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**UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF UTAH**

	)	
<b>SECURITIES AND EXCHANGE COMMISSION,</b>	)	
	)	<b>COMPLAINT</b>
<b>PLAINTIFF,</b>	)	
	)	
<b>v.</b>	)	Civil No. 2:17-cv-00260-PMW
	)	
<b>MICHAEL D. SHUMWAY,</b>	)	Magistrate Judge Paul M. Warner
	)	
<b>DEFENDANT.</b>	)	
	)	
	)	

Plaintiff, Securities and Exchange Commission (the “Commission”), for its Complaint against Defendant Michael D. Shumway (“Shumway” or “Defendant”) alleges as follows:

**INTRODUCTION**

1. This matter involves an egregious fraud committed by Shumway while acting as corporate secretary and treasurer of two Utah water companies, American Fork Irrigation Company (“AFIC”) and Lehi Irrigation Company (“LIC”) (collectively “the Companies”). Over a period of more than twelve years, Shumway misappropriated dozens of shares of unauthorized stock in the Companies, selling them to unsuspecting investors. The estimated value of the

shares Shumway is known to have misappropriated is at least \$435,500. Shumway also misappropriated at least \$633,396 in funds from the Companies. The total value of funds and shares of stock misappropriated by Shumway from the Companies is at least \$1,068,896.

2. Shumway concealed and facilitated his theft from the Companies by falsifying their accounting, shareholder and other books and records and by misleading the Companies' boards of directors and officers.

3. Shumway sold the misappropriated stock to unsuspecting investors, misleading the investors to believe they were buying shares authorized and issued by the Companies, and that those shares included water rights in the Companies. In fact, the shares Shumway sold carried no legal rights to ownership in the Companies or any pertinent water rights.

#### **JURISDICTION AND VENUE**

4. This Court has subject matter jurisdiction by authority of Sections 20 and 22 of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. §§ 77t and 77v] and Sections 21 and Section 27 of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. §§ 78u and 78aa].

5. Defendant, directly and indirectly, singly and in concert, has made use of the means and instrumentalities of interstate commerce and the mails in connection with the transactions, acts and courses of business alleged herein, certain of which have occurred within the District of Utah.

6. Venue for this action is proper in the District of Utah under Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and under Section 27 of the Exchange Act [15 U.S.C. § 78aa] because certain of the transactions, acts, practices, and courses of business alleged in this

Complaint took place in this district and because Defendant resides in and transacted business in this district.

7. Defendant, unless restrained and enjoined by this Court, will continue to engage in the transactions, acts, practices, and course of business alleged herein and in transactions, acts, practices, and courses of business of similar purport and object.

8. Defendant's conduct took place in connection with the offer, purchase and/or sale of shares of stock purportedly issued by AFIC and LIC.

#### **DEFENDANT**

9. **Michael L. Shumway**, age 61, is a resident of American Fork, Utah. At the time of the conduct, Shumway was a licensed CPA with an active practice. Shumway has engaged in other enterprises including real estate development and serving on local charitable boards. Shumway was employed as corporate secretary and treasurer of AFIC from 1997 to 2015, and was employed as corporate secretary and treasurer of LIC from 2006 to 2015.

#### **THE COMPANIES**

10. **American Fork Irrigation Company** is a corporation that provides services related to water rights and delivery proximate to American Fork, Utah. AFIC has over 400 shareholders, with the cities of American Fork, Utah, and Highland, Utah, owning almost 50% of AFIC's shares. Other shareholders include businesses, farms and individual homeowners. Those shareholders own rights to water sources that are used to provide water for civic, culinary, commercial and agricultural uses in the water district.

11. **Lehi Irrigation Company** is a corporation that provides services related to water rights and delivery proximate to Lehi, Utah. LIC has 633 shareholders, with the cities of Lehi, Utah, and Highland, Utah owning 53% of its shares. Other shareholders include businesses,

farms and individual homeowners. Those shareholders likewise own rights to water sources that are used to provide water for civic, culinary, commercial and agricultural uses in the water district.

