

WHEELLESS, SHAPPLEY, BAILESS & RECTOR, LLP

ATTORNEYS AT LAW
A Partnership of Professional Corporations

POST OFFICE BOX 991
820 SOUTH STREET
SUITE 501
VICKSBURG, MISSISSIPPI 39181-0991
(601)636-8451 (601)636-8481
TELEPHONE FACSIMILE

WILLIAM L. SHAPPLEY, JR., P.C.
ROBERT R. BAILESS, P.C.
KENNETH B. RECTOR, P.C.*
ALLISON M. BREWER

* also licensed in Illinois

Honorable Delbert Hosemann
Secretary of State
State of Mississippi
P.O. Box 136
Jackson, MS 39205-0136

March 19, 2014

JOHN C. WHEELLESS, JR.
OF COUNSEL
WILLIAM G. BEANLAND
(1927-2001)

rbailess@wsbrlaw.com

RE: In the Matter of: Watkins Development, LLC
Administrative Proceeding Number LS-13-0608

Dear Secretary Hosemann:

Enclosed please find the Hearing Officer's recommendations for Findings of Fact and Conclusions of Law. Should you have any questions or need clarification, please do not hesitate to contact me at your convenience.

By copy of this letter, I am forwarding by e-mail a copy to Ms. Netz, Ms. Long and Mr. Pigott.

Very sincerely yours,



ROBERT R. BAILESS

RRB/jmg

Enclosure

**OFFICE OF THE MISSISSIPPI SECRETARY OF STATE
SECURITIES DIVISION**

In the Matter of:	)
	)
Watkins Development, LLC	)
	)
David Watkins, Individually and as Manager of Watkins Development, LLC	)
	)
<i>Respondents</i>	)

**HEARING OFFICER'S FINDINGS OF FACT
AND CONCLUSIONS OF LAW**

The Hearing Officer submits his recommendations for findings of fact and conclusions of law.

This matter is before this hearing officer at the request of the Respondents, Watkins Development, LLC and David Watkins (“Watkins Development,” “Watkins,” or “Respondents”), for a review of the Secretary of State’s Securities Division’s (“Division”) Notice of Intent to Impose Administrative Penalty and Order Restitution and Disgorgement of Profit dated July 30, 2013, as amended on October 23, 2013 (collectively “Notice of Intent”). The Notice of Intent cited violations of Mississippi Code Annotated §75-71-501.

An administrative hearing was conducted on October 29 and October 30, 2013 in Jackson, Mississippi at the Offices of the Mississippi Secretary of State before this hearing officer and a court reporter. Mr. Brad Pigott represented the Respondents. Ms. Cheryn Netz, Assistant Secretary of State, and Ms. Jessica Leigh Long represented the Division. Mr. L. Keith Parsons, bond counsel, and Ms. Marla Breland, Director of Examinations of the Division, provided testimony for the Division. Mr. David Watkins, Respondent, and Mr. Archie McDonnell, President of Citizen’s Bank in Meridian, provided testimony for the Respondents.

On October 28, 2013, the Respondents filed “Respondents’ Hearing Brief” citing authority for various relevant terms. The Division filed “Division’s Reply to Respondents’ Hearing Brief” on November 14, 2013. Neither party raised any challenges to jurisdiction, procedure, or evidence.

As the hearing officer appointed in the above referenced case, I have reviewed the Amended Notice of Intent to Impose Administrative Penalty and Order Restitution and Disgorgement of Profit, the hearing transcript, and the applicable law. I hereby find:

I. Findings of Fact

1. In early 2010, Respondents began work as the master planner for Meridian, Mississippi to redevelop areas of Meridian. During this engagement, Watkins discovered the police station was so substandard, that it was in such an immediate need, that it could not be put off any longer. [Transcript, pp.236-237, 335-336]

