194 does not reflect all the salespeople whom they claim sold Concordia's investments – Lisa Furhman, Ken Crowder, Christopher Crowder, Randy Albers or Charles Buttke – and that it includes Ms. Furhman as being owed restitution. These issues are irrelevant. Those individuals are not respondents.

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[356] ER Respondents' Br. at 71:18-19.

[357] *E.g. In the Matter of Shadow Beverages and Snacks, LLC*, A.C.C. Decision No. 76155 dated 6/22/2017 at 57:28 to 58:5.

The Legislature has given the Securities Division and the Commission broad discretion as to how to enforce the Act.[358] It is not for Respondents to dictate who the Division should name in this enforcement action. *See State v. Buckholz*, 139 Ariz. 303, 309 (App. 1983) ("'[I]t is within the prosecuting attorney's discretion to file charges or refuse to charge for reasons other than the mere ability to establish guilt. He may consider a wide range of factors in addition to the strength of the state's case in deciding whether prosecution would be in the public interest.'") (quoting *State v. Rowe*, 609 P.2d, 1348, 1353 (Wash. 1980)). That others may have also sold Concordia's investment contracts does not excuse Respondents' sales or mitigate their violations.

Respondents also complain that S-194 does not group investments by members of the Guest family or the Singleton family. Respondents do not cite anything in the record as to why investments by separate members of these families should be grouped together. Respondents' contention is irrelevant.

Respondents further complain that Mr. Beliak was an expert witness and S-194 was an expert report, neither of which is true. An expert witness is one who testifies "in the form of an opinion."[359] Having certain knowledge, skill, experience, training or education does not convert a fact or summary witness into an expert witness if the witness does not testify in the form of an opinion.

Mr. Beliak testified as a fact witness who summarized the voluminous documents Concordia produced concerning the investments and repayments to investors. S-194 was a summary of those documents, not an expert report containing opinions. The Division did not ask Mr. Beliak his opinion on anything.

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[358] *See, e.g.*, A.R.S. §§ 44-1971 & 44-2032.
[359] Ariz. R. Evid. 702.

Respondents attempted to characterize Mr. Beliak as an expert witness at the hearing.[360] The Administrative Law Judge, however, correctly ruled that Mr. Beliak "has not been brought forth as an expert witness."[361]

Finally, Respondents assert that when Mr. Beliak updated his original summary, S-172, to S-194, "the Division refused to disclose any additional documents."[362] That assertion is untrue. As stated on the record, on December 5, 2016, the Division sent an e-mail to Respondents' counsel attaching an update of the list of documents Mr. Beliak reviewed in compiling S-194.[363] Respondents' counsel acknowledged receiving that disclosure.[364] The Administrative Law Judge found that "the documents that went into the summary [S-194] have been produced."[365]

B. Reducing Respondents' Restitution Obligations Would Undermine Investor Protection and the Public Interest.

Fifty-nine (59) investors to whom Respondents sold their unlawful securities lost and are owed $2,643,939.65.[366] "'[I]t is well settled that once the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor.'" *F. Hoffman–La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 170-71 (2004) (quoting *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 334 (1961)). The Commission should exercise its broad discretion to order Respondents to remedy their violations by ordering full restitution for the investor-victims.

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[360] Vol. VI at 1071:2 to 1074:13.
[361] Vol. VI at 1075:1-2.
[362] ER Respondents' Br. at 72:21-22.
[363] Vol. VI at 1073:6-16.
[364] Vol. VI at 1073:17-18.
[365] Vol. VI at 1074:25 to 1075:2.
[366] S-194 at page 3 of 3.

The Commission has discretion to reduce a respondent's restitution obligation "if necessary or appropriate to the public interest and consistent with the protection of investors...." A.A.C. R14-4-308(C)(5). Reducing these Respondents' restitution obligations based on their purported inability to pay would be contrary to the public interest and inconsistent with the protection of investors, especially the 59 who lost $2.643 million.

