

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA
At Charleston

GEORGE A. GRAYIEL, JR.,

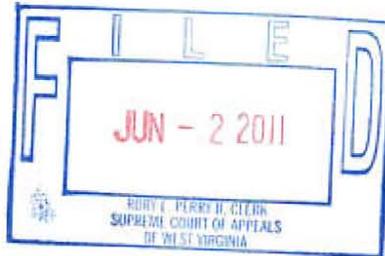
Petitioner,

v.

No. 11-0371

APPALACHIAN ENERGY PARTNERS 2001-D, LLP,
APPALACHIAN ENERGY PARTNERS 2001-S, LLP,
APPALACHIAN ENERGY PARTNERS 2001 II, LLP,
APPALACHIAN ENERGY PARTNERS 2003 S-II, LLP,
BURNING SPRINGS ENERGY PARTNERS 1999, LLP,
BURNING SPRINGS ENERGY PARTNERS 2000, LLP,
BURNING SPRINGS ENERGY PARTNERS 2001-S, LLP,
CHEROKEE ENERGY COMPANY, HAYNES #2 ENERGY
PARTNERS 2001, LLP,
MARTIN TWIST ENERGY COMPANY, LLC,
MARTIN R. TWIST,
DREW THOMAS,
TAMMY CURRY TWIST and
TODD PILCHER,

Respondents.



**AMICUS BRIEF OF GLEN B. GAINER III
WEST VIRGINIA STATE AUDITOR
AND COMMISSIONER OF SECURITIES**

LISA A. HOPKINS
General Counsel

SHANE P. McCULLOUGH
Associate Counsel
Capitol Complex, Bldg. 1, Room W-100
Charleston, West Virginia 25305
304-558-2251
Counsel for Glen B. Gainer III
West Virginia State Auditor and
Commissioner of Securities

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AMICUS BRIEF OF GLEN B. GAINER III, WEST VIRGINIA STATE AUDITOR

I. INTRODUCTION

Glen B. Gainer, III, the West Virginia State Auditor and Commissioner of Securities ("Auditor"), by and through his legal counsel, respectfully submits this Amicus Brief in support of George Grayiel's Petition for Appeal in the above referenced matter. As an elected officer of the State of West Virginia, the Auditor is filing this amicus brief as a matter of right under Rule 30 of the West Virginia Rules of Appellate Procedure. (W. Va. R.A.P., Rule 30 (2010)). No party has assisted with or contributed to the preparation of this brief.

Pursuant to West Virginia Code § 32-2-406, the Auditor is designated Commissioner of Securities and administers the Uniform Securities Act of West Virginia (W. Va. Code § 32-1-101, *et. seq.*) (hereinafter "The Act"). The Securities Division of the West Virginia State Auditor's Office (hereinafter "Division") operates at the direction of the Auditor as the primary securities regulatory agency in West Virginia, and it is charged with the administration and enforcement of The Act. The Division is responsible for the regulation of all non-exempt securities, broker-dealers, issuers, and investment advisors, as well as the enforcement of the Act through administrative actions and penalties against individuals and entities that fail to comply with its provisions.

During the past eight years, the Division has investigated the activities of Respondent Martin Twist and his companies (hereinafter "Twist") multiple times. As a result, numerous violations of The Act have been uncovered and documented in Cease and Desist Orders issued by the Division. Violations have included findings of fraud and

commingling of investor funds. Twist's scheme included the use of contract documents to create a sense of legitimacy to the target victims. Furthermore, Twist used arbitration clauses (such as the arbitration clauses at issue herein) as a shield to circumvent accountability within the legal system and to deny his victim's access to justice by making the cost of the process prohibitive. Therefore, for these reasons, and many more, arbitration is an illusory remedy and should not have been granted by the trial court.

According to the Financial Industry Regulatory Authority (FINRA) Investor Education Foundation, the most common victim of investment fraud is a male, 55 years old or older, with some education. (See FINRA statistics, page 1, saveandinvest.org, Auditor's Appendix 001). Furthermore, investment fraud victims dramatically under-report victimization by such scams (NASD Investor Fraud Study Final Report, Page 17, Auditor's Appendix 003). West Virginia has both the third highest median age and number of elderly citizens in the nation. (See U.S. Census Bureau statistics, cited in Fairmont Times West Virginian (May 6, 2011) by John Raby, Auditor's Appendix 034). Thus, our population has a concentration of the targeted group. The lack of reporting contributes to the problem, as does the use of legal gimmicks by perpetrators to avoid the legal process. This large (and vulnerable) demographic of West Virginia citizens needs special attention and protection from investment scams.