2. In 2010, the Jackson, Mississippi mayor asked Respondents to help rebuild the Highway 80 corridor of which “Metrocenter [Mall] is just a pivotal point.” [Transcript, p. 289] Respondents went with the Jackson mayor to Las Vegas to “learn what do to” about Metrocenter. [Transcript, p. 290]

3. Respondents made an offer on the Belk building at Metrocenter Mall to assist in the redevelopment process and created a master redevelopment plan for the entire mall. [Transcript, pp. 290, 339]

4. In August 2010, Respondents filed with the Secretary of State the Certificate of Formation to form Retro Metro, LLC (hereinafter “Retro Metro”), a Mississippi limited liability company, for the purpose of revitalizing the Belk building in Metrocenter Mall in Jackson, Mississippi.

David Watkins was the manager of Retro Metro until July 2012. [Exhibit S1; Operating Agreement, Exhibit S2; Transcript pp. 52-55]

5. Respondents entered into a development agreement (the “Development Agreement”), dated February 21, 2011, with Retro Metro signed by David Watkins as managing member of Retro Metro to undertake a design-build project at Metrocenter Mall (the “Project”). [Exhibit S4] Actually, Watkins Development was the member of Retro Metro. [Ex. S2 Operating Agreement.]

6. The Development Agreement, among other things, provided for the developer, Watkins Development, to be paid a flat fee of \$500,000.00, although with no specified date of payment, and a mobilization fee of 25% of “project cost” which amount was due at closing. Project costs included \$2.5 million in construction cost [City of Jackson Lease Agreement, Exhibit S5] plus overhead costs which included rents for office space, wages, and compensation of employees of Developer. [Development Agreement, Exhibit S1 § 2.03; Transcript, pp. 287-288] Watkins Development named a then current Watkins Development employee as the contractor for the Project. [Transcript, pp. 274-275, 293] According to bond attorney Keith Parsons, had the Respondents disclosed the Development Agreement as required by the Loan Agreement, and the way that the Respondents would requisition payments from the Construction Fund, he would not have provided his opinion for the bonds and there would not have been a bond issue. [Transcript pp. 60-62].

7. David Watkins took the position that Retro Metro’s financial liability to Watkins Development would vest, under the terms of the Development Agreement, on the day of closing on the loan of the bond proceeds. [Transcript, pp. 278-279]

8. The financial liability from Retro Metro to Watkins Development was, under the terms of the Development Agreement, 25% of costs (or \$625,000) for the mobilization fee and \$500,000 as a fixed fee for a minimum of \$1.125 million. [Transcript, pp. 282, 283]
9. Watkins began around December 6, 2010 to arrange for financing to fund the Project. [Exhibit R31] Due to the nature of the financing, the financing firm decided a formal Private Placement Memorandum (“PPM”) was needed. Bond counsel began drafting one. [Transcript, pp. 44-45]
10. On February 3, 2011, Bond counsel emailed Watkins and Retro Metro’s attorney seeking suggested changes to and for the approval of the PPM. [Exhibit R34] David Watkins is an experienced bond attorney participating in more than seven hundred (700) bond issues over a period of twenty years. [Transcript P. 230].
11. Respondents had an opportunity, at least twice, [Transcript, p. 80, Exhibit R34] to provide comments to and add anything to the PPM that should be in the PPM that had not been included. [Transcript, pp. 80, 338; Exhibit S5]
12. Respondents were responsible for the contents of the PPM and had an obligation to review and comment on the PPM and correct any misstatements. [Transcript, pp. 83, 338]
13. The PPM does not mention or reference the Development Agreement. [Exhibit S5]
14. Respondents took the position that the purchaser of the bonds was only interested in the City of Jackson Lease in making its decision regarding the bonds. [Transcript, pp. 306-307]
15. As part of the bond offering, Respondents executed a loan agreement on April 1, 2011 (the “Loan” or “Loan Agreement”). In Section 2.2(k) of the Loan Agreement, the Respondents made the following representations: “Other than any agreements which have been delivered to the Issuer and the Trustee or the Purchaser, the Company [Retro Metro] is not a party to any

indenture, agreement or other instrument materially and adversely affecting its business, properties, assets, liabilities, operations, income or condition, whether financial or otherwise;” [Exhibit S6, p. 13]