Bersch, Wanzek and ER Financial made over $3.09 million.[367] Since 2006, Concordia has paid C. Crowder more than $1.7 million[368] and its consultant/chief financial officer, Armen Dekmejian, at least $1,756,500. During the same period, Concordia lost more than $13.8 million. The following table illustrates how generously Crowder and Dekmejian paid themselves each year while Concordia bled high six-figure and seven-figure losses:

YEAR	C. CROWDER SALARY	FEES CONCORDIA PAID DEKMEJIAN (PACIFIC FINANCIAL ADVISERS)	CONCORDIA'S NET INCOME (LOSS)
2006	**$175,000** *Vol. III at 539:20 to 540:1, and 623:5-7*	**$150,000** *Vol. XIV at 2505:22 to 2506:2*	**($836,186)** *ER-2 at 122*
2007	**$175,000** *Vol. III at 623:8-24*	**$150,000** *Vol. XIV at 2505:22 to 2506:10*	**($1,055,451)** *ER-2 at 134*
2008	**$175,000** *Vol. III at 623:8-24*	**$150,000** *Vol. XIV at 2505:22 to 2506:18*	**($2,252,777)** *ER-2 at 053; ER-2 at 134*
2009	**$140,000** *Vol. III at 623:14 to 624:4;* *Vol. XIV at 2508:19-25*	**$315,000** *Vol. XIV at 2509:5-24*	**($4,423,362)** *ER-2 at 141*

[367] S-194 at pages 1 and 2 of 3.
[368] Vol. XIV at 2500:7-11.

2010	**$140,000** *Vol. III at 623:14 to 624:4*	**$315,000** *S-164 at Ex. 13, at ACC011898; Vol. XIV at 2507:21-23.*	**($4,011,597)** *ER-2 at 141*
2011	**$125,000** *Vol. III at 624:3-12; Vol. XIV at 2511:10-14*	**$350,000** *S-164 at Ex. 13, at ACC011901; Vol. XIV at 2512:18-21, and 2513:12-14*	**$3,754** *ER-2 at 159*
2012	**$125,000** *See Vol. III at 624:3-12; Vol. XIV at 12-14*	**$200,000** *S-164 at Ex. 13, at ACC0119003; Vol. XIV at 2514:17-21*	**$80,611** *ER-2 at 055*
2013	**$125,000** *See Vol. III at 624:3-12; Vol. XIV at 12-14*	Unknown	**($119,893)** *ER-2 at 056*
2014	**$175,000** *Vol. III at 624:13-22; Vol. XIV at 12-14*	**$126,500** *ER-2 at 164; Vol. XIV at 2515:19 to 2516:1*	**($1,257,626)** *ER-2 at 164*
2015	**$175,000** *Vol. III at 624:13-22*	Unknown	
2016	**$175,000** *Vol. III at 624:13-22*	Unknown	
	Total C. Crowder Salary 2006-2016 = $1,705,000	**Total Consulting Fees Paid Dekmejian 2006-2014 = $1,756,500**	**Total Net Loss for 2006-2014 = ($13,872,527)**

The generous six-figure sums Crowder and Dekmejian paid themselves each year make clear that they were not working to maximize the amounts Concordia could return to its investors. Rather, Crowder and Dekmejian did not want their gravy train to end. They have been working to pay themselves as much as they can for as long as they can, at the investors' expense.

That Concordia may go bankrupt is not surprising given how much compensation Crowder and Dekmejian have paid themselves. That their lucrative run may end is the natural consequence of Concordia's serial violations of the Act. In any event, the Commission's order for restitution will not be dischargeable if any of the Respondents file for bankruptcy. *See* 11 U.S.C. 523(a)(19) (debts arising from orders for violations of state securities laws are non-dischargeable).

Respondents are undeserving of any reduction in the amount of restitution they should be ordered to pay. Reducing these Respondents' restitution obligations would be contrary to the public interest and investor protection. It would add insult to the investors' injuries. The Commission should order Respondents to pay full restitution.

C. Significant Penalties Are Warranted.

Respondents refuse to accept any responsibility for their serial violations of the Act. They express no remorse for any of their 59 investor-victims who lost $2,643,939.65. Instead, Respondents paint themselves as the victims.

Significant penalties are warranted. Respondents acted recklessly, fraudulently and oppressively toward their investor-victims as follows:

- Crowder did not have any interest in knowing what Bersch, Wanzek and ER Financial were telling investors.[369]
- Concordia did not supervise the marketing of its investments by Bersch, Wanzek or ER Financial.[370]
- Concordia did not do anything to determine if an investor had the financial wherewithal to invest.[371]
- Bersch and Wanzek misrepresented to investors that they monitored Concordia's financial position for the investors.[372]
- C. Crowder periodically took money for himself from Concordia's petty cash.[373] He also used his company credit card for personal items.[374] Crowder's misappropriations of Concordia's funds for his personal use were bad enough that Dekmejian made Crowder enter a repayment agreement.[375]
- In blaming the economy for Concordia's financial condition, C. Crowder wrote, "Concordia was in a good position back in December of 2006."[376] C. Crowder's letter did not inform investors that Concordia's December 31, 2006, financial statement showed an $838,186 net loss.

