IN THE CALIFORNIA COURT OF APPEAL
FOR THE FOURTH APPELLATE DISTRICT, DIVISION ONE

THE PEOPLE OF THE STATE OF CALIFORNIA,
By and Through the Commissioner of Corporations,
Plaintiff/Respondent,
v.

INNOVATIVE FINANCIAL SERVICES, INC.;
ROBERT N. SHEARBURN; AND ROBERT L. SHEARBURN,
Defendants/Appellants

Court of Appeal No. D045555
Trial Court No. GIC785226

On Appeal From a Judgment of the
Superior Court of California for the County of San Diego
Trial Judge:
The Honorable Ronald S. Prager

BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., AS *AMICUS CURIAE* IN SUPPORT OF THE PEOPLE OF THE STATE OF CALIFORNIA

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IDENTITY AND INTEREST
OF THE *AMICUS CURIAE*

The North American Securities Administrators Association, Inc. ("NASAA"), is the nonprofit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, it is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities.

The members of NASAA include the state agencies that are responsible for regulating securities transactions under state law. Their fundamental mission is protecting investors, and their jurisdiction extends to a wide variety of securities, including, in most states, viatical investments. Their principal activities include registering certain types of securities; licensing the firms and agents who offer and sell securities; investigating violations of state law; and filing enforcement actions where appropriate. State securities regulators also educate the public about investment fraud and advocate for the adoption of strong, fair, and uniform securities laws and regulations at both the state and federal level.

NASAA supports the work of its members by coordinating multi-state enforcement actions, offering training programs, publishing investor education materials, and assisting in the development of sound laws and regulations in the securities field. Another core function of the association is to represent the membership's position, as *amicus curiae,* in significant cases involving the interpretation of the securities laws and the rights of investors.

NASAA and its members have a stake in the outcome of this appeal because the Court's disposition of the issues will significantly affect the ability of state regulators – and state legislatures – to deter and remediate fraud and abuse in the offer and sale of securities. The trial court issued three important rulings that serve the interests of investor protection. First, it correctly held that viaticals are investment contracts subject to regulation as securities. Viaticals have proven to be notorious vehicles for securities fraud. While many states, along with California, have now expressly included them in their statutory definition of a security, many states have not done so. Securities regulators in those states must continue to rely on investment contract theory or related judicially-fashioned doctrines to

establish jurisdiction over these investment offerings. Affirming the trial court's judgment will help maintain the vitality of investment contract theory as a basis for regulating a wide variety of investment products that pose significant risks to investors, including viaticals.

Second, the trial court correctly ruled that when the California legislature added viaticals to the statutory definition of a security in the California Corporations Code ("Code" or "Securities Law"), it was merely clarifying existing law, not changing it. This aspect of the trial court's decision is important because it forecloses the argument that the definition, as amended, may not be applied retroactively to viatical sales made prior to the enactment. Abuses in the sale of viaticals have been pervasive and an increasing number of state legislatures have responded with statutory clarifications much like the one at issue here. These amendments eliminate any lingering doubt – generated by isolated case law – that state securities regulators have jurisdiction over these products. State legislatures must remain free to adopt these important statutory clarifications, without running the risk that they will be immunizing unscrupulous viatical promoters from liability for abuses that occurred prior to the amendments.

Finally, the trial court correctly ruled that Robert N. Shearburn ("Shearburn Sr.") should be held jointly and severally liable for restitution of all funds that his operation took from investors, irrespective of the dollar amount he was able to retain for his own personal benefit. Restitution of funds taken illegally from investors is an enormously important remedy that state securities regulators must have at their disposal to deter illegal conduct and to help victims of fraud recover their losses. In some states, like California, the securities regulator may seek restitution by statute; in other states, it remains purely a creature of equity. In either case, to achieve its full effect, the restitution remedy must be distinguished from disgorgement and measured by the harm to investors, not by the ill-gotten gains wrongdoers have retained. A decision affirming the trial court's restitution order will not only do justice in this case, it will help promote the correct application of the all-important restitution remedy in other cases where securities fraud has taken its toll on investors.

STATEMENT OF THE ISSUES

1. Whether the viatical investments offered and sold by the Appellants (collectively "Shearburn") are investment contracts under

the *Howey* test, and, more specifically, whether a promoter's entrepreneurial efforts should be excluded from consideration as the "efforts of others" under *Howey* merely because the promoter chooses to conduct those activities before accepting investor funds.

2. Whether the California legislature was clarifying or changing the law when it added the term "viatical" to the statutory definition of a security, where the legislative history expressly states that the amendment is a clarification, and where, at the time of amendment, most state securities regulators, including the California Department of Corporations, already regarded viaticals as securities.