16. Watkins, as manager of Retro Metro, executed the Bond Purchase Contract (Ex. S 10, ¶ 4(b)), stating, “The Company [Retro Metro] will not take or omit to take, as may be applicable, any action which would, in any way, cause the proceeds of the Series 2011 Bonds to be applied in a manner contrary to the requirements of the Indenture, the Loan Agreement and the Series 2011 Note.”

17. Relying on the representations in the PPM dated April 5, 2011, the Mississippi Business Finance Corporation (“MBFC”), as a conduit issuer, issued Taxable Revenue Bonds, Series 2011 (Retro Metro, LLC Project) (“Bonds”) in the principal amount of \$5,195,000.00. [Exhibits S5, S10]

18. The closing of the Bond issue was completed on April 12, 2011 and the Bonds were issued on the same date (the “Closing Date”). [Exhibits R2, S7, S16]

19. On the Closing Date, Watkins executed the Certificate Designating Authorized Representatives, certifying he was authorized to represent Retro Metro in the bond closing. [Exhibit S3]

20. On the Closing Date, Watkins executed a Closing Certificate for the Bond issue representing and certifying that the Loan Agreement and other Bond Documents were correct in all material respects. [Exhibit S2]

21. The Bond Documents do not mention or reference the Development Agreement or Retro Metro’s liability pursuant to the Development Agreement. [Exhibits S2, S3, S5-16]

22. The Bonds were issued pursuant to a Trust Indenture between MBFC and BankPlus, as the trustee (the "Trust Indenture"). BankPlus, as trustee under the Trust Indenture ("Trustee"), held the Proceeds, \$4,875,000.00, in a Construction Fund account for Retro Metro ("Construction Account"). [Exhibit S9; Transcript, p. 181]

23. Pursuant to the Loan Agreement with Retro Metro, MBFC, through the Trustee, loaned the proceeds of the Bonds (the "Proceeds") to Retro Metro to revitalize the first floor of the "Belk Building" in Metrocenter shopping center in Jackson, Mississippi. [Exhibit S6].

24. Respondents take the position that the members of Retro Metro approved the Development Agreement and since those members approved it, the Development Agreement should not be a problem for the other interested parties. [Transcript pp. 268-269, 333-334]. It should be noted that immediately after the issuance of the Bonds, each of the members of Retro Metro received a "partner distribution" of forty (40) times their alleged initial contribution to the formation of Retro Metro. (From an examination of the bank account of Retro Metro (Exhibit S19 Page 3), it is not clear that Watkins Development, Sam Begley or one of the others required to contribute \$1,500 even made their initial contribution to Retro Metro.) [Ex. S2, p. 10]

25. Pursuant to Page 2 of Exhibit C of the Loan Agreement (Exhibit S6) with each Requisition for payment from the Construction Account, Respondents were required to "Attach copies of invoices or other appropriate supporting documentation for this requisition." Not only did the Respondents not attach any invoices or other appropriate supporting documentation to the Requisitions, the quoted language was deleted from each of the Requisitions (See Exhibit S18).

26. Respondents' withdrawal of Four Hundred Thousand Dollars (\$400,000) from the Construction Account to pay a "partner distribution" is not authorized by the Loan Agreement. [Exhibit S6 Page 5 "Costs"].

27. On June 2, 2011, as of the date of Requisition # 3, the Requisition reflected a request for Eight Hundred Thousand Dollars (\$800,000) for Construction Costs. Requisition # 1 had requested a payment for Construction Costs of One Million Two Hundred Fifty Thousand Dollars (\$1,250,000). Request # 2 had requested a payment for Construction Costs of an additional Five Hundred Thousand Dollars (\$500,000). According to these three Requisitions for payment, Respondents had represented to the Trustee that Construction Costs incurred already totaled Two Million Five Hundred Fifty Thousand Dollars (\$2,550,000).

