Clerk of the Superior Court
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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

LC2021-000080-001 DT 03/15/2022

HONORABLE DANIEL J. KILEY

CLERK OF THE COURT
D. Tapia
Deputy

ISAIAS M VERDUGO

MARK W HORNE

v.

ARIZONA CORPORATION COMMISSION (001)

MICHAEL E SHAW

JUDGE KILEY
OFFICE OF ADMINISTRATIVE HEARINGS
REMAND DESK-LCA-CCC

RECORD APPEAL RULING / AFFIRMED

Arizona Corporation Commission Decision No. 77902

Appellant Isaias M. Verdugo ("Appellant") appeals from the February 12, 2021 Opinion and Order (the "Final Decision") of Appellee Arizona Corporation Commission ("Appellee" or the "Commission"). For the following reasons, this Court affirms.

FACTUAL BACKGROUND & PROCEDURAL HISTORY

Viewed in the requisite light most favorable to sustaining the administrative decision, *see Shorey v. Ariz. Corp. Comm'n*, 238 Ariz. 253, 258 ¶ 14 (App. 2015), the relevant facts can be summarized as follows:

At all material times, Appellant was the owner of a business known as the "Verdugo Gift Company" or "VGC," which purchased home décor products for online resale. Final Decision at p. 6. Between August 2014 and January 2017, approximately 377 individuals entered into Short Term Investment Agreements with VGC pursuant to which the individuals would invest funds in VGC in exchange for the promise of repayment with interest. *Id*. at pp. 62-63. The Short Term

Investment Agreements, or "VGC Notes," were signed by Appellant on behalf of VGC. *Id*. at p. 63. *See also* Index of Record ("I.R.") C-101, Hearing Exhibit S-78, at p. ACC025150, Short Term Investment Agreement dated January 14, 2017. At no time was Appellant registered as a securities dealer or salesperson. Final Decision at p. 61.

VGC allowed and/or encouraged VGC investors to "roll over" their VGC Notes as they matured, meaning that, instead of withdrawing his or her invested principal with accrued interest, the investor left his or her funds with VGC and entered into a new VGC Note with a new maturity date. Final Decision at p. 67.

From May 2016 through January 2017, Teodoro Medellin ("Medellin"), a pastor and acquaintance of Appellant's, actively promoted the VGC investment to members of his congregation and to other pastors. Final Decision at p. 66. VGC paid Medellin a referral fee or commission for bringing new investors to VGC, a fact that was never disclosed to investors. *Id*.

On or about January 27, 2017, VGC closed its doors without notice to investors. At the time, VGC owed promised returns to approximately 150 investors. Final Decision at p. 69.

The Securities Division of the Commission (the "Division") initiated an enforcement action against Appellant and others for violating the Arizona Securities Act ("ASA") by allegedly making, participating in and/or inducing offers and sales of securities in the form of the VGC Notes. Final Decision at p. 6.

An evidentiary hearing (the "Hearing") was held before an administrative law judge (the "ALJ") from November 12, 2019 through November 15, 2019, at which a number of VGC investors and Division representatives testified. Appellant represented himself at the Hearing. He did not testify or present evidence at the Hearing. *See* Reporter's Transcript of November 15, 2019 ("R.T. 11/15/2019") at p. 674.

At the conclusion of the administrative proceedings, following post-hearing briefing and the ALJ's issuance of a proposed ruling, the Commission issued its lengthy and detailed Final Decision in which it determined, *inter alia*, that the VGC Notes constitute "securities" under the ASA; Appellant "failed to meet [his] burden of proof…to establish" that the VGC Notes were "exempt from regulation under the ASA"; and that Appellant and others "committed fraud" by making, participating in, or inducing the offer and sale of securities in violation of A.R.S. § 44-1991. Final Decision at pp. 69-70. The Commission concluded its Final Decision by issuing various orders, including an order that Appellant cease and desist from the violations found in the Final Decision and pay restitution in the principal amount of $6,174,398.38. *Id*. at pp. 70-71.

Appellant filed a timely Notice of Appeal. This Court has jurisdiction pursuant to Ariz. Const. art. 6, § 14 and A.R.S. §§ 12-124(A), 12-905(A), and 44-1981.

ISSUES PRESENTED

After reviewing the Opening Brief ("Opening Brief" or "O.B.") filed by Appellant and the Answering Brief ("Answering Brief" or "A.B.") filed by Appellee, the Court finds that this case presents three issues:

1. Did the Commission abuse its discretion or otherwise err in concluding that the underlying transactions constitute non-exempt securities for purposes of the ASA?

2. Did the Commission abuse its discretion or otherwise err in concluding that Appellant committed fraudulent practices in violation of A.R.S. § 44-1991(A)?