3. Whether Shearburn Sr. should be held jointly and severally liable for restitution of the funds that his sales operation took from investors, where the California Securities Law expressly authorizes the Commissioner of Corporations ("Commissioner") to seek restitution on behalf of investors, where Shearburn Sr. was found to be an "indispensable" participant in the sales operation, and where time-honored principles of equity and justice support the trial court's imposition of liability.

<u>SUMMARY OF THE ARGUMENT</u>

The trial court's judgment should be affirmed because the viatical investments that Shearburn offered and sold to the public are securities. They have all the elements of an investment contract under the *Howey* test, including the "efforts of others" feature. Shearburn's reliance on the *Life Partners* decision issued in 1996 by the U.S. Circuit Court of Appeals for the District of Columbia Circuit is to no avail. The D.C. Circuit's disregard for a promoter's post-investment efforts – no matter how crucial to the success of a venture – has been repudiated by virtually every state and federal court that has addressed the status of viaticals as securities.

The California legislature has confirmed that viatical investments are securities under California law by adding viaticals to the statutory definition of a security effective in 2001. The legislative history of the amendment, the context in which it was adopted, and the policy of investor protection underlying the Securities Law all demonstrate that the amendment was a clarification, not a change in the law. Accordingly, viaticals were securities not only from the time of the amendment forward, but before 2001 as well, when Shearburn offered and sold them to the public.

The trial court properly imposed joint and several liability upon Shearburn Sr. for restitution of the entire $14 million that his operation took from investors. The California Securities Law expressly authorizes courts to grant restitution, in addition to disgorgement, in order to help the victims of securities fraud recover their losses. Well-established principles of equity also support the court's restitutionary award. The proper measure of restitution is the injury to investors, and such restitution is not limited by the amount of ill-gotten gains violators have retained for their own personal benefit. The court's award against Shearburn Sr. is also appropriate as a matter of disgorgement. The law recognizes that the principals of a fraudulent enterprise – those who are at the center of the scheme – should bear joint and several liability for the disgorgement of all funds that the enterprise as a whole derives from its victims.

ARGUMENT

I. The Viatical Investments That Shearburn Offered And Sold Are Securities Under California Law

A. Viaticals Are Investment Contracts Under *Howey*

The trial court correctly ruled that the viatical settlements offered and sold by Shearburn were investment contracts subject to regulation as securities under California law. Like its federal

counterpart and virtually all state securities laws, the California Securities Law includes "investment contracts" in the statutory definition of a security. *See* CAL. CORP. CODE § 25019. The meaning of the phrase "investment contract" has been developed through a long line of judicial decisions, beginning in 1946 with the Supreme Court's ruling in *SEC v. W. J. Howey Co.,* 328 U.S. 293 (1946). The *Howey* test, with relatively minor modifications, has become the most widely followed standard for identifying investment contracts under both state and federal securities law.

Under *Howey,* an investment offering is an investment contract if it involves: (1) the investment of money, (2) in a common enterprise, (3) with the expectation of profits, (4) derived from the efforts of others. *Howey,* 328 U.S. at 298-99. Profits are deemed to flow from the "efforts of others" where "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *SEC v. Glenn W. Turner Enterprises, Inc.,* 474 F.2d 476, 483 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973).

Shearburn does not dispute that the first three elements of the test are present in this case, and the trial court easily demonstrated that

they apply. *See* Final Judgment Against Defendants Robert N. Shearburn, Innovative Financial Services, and Robert L. Shearburn (Sept. 16, 2004) ("Judgment"), Ex. App. at 10-11. Shearburn was clearly soliciting and accepting investor money; the investment involved multiple forms of a common enterprise; and investors obviously expected to receive profits. *See id*.

The trial court also correctly ruled that the fourth *Howey* element is present in this case. As explained by the court, investors purchasing viaticals from Shearburn relied on others "to evaluate insurance companies, to learn the dates of the original purchase of the policies, to ascertain the life expectancy of the beneficiary, [and] to evaluate the type of illness the beneficiary suffer[ed]. In other words, to pick and choose the most suitable investments." *Id.* at 11. These activities were "essential managerial efforts," critical to any investment returns that Shearburn's viatical investments might have produced.

Shearburn rests his appeal on the argument that the "efforts of others" element is absent in this case, and for this proposition he relies upon *SEC v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir.), *rehearing denied*, 102 F.3d 587 (D.C. Cir. 1996). In *Life Partners*, the U.S.

Court of Appeals for the District of Columbia Circuit held that the viaticals at issue were not investment contracts because the promoter's key managerial efforts – the "efforts of others" – happened to occur before money was accepted from investors. *See id.* at 545. The D.C. Circuit also held that *after* investors parted with their money, the viatical promoter's tasks were only "ministerial" in nature, and the profitability of the investment really hinged upon the mortality of the insureds. *Id.* at 548.