28. As reflected in Requisition # 4 (\$200,000) and # 5 (\$300,000), respectively, the Respondents' total request for payment for Construction Costs incurred totaled Three Million Fifty Thousand Dollars (\$3,050,000).

29. Yet, as reflected in Exhibit R44, which is Respondents' June 24, 2011 AIA draw request, (which corresponds with Requisition # 5), the total amount of construction completed as of June 24, 2011 was only Nine Hundred Fifty Nine Thousand Three Hundred Eighty-Two Dollars and Ninety Cents (\$959,382.90) and that the current payment due was only One Hundred Ninety Five Thousand Two Hundred Seventy-Five Dollars (\$195,275).

30. Between April 12, 2011 and June 7, 2011, Respondents caused Three Million Eight Hundred Thousand Dollars (\$3,800,000) to be paid from the Construction Account to the Retro Metro account and over Two Million Nine Hundred Forty-Three Thousand Dollars (\$2,943,000) to be paid from the Retro Metro Account. [Exhibit S19].

31. Although, the Respondents state that Watkins and Watkins Development still have invoices and records for both accounts payable and accounts receivable for Watkins Development, none were submitted in evidence. [Transcript, pp. 343, 344]

32. Watkins testified that in June 2011, Retro Metro owed Watkins Development more than \$587,000. [Transcript, p. 258] However, no monies were withdrawn by Retro Metro to pay any alleged debt owed by Retro Metro to Watkins Development and no Requisitions for payment were submitted that referred to Retro Metro debt owed to Watkins Development. (Exhibit S18). Repayment to Watkins Development for acquisition costs had already been paid out of the Construction Account on April 12, 2011 as a part of Requisition # 1 [Exhibits S 18 P. 3 and S19 P. 3].
33. The Respondents have proffered no documentation to support that debt, other than the fees allegedly due under the Development Agreement, was owed to Respondents. [First Notice of Intent, p. 7; Amended Notice of Intent, p. 8; Transcript, pp. 1-369]
34. On April 1, 2011, Respondents executed documents to form Meridian Law Enforcement Center, LLC (“MLEC”) in order to redevelop the old Cowboy Maloney’s building in Meridian, Mississippi. [Transcript, p. 233]. The Certificate of Formation was filed with the Secretary of State’s Office on April 12, 2011. [Exhibit S17]
35. The Respondents stated that the Respondents did not have time “to do” an acquisition loan to purchase the Meridian property but continued to pursue a construction loan. The Respondents testified they “weren’t going to need the money to fund the construction loan as long as [they] had a commitment to fund it.” The commitment came on May 18, 2011. [Transcript p. 238-240]. Besides Citizens National Bank, the Respondents did not seek a loan or talk to any other bank about a loan for the Meridian project. [Transcript p. 240]
36. Respondents also testified that on or about June 1, 2011, Respondents knew that an acquisition loan for the purchasing of the Meridian property was not going to be possible. [Transcript, p. 238-239]