3. Is the restitution award set forth in the Final Decision support by substantial evidence?

STANDARD OF REVIEW & APPLICABLE LEGAL PRINCIPLES

The Court's review of a final decision by the Commission is limited to "whether the administrative action was illegal, arbitrary, capricious or involved an abuse of discretion." *Hirsch v. Ariz. Corp. Comm'n*, 237 Ariz. 456, 461-62 ¶ 18 (App. 2015) (citation and internal quotations omitted). An abuse of discretion will be found if the record does not provide substantial support for the agency's decision, or if the agency committed an error of law in making its decision. *See Carey v. Soucy*, 245 Ariz. 547, 552 ¶ 19 (App. 2018) ("A court abuses its discretion where the record fails to provide substantial support for its decision or the court commits an error of law in reaching the decision."). The party challenging the Commission's decision has the "burden" of "show[ing] by clear and satisfactory evidence that the Commission's decision was unreasonable or unlawful." *Ariz. Corp. Comm'n v. Pacific Motor Trucking Co*., 116 Ariz. 465, 467 (App. 1977).

"In reviewing the facts determined by" the Commission, the reviewing court does not "reweigh the evidence," and will affirm the decision as long as "substantial evidence supports" it. *Nutek Info. Sys., Inc. v. Ariz. Corp. Comm'n,* 194 Ariz. 104, 107 ¶ 15 (App. 1998). *See also DeGroot v. Ariz. Racing Comm'n*, 141 Ariz. 331, 336 (App. 1984) ("[I]n order to reverse the agency's decision, the trial court must find that there was no substantial evidence to support the agency decision."). The "substantial evidence" required to affirm an agency decision will be found to exist "if either of two inconsistent factual conclusions are supported by the record." *Eastern Vanguard Forex, Ltd. v. Ariz. Corp. Comm'n*, 206 Ariz. 399, 409 ¶ 35 (App. 2003). *See*

also Wales v. Ariz. Corp. Comm'n, 249 Ariz. 263, 268 ¶ 19 (App. 2020) ("Substantial evidence exists if the evidentiary record supports the decision, even if the record would also support a different conclusion."). Moreover, a court reviewing a decision by the Commission "view[s] the evidence in the light most favorable to upholding the Commission's decision." *Shorey*, 238 Ariz. at 258 ¶ 14.

Whether a particular investment or transaction constitutes a "security" for purposes of the ASA is a question of law. *See Vairo v. Clayden*, 153 Ariz. 13, 18 (App. 1987). Courts review questions of law *de novo*. A.R.S. § 12-910(F).

An administrative agency's decision will be affirmed if it is correct for any reason, even a reason not relied upon by the agency itself. *See Lewis v. Ariz. St. Personnel Bd*., 240 Ariz. 330, 334 ¶ 15 (App. 2016) (administrative agency's decision "will [be] affirm[ed] if any reasonable interpretation of the record supports the decision"); *BNSF Ry. Co. v. Ariz. Corp. Comm'n*, 228 Ariz. 481, 485 ¶ 12 (App. 2012) ("The court of appeals will affirm the trial court's decision if it is correct for any reason[].") (citation and internal quotations omitted).

DISCUSSION

The Court has considered the Opening Brief, the Answering Brief, the authorities cited therein, and the arguments of counsel at Oral Argument on January 19, 2022.

A. The Commission Did Not Abuse Its Discretion or Commit an Error of Law in Determining that the VGC Notes Constitute "Notes" Within the Meaning of the ASA.

A.R.S. § 44-1801(27) defines "security" to include, *inter alia*, "any note," as well as an "evidence of indebtedness" or an "investment contract." The Commission determined that the VGC Notes fall within the definition of "notes" under the registration provisions of the ASA. Final Decision, at p. 42 ("[T]he VGC Agreements are notes and, therefore, they are securities, for registration purposes, unless exempt under the [ASA].").

In his Opening Brief, Appellant argues, *inter alia*, that "the underlying loan transactions are not 'investment contracts' and they therefore do not qualify as 'securities' under the [ASA]." O.B. at p. 11. In response, Appellee observes that Appellant "does not dispute the Commission's conclusion that the instruments…were Notes[.]" A.B. at pp. 20-21. The Commission's undisputed finding that the instruments are "notes" "is reason enough," Appellee concludes, "to affirm the Commission's findings that these instruments are securities," "without needing to decide" whether, in addition to being "notes," the VGC Notes are also "investment contracts." *Id*. at pp. 21, 30.

As Appellee correctly points out, although Appellant contends that the VGC Notes "are not 'investment contracts'," O.B. at p. 11, he does not dispute that they constitute "notes." He could hardly do so. Arizona courts have given a broad construction to the term "note" as used in the ASA, interpreting it to mean "*any note* unless the note in question is specifically exempted by the securities statutes." *MacCollum v. Perkinson*, 185 Ariz. 179, 185 (App. 1996). Here, the transactions clearly fall within the dictionary definition of "note" as "[a] written promise by one party…to pay money to another party…or to [the] bearer." Black's Law Dictionary (11th ed. 2019). Indeed, the provisions of the VGC Notes themselves identify the documents as "notes." *See*, *e.g.*, I.R. C-98, Hearing Exhibit S-75, Short Term Investment Agreement dated December 28, 2016, at p. ACC019172 ("Borrower will repay the amount of *this note* in full (principal plus interest) on 06/28/2017.") (emphasis added); I.R. C-101, Hearing Exhibit S-78, Short Term Investment Agreement dated November 3, 2016, at p. ACC025145 ("Borrower will repay the amount of *this note* in full on 2/03/2017.") (emphasis added); I.R. C-107, Hearing Exhibit S-84, Short Term Investment Agreement dated January 20, 2017, at p. ACC025605 ("Borrower will repay the amount of *this note* in full (principal plus interest) on 02/03/2017.") (emphasis added).