The *Life Partners* decision has been roundly criticized by courts and scholars alike for narrowing the *Howey* test in a way that has no legal support or policy rationale. *See* JOSEPH C. LONG, 12 BLUE SKY LAW §§ 3:15, 3:16.1 (June 2004) (explaining that the decision was irrational and that it was quickly the subject of judicial and scholarly criticism); Anna D. Halechko, *Viatical Settlements: The Need for Regulation to Preserve the Benefits While Protecting the Ill and the Elderly From Fraud,* 42 DUQ. L. REV. 803, 815, 817 (Summer 2004) (the timing of promoter effort is immaterial).

The distinction between a promoter's pre- and post-investment efforts certainly cannot be drawn from the wording or the structure of the securities laws. The definition of a "security" found in the state

and federal securities acts includes a wide variety of instruments and offerings in addition to "investment contracts," ranging from stocks and bonds to notes and profit-sharing agreements. *See, e.g.,* 15 U.S.C. § 78c(a)(10). The items encompassed by the definition do not suggest a legislative intention to define securities strictly in terms of post-investment efforts. Indeed, many of the investments listed in the definition of a security "derive their potential profitability from managerial and entrepreneurial efforts employed prior to investor involvement." *See Siporin v. Carrington*, 23 P.3d 92, 99 (Ariz. Ct. App. 2001).

Nor can support for the rule in *Life Partners* be found in the early cases that established the investment contract definition. In *Howey*, the Supreme Court simply held that for an investment contract to exist, an investor's profits must be derived from "the efforts of the promoter or a third party." *See Howey,* 328 U.S. at 299. The Court did not impose any limitations on when those efforts must be expended in relation to the investment of funds.[1]

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[1] After *Howey* was decided but before *Life Partners*, federal courts repeatedly held that the pre-investment efforts of a promoter were sufficient to satisfy the "efforts of others" test. *See SEC v. Mutual Benefits Corp.,* 408 F.3d 737, 744 (11th Cir. 2005), and cases cited therein. In these cases, promoters used their expertise to select items

Since 1996, when the *Life Partners* decision was issued, federal and state courts have consistently rejected the ruling and have held that viatical investments *are* securities under *Howey*. A recent decision of the U.S. Court of Appeals for the Eleventh Circuit exemplifies the widespread disapproval of the rule in *Life Partners*. In *SEC v. Mutual Benefits Corp.,* 408 F.3d 737 (11th Cir. 2005), the SEC filed an action against a viatical promoter that had sold over $1 billion in viatical investments to 29,000 investors through a fraudulent sales campaign. *Id.* at 738. The promoter invoked the decision in *Life Partners* to challenge the SEC's jurisdiction. *Id.* at 741. The Eleventh Circuit forthrightly rejected that challenge, stating "We

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within a particular class of assets that had greater value than other items within the class or that would appreciate at a higher rate than other items within the class. *See, e.g., Bailey v. J.W.K. Properties, Inc.,* 904 F.2d 918 (4th Cir. 1990) (embryos for cattle breeding); *Glen-Arden Commodities, Inc. v. Costantino*, 493 F. 2d 1027 (2d Cir. 1974) (scotch whiskey); *SEC v. Brigadoon Stock Distributors, Ltd.,* 388 F. Supp. 1288 (S.D.N.Y. 1975) (rare coins). For example, in *SEC v. Brigadoon,* the investors relied upon the company's expertise in selecting rare coins, and they had no obligation to subscribe to any post-purchase services. *See* 388 F. Supp. at 1291-92. The court held that under these circumstances, the company's sale of the coins to investors constituted the sale of investment contracts. 388 F. Supp. at 1293. Whether any of the company's post-purchase services affected the value or price of the coins was deemed irrelevant since the initial "selection is the most crucial factor in determining how much profit an investor in coins will make." *Id.* This reasoning applies to the

decline to adopt the test established by the *Life Partners* court." *Id.* at 743. Citing to the lack of a persuasive rationale underlying *Life Partners,* and to Supreme Court precedent requiring a broad application of the securities laws, the court held that "[s]ignificant pre-purchase managerial activities undertaken to ensure the success of the investment may also satisfy *Howey.*" *Id.* at 743. The court concluded its analysis with the observation that the promoter's viatical investments "amount[ed] to a classic investment contract." *Id.* at 744.[2]

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selection of viators and their life insurance policies just as it does to the selection of scotch whiskeys, coins, and embryos.