37. Immediately before June 2, 2011, the Retro Metro checking account had a balance of approximately sixty thousand dollars (\$60,000). [Exhibit S19]
38. On June 2, 2011, the Respondent submitted Requisition Number 03 to the Trustee for Eight Hundred Thousand Dollars (\$800,000) (“Requisition #3”). [Transcript pp. 215-216; Exhibit S18]. Requisition #3 stated, “This requisition relates to the following portion of the Project, if any (please specify in reasonable detail the nature of the obligation): Construction costs, architects and professional fees, acquisition costs and partner distribution, as shown in the attached schedule.” [Exhibit S18, page 9; Transcript, p. 226] (The referenced language repeated language from Requisitions # 1 and 2, although none of the attached schedules in Requisitions # 2 and 3 included anything but “Construction Costs.”) The schedule attached to Requisition #3 only discloses that Respondents request a distribution for “Construction Costs (demolition, framing, Plumbing, electrical)” for 800,000. [Exhibit S18]
39. Requisition #3 does not include any of the required supporting documentation for payment other than “Construction Costs” nor does it include any supporting documentation for payment to Watkins Development or any description of things that could be payable to Watkins Development. [Exhibit S18]
40. By signing and submitting Requisition #3, the Respondents made “all the covenants and all the reps and warranties [made in the Loan Agreement on April 1, 2011] be sort of evergreen. Every time a disbursement is requested, they’re all made anew.” [Transcript, p. 159 Exhibit S6, P. 14 § 3.4]
41. On June 8, 2011, six days after receiving the \$800,000 from the Trustee from the Construction Account into the Retro Metro checking account allegedly for construction costs, Watkins wired \$587,084.34 from the Retro Metro Account to a real estate closing account at the

law firm of Hammack, Barry, Thaggard, and May, LLP of Meridian, Mississippi to purchase real property located at 510 22nd Avenue, Meridian, Mississippi for MLEC. [Transcript, pp. 262, 263; Exhibit S19 P. 8]

42. Respondents were preparing for the closing on the Meridian property and knew the closing was going to have to be done in a hurry. However, Respondents only offered as an excuse for the inappropriate use of these funds that Watkins had a “serious time crunch.”

[Transcript, p. 263]

43. Respondents testified that they had multiple resources, including cash reserves, for financing the Meridian property purchase. [Transcript, pp. 255-256] However, no documentation was offered to substantiate this allegation.

44. The Bonds first defaulted in April 2012 and have remained one payment in default since that time. [Transcript, pp. 52, 64]

45. Respondents state they did not knowingly and intentionally lie to anyone or conceal anything. [Transcript, p. 333]

CONCLUSIONS OF LAW

Jurisdiction

46. The Mississippi Securities Act, codified at Miss. Code Ann. Sections 75-71-101, et. seq. (2010) (hereinafter “Act”), authorizes the Secretary of State to regulate the sale of securities in Mississippi, including any offer, sale or purchase of securities that involves fraud.

47. Section 75-71-501 of the Act sets forth:

General Fraud.

It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly:

- (1) To employ a device, scheme, or artifice to defraud;
- (2) To make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or
- (3) To engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.

48. The Division may employ remedies set out in Miss. Code Ann. Section 75-71-604 of

the Act which sets forth:

Administrative enforcement.

(a) Issuance of an order or notice. If the administrator determines that a person has engaged, is engaging, or is about to engage in an act, practice, or course of business constituting a violation of this chapter or a rule adopted or order issued under this chapter or that a person has materially aided, is materially aiding, or is about to materially aid an act, practice, or course of business constituting a violation of this chapter or a rule adopted or order issued under this chapter, the administrator may:

- (1) Issue an order directing the person to cease and desist from engaging in the act, practice, or course of business or to take other action necessary or appropriate to comply with this chapter;
- (2) Issue an order denying, suspending, revoking, or conditioning the exemptions for a broker-dealer under Section 75-71-401(b)(1)(D) or (F) or an investment adviser under Section 75-71-403(b)(1)(C); or
- (3) Issue an order:
 - (A) Under Section 75-71-204;
 - (B) Imposing a civil penalty in the case of an issuer of registered securities, broker-dealer, investment advisor, agent, investment adviser representative, or other person who violated this chapter;
 - (C) Barring or suspending the person from association with a broker-dealer or investment advisor registered in this state; or
 - (D) Requiring the person to pay restitution for any loss or disgorge any profits arising from the violation, including interest.

Burden of Proof

49. The Mississippi Securities Act Rule 817 (B) provides that “[u]nless otherwise specified by law, the standard of proof at the hearing shall be by a preponderance of the evidence.”