Moreover, in the argument he presented at the close of the Hearing during the administrative proceedings, Appellant acknowledged that the agreements were "notes." *See* R.T. 11/15/19 at p. 679 ("Your Honor, during this hearing, several things were proven. One was that *I did indeed create these notes*…") (emphasis added); *id*. at p. 688 ("Your Honor, I think when you look at the full body of evidence here, the only thing that can be proven is that, *yes, I did sign these notes*, yes, there is [*sic*] still principal amounts that are owed to these investors, however, everything else that the Corporation Commission is attempting to prove here, they have absolutely no proof of that.") (emphasis added). The record amply supports the Commission's determination that "the VGC Agreements are notes." Final Decision at p. 42. The Court therefore agrees with Appellee's assertion that "the Court can ignore" Appellant's argument that the VGC Notes are not "investment contracts" because the Commission found, and Appellant does not dispute, that the transaction are "notes." A.B. at p. 30.

Because the contracts constitute "notes," they necessarily constitute securities unless a statutory exemption applies. *MacCollum*, 185 Ariz. at 185 (a note "is a security, and its registration is required, unless it is exempted by one of the exemption statutes"). The burden is on Appellant to establish the applicability of an exemption. A.R.S. § 44-2033 ("In any action, civil or criminal, when a defense is based upon any exemption provided for in this chapter, *the burden of proving the existence of the exemption shall be upon the party raising the defense*, and it shall not be necessary to negative the exemption in any petition, complaint, information or indictment, laid or brought in any proceeding under this chapter.") (emphasis added).

Appellant asserts that, "even if the transactions at issue" constitute "securities," they are "exempt pursuant to A.R.S. § 44-1843(8)." O.B. at p. 13. This exemption applies, Appellant contends, because "[n]one of the transactions were fore [*sic*] more than nine months." *Id*.

A.R.S. § 44-1843(8) establishes an exemption for

> [c]ommercial paper that arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, that evidences an obligation to pay cash within nine months of the date of issuance or sale, exclusive of days of grace, or any renewal of such paper that is likewise limited, or any guarantee of such paper or of any such renewal.

A.R.S. § 44-1843(8).

The Commission determined that Appellant had failed to meet his burden to establish that the exemption created by A.R.S. § 44-1843(8) applies here. *See* Final Decision at p. 47. Ample evidence in the record supports this determination. "Commercial paper" is defined as "short-term, high quality instruments issued to fund current operations and sold *only* to highly sophisticated investors." *S.E.C. v. Wallenbrock*, 313 F.3d 532, 541 (9th Cir. 2002) (emphasis added, citation and internal quotations omitted). Far from being sold "only to highly sophisticated investors," the record shows that many of the VGC investors were unsophisticated and inexperienced investors of modest means. Investor Jose Torres ("Torres"), for example, testified at the administrative hearing that he "take[s] home…$450 a week" as a pastor and that, before he made his investment with VGC, he had "[n]ever invested any money" and had no experience with investing. Reporter's Transcript of Proceedings on November 12, 2019 ("R.T. 11/12/19") at pp. 73-74, 79, 86. Moreover, Torres added, at the time he made his investment in VGC, neither Appellant nor anyone else at VGC ever asked him about his financial status or his investment experience. *Id*. at pp. 85-86. Similarly, investor Maria Ruiz, who has an eighth grade education and works as a housekeeper at a hotel, testified that the $3,000 she invested in VGC was the first investment she had ever made. *Id*. at pp. 184, 203.

Investor Jose Payan ("Payan") met with Appellant before investing in VGC, and, during their conversation, Appellant told him that his investment would be "safe," that "it was protected by insurance," and that VGC "was certified with the Arizona Corporation Commission." Reporter's Transcript of Evidentiary Hearing on November 14, 2019 ("R.T. 11/14/19") at pp. 537-38. In his subsequent interview with the Division's investigator, Payan did not state that Appellant asked him any questions about his financial status or financial condition. *Id*. at pp. 538-39.

Appellant himself admitted, in his Examination Under Oath ("EUO"), that he never asked any VGC investors about their investment experience and that he imposed no restrictions on eligibility to invest. I.R. C-16, Hearing Exhibit S-11, Reporter's Transcript of April 16, 2018 Examination Under Oath of Isaias Miguel Verdugo ("EUO Transcript"), at pp. 274-75. On the contrary, Appellant testified, "anybody could invest," without regard to investment status. *Id*. at p. 275.

Because the uncontroverted evidence in the record shows that the VGC Notes were not "sold *only* to highly sophisticated investors," *Wallenbrock*, 313 F.3d at 541 (emphasis added), the VGC Notes were not "commercial paper" within the meaning of A.R.S. § 44-1843(8). *See also Holloway v. Peat, Marwick, Mitchell & Co*., 900 F.2d 1485, 1489 (10th Cir. 1990) (statutory exemption from federal securities law for "short-term notes" is "limited to prime quality negotiable commercial paper of a type not ordinarily purchased by the general public").