[2] Other federal courts have questioned the validity of the holding in *Life Partners*. In *Wuliger v. Christie,* 310 F. Supp. 2d 897 (N.D. Ohio 2004), the court held that viaticals were investment contracts and that the efforts of others test was met because it was the promoter's selection of viator policies that determined the success of the venture. *Id.* at 907. Those selections were made after purchase, so the court observed that the viaticals at issue would meet the *Howey* test even under *Life Partners. Id.* Nevertheless, the court stated that narrowly considering only the pre-investment conduct of the promoter would '"violate the principle that form should not be elevated over substance and economic reality."' *Id.* (quoting Judge Wald in *SEC v. Life Partners,* 87 F.3d at 551); *see also Melton v. Keisling*, MO:99-CA-145, at 8 (W.D. Texas, May 16, 2000) (denying a viatical promoter's motion to dismiss and observing that the return on a viatical settlement does not depend solely on the death of the viator but rather on the accuracy of the promoter's assessment of the viator's life span, *a prediction that is made pre-purchase)* (emphasis added). *But cf. SEC v. Tyler,* No. Civ.A.3:02 CV 0282 P, 2002 WL 32538418, at *5, 6 (N.D. Tex. Feb. 21, 2002) (holding that the promoter's creation of a

Many state courts have had occasion to address the *Life Partners* decision and the overwhelming majority of them, from jurisdictions across the country, have rejected the D.C. Circuit's analysis. *See Rumbaugh v. Ohio Dep't of Commerce,* 800 N.E. 2d 780, 785-86 (Ohio Ct. App. 2003); *Michelson v. Voison*, 658 N.W. 2d 188, 190-91 (Mich. Ct. App. 2003); *Poyser v. Flora,* 780 N.E. 2d 1191, 1195-97 (Ind. Ct. App. 2003); *Joseph v. Viatica Management, LLC,* 55 P. 3d 264, 266-67 (Colo. Ct. App. 2002); *Siporin v. Carrington*, 23 P.3d 92, 97-99 (Az. Ct. App. 2001); *Alabama v. Kash*, Case Nos. CC-00-25, 26, & 27, at 3 (Ala., St. Clair Co. Cir. Ct., July 14, 2001); *Landau v. Sheaffer*, Case No CI-00-04672 (Pa. Ct. of Common Pleas, Lancaster County, June 22, 2001); *Oklahoma Dep't of Securities v. Accelerated Benefits Corp.*, No. CJ-99-2500-66, at 8-9 (Okla. Co. Dist. Ct., Mar. 13, 2001);[3] *Hill v. Dedicated Resources*,

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secondary market distinguished the case from *Life Partners*, but expressing an inclination to follow the result in *Life Partners* if not for the distinction).

[3] *Available at* http://www.securities.state.ok.us/Enforcement/Orders/ABC_Order.pdf

Case No. 99-C-1714, 2000 WL 34001915, at *3 (Kan. D. Ct., July 12, 2000).[4]

These courts have faulted the decision in *Life Partners* for its flawed logic, lack of precedent, and disregard for the investor protection rationale of the securities laws. For example, in one of the leading state court decisions addressing *Life Partners*, the Arizona Court of Appeals declared that it would not follow the D.C. Circuit's decision because it so plainly undermines the policy of investor protection:

> We disagree with the court of appeals' analysis in *Life Partners*. Although Arizona courts have consistently been guided by the federal courts' interpretation of the 1933 and 1934 federal Acts when applying the Arizona Securities Act, we will not defer to federal case law when, by doing so, we would be taking a position inconsistent with the policies of our own legislature. We will depart from those federal decisions that do not advance the Arizona policy of protecting the public from unscrupulous investment promoters. *Life Partners* falls squarely within this category.

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[4] Other state courts have held that viaticals are investment contracts without expressly addressing the *Life Partners* decision. *See, e.g., Accelerated Benefits Corp. v. Peaslee,* 818 N.E. 2d 73, 76-77 (Ind. Ct. App. 2004) (viaticals meet *Howey* test, including "efforts of others" element); *Allen v. Jones,* 604 S.E. 2d 644, 646 (Ga. Ct. App.) (appellant conceded viatical offerings at issue were investment contracts); *Kligfeld v. Florida Office of Financial Regulation,* 876 So. 2d 36, 38 (Fla. Ct. App. 2004) (viatical program clearly met investment contract standard as adopted by Florida courts), *review denied,* 889 So. 2d 71 (Fla. 2004).

Siporin v. Carrington, supra, 23 P. 3d at 98. The court went on to describe the essential legal flaw in the *Life Partners* decision:

> The extent to which each package would be profitable for the investor depended on the accuracy of Carrington's conclusions concerning the life expectancy of the viator, the terms of the insurance policy, and the financial soundness and reliability of the issuing insurance company. The fact that Carrington's efforts preceded the sale of interests in viatical settlements to its investors does not change the nature of the investment. . . . Under the *Howey* test, as here, the pre-sale activities were sufficient to classify the transaction as an investment contract.