The matter before the court illustrates the above-referenced statistics. For these reasons, the Auditor prays that this Court reverse the decision of the trial court and require Respondents to answer the allegations against them in a court of law.

II. FACTUAL HISTORY

In the interest of time and efficiency, the Auditor adopts the factual section, in its entirety, used in the Appellate Brief of Petitioner Grayiel as if fully set forth herein. In addition to those facts enunciated by Petitioner, the Auditor further submits to this Court that, as noted above, Twist has been the subject of previous investigations by the Division, culminating in four (4) Cease and Desist Orders over a six (6) year time frame. ((See *In the Matter of: Appalachian Energy Partners 2001-D LLP*, No. 03-1291 (2003) (Attached Auditor's Appendix 036), *In The Matter of: Blue Flame Energy Co., LLC*, No. 06-1333 (2006)(Auditor's Appendix 041) (*In The Matter of: Appalachian Energy Partners 2001-D LLP*, No. 07-1343 (2007) (Attached Auditor's Appendix 045) (*In The Matter of: Appalachian Energy Partners 2001-D LLP*, No. 03-1343 (2009) (Attached Auditor's Appendix 049, Exhibits thereto attach at 058)). Attached the Division's analysis of the information obtained from these investigations has shown that Twist engaged in a pattern and practice of creating shell companies to induce investment in specific alleged wells. Then, after inducing investments, Twist merged investor funds into one or two shell corporations, such as Cherokee Energy and Martin Twist Energy, and funds were then cashed out by Twist without any cognizable business purpose. (Charted summaries of the money transfers and cash withdrawals are attached hereto at Auditor's Appendix 199-225). During the three-year time span from 2002 to 2005, which is the time span for which the Division has access to some of Twist's corporate financial records, the amount of funds transferred and/or withdrawn by Twist in this manner from just two of his shell companies, Cherokee Energy and Martin Twist

Energy, totals over \$1.5 million dollars. (2002-2005—Summary Attached at Auditor's Appendix 226).

III. ARGUMENT

1. THE TRIAL COURT'S DECISION THAT THE ARBITRATION CLAUSES WERE NOT UNCONSCIONABLE IS ERRONEOUS AND CONTRARY TO APPLICABLE LAW.

The written opinion of the trial court below in this matter states that:

...Mr. Grayiel signed 15 subscription agreements and 5 partnership agreements over a two year period. This fact alone suggests to this Court that Mr. Grayiel did not feel that he had grossly inadequate bargaining power. If he did think as such, there is no way that he would have signed such agreements. (**emphasis added**) (Order Granting Defendants Motion to Dismiss, February 2, 2011, Judge Spalding, Appendix Pg. 4-10).

The lower court relied heavily on the Petitioner's alleged feelings about the adequacy of his bargaining position at the time he invested. However, the feelings of any party to a contract concerning whether they have grossly inadequate bargaining power are irrelevant to the determination of whether a clause or contract is unconscionable. A party's feelings about or self-appraisal of its bargaining position are not utilized or included in any recognizable judicial or statutory test concerning unconscionability. Such a standard would eviscerate the law concerning unconscionability since it would be highly improbable that an individual would perceive a grossly inadequate bargaining position, and then proceed to sign the agreement regardless of that feeling. After cold-calling Petitioner Grayiel, Twist told Petitioner that the investments were "safe" and would yield a high return, and that Twist had never been the subject of any lawsuits,

liens, bankruptcies, or judgments. (Grayiel Deposition, Pg. 33 Line 1-7, Appendix Pg. 45). None of these representations were true. Considering Twist's material misrepresentations and omissions about crucial components of the contract itself, adherence to such a standard would lead to an absurd and inequitable result. For those reasons, Mr. Grayiel's feelings about his bargaining position are irrelevant to a determination of unconscionability, and, in fact, his feelings at the time of signing are a good indication of the persuasiveness of the misrepresentations made by Twist.