Additionally, Appellant has pointed to no evidence in the record to indicate that the investments arose out of current transactions or that the proceeds were used to fund VGC's current transactions.[1] Because Appellant has identified no evidence that would support a finding that the VGC Notes were "issued to fund current operations," *Wallenbrock*, 313 F.3d at 541, the Court finds that the record supports the Commission's determination that Appellant failed to prove that the VGC Notes constitute "commercial paper." The Court therefore affirms the Commission's determination that Appellant failed to meet his burden of establishing that the exemption established by A.R.S. § 44-1843(8) applies here.

In a single sentence of his Opening Brief, Appellant asserts that A.R.S. § 44-1843(10) also "applies as an exemption" because, Appellant states, "many of the notes were secured by collateral." O.B. at p. 13.[2] The Court finds this cursory assertion - - which does not specifically identify any of the "notes" that were purportedly "secured by collateral" - - to be insufficiently

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[1] Evidence in the record is to the contrary. At his EUO, Appellant testified that he formed another company, Glass Hobby Industries, to purchase an existing company, Stained Glass Shop, in 2016, and Appellant admitted that "[i]t is possible" that he purchased this business using funds provided by VGC investors. I.R. C-16, Hearing Exhibit S-11, EUO Transcript, at pp. 154-55. Appellant conceded, in other words, that he may have used funds obtained from VGC investors for purposes unrelated to VGC.

[2] A.R.S. § 44-1843(10) establishes an exemption for

> [n]otes or bonds secured by a mortgage or deed of trust on real estate or chattels, or a contract or agreement for the sale of real estate or chattels, if the entire mortgage, contract or agreement together with all notes or bonds secured thereby is sold or offered for sale as a unit, except for real property investment contracts.

A.R.S. § 44-1843(10).

developed to properly present an argument for appellate review. *Ritchie v. Krasner*, 221 Ariz. 288, 305 ¶ 62 (App. 2009) ("Opening briefs must present and address significant arguments, supported by authority that set forth the appellant's position on the issue in question," and the appellant's "[f]ailure to do so can constitute abandonment and waiver of that claim."). Further, Appellant did not raise this argument during the administrative proceedings. No such argument appears, for example, in Appellant's post-hearing briefing. *See generally* I.R. A-77, Respondent Isaias M. Verdugo's Post-Hearing Brief; I.R. A-78, Notice of Errata. Accordingly, Appellant waived it. *See Neal v. City of Kingman*, 169 Ariz. 133, 136 (1991) ("Failure to raise an issue at an administrative hearing that the administrative tribunal is competent to hear waives that issue.").

Even if Appellant had not waived his claim that "many of the notes were secured by collateral," O.B. at p. 13, the Court sees no basis in the record for it. Many of the VGC Notes contain language to the effect that, in the event of a default by VGC, VGC's inventory "should" be sold off and the proceeds used to repay investors. *See*, *e.g.*, I.R. C-98, Short Term Investment Agreement dated December 28, 2016, at p. ACC019172 ("In the event of non-payment of this note assets *should* be sold and proceeds collected *should* be used to pay the principal amount of this note.") (emphasis added); I.R. C-101, Hearing Exhibit S-78, Short Term Investment Agreement dated November 4, 2016, at p. ACC025146 ("In the event of non-payment of this note assets *should* be sold and proceeds collected *should* be used to pay the principal amount of this note.") (emphasis added); I.R. C-107, Hearing Exhibit S-84, Short Term Investment Agreement dated January 20, 2017, at p. ACC025605 ("In the event of non-payment of this note assets *should* be sold and proceeds collected *should* be used to pay the principal amount of this note.") (emphasis added). VGC's statement that its inventory "should" be sold to pay off investors hardly creates an enforceable security agreement in VGC's inventory, or otherwise establishes that the investments were secured by collateral.

The Court finds that the Commission did not abuse its discretion or commit an error of law in determining that the VGC Notes were securities that were not exempt from the ASA's registration requirements.

Arizona courts have long recognized that the securities fraud statute, A.R.S. § 44-1991, "defines" the term "security" in "broader terms" than "the registration statutes," and that A.R.S. § 44-1991 encompasses "the sale of even those securities that are exempted from…registration requirements." *MacCollum*, 185 Ariz. at 186. Accordingly, "[t]he analysis for determining whether" a note is a security" under A.R.S. § 44-1991 "is different from that which" is used "under the registration statutes." *Id*.

As the Commission observed in its Final Decision, "[w]hen analyzing a note in terms of whether it is a security for the purposes of the antifraud provisions of the [ASA]," Arizona courts

apply "the 'family resemblance' test" that was adopted by the United States Supreme Court in *Reves v. Ernst & Young*, 494 U.S. 56 (1990). Final Decision at pp. 42-43. The Commission explained that the "family resemblance" test "begins with the presumption that every note is a security," but that "[t]his presumption can be rebutted" if the notes at issue bear "a 'family resemblance' to a list of instruments that are not securities," or if the nature of the notes justifies "establish[ing] a new category of instrument that should be added to the list." Final Decision at p. 43. The Final Decision went on to discuss the four factors to be considered in applying *Reves*'s "family resemblance" test before "conclud[ing] that the VGC Notes do not resemble instruments on the *Reves* list, and the evidence does not establish that they should be a category added to that list." *Id*. at pp. 43-46. "Accordingly," the Commission determined, "the VGC Notes are securities subject to the antifraud provisions of the [ASA]." *Id*. at p. 46.