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[369] Vol. I at 94:15-18 and 130:8-10.
[370] Vol. I at 129:1-12.
[371] Vol. I at 96:24 to 97:2.
[372] Vol. III at 510:13-19; S-2f; S-17e; S-2h; *see* Vol. IX at 1637:25 to 1638:3, and Vol. IX at 1639:13 to 1640:16; Vol. X at 1903:9-11 and 1904:9-14.
[373] Vol. X at 1883:18-21.
[374] Vol. X at 1883:24 to 1884:25.
[375] Vol. X at 1883:22 to 1824:25.
[376] S-2i; Vol I at 182:25 to 183:3.

- Concordia threatened to withhold, and did withhold, the monthly payments it owed investors in order to force them to sign the First Amendment.[377]
- In 2010, Crowder and Dekmejian attempted to raise more investor money for Concordia's use without disclosing it was nearly bankrupt, and by misrepresenting Concordia then currently had "a portfolio with stellar performance."[378]
- In November 2010, Concordia instructed ER Financial to return the vehicle titles, which purportedly served as the investors' collateral,[379] to Concordia[380] without the investors' permission. In doing so, Respondents breached Sections 4.1, 4.2 and 4.3 of the Servicing Agreement, and Section 4 of the Custodial Agreement. When Wanzek sent the vehicle titles back to Concordia in November 2010, the investors' purported collateral was gone.[381]
- Starting in December 2011, Concordia threatened investors that it would not return any more of their principal unless the investors agreed to forego 55% of the balance they were owed and signed releases that purport to absolve Respondents of any liability.[382]
- Not long after Respondents did this to the investors, C. Crowder raised his six-figure salary by another 40%.[383]

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[377] S-2k; S-2l; LeMay – Vol. II at 299:21 to 300:23, 301:3 to 302:5, and 330:5-20; Dennison – Vol. III at 516:22 to 517:6; Crowder – Vol. III at 565:18-20, and 566:22-23.
[378] ER-15 at ACC011566 (emphasis added).
[379] Vol. IX at 1696:18-21 and 1753:11-14.
[380] S-161 at ¶ 4.
[381] Vol. IX at 1697:2-8.
[382] *See* Vol. III at 587:21 to 588:4.
[383] Vol. III at 624:13 to 625:4.

In addition, Bersch and Wanzek terminated ER Financial in response to the Division's investigatory subpoena for ER Financial's records.[384] The ER Respondents have concealed and refused to produce at least one thousand pages of ER Financial's documents that their counsel is holding.[385] Bersch invoked his privilege against self-incrimination[386] when asked whether he purposefully terminated ER Financial in an attempt to frustrate the Division's investigation.[387] Bersch also invoked his privilege against self-incrimination[388] when asked whether, after being served with the Division's subpoena, he destroyed or directed anyone to destroy ER Financial's records.[389] Based on Bersch's invocation of his privilege against self-incrimination, the Commission should draw an adverse inference against the ER Respondents that they destroyed ER Financial's records to frustrate the Division's investigation. *See, e.g., Baxter v. Palmigiano*, 425 U.S. 308, 316-19 (1976); *Curtis v. M&S Petroleum, Inc.*, 174 F. 3d 661, 673-75 (5th Cir. 1999) (fact-finder may draw an adverse inference against a party from the assertion of the Fifth Amendment privilege by a witness whose interests are aligned, such as the party's agents or representatives).

The Commission should order significant penalties based on Respondents' misconduct and refusal to accept any responsibility for their serial violations.

RESPECTFULLY SUBMITTED this 15th day of August, 2017.

By _____
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[384] S-168.
[385] Vol. IX at 1600:15-19, 1653:23-25 and 1654:12-14.
[386] S-173 at 34:22 to 35:5.
[387] S-173 at 34:22 to 35:5.
[388] S-173 at 34:22 to 35:5.
[389] S-173 at 32:18-25.

On this 15th day of August, 2017, the foregoing document was filed with Docket Control as a Securities Division Brief, and copies of the foregoing were mailed on behalf of the Securities Division to the following who have not consented to email service. On this date or as soon as possible thereafter, the Commission's eDocket program will automatically email a link to the foregoing to the following who have consented to email service.

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