This Court has held that an arbitration clause will be invalidated if the terms of that agreement are unconscionable or were thrust upon a contracting party. (*The Board of Education of the County of Berkeley v. W. Harley Miller, Inc., a corp.*, 160 W.Va. 473, 473 (1977)).

This Court has enunciated the following test when analyzing arbitration clauses for unconscionability in the case *Art's Flower Shop v. C & P Telephone Co.*:

A determination of unconscionability must focus on the relative positions of the parties, the adequacy of the bargaining position, the meaningful alternatives available to the plaintiff, and 'the existence of unfair terms in the contract'. *Art's Flower Shop v. C & P Telephone Co.*, 186 W. Va. 613, Syl. Pt. 4 (1992).

Thus, a finding of unconscionability depends on the relative position of the parties, the adequacy of the bargaining positions held by each respective party, the presence of meaningful alternatives available to the plaintiff, and the existence of unfair terms in the contract.

This Court has considered the issue of unconscionability in a factual situation similar to the situation herein presented in the case *Arnold v. United Cos. Lending Co.* (*Arnold v. United Cos. Lending Co.*, 204 W. Va. 229 (1998)). This Court first analyzed

the relative positions of the parties. The Arnolds were an older couple, with no previous investment experience (*Arnold* at 236, footnote 7). The contracting party, United Cos. Lending, was a sophisticated national corporation, with much experience in the legal process and the subject matter of the contracts and clauses at issue. After considering the relative positions of the parties in *Arnold*, this Court arrived at the inevitable conclusion that the Arnolds bargaining position was “grossly unequal” to that of United Lending. (*Arnold* at 236).

In this case, Twist was a sophisticated business man who had entered into innumerable similar contracts with other “investors”. (See footnote 1, below). He had been involved in countless lawsuits and arbitrations and therefore had great understanding of the impact of the clauses and all of their terms. While Twist’s companies are not national, they have induced similar investments all over the country, and clearly have great expertise and experience in this process¹. Twist and his companies have been subject to countless enforcement actions, private actions, and arbitration proceedings, none of which were ever disclosed to Petitioner. (Grayiel

¹ Respondent Twist has been the subject of investigations by no less than nine (9) different state securities regulators, as well as numerous enforcement actions by those regulators. In each of these actions, the regulatory agencies found the same pattern and practice utilized by Twist. Twist cold-calls residents, and presents a “safe” investment with high returns in a quick amount of time. Then, Twist either gives an extremely limited return or no return at all. Other states that have issued orders or investigated Twist include, but are not limited to: Alabama (See *In the Matter of Cherokee Energy Co., LLC*, No. CD-2003-02 (Ala. Sec. Comm’n) (Attached Auditor’s Appendix 230), *In the Matter of Malory Inv., LLC*, No. CD-2007-19 (Ala. Sec. Comm’n)), California (See *Twist v. Arbusto*, No. 4:05-CV-187 (S.D. Ind.)), Illinois (See *In the Matter of Malory Inv., LLC*, No. 07-00319 (Illinois Sec. Dept.)), Kentucky (See *OFI v. Tomljenovic*, No. 2005-AH-012 (Kentucky Securities Comm’n)), Ohio (See Attached 17 orders issued against Twist by the Ohio Dept. of Comm., Division of Securities, Auditor’s Appendix 238-347)), Oklahoma (See *In the Matter of: Cherokee Energy Co., L.L.C.*, No. 03-045 (Okla. Dept. of Secs.) (Attached Auditor’s Appendix 352), Pennsylvania (See *In the Matter of Appalachian Energy Partners 2001-D, LLP*, No. 2002-11-28 (Penn. Sec. Comm’n) (Attached Auditor’s Appendix 364), Wisconsin (See *In the Matter of Burning Springs Energy Partners*, No. S-04122(EX) (Wisc. Dept. of Fin. Inst.) (Attached Auditor’s Appendix 370), and West Virginia (See *In the Matter of: Appalachian Energy Partners 2001-D LLP*, No. 03-1291 (2003) (Attached Auditor’s Appendix 036), *In The Matter of: Blue Flame Energy Co., LLC*, No. 06-1333 (2006) (Auditor’s Appendix 041) (*In The Matter of: Appalachian Energy Partners 2001-D LLP*, No. 07-1343 (2007) (Attached Auditor’s Appendix 045) (*In The Matter of: Appalachian Energy Partners 2001-D LLP*, No. 03-1343 (2009) (Attached Auditor’s Appendix 049, Exhibits thereto attach at 058)).