In its Answering Brief, Appellee discusses the "family resemblance" test set forth in *Reves* in some detail, addressing such factors as "the motivations of the buyer and seller" and "the reasonable expectations of the investing public" before asserting that the VGC Notes "do not bear a family resemblance to any of the recognized non-securities" and "should not be added as an additional category of non-security notes." A.B. at pp. 26-30.

The Court finds it unnecessary to address the "family resemblance" test, however, because Appellant does not cite to *Reves* or address the "family resemblance" test in his Opening Brief. *See generally* O.B. Because Appellant does not even address this issue, he cannot be said to have "rebutted" the "presumption" that the VGC Notes are securities by making the requisite "showing" that they "bear a strong resemblance…to an item on the judicially crafted list of instruments that were not intended to be regulated as a security." *MacCollum*, 185 Ariz. at 187. The Court therefore affirms the Commission's determination that "the VGC Notes are securities subject to the antifraud provisions of the [ASA]." Final Decision at p. 46. *See MacCollum*, 185 Ariz. at 188 (concluding that note at issue "is a security" in part because "the defendants have offered no meaningful analysis as to how applying the four *Reves* factors rebuts the presumption that [the note] is a security").

B. The Commission Did Not Abuse Its Discretion or Commit an Error of Law in Determining that Appellant Violated A.R.S. § 44-1991.

In its Final Decision, the Commission found that Appellant was directly responsible for fraudulent representations pursuant to A.R.S. § 44-1991(A) because, *inter alia*, he "represented to VGC investors that their investment funds would be used for the purchase of merchandise" for resale online, and failed to tell them "that a portion of [their] investment funds was being used to pay commissions" to those who referred investors to VGC. Final Decision at p. 52. The Commission also found that Appellant "is liable as a control person for the antifraud violations of VGC, pursuant to A.R.S. § 44-1999(B)." *Id*. at p. 57. In his Opening Brief, Appellant

challenges both findings, asserting that he "is not directly liable nor is he liable as a controlling person under A.R.S. 44-1999(B)." O.B. at p. 10.

In support of his challenge to the Commission's finding of direct liability, Appellant asserts that the Division "failed to satisfy its burden of proof in showing that [he] committed any wrongful conduct at all." O.B. at p. 10. "To the extent that there was a credible evidence of fraudulent conduct," Appellant goes on, he cannot be held liable because "other respondents were the ones giving the information" to prospective investors." *Id*. at pp. 10-11. He "was not," Appellant insists, "around at the time" when prospective investors were given information about the transactions." *Id*. at p. 11.

A.R.S. 44-1991(A) provides in part that

> [i]t is a fraudulent practice and unlawful for a person, in connection with a transaction…involving an offer to sell or buy securities, or a sale or purchase of securities…directly or indirectly to…[e]ngage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.

A.R.S. 44-1991(A)(3). The Commission found Appellant liable under this statute because, it found, Appellant "engag[ed] in…fraud or deceit" by failing to disclose that, "contrary to the representations made to VGC's investors," "a portion of investor funds" were to be used "to pay commissions" and "to purchase another business," Stained Glass Shop. Final Decision at p. 52. Ample evidence supports this finding. Investor Jose Torres, for example, testified that he invested in VGC on the recommendation of Medellin, a fellow pastor, and that, although he met personally with Appellant when he made his investment, neither Appellant nor Medellin ever disclosed that VGC had paid Medellin a referral fee. R.T. 11/12/19 at pp. 75, 77-79, 83, 105, 108-09, 114-15. Indeed, Torres testified that he did not learn that Medellin had been paid a referral fee until after this enforcement action had begun. *Id*. at pp. 79, 105, 114-15.

Similarly, first-time investor Maria Esparza testified that she spoke with Appellant before investing $30,000, a sum that constituted all of her savings, with VGC. R.T. 11/13/19 at pp. 323-26. She testified that Appellant told her that her investment would be used "only" for VGC, and did not indicate that her investment would be used in any other way. *Id*. at p. 326.

Indeed, although Appellant asserts in his Opening Brief that he did not personally provide information to any of the investors, *see* O.B. at pp. 10-11, his testimony at his EUO refutes this assertion. In his testimony at his EUO, Appellant admitted that he "probably spoke to about 200, maybe more," of the approximately 300 people who invested money in VGC. I.R. C-16, Hearing Exhibit S-11, EUO Transcript, at pp. 103-04. Appellant further testified that, although he told

"the initial lenders" that the full amount of their investment monies would be devoted to purchasing inventory, the "new lenders" who "started coming in" were told that the funds would be used "for business expenses" as well as to "purchase inventory." *Id*. at p. 104. He went on to state that part of the investment funds were used to pay "a referral fee" of between "2 percent" and "5 percent" to those who brought investors to VGC. *Id*. at p. 108. When asked whether the lenders were aware that "part of their money" was going to be used to pay referral fees, Appellant admitted he did not disclose that information during his conversations with them. He stated,

> I don't know. I don't know if they were aware. *It wasn't something I mentioned to them*. *They never asked me about it*.

Id. (emphasis added).