Id.

Other state courts have been equally emphatic in their criticism of the decision. In the words of the court in *Alabama v. Kash:*

> [T]his Court expressly rejects the decision of the Circuit Court of the District of Columbia in *SEC v. Life Partners* . . . . The *Life Partners* decision is based upon flawed logic and is without case precedence. It establishes a "bright line rule" that "whatever the surrounding circumstances, an investment is not a security unless significant managerial activities by the promoter occur post-purchase." [citation omitted]. No Court before *Life Partners,* nor since, has ever read into the fourth prong of the *Howey* test a requirement that the efforts of others generating profits of others must be expended after the purchase of the investment. To ignore the significant pre-purchase efforts made by the viatical company is simply illogical. [*citing Siporin v. Carrington*]

Alabama v. Kash, supra, at 3.

The court in *Oklahoma Dep't of Securities v. Accelerated Benefits Corp.* similarly repudiated *Life Partners,* rejecting the court's emphasis on managerial efforts at the point of investment and holding that the outcome of the investment "is totally dependent on the expertise and managerial efforts of ABC in seeking out and choosing the right viatical settlement." *Oklahoma Dep't of Securities v. Accelerated Benefits Corp., supra,* at 8-9.[5]

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[5] NASAA's research reveals only one case in which a state court clearly followed the D.C. Circuit's ruling in *Life Partners. See Decker v. Mutual Benefits Corp.*, Case No. 00-0541-CA-17 (19th Judicial Circuit, River County, Fla. May 17, 2001) (Order on Motion to Dismiss). In *Decker,* the court felt compelled to adopt the federal rule, citing language from the Florida Supreme Court to the effect that the state legislature "intended Florida securities law to be *hand-in-glove* with federal securities law." *Id.* at 2 *(quoting Oppenheimer v. Young*, 456 So. 2d 1175, 1178 (Fla. 1978)) (emphasis added). Two other state courts have held that viaticals are not securities, but they did not rely on the temporal divide established in *Life Partners. See Griffitts v. Life Partners, Inc.,* No. 10-01-00271-CV, 2004 WL 1178418, at *2 (Tex. Ct. App. May 26, 2004) (finding that the profitability of the investment was determined by the "mortality of the insured," not by "any managerial efforts"); *Glick v. Sokol,* 777 N.E. 2d 315, 319 (Ohio Ct. App. 2002) (not applying the *Howey* test and not mentioning *Life Partners,* but nevertheless holding that viaticals are not securities on the view that the only variable affecting the profitability of the investment is the timing of death), *appeal dismissed,* 786 N.E. 2d 896 (Ohio 2003). *Glick* was rejected by a later decision of the Georgia Court of Appeals, *Rumbaugh v. Ohio Department of Commerce,* 800 N.E. 2d 780 (Ohio Ct. App. 2003).

At the heart of these cases is the recognition that the *Life Partners* decision conflicts with the policy of full disclosure underlying the federal securities laws and with the Supreme Court's admonition that the securities laws must be interpreted flexibly to serve that policy. In *Howey*, the Court described the purpose of the securities laws as one of "compelling full and fair disclosure relative to the issuance of" securities. 328 U.S. at 299. The Court established a broad and flexible definition of an investment contract to ensure that the law would be "capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Id.* In accordance with this approach, the Court in *Howey* rejected a series of technical distinctions advanced by the defendants to evade application of the securities laws under an investment contract analysis – distinctions relating to how the investment was documented, *id.* at 299; whether the investment was speculative in nature, *id.* at 301; and whether investors received an interest in tangible assets having intrinsic value independent from the success of the enterprise, *id.* The Court brushed aside all of these distinctions by observing that "The statutory policy

of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae." *Id.*

The Supreme Court reaffirmed this principle in *SEC v. Edwards*, 540 U.S. 389 (2003). There the Court held that a pay phone sale and leaseback program was an "investment contract" under federal securities law, notwithstanding the respondent's contention that the program offered investors a fixed, as opposed to a variable, rate of return. The Court unanimously rejected the respondent's technical distinction based on rates of investment return, stating that "We will not read into the securities laws a limitation not compelled by the language that would so undermine the laws' purposes." *SEC v. Edwards,* 540 U.S. at 395.