Deposition Pg. 115 line 1-6, Pg. 116, line 16-18, Appendix Pg. 52). Mr. Grayiel, however, had no facility in the oil and gas business, complex investment litigation or arbitration. Petitioner Grayiel has little experience or familiarity with the various forums, legal processes, and requirements of the law available to him. In his deposition, Petitioner Grayiel stated that he did not understand the Agreements, in general, and the arbitration clause specifically, thus evidencing his inexperience and naivety in the realm of complex securities contracts. (Appendix Pgs. 46-49, Grayiel Deposition, Pg. 43 line 22-23, Pg. 46, line 14-18, Pg. 48 line 15-19, Pg. 49 line 17-19, Pg. 66 line 4-6).

In *Arnold*, this Court also analyzed the “meaningful alternatives” prong of the unconscionability test. In *Arnold*, United presented no meaningful loan options to the Arnolds, and rather presented the loan agreements as a form or adhesion contract (*Arnold* at 236). Here, much like the Arnolds, there is no evidence showing any options provided to Mr. Grayiel concerning forum selection, when he signed any of the fifteen (15) agreements involved herein. Rather than offering alternative clauses or options to Petitioner, Twist presented the contracts as standard forms. As evidenced by the contracts themselves, all the arbitration agreements were identical in form and substance. (See Subscription Agreements, Appendix Pg. 429-430, Grayiel Deposition Pg. 45, lines 2-5, Appendix Pg. 46). There is no evidence that any of the terms, including the arbitration clause, were ever bargained for. Rather, the contracts were effectively given in a “take it or leave it” fashion. Furthermore, the arbitration clauses at issue required any dispute be sent to arbitration in another state (either Kentucky or Indiana). This was required despite the fact that Twist maintained business offices and well locations within West Virginia. (West Virginia Securities Comm’n. Order to Cease

and Desist, *In the Matter of: Appalachian Energy Partners 2001-D LLP*, No. 03-1291(2003), Attached Auditor's Appendix 036). Therefore, this situation meets the lack of meaningful alternatives prong of the unconscionability test as analyzed by the Court in *Arnold*.

The final prong of the unconscionability test is the existence of unfair terms in the contract. This Court enunciated the following factors it considers when evaluating the terms of a contract or arbitration clause:

As a means of assessing the fairness of the contractual terms being challenged, we identified two additional inquiries in *Dunlap*: (1) whether the contract prevents a claimant from vindicating his or her rights; and (2) whether the costs of arbitration are unreasonably burdensome. (*State ex rel. AT&T Mobility v. Wilson*, 703 S.E.2d 543, 550 (2010), citing *State ex rel. Dunlap v. Berger*, 211 W.Va. at 550-51.)

Here, the terms of the arbitration agreements at issue include mandatory arbitration in Indiana or Kentucky (See subscription agreement, Appendix Pg. 429-30). For Petitioner, the costs of travel and legal fees would be exorbitant and prohibitive. The Indiana and Kentucky arbitration clauses thereby prohibit Petitioner from vindicating his rights and claims against Respondents. Furthermore, the costs of arbitration in another forum are unreasonably burdensome as applied to Petitioner due to his financial situation. Petitioner has lost his entire life savings. (See Plaintiff's Response to Defendants' Motion to Dismiss, Page 1, Appendix Pg. 390-393). Arbitration in another forum like Indiana or Kentucky is unfair to a person decimated financially by the opposing party. Additionally, at the time of the investments, Twist maintained offices in West Virginia and purportedly drilled wells here. Furthermore, according to the affidavit of Twist's former employee, Lonny Armstrong:

Martin Twist knew the arbitration clause in the subscription agreements by heart and he personally decided to include the Indiana arbitration forum to discourage investors from pressing their rights under the agreements, knowing that it would be prohibitively expensive and inconvenient for investors to travel to Indiana, hire both personal and local counsel, and undertake all the activities necessary to effectively prosecute an Indiana arbitration proceeding... (Affidavit of Lonny Armstrong, Page 1 No. 4, Appendix Pg. 143-145).