Evidence in the record, including Appellant's own testimony, thus establishes that Appellant did indeed personally speak with investors before they invested, and that he did not disclose either that VGC pays commissions to its referral sources or that the investors' monies may be used for purposes unrelated to VGC. This evidence supports the Final Decision's determination that Appellant "violated A.R.S. 44-1991(A) by engaging in any transaction, practice or course of business which operates or would operate as a fraud or deceit, namely[,] the undisclosed use of a portion of investor funds that was contrary to the representations made to VGC's investors." Final Decision at p. 52.

Appellant further argues that the Final Decision errs in finding him liable for violating A.R.S. § 44-1991 on a "control person" theory of liability because, he asserts, the Division failed to prove "that [he] acted in bad faith or that he otherwise induced others to commit fraud." O.B. at p. 11.[3]

As Appellee correctly argues in response, however, the burden of proof on this issue is on Appellant, not the Division. A.B. at p. 34. *See Eastern Vanguard*, 206 Ariz. at 413 ¶ 46 ("The burden of proof" on the defense established by A.R.S. § 44-1999(B) "falls on the controlling

[3] As Appellant correctly notes, "control person" liability and defenses thereto are established in A.R.S. § 44-1999, which provides in part that

> [e]very person who, directly or indirectly, controls any person liable for a violation of section 44-1991 or 44-1992 is liable jointly and severally with and to the same extent as the controlled person to any person to whom the controlled person is liable unless the controlling person acted in good faith and did not directly or indirectly induce the act underlying the action.

A.R.S. § 44-1999(B).

person"). To successfully establish a defense pursuant to A.R.S. § 44-1999(B), a control person must "demonstrate[s] *both* good faith *and* lack of inducement." *Eastern Vanguard*, 206 Ariz. at 413 ¶ 48 (emphasis added). To satisfy the "good faith" element of a defense under A.R.S. § 44-1999(B), a control person must,

> [a]t the minimum,…establish that [he or she] exercised due care by taking reasonable steps to maintain and enforce a reasonable and proper system of supervision and internal control[s].

Eastern Vanguard, 206 Ariz. at 414 ¶ 50 (citations and internal quotations omitted). Moreover, a finding of control liability "may be premised on the *power* to control[,] and does not require *actual participation* in the wrongful conduct[.]" *Id*. at 413 ¶ 44 (emphasis added). *See also id*. at 412 ¶ 42 (A.R.S. § 44-1999(B) imposes "presumptive control liability on those persons who have the *power* to directly or indirectly control the activities of those persons or entities liable as primary violators.") (emphasis in original).

The evidence establishes that, at all material times, Appellant was the owner of VGC. Appellant is the one who signed the VGC Notes on behalf of VGC. There can, therefore, be no doubt that Appellant was in a position of control over VGC. Further, there is no evidence that Appellant exercised due care by taking *any* steps, much less the requisite "reasonable steps," to exercise supervision or control over his employees or VGC's referral sources who encouraged potential investors to engage in the VGC Notes. Indeed, Appellant presented no evidence at all at the Hearing. The Commission cannot be said to have abused its discretion in determining that Appellant failed to meet his burden of establishing the defense afforded by A.R.S. § 44-1999(B).

Moreover, the fact that, as discussed above, the record shows that Appellant directly induced violations of A.R.S. § 44-1991(A) establishes an independent basis for affirming the Commission's determination that Appellant had failed to meet his burden of proving that the "good faith" defense afforded by A.R.S. § 44-1999(B) applies here. *See* A.R.S. § 44-1999(B) (providing that statutory defense does not apply "unless the controlling person acted in good faith *and did not directly or indirectly induce the act* underlying the action.") (emphasis added).

C. With One Exception, the Commission Did Not Abuse Its Discretion or Commit an Error of Law in Determining the Amount of the Restitution Award.

Appellant goes on to argue that the restitution award is excessive and unsupported by the evidence. O.B. at p. 13. "[T]he claimed loss cannot possibly be anywhere near accurate," he insists. *Id*. at p 14. In support of his position, he asserts that the trustee in the bankruptcy case has "brought a total of forty-four adversary proceedings" against investors to "claw back payments made to them" by VGC, but that the Division's investigator identified "only eleven investors" as

having received payment from VGC. *Id*. at p. 15. As one example, Appellant asserts that the trustee in the bankruptcy case has alleged that one of the investors received $132,283.94 from VGC, but that these payments are not "reflected in the [Division] investigator's summary of payments" VGC made to investors. *Id*. at p 14. According to Appellant, the fact that the trustee has alleged, in VGC's bankruptcy proceedings, that VGC paid investors far more than the amount alleged by the Division in these proceedings shows that "[t]he Division has greatly overstated the amount of loss." *Id*. at p. 16.