## **STATEMENT OF FACTS**

### **BACKGROUND**

12. Utah is the second-most arid state in the United States and ownership of water rights is a valuable asset. Utah's water law follows the legal doctrine of prior appropriation which prioritizes access to water to those holding water rights with earlier appropriation dates.

13. In many areas of the state, water from a particular water district is fully appropriated, and the granting of new water rights is closed. In those districts, persons in need of water rights are required to purchase or lease those rights from existing water right holders or obtain contracts from municipalities in order to obtain permits to develop property.

14. In many instances, Utah water rights are owned through water companies which were formed by original water right owners to effectively administer and distribute the water in a specific water district. Those water rights are reflected as shares of stock in the water company, with a specified amount of water allotted per share.

15. Water rights owned by AFIC have been fully appropriated to its shareholders, and AFIC has not been able to issue new shares of stock allocating new water rights beyond its current appropriation.

### **SHUMWAY'S EMPLOYMENT WITH AFIC AND LIC**

16. Shumway began working for AFIC in 1997 in response to AFIC's need for a corporate secretary and treasurer with expertise in accounting and the proper maintenance of corporate books and records. Shumway was a shareholder of AFIC and was a licensed CPA who offered to serve as AFIC's corporate secretary and treasurer because of his expertise. In 1997,

AFIC hired Shumway with the expectation that Shumway would properly organize and oversee the maintenance of AFIC's accounting, shareholder and other corporate records.

17. In 2006, LIC was looking for a corporate secretary and treasurer, and the president of LIC contacted the president of AFIC for a reference. The president of AFIC recommended Shumway, who was hired by LIC to serve as its corporate secretary and treasurer.

#### **SHUMWAY'S DEFALCATION OF AFIC AND LIC FUNDS**

18. Shortly after being hired at LIC, Shumway began misappropriating funds from LIC. While Shumway was reviewing LIC's accounts, he discovered a bank account in LIC's name that had been dormant for several years. When Shumway discovered that no one at LIC was aware of its existence, he made himself signatory on the account and began diverting checks intended for LIC, depositing them into LIC's dormant account and then converting the funds to his own use.

19. In about May 2015, a member of LIC became aware of transactions in the dormant LIC account and brought them to the attention of LIC's management.

20. LIC retained a forensic auditor to audit LIC's books. The forensic auditor determined that Shumway had, from at least January 2007 through May 2015, misappropriated at least \$189,274 from LIC by diverting LIC's funds and checks into the dormant LIC account, falsifying its accounting and other records, and converting the funds to his own use.

21. After discovering Shumway's defalcation of LIC funds, LIC management confronted Shumway regarding his illegal conduct.

22. Shumway initially denied to LIC that he had misappropriated LIC funds but ultimately admitted his defalcation and entered into an agreement to repay LIC the stolen funds.

23. Due to certain transactions identified in LIC's audit, representatives of LIC believed Shumway was also misappropriating funds from AFIC and required that Shumway inform AFIC of his likely defalcation. In early May 2015, Shumway contacted the president of AFIC and told the president of AFIC that he had taken a few thousand dollars of AFIC funds.

24. As a result of Shumway's admission, AFIC conducted a forensic audit of its books and records. That audit reflects that Shumway misappropriated funds from AFIC through the use of a secret bank account Shumway had established and by diverting AFIC funds and checks into that account, falsifying AFIC's accounting and other records and converting AFIC funds to his own use.

25. Due to a lack of complete corporate and bank records, AFIC's forensic audit was only able to quantify Shumway's misappropriation from January 2003 to May 2015. AFIC estimates that Shumway misappropriated at least \$444,122 from AFIC during that period.