As in *Howey, Edwards*, and *Mutual Benefits,* Shearburn is advancing an irrelevant technical distinction in an effort to evade the requirements of the securities laws. The Court should reject this effort to circumvent the law and should affirm the trial court's judgment that the viatical investments he offered and sold to the public were investment contracts, subject to regulation as securities. Investors in California and elsewhere who purchase viaticals are entitled to the

protections of the securities laws regardless of when a promoter expends his efforts on behalf of the enterprise.[6]

B. By Expressly Including Viaticals In The Statutory Definition Of A Security, California Was Clarifying The Law, Not Changing It

Effective January 1, 2001, the California legislature amended Section 20519 of its Securities Law by adding viaticals to the list of investments expressly defined as securities. This amendment was a clarification, not a change, and it was intended to remove any doubt that viaticals *are* properly regarded as securities under California law and *were* properly regarded as securities prior to the amendment. Because the amendment was a clarification rather than a change in the law, Shearburn's suggestion that it should apply only prospectively has no merit. *See McClellan v. County of San Diego Dept. of Child Support Services,* 130 Cal. App. 4th 247, 255 (Cal. Ct. App. 2005) (where the court decides that an amendment only clarifies existing

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[6] NASAA also supports the trial court's conclusion that the viaticals at issue meet the alternative "risk capital test" for identifying securities. *See* Judgment, Ex. App. at 9-10. In addition, the trial court's ruling that intent is not a required element of a fraud claim brought by the Commissioner under Code Section 25401 is correct, and consistent with the law in most states. *See* Judgment, Ex. App. at 16.

law, there is no need to analyze the application of the amendment as a "retroactivity issue").

Under California law, courts look to a variety of factors when considering whether a legislative amendment was intended as a clarification or a change in the law. Among those factors are the actual language of the amendment, its legislative history, the context in which the legislation was passed, and the policies underlying the statute. *See Borden v. Division of Medical Quality,* 30 Cal. App. 4th 874, 882 (Cal. Ct. App. 1994) (amendment to physician disciplinary statute held to be a clarification, not a change). If the circumstances indicate that the legislature was acting in response to confusion generated by a specific court decision, then the amendment can often be viewed as a clarification rather than a change in the law. *See McClellan,* 130 Cal. App. 4th at 257 (amendment to statute on child support payments held to be a clarification, not a change).

Measured by these standards, the California legislature's addition of viaticals to the list of items defined to be securities was plainly a clarification, not a change in the law. The first guide to the legislature's intention is the amending language itself. Here, the amending language simply expands the illustrative roster of

investments that constitute securities, without changing the scope of the more general, catchall term "investment contract." *See Allen v. Jones,* 604 S.E. 2d 644, 646 (Ct. App. Ga. 2004) (act's list of securities is illustrative rather than exclusive and it contains the broad term "investment contract").[7] Moreover, the amendment contains no language suggesting that it applies only prospectively. The legislature's decision to omit such language – which could have been incorporated into the amendment – indicates that a mere clarification was intended.[8]

The legislative history of the amendment provides further compelling evidence that the California legislature intended it to serve as a clarification and nothing more. The legislative summary of the

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[7] The term "investment contract" was added as a catchall provision to ensure that the statute would cover not just the items specifically listed, but "virtually any instrument that might be sold as an investment." *See, e.g., Reves v. Ernst & Young,* 494 U.S. 56, 61 (1990); *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 847-48 (1975); *See also SEC v. Mutual Benefits Corp.,* 408 F. 3d 737, 742 (11th Cir. 2005) (federal definition of the term "security" includes the "catch-all" term "investment contract").

[8] Apparently only Montana has viewed the addition of viaticals to the definition of a security as a change in law, with strictly prospective application. Montana legislators were able to make their intentions clear with very little drafting effort. They simply added a sentence: "[This act] applies to viatical settlement contracts entered into on or after [the effective date of this act]". *See* Compiler's Comments to

bill makes quite clear that the purpose of the amendment was clarification rather than change:

> COMMENTS: The main purpose of this bill is to clarify that viatical and life settlement contracts are securities. This is intended to eliminate any confusion in this area and to allow the Department of Corporations to better regulate and enforce viatical and life settlements.

See SENATE COMMITTEE ON BANKING AND FINANCE, REP. ON SB 1837, at 3, Ex. App. at 174 (Cal. 2000). This commentary means just what it says: the intent is "to clarify" and "to eliminate any confusion," not to change the law. Slightly less obvious but just as convincing is this inference: if the intent was to allow *better* regulation of viaticals by the Department of Corporations, then the Department must *already* have been regulating viaticals. *Cf. People v. Jacob,* 130 Cal. App. 4th 429, 436-37 (Cal. Ct. App. 2005) (legislative history using the words "additionally," and "this new provision would provide for . . ." support a finding that amendment at issue was a change, not simply a clarification).[9]

Section 14, Ch. 493, L. 2003, amending the Montana Securities Code, MONT. CODE ANN. § 30-10-103 (definitions).