50. The US Supreme Court has upheld the preponderance of the evidence standard in federal antifraud cases: *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387-89 (1983) and *Steadman v. SEC*, 450 U.S. 91, 92, 96 (1981).

51. In a recent Mississippi Supreme Court case, *Harrington v. Office of Mississippi Sec'y of State*, 2012-CA-00826-SCT, 2013 WL 6115678 (Miss. Nov. 21, 2013), the Court affirmed this burden of proof in light of Rule 817 and federal case law.

Omissions and False Statement in the Bond Documents

52. The Respondents' failure to disclose in the PPM or Bond Documents the significant and material liabilities of Retro Metro to Watkins Development as set forth in the Development Agreement is a violation of Section 75-71-501 of the Act. The minimum which Watkins Development was entitled to receive under the Development Agreement was One Million One Hundred Twenty-Five Thousand Dollars (\$1,125,000). This was forty-five percent (45%) of the total construction cost estimate of the project that, according to Watkins, was due at closing.

53. Additionally, Watkins affirmatively represented in the Bond Documents that Retro Metro had no other material financial obligations which had not been disclosed and therefore Respondents' representation in the Bond Documents to that effect was an untrue statement of material fact and a violation of Section 75-71-501.

54. In *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 180 L. Ed. 2d 166 (2011) the Court held that for the purposes of SEC Rule 10b-5, "the maker of a statement is the person or entity with ultimate authority over the statement....One who prepares or publishes a statement on behalf of another is not its maker."

55. Applying that definition to the case at hand, the MBFC, through its counsel, prepared the PPM on behalf of and with the information from Respondents.

56. Retro Metro was the conduit borrower of the Bonds, and the Respondents were responsible for the omissions and material misstatements set forth in the Bond Documents which omitted: a) disclosing the Development Agreement and b) financial liability of Retro Metro to Watkins Development. Further, Respondents affirmatively made untrue statements in the Bond Documents.

57. In the *Harrington* case, the respondents had made an offer of securities in a private placement memo. In that private placement memo, the respondents made representations that investor funds would be placed into an escrow account and that books and records would be maintained. “Those were promises pertaining to business practices with which [the respondents] failed to comply.” (*Harrington*, p. 18). The Court said, “The assurances that funds would be held in escrow likely would be a “material fact” to investors...” and that since they were not held in escrow, after the sale of the security, in accordance with the private placement memo, “false statements were made in the PPM, and the use of the investors’ money [not in accordance with the terms of the private placement memo] was deceitful and fraudulent” and that “the conduct was a violation of Section 75-71-501.” (*Harrington*, p. 22)

58. Likewise, “the PPM promised that books and records would be maintained and would be available for investors to review at any time. That was not done. As such, the promise was untrue, misleading, and part of the overall fraud committed by [the respondents].... [T]he conduct constituted a violation of Section 75-71-501.” (*Harrington*, p. 24)

59. Much like the *Harrington* case, the PPM and § 2.2 (k) of the Loan Agreement (Exhibit S6) had a representation that there were no other agreements with material adverse financial obligations. The Respondents either failed to disclose this Development Agreement or intended to hide, that Retro Metro had an agreement with material adverse financial liabilities. This

representation was untrue, misleading, and part of the overall deceit. Consequently, the Respondents' conduct constitutes a violation of Section 75-71-501.

Scienter

60. Respondents allege that there was no intention to lie or conceal. However, the “omission or untrue statement” language is found in Section 75-71-501(2) and the Court in *Harrington* addressed that issue holding, “Scienter is not a required element for charges brought under Mississippi Code Sections 75-71-501(2) and (3). (*Harrington*, pp. 16-17]

Reliance

61. Although the Respondents have taken the position that the investors were only interested in the City of Jackson Lease and consequently did not rely on any other representation of Respondents, *Harrington* holds that reliance is not an element of proving securities violations in enforcement actions such as this action. (*Harrington*, p. 27).