#### **SHUMWAY'S MISAPPROPRIATION AND SALE OF THE COMPANIES' STOCK**

26. From at least 2007 through 2015, Shumway misappropriated shares of both AFIC's and LIC's stock and fraudulently sold a number of those shares to investors.

#### **SHUMWAY'S FRAUDULENT SALE OF LIC STOCK**

27. During his tenure as corporate secretary and treasurer of LIC, Shumway was regularly contacted by persons looking to purchase LIC stock. In response, Shumway misappropriated LIC shares by filling out blank LIC stock certificates from LIC's certificate books, without the knowledge and authorization of LIC's board of directors, and imprinting a facsimile signature of LIC's president on the stolen certificates. Shumway then used his real estate development company, AF Development Inc., as the purported seller of the stock and sold those unauthorized shares of stock to unwitting investors.

28. Shumway falsified LIC's books and records by making the records appear to reflect a lawful resale or issuance of LIC shares to new investors. Shumway also misled LIC's officers and directors to believe the issuance of those shares was lawful.

29. LIC's forensic audit of Shumway's fraud determined that Shumway had fraudulently sold at least 34 shares of unauthorized LIC stock. LIC has determined the value of those shares to be at least \$340,000.

#### **SHUMWAY'S FRAUDULENT SALE OF AFIC STOCK**

30. Upon discovering Shumway's misappropriation of its funds, AFIC asked Shumway for a return of all its books and records, including shareholder records, in Shumway's possession or under his control. Over the ensuing weeks, Shumway began to return certain of AFIC's books and records, but never returned all of AFIC's books and records. Included in the books and records Shumway failed to return to AFIC were 22 books of blank stock certificates, totaling 1100 blank certificates. Those books of blank AFIC certificates have never been recovered.

31. Based on AFIC's review of extant shareholder records, including what appear to be forged certificates, AFIC concluded that Shumway sold a number of unauthorized shares to investors.

32. Bank and other records reflect that Shumway sold at least 10.75 unauthorized shares of AFIC stock to investors, for a total of \$95,500.

33. Due to the poor state of AFIC's shareholder records, it is unknown how many shares of stock Shumway actually misappropriated from AFIC.

34. Shumway falsified AFIC's books and records by making the records appear to reflect a lawful resale or issuance of AFIC shares to new investors. Shumway also misled the officers and directors of AFIC to believe the issuance of those shares was lawful.

### **MISREPRESENTATIONS TO INVESTORS**

35. Shumway misappropriated shares of stock from AFIC and LIC and sold those shares to investors who were unaware of the misappropriation.

36. The shares of stock Shumway stole from the Companies were not lawfully authorized and issued and did not provide to the unwitting purchasers of those unauthorized shares any legal water rights.

37. Shumway represented to investors, directly and indirectly, that the shares of stock he was selling to them were lawfully authorized and issued by the Companies and included water rights entitling those shareholders to water appropriated to the Companies by the State of Utah.

38. Shumway's direct and indirect representations to investors that the stock they were purchasing in the Companies were lawfully authorized and issued, and carried legal water rights were material facts.

39. Shumway's failure to disclose that the stock investors were purchasing were not lawfully authorized and issued by the Companies and did not provide legal water rights were material omissions to the investors.

### **SHUMWAY'S ADMISSIONS AND GUILTY PLEA**

40. On January 15, 2016, Shumway met with representatives of the Commission, U.S. Attorney's Office for the District of Utah and Federal Bureau of Investigation and admitted his misappropriation of the Companies' funds. Shumway also admitted to misappropriating shares of stock of LIC and selling those shares to investors. Shumway initially denied misappropriating and selling shares of AFIC to investors, but subsequently admitted to misappropriating and unlawfully selling shares of AFIC stock.