As his former employee makes clear, Twist purposefully and strategically chose Indiana as the forum state so as to prevent his victims from pursuing claims. Therefore, under the *Dunlap* test enunciated by this Court, the terms of this contract are unfair as applied to Petitioner. They prevent Petitioner's vindication of his claims and are unreasonably burdensome in terms of costs.

After consideration of the facts, noting especially the "grossly inadequate" bargaining positions, this Court in *Arnold* deemed the arbitration clause at issue unconscionable, and thereby unenforceable. (*Arnold* at 239). It is the Auditor's position that the facts herein mirror the factual situation of the Arnolds. Furthermore, the terms of the arbitration agreement are unfair under the *Dunlap* test. Therefore, as this Court ruled in *Arnold* and *Dunlap*, the arbitration clauses here should be deemed unconscionable and unenforceable.

2. TWIST CANNOT RELY ON THE EQUITABLE REMEDY OF ARBITRATION BECAUSE HE HAS UNCLEAR HANDS.

As discussed above, Twist attempts to utilize the equitable remedy of arbitration to avoid the allegations against him. This Court has held, "Unconscionability is an equitable principle, and the determination of whether a contract or a provision therein is

unconscionable should be made by the court.” *Troy Mining Corp. v. Itmann Coal Co.*, 176 W. Va. 599, 602 (1986)).

It is a basic tenet of equity that those with unclean hands cannot and will not be rewarded. That rule is a fundamental and organic component of the laws of West Virginia. In fact, this Court has unequivocally held: “Equity never helps those who engage in fraudulent transactions, but leaves them where it finds them.” *Province v. Province*, 196 W. Va. 473, 473 S.E.2d 894 (1996) (quoting *Moore v. Mustoe*, 47 W. Va. 549, 552, 35 S.E.871, 873 (1900)). This doctrine has been expressly and specifically made a part of the organic law in this State. *Id.*” (*Foster v. Foster*, 221 W. Va. 426, 431 (2007)).

Here, there are numerous examples of Twist’s unclean hands. First, Twist violated multiple provisions The Act. For example, when Twist offered and sold unregistered investments to a West Virginia resident (Petitioner), Respondents violated West Virginia Code §32-2-201, and § 32-2-301, and Federal Regulation D Rule 506 (17 C.F.R. §230.506 (2011)). Furthermore, the Division’s investigation has shown that Twist commingled over one (1) million dollars from his shell corporations, the use of which cannot be attributed to their purported business purposes. (Martin Twist Misappropriated Funds Summary Chart, Auditor’s Appendix 226).

Second, Twist routinely uses arbitration as a vehicle to avoid answering allegations against him in a court of law. After dismissal from court, Twist uses any and all excuses possible to prolong the arbitration process and exact further financial hardship (car accident, sickness, files were “stolen”, etc). In the California case listed above, *Twist v. Arbusto*, Twist’s modus operandi in these cases is evidenced—that

being Twist manipulating the legal system's relatively new emphasis on the arbitration process to avoid taking responsibility for his actions. (See footnote 1, above).

This Court has the power *sua sponte* to prevent Twist from abusing the arbitration process to bypass the legal system. In *Foster*, this Court held:

The unconscionable character of a transaction between the parties need not be pleaded or set up as a defense. Whenever it is disclosed the court will of its own motion apply the maxim. It does not matter at what state of the proofs or in what order a lack of clean hands is discovered. A party cannot waive application of the clean hands rule at the instance of the court, nor does such application depend on the wish of counsel. (*Foster* at 431, quoting *Wheeling Dollar Sav. & Trust Co. v. Hoffman*, 127 W. Va. 777, 779-80 (1945), (quoting 30 C.J.S., Equity, §97)).

In *Foster*, a father used the statute of limitations to avoid payment of child support. Then, he subsequently attempted to enforce a judgment against the mother for an overpayment credit. (*Foster* at 431). As this Court noted, that type of use of the statute of limitations goes against the general rule that the legal process must support the general interest of the child. (*Foster* at 432). After consideration of the facts in *Foster*, this Court held, "we cannot permit this uncleanness to continue." (*Foster* at 432).