Failure to Disclose Intent to Use Proceeds as a Scheme

62. When the Respondents failed to disclose their intentions to use the Proceeds for any purpose other than the improvements for the Retro Metro project, the Respondents violated Section 75-71-501 by employing a device, scheme, or artifice to mislead or deceive.

63. The Respondents testified that they had funds to finance the Meridian property purchase with cash. The Respondents knew at least one week, if not three weeks, prior to the transaction that funds other than from a loan would be needed. The Respondents knew that the closing on the property would be hurried. But the Respondents made no preparations to secure sources of funding other than the funds from the Construction Account.

64. The Respondents intended to use the Proceeds for purposes other than the Project when the Respondents requisitioned \$800,000 for construction costs and then spent almost three-

fourths of that money, not for construction costs incurred on the Retro Metro project, but to help fund the MLEC project.

65. Requisitioning the money days before the Meridian property closing, while knowing that 1) the closing would be hurried, 2) there would not be an acquisition loan, and 3) there was a cash reserve that could be used, and making no preparations for funding other than from the requisition demonstrates the Respondents' were employing a scheme to mislead or deceive.

Failure to Disclose Intent to Use Proceeds as an Omission

66. The Respondents' failure to disclose in the Bond Documents, including the Requisition, the intent to use any portion of the Proceeds to finance the activities of MLEC is a material omission and violation of Section 75-71-501(2) of the Act.

67. The Respondents requisitioned a disbursement within days of the Meridian property purchase, knowing that there would be no acquisition loan and knowing the closing would be hurried. By submitting that requisition, the Respondents renewed the covenant they made in the Loan Agreement that the Proceeds would be used to finance the Retro Metro project.

68. The failure to disclose the intent was in connection with the offer and sale of the security and has operated to mislead or deceive.

69. In *S.E.C. v. Zandford*, 535 U.S. 813 (2002), the Court stated

Rule 10b-5, which implements [Section 10(b) of the 1934 Act], forbids the use, “**in connection with the purchase or sale of any security,**” of “**any device, scheme, or artifice to defraud**” or any other “**act, practice, or course of business**” that “**operates ... as a fraud or deceit.**” 17 CFR § 240.10b-5 (2000). Among Congress' objectives in passing the Act was “to insure honest securities markets and thereby promote investor confidence” after the market crash of 1929. *United States v. O'Hagan*, 521 U.S. 642, 658, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997); see also *United States v. Naftalin*, 441 U.S. 768, 775, 99 S.Ct. 2077, 60 L.Ed.2d 624 (1979). More generally, Congress sought “to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.” Affiliated

Ute Citizens of Utah v. United States, 406 U.S. 128, 151, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972) (quoting SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186, 84 S.Ct. 275, 11 L.Ed.2d 237 (1963)).

(*Zandford*, p. 819) (Emphasis added). The Court further stated,

Consequently, we have explained that the statute should be “construed ‘not technically and restrictively, but flexibly to effectuate its remedial purposes.’” 406 U.S., at 151, 92 S.Ct. 1456 (quoting *Capital Gains Research Bureau, Inc.*, 375 U.S., at 195, 84 S.Ct. 275). In its role enforcing the Act, the SEC has consistently adopted a broad reading of the phrase “in connection with the purchase or sale of any security.

(*Zandford*, p. 819)

70. In *Zandford*, the Court found that a misappropriation of proceeds from the sale of a security that occurred after the sale of the security was “in connection with” and a violation of the remedial purpose of the Act.

71. The language used in *Zandford* is essentially the same language as found in Miss. Code Ann. Section 75-71-501.

72. In the same vein, in *Harrington* the Mississippi Supreme Court agreed with the rationale of construing flexibly. Again, in *Harrington* the PPM represented one thing, but the funds were not put into an escrow account as stated in the PPM. And, although the PPM represented that books and records would be maintained, they were not. The Court in *Harrington* found that both the failure to put funds into an escrow account and the failure to keep books was a violation of Section 75-71-501. Both of these acts occurred after the offer and after the sale and they were determined to be material and in connection with the offer, sale, or purchase of the securities.