[9] The case of *McClung v. EDD,* 34 Cal. 4th 467 (Cal. 2004) is not to the contrary. There the court held that the legislature has no power to declare that an amendment merely clarifies existing law if it is in fact an "unmistakable change" in light of prior Supreme Court precedent definitively interpreting the section at issue. *Id.* at 473. In this case,

Another summary of the bill explains the need for the amendment specifically in terms of the *Life Partners* decision and the confusion it generated:

> The Department considers a viatical settlement contract to be an investment contract, or evidence of indebtedness and therefore, a viatical settlement contract is a security. However, a federal court of appeals (Washington, D.C.) concluded that viatical settlement contracts are not securities. The Department of Corporations maintains that most states and securities experts believe the court "ruling to be incorrect, [sic] the ruling has caused a great deal of confusion and has allowed, to a certain extent, the viatical settlement industry to function without regulation."

See SENATE COMMITTEE ON FINANCE, INVESTMENT AND INTERNATIONAL TRADE, REPORT ON SB 1837, at 1, Ex. App. at 175 (May 8, 2000) (underlining in original). This type of legislative response to an erroneous court decision is properly viewed as a clarification rather than a change in the law. *See McClellan,* 130 Cal. App. 4th at 257.

The context in which the amendment was passed supports this conclusion. At the time California adopted its amendment in 2000,

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of course, California's highest court has never addressed whether viaticals are securities, and the overwhelming body of legal authority – from state and federal court decisions to administrative rulings across the country – holds that viaticals *are* securities.

viaticals were an increasingly prevalent vehicle for fraud and abuse, taking a substantial toll on investors throughout the country. Many state regulators had been asserting jurisdiction over viaticals as securities for years and had brought enforcement actions to address those abuses, notwithstanding the decision in *Life Partners.* Between 1996, when *Life Partners* was issued, and 2001, when the California amendment became effective, a host of state securities regulators brought dozens of enforcement actions against promoters selling viatical investments and issued numerous formal bulletins and opinions to the effect that viaticals were securities. *See, e.g., In re Beneficial Assistance,* File No. S-01297, 2003 WL 297791, at *3 (Wisc. Comm'r of Sec. Feb. 5, 2003) (Order of Prohibition and Revocation) (noting that promoter's offering documents cited *Life Partners* but failed to describe the "well over 200 opinions, administrative decisions, and court cases from most states . . . finding that viatical settlements were securities); *In re Carpenter,* File No. S-00272, 2002 WL 399655, at *8 (Wisc. Comm'r of Sec. Feb. 28, 2002) (Op. and Order) (citing formal 1997 bulletin and numerous enforcement orders declaring that viaticals are investment contracts under Wisconsin law); *In re Reynolds,* Admin. Order No. CD-99-

0002, 1999 WL 16728, at *1 (Ala. Sec. Comm'n Jan. 8, 1999) (Cease and Desist Order) (viatical contracts are investment contracts); *In re Alpha & Omega Asset Protection Strategies, LLC,* Order No. CD-98-28, 1998 WL 259548, at *2 (Mo. Div. of Sec. May 15, 1998) (Order to Cease and Desist) (noting that in 1998, Missouri reaffirmed its policy that viaticals are securities, "notwithstanding" the *Life Partners* ruling); *Viatical Settlements Under the Colorado Sec. Act,* Interpretive Letter, 1997 WL 433361, at *1-2 (Colo. Div. of Sec. June 2, 1997) (finding that a specific offering was an investment contract, notwithstanding *Life Partners,* and cautioning that anyone offering unregistered viaticals does so at their peril, unless they have definitive regulatory or judicial authority to the contrary). California itself was among those states. *See Pasternak v. Boutris,* 99 Cal. App. 4th 907, 913 (Cal. Ct. App. 2002) (citing desist and refrain order issued by the California Department of Corporations in February 1997 against a promoter offering securities in the form of viatical investments).[10]

[10] This review of the context in which the California legislature acted – particularly the abundance of state and SEC enforcement actions taken against viatical promoters – disposes of Shearburn's astonishing claim that the only guide to the legal status of viaticals "prior to 2001" was the *Life Partners* decision. *See* Appellants' Opening Br. at 12, 14. Of course, even if *Life Partners* had been the sole judicial pronouncement on viaticals at the time, Shearburn would fare no

In those enforcement actions, unscrupulous promoters were often invoking *Life Partners* to support the defense that viaticals were not securities and therefore not subject to securities regulation. For the most part, those defenses were rejected, but they occasionally succeeded. *See Griffitts v. Life Partners, Inc.,* No. 10-01-00271-CV, 2004 WL 1178418 (Tex. Ct. App. May 26, 2004). Even where those