In support of his assertions on this point, Appellant cites to the exhibits that are attached to the Post-Hearing Brief he filed in the administrative proceedings on May 29, 2020. O.B. at pp. 14, 15. These documents consist of a complaint filed by the bankruptcy trustee in VGC's pending bankruptcy proceedings and related court documents. *See* I.R. A-77, Appellant's Post Hearing Brief, Exhibit 1, Complaint in In re Verdugo Enterprises, LLC aka Verdugo Gift Company, and Exhibit 2, Associated Cases Docket. Although Appellant asserts that the Court "should take judicial notice of the filings in the Bankruptcy matter," O.B. at p. 16, a court cannot properly take judicial notice of the truth of unproven allegations in an unrelated case. *Matter of Ronwin*, 139 Ariz. 576, 580 n.4 (1983) (although court may take judicial notice of "allegations…made" in unrelated cases, court "cannot…take notice of the truth or falsity of specific allegations except as established by final judgment"). *See also Liberty Mut. Ins. Co. v. Rotches Pork Packers, Inc*., 969 F.2d 1384, 1388 (2nd Cir. 1992) ("A court may take judicial notice of a document filed in another court" to "establish the *fact* of such litigation and related filings," but "not for the *truth* of the matters asserted in the other litigation[.]") (emphasis added, citations and internal quotations omitted); *Larsgard v. Williams*, 2021 WL 808791 at *2 (D.Ariz., Jan. 8, 2021) ("As a general rule, a court may not take judicial notice of proceedings or records in another cause so as to supply, without formal introduction of evidence, facts essential to support a contention in a cause then before it.") (citation and internal quotations omitted).

Because "unverified allegations in a complaint are not evidence," *Geshke v. Crocs, Inc*., 740 F.3d 74, 78 n.3 (1st Cir. 2014), the fact that a bankruptcy trustee has made certain allegations in an unverified complaint filed in a pending bankruptcy proceeding is not evidence that can be used to controvert the factual findings of the Commission.

In support of his challenge to the amount of the restitution award, Appellant asserts that, even though investor Jose Payan testified that he received four payments in the amount of $1,000 each during the months from January 2017 through April 2017, "none of these payments are reflected in the investigator's summary of payments made." O.B. at p. 14.

Appellant is correct in noting that the report summarizing investments by, and payments to, VGC investors, which was prepared by the Division's forensic accountant, Avi Beliak ("Beliak"), does not take into account the four payments totaling $4,000 that Payan received

from January 2017 through April 2017. *See* R.T. 11/14/2019 at p. 476; I.R. C-103, Hearing Exhibit S-80. The Commission's Final Decision, however, *does* take those payments into consideration. The Final Decision expressly states that, although the Division requested restitution in the amount of $6,178,398.38, the Commission would deduct $4,000 from this amount to account for the fact that Payan "was repaid $4,000 on his investment." Final Decision at p. 59. The Commission therefore fixed the restitution amount at $6,174,398.38, or $4,000 less than the amount the Division had requested. *Id*. Because the amount of restitution awarded takes into account the $4,000 repayment to Payan from January 2017 through April 2017, Appellant is entitled to no relief on his complaint that the payments totaling $4,000 that Payan received from January 2017 through April 2017 are not "reflected in [Beliak's] summary of payments made." O.B. at p. 14.

In further support of his challenge to the amount of the restitution award, Appellant goes on to allege that Beliak improperly counted certain investments twice. Specifically, Appellant contends, the roll-over of certain investments was counted as a fresh infusion of cash, resulting in a single investment being double-counted. O.B. at p. 15. "For example," he asserts, Beliak "counted," in his calculation of investor losses, both Payan's initial investment and a January 14, 2017 roll-over of that same investment, "despite the fact that no new loan was actually made." *Id*.

In its Answering Brief, Appellee does not directly respond to this argument. *See generally* A.B. Moreover, a review of the record supports Appellant's assertion that Payan did not, in fact, invest an additional $10,138.39 in VGC on January 14, 2017. Beliak's summary of investments reflects an investment by Payan of $10,138.39 on January 14, 2017. *See* I.R. C-103, Hearing Exhibit S-80, at p. 11. However, the underlying Short-Term Investment Agreement between Payan and VGC that is dated January 14, 2017 reflects a loan in the amount of only $6,419.22, not $10,138.39. *See* I.R. C-101, Hearing Exhibit S-78, at p. ACC025150. This document thus does not support a finding that Payan invested the sum of $10,138.39 on that date. Moreover, this document contains the notation, "Cycle: 9," *id*., which supports Appellant's assertion that this document reflects a roll-over of a prior investment, rather than an initial investment of new monies. Finally, Division investigator Jones testified at the Hearing that, the day before the Short-Term Investment Agreement was signed on January 14, 2017, Payan discussed with Appellant his intention to "roll over his investments." R.T. 11/14/19 at p. 547. Taken together, this evidence supports Appellant's position that the record does not support a finding that Payan invested an additional $10,138.39 in VGC on January 14, 2017. Based on this evidence, and in light of Appellee's failure to directly respond to Appellant's argument on this point, the Court will modify the restitution award, reducing it by $10,138.39. *See Hodai v. City of Tucson*, 239 Ariz. 34, 45 ¶ 36 (App. 2016) ("Failure to respond" to argument raised on appeal "may be considered a confession of error.").