Act of Misuse of Proceeds

73. Respondents' misuse of the Bond Proceeds was an act and course of business that operated to mislead or deceive. This is in connection with the offer and sale of securities and is a violation of Section 75-71-501.

74. In *Harrington*, the Respondents made representations that offering proceeds would be used in a specific way. "Those were promises pertaining to business practices with which [the respondents] failed to comply." (*Harrington*, p. 18). The Court said, "The assurances that funds would be held in escrow likely would be a "material fact" to investors..." and that since they were not held in escrow, after the sale of the security, as in accordance with the private placement memo, "false statements were made in the PPM, and the use of the investors' money [not in accordance with the private placement memo] was deceitful and fraudulent" and "the conduct was a violation of Section 75-71-501." (*Harrington*, P. 22)

75. As in the *Harrington* case, the private placement memo in the case at hand had a promise that the bond proceeds would be used for the Belk building at Metrocenter Mall in Jackson, Mississippi. That promise was not honored when the money was instead used to pay Four Hundred Thousand Dollars (\$400,000) as partner distributions and to purchase property in Meridian, Mississippi. And just as in *Harrington*, false statements of the use of the money were made in the offering document and the misuse of the investors' money was deceitful and misleading.

76. Further, in *Harrington* the Court states that "the plain language of Section 75-71-501 (3) does not contemplate the actual commission of a fraud, but rather 'any act, practice[,] or course of business which operates or *would operate* as a fraud or deceit[.]' (Emphasis added.)

Accordingly, there exists no applicable statutory requirement that fraud be proven at all; it is

enough to satisfy the statute by showing the existence of an act, practice, or course of business that *would operate* as a deceit.”

77. Although the Respondents argue that more than \$587,000 was owed to Watkins Development, whether or not the money was owed is irrelevant. The actual act of the transfer, particularly without any paperwork documenting the validity of such an obligation, *would operate* as a deceit.

78. Respondents argue that they had the right to expend from the Construction Account more than Two Million Dollars (\$2,000,000) in professional fees and other non-construction expenses above and beyond the amount required to construct and improve the Metro Center space to accommodate the City of Jackson as the tenant. Respondents further argue that both the purchaser of the bonds and all other parties were aware of that right. A reading of the Loan Agreement at Page 5 defines the word “Costs”. The definition of Costs does not provide for the argument of Respondents. In addition, at Page 10 of the Loan Agreement, can be found the definition for the phrase “Surplus Bond Proceeds”. Had there been any Surplus Bond Proceeds, those amounts would not have been available to Respondents.

CONCLUSION

Any of the violations above is sufficient basis for the imposition of an administrative penalty. The violations are a sufficient basis for restitution.

THEREFORE, a Final Order is hereby recommended ordering Respondents, Watkins Development and David Watkins, collectively, to immediately make restitution of \$587,084.34 plus legal interest from June 8, 2011 until paid to Retro Metro, LLC arising from the use of bond proceeds to purchase the Meridian property.

FURTHER, an administrative penalty in the amount of Seventy-Five Thousand Dollars (\$75,000.00) is hereby recommended against Watkins Development and David Watkins,

collectively. The penalty is calculated as follows:

1. Twenty Five Thousand Dollars (\$25,000.00) for violating Mississippi Code Annotated Section 75-71-501 by omissions and untrue statements in the bond offering and sale.

2. Twenty Five Thousand Dollars (\$25,000.00) for violating Mississippi Code Annotated Section 75-71-501 by employing misleading and deceptive actions in connection with the use of bond proceeds.

3. Twenty Five Thousand Dollars (\$25,000.00) for violating Mississippi Code Annotated Section 75-71-501 by manipulating the Requisition forms and by substantial omissions in the requisitions for payments.

This the 19th day of March, 2014.



ROBERT R. BAILESS
HEARING OFFICER