The maneuvering in *Foster* is quite analogous to the situation here. Here, Twist uses arbitration to deny investors their day in court. As previously discussed, it is in the best interest of the public if investors, particularly the at-risk portions of our population, are protected from investment fraud. In both *Foster* and this case, one party attempts to use a protection of the legal system to avoid culpability. Twist has shown that it is his modus operandi to push cases to arbitration as a mechanism to delay the legal and

arbitration processes, just as the father in *Foster* used the statute of limitations as an attempt to avoid justice.

As previously noted, Lonny Armstrong, Twist's former employee, disclosed that Twist purposefully and strategically made Indiana the site of arbitration. Twist's decision to make Indiana the forum for arbitration was not for any true business purpose. Rather, Twist's decision was an attempt to avoid Kentucky Securities regulators and to discourage the pursuit of claims against him. (See Affidavit of Lonny Armstrong, Appendix Pg. 143-145). This is a clear example of Twist's manipulation and unclean usage of legal processes to his victim's detriment. Just as in *Foster*, Twist's uncleanness cannot be allowed to continue.

Twist has exhibited disdain for the legal system and its direct orders. As Twist's deposition illustrates, he refused to meaningfully cooperate in any type of discovery, in violation of Rule 37(b) of West Virginia Rules of Civil Procedure (See Deposition of Martin Twist) (W.Va. R.C.P. 37(b)). Pursuant to the West Virginia Rules of Procedure, Twist should be ordered to fully and meaningfully cooperate with the discovery process and to answer the complaint against him in a West Virginia court of law.

IV. CONCLUSION

In conclusion, Twist should not be permitted to use arbitration as a shield from liability for wrongdoing. Under the applicable law of this State, the arbitration clauses are unenforceable and unconscionable because of the grossly unequal bargaining position of the parties, the inadequate bargaining position held by Petitioner, the

absence of meaningful alternatives presented to Petitioner, and the unfair terms slanted in Twist's favor.

Furthermore, Twist should not be permitted to utilize the equitable remedy of arbitration because he has unclean hands. Twist fraudulently induced Petitioner into the contract, commingled and improperly utilized invested monies, and has a history of using the arbitration process to avoid culpability, unjustly prolonging any actions against him. Twist should not and cannot be allowed to continue to openly flaunt and "work" the judicial system. It is in the best interest of the people of West Virginia for Twist to answer the allegations against him in a court of law in West Virginia, under the laws of West Virginia.

The Auditor prays that this Honorable Court rule that the arbitration clauses at issue are unenforceable and unconscionable, so that this case can be litigated in a forum where Petitioner can fairly pursue his claims.

Glen B. Gainer III

West Virginia State Auditor and
Commissioner of Securities

By:  _____
Lisa A. Hopkins, Esq.

West Virginia Bar ID No. 6082
General Counsel and Senior
Deputy Commissioner of Securities
West Virginia Bar # 6082
West Virginia State Auditor's Office
Capitol Complex, Bldg. 1, Room W-100
Charleston, West Virginia 25305
304-558-2251

By: 
SHANE P. McCULLOUGH
West Virginia Bar ID No. 11533
Associate General Counsel
Capitol Complex, Bldg. 1, Room W-100
Charleston, West Virginia 25305
304-558-2251
Counsel for Glen B. Gainer III
West Virginia State Auditor

CERTIFICATE OF SERVICE

I, Lisa A. Hopkins, General Counsel and Senior Deputy Commissioner of Securities, do certify that I have served this **AMICUS BRIEF OF GLEN B. GAINER III, WEST VIRGINIA STATE AUDITOR** to the following parties on this 2nd day of June, 2011, via hand delivery and/or United States mail at the addresses set forth below:

The Honorable Rory L. Perry II
West Virginia Supreme Court Clerk
Building 1, Room E-317
1900 Kanawha Blvd., East
Charleston, WV 25305-0830

Scott Kaminski
Balgo & Kaminski
PO Box 3548
Charleston, WV 25335

Jeffrey Phillips
Robert Bailey
Steptoe & Johnson
Chase Tower - Eighth Floor
707 Virginia Street, E.
Charleston, WV 25301

BY COUNSEL



Lisa A. Hopkins
General Counsel and Senior
Deputy Commissioner of Securities