With that exception, however, the Court finds that Appellant has failed to support, with specific reference to evidence in the record, his contention that Beliak improperly "counted roll-over contracts as independent loans." O.B. at p. 15. Because Appellant has failed to support his argument with specific citations to the record, the Court grants no additional relief beyond the $10,138.39 reduction in the restitution award discussed above. *See* J.R.A.D. 7(a)(3) (appellant's brief must contain "appropriate references to the record"). *See also State Farm Mut. Auto. Ins. Co. v. Arrington*, 192 Ariz. 255, 257 n.1 (App. 1998) ("We disregard the facts set forth in the opening brief" because the opening brief "does not contain any citations to the record[.]"); *Gen. Elec. Capital Corp. v. Osterkamp*, 172 Ariz. 191, 193 (App. 1992) ("The burden is on the party who disagrees with the judgment to show that the trial court abused its discretion."); *Adams v. Valley Nat'l Bank of Ariz*., 139 Ariz. 340, 343 (App. 1984) ("We are not required to assume the duties of an advocate and search voluminous records and exhibits to substantiate an appellant's claims.").

Appellee does not dispute that Appellant "is entitled to be credited for any payments that he can verify [were] made" to investors, but points out, correctly, that "it is incumbent on [Appellant] that he do so." A.B. at p. 37. After all, payment is an affirmative defense, and so the burden is on Appellant to establish the amount of any payments made to investors. *See, e.g., B&R Materials, Inc. v. U.S. Fidelity & Guaranty*, 132 Ariz. 122, 124 (App. 1982) ("Payment is an affirmative defense which must be pled and the burden is upon the defendant to prove payment with some affirmative evidence."). *See also U.S. v. Sheinbaum*, 136 F.3d 443, 449 (5th Cir. 1998) ("[T]he defendant should know the value of any compensation he has already provided to the victim in civil proceedings, so the burden should fall on him to argue for a reduction in his restitution order by that amount.").

With the exception of the $10,138.39 reduction discussed above, the Court finds that Appellant is entitled to no relief on his challenge to the restitution award.

Appellant raises a number of other issues and arguments that are either lacking in merit or insufficiently developed. Appellant poses the question, for example, of "whether the [Commission] has jurisdiction over [this] matter." O.B. at pp. 9-10. He takes the position that "the Commission lacked jurisdiction over this matter altogether" because, he asserts, "this is a simple case of breach of contract for the failure to repay commercial loans." *Id*. at p. 3. Because, for the reasons set forth above, the Commission did not err or abuse its discretion in finding the notes at issue here to constitute non-exempt securities, the Court rejects Appellant's assertion that this matter involves nothing more than "a simple case of breach of contract." *Id*.

Appellant complains about being the victim of "slant or bias" as a result of "baseless and irrelevant allegations that he is prejudiced and racist." O.B. at p. 2. "The Division and its witnesses requested desperate [*sic*] treatment," he complains, "solely on account of [the

witnesses'] race and religion." *Id*. "The race and religion of the alleged victims is not relevant," he concludes, "and should not have been taken into consideration by this [*sic*] Commission." *Id*.

Appellant cites no portion of the record to support his accusation that the Commission based its Final Decision on impermissible considerations as the race and/or religion of the investors. His failure to include any reference to the record alone warrants the summary rejection of this accusation. *See* J.R.A.D. 7(a)(3) (appellant's brief must contain "appropriate references to the record").

Further, the Court sees nothing in the record to suggest that the Division or the Commission raised or relied on impermissible considerations. At the Hearing, some of the investors testified, without objection by Appellant, that they felt comfortable investing in VGC because VGC's referral sources were pastors whom the investors knew and trusted. At the Hearing, for example, investor Jose Torres testified without objection that he "assume[d] that everyone there" at VGC "was Christian, good Christians," because "Pastor Medellin says that he was [Appellant's] pastor" and that Appellant "grew up in his church." R.T. 11/12/19 at p. 113. Torres went on that he and the other investors acted "on the assumption that this was a Christian thing, that it was a good thing, that it was a legal thing, that it was the right thing to do[.]" *Id*. at p. 114. Investor Maria Ruiz likewise testified without objection that Medellin's position as a pastor "of course" led her to trust his recommendation about investing with VGC, stating that, "[b]ecause [Medellin] is a man of God," she would not expect him "to do something that's not right." *Id*. at p. 187.

All of this evidence provides a factual basis for the Final Decision's finding that "[m]any VGC investors trusted [Appellant and the other respondents] and were induced to invest in VGC [N]otes because of [their] church affiliations." Final Decision at p. 64. Evidence of the shared religious affiliation of various participants in the VGC investments was relevant to explain the factors that induced the investors to invest their funds in VGC. The evidence was offered for a relevant purpose and admitted without objection. The admission of such evidence was therefore proper, and hardly supports Appellant's accusation that he was unfairly portrayed in the administrative proceedings as "a racist that targeted Hispanics and pastors." O.B. at p. 10.

DISPOSITION & ORDERS

In accordance with the foregoing,

IT IS ORDERED modifying Decision No. 77902 of the Arizona Corporation Commission by reducing the restitution award from $6,174,398.38 to $6,164,259.99.

IT IS FURTHER ORDERED affirming Decision No. 77902 of the Arizona Corporation Commission in all other respects.

IT IS FURTHER ORDERED remanding this matter to the Arizona Corporation Commission for such further proceedings, if any, as may be appropriate.

No matters remain pending in connection with this appeal. This is a final order pursuant to J.R.A.D. 13 and Ariz.R.Civ.P. 54(c).

/s/ Daniel J. Kiley
THE HON. DANIEL J. KILEY
Judge of the Superior Court

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