41. On November 16, 2016, a criminal information was filed against Shumway by the U. S. Attorney's Office for the District of Utah charging one count of violating 18 U.S.C. § 1431, wire fraud, based on some of the conduct described in this Complaint. On December 14, 2016, Shumway pled guilty to the one count of wire fraud and agreed to pay full restitution of \$1,100,481.78 in the criminal case. On April 5, 2017, Shumway was sentenced to prison for twelve months and one day and ordered to pay full restitution of \$1,100,481.78

**FIRST CAUSE OF ACTION  
EMPLOYMENT OF A DEVICE, SCHEME OR ARTIFICE TO DEFRAUD  
Violation of Section 17(a)(1) of the Securities Act [15 U.S.C. § 77q(a)(1)]**

42. The Commission realleges and incorporates by reference the allegations contained in Paragraphs 1 through 41, above.

43. Defendant, by engaging in conduct described above, directly or indirectly, in the offer or sale of securities, by the use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, with scienter, employed devices, schemes, or artifices to defraud.

44. By reason of the foregoing, Defendant, directly or indirectly, violated, and unless restrained and enjoined by this Court, will continue to violate, Section 17(a)(1) of the Securities Act [15 U.S.C. § 77q(a)(1)].

**SECOND CAUSE OF ACTION  
FRAUD IN THE OFFER AND SALE OF SECURITIES  
Violations of Section 17(a)(2) and (3) of the Securities Act  
[15 U.S.C. § 77q(a)(2) and (3)]**

45. The Commission realleges and incorporates by reference the allegations contained in Paragraphs 1 through 41, above.

46. Defendant, by engaging in the conduct described above, directly and indirectly, in the offer and sale of securities, by the use of the means or instruments of transportation or

communication in interstate commerce or by use of the mails, obtained money or property by means of untrue statements of material fact or by omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and engaged in transactions, practices, or courses of business which operate or would operate as a fraud or deceit upon the purchaser.

47. By reason of the foregoing, Defendant, directly or indirectly, violated, and unless restrained and enjoined will continue to violate, Section 17(a)(2) and 17(a)(3) of the Securities Act [15 U.S.C. §§ 77q(a)(2) and 77q(a)(3)].

**THIRD CAUSE OF ACTION**  
**FRAUD IN CONNECTION WITH THE PURCHASE AND**  
**SALE OF SECURITIES**  
**Violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5**  
**thereunder [17 C.F.R. § 240.10b-5]**

48. The Commission realleges and incorporates by reference the allegations contained in Paragraphs 1 through 41, above.

49. Defendant, by engaging in the conduct described above, directly or indirectly, by the use of means or instrumentalities of interstate commerce or use of the mails, in connection with the purchase or sale of securities, with scienter, (1) employed devices, schemes, or artifices to defraud; (2) made untrue statements of material fact or omitted to state a material fact necessary in order to make statements made, in light of the circumstances under which they were made not misleading; or (3) engaged in acts, practices, or courses of business that operated or would operate as a fraud and deceit upon other persons.

50. By reason of the foregoing, Defendant, violated, and unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

**RELIEF REQUESTED**

WHEREFORE, the Commission respectfully requests that this Court:

**I**

Issue findings of fact and conclusions of law that Defendant committed the violations charged herein.

**II**

Issue in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure orders that permanently enjoin Michael D. Shumway and his officers, agents, servants, employees, attorneys, and accountants, and those persons in active concert or participation with any of them, who receive actual notice of the order by personal service or otherwise, and each of them, from engaging in transactions, acts, practices, and courses of business described herein, and from engaging in conduct of similar purport and object in violation of Section and 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

**III**

Enter an order directing Defendant to disgorge all ill-gotten gains received from the unlawful sale of the Companies' stock during the period of the violative conduct.

**IV**

Enter an order barring Defendant from serving as an officer or director of any issuer required to file reports with the Commission under Section 12 or Section 15 of the Exchange Act [15 U.S.C. § 78(1) and 78(o)].

**V**

Grant such further equitable relief as this Court deems just, appropriate, and necessary.

VI

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

Dated: April 5, 2017.

Respectfully submitted,

/s/ Daniel J. Wadley

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