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better in this appeal. The law of "investment contracts" was certainly well-established in the California Code and in the case law when Shearburn launched his fraudulent enterprise, and that term has been repeatedly and successfully defended against claims of vagueness. *See Miller v. Pace,* 677 N.W. 2d 761, 773-74 (Iowa 2004) (rejecting unfair lack of notice argument in connection with status of sale and leaseback agreements as securities); *Poyser v. Flora,* 780 N.E. 2d 1191, 1198 n. 6 (Ind. Ct. App. 2003) (observing that argument asserting the term "investment contract" is impermissibly vague has been found untenable given plentiful case law defining and applying it). Moreover, the principle that "judicial decisions operate retrospectively is familiar to every law student." *Miller,* 677 N.W. 2d at 772; *see also In re Retirement Cases,* 110 Cal. App. 4th 426, 442 (Cal. Ct. App. 2003). The *Life Partners* decision was therefore always subject to reversal in a court case applied retroactively. At the very least, Shearburn's "claimed reliance on *Life Partners* was a calculated and voluntarily assumed business risk." *Siporin v. Carrington,* 23 P. 3d 92, 99 (Ariz. Ct. App. 2001) (rejecting defense based on reliance upon *Life Partners*). The court should also dismiss Shearburn's notion that his supposed efforts to learn the state of the law entitle him to an estoppel defense. None of the elements of estoppel are present in this case, and even where they pertain, courts refuse to apply the doctrine against the government if, as here, the harm to the public interest would outweigh unfairness to a private party. *Medina v. Board of Retirement,* 112 Cal. App. 4th 864, 868-69 (Cal. Ct. App. 2003).

defenses were overcome, state regulators found themselves devoting considerable investigative and litigation resources simply to establishing the status of viaticals as securities, rather than addressing the pernicious fraud so often associated with these investments. As a result of these trends, state legislatures began to add viaticals to their statutory definitions of a security, to remove any question that they were securities and to lighten the burden on regulators confronted with jurisdictional defenses. *See, e.g.,* SENATE COMMITTEE ON FINANCE, INVESTMENT AND INTERNATIONAL TRADE, REPORT ON SB 1837, at 3, Ex. App. at 177 (May 8, 2000) (citing Alaska, Iowa, Maine, North Dakota, and South Dakota as having enacted similar amendments listing viaticals as securities); *see also* amendments adopted in Arizona, ARIZ. REV. STAT. § 44-1801(26) (eff. Apr. 3, 2000); Indiana, IND. CODE § 23-2-1-1(k) (eff. Mar. 17, 2000); Mississippi, MISS. CODE ANN. § 75-71-105(n) (eff. July 1, 2000); *cf. Michelson v. Voison,* 658 N.W. 2d 188, 191 (Mich. Ct. App. 2003) (reviewing the states that have added viaticals to their statutory definition of a security).

For example, Idaho added viaticals to its statutory definition of a security in 2004. The Official Comment explains that the amendment was intended purely as a clarification of the law:

> This Act also refers to an investment in a viatical settlement or similar agreement *to make unequivocally clear* that viatical settlement and similar agreements, which otherwise satisfy the definition of an investment contract, are securities. This is intended to reject the holding of one court that a viatical contract could not be a security. *See SEC v. Life Partners, Inc.,* 87 F. 3d 536 (D.C. Cir. 1996), *reh'g denied,* 102 F. 3d 587 (D.C. Cir. 1996). A number of states have done so by statute. Judicial construction of the term "investment contract" has been the most frequently litigated issue concerning the term "security."

See Official Comment, Uniform Sec. Act of Idaho, IDAHO CODE § 30-14-102 (emphasis added). The legislative history of the California amendment at issue in this case echoes the same point:

> The Department of Corporations maintains that SB 1837 would "clarify California law that viatical settlement contracts . . . are securities. Consequently, this proposal would allow DOC to focus its enforcement efforts on investigation of, and specific action concerning, particular companies offering viatical investments instead of on whether there is definitional jurisdiction."

See SENATE COMMITTEE ON FINANCE, INVESTMENT AND INTERNATIONAL TRADE, REPORT ON SB 1837, at 2, Ex. App. at 176 (May 8, 2000). In short, the context in which the California legislature acted supports the conclusion that the legislature's intent

was to confirm what securities regulators and legislators in states throughout the country already understood: that viaticals were securities.[11]

The factors discussed above – the statutory language, the legislative history, and the context in which the amendment was adopted – all demonstrate that the addition of viaticals to the definition of a security in the California Code was a clarifying amendment, not a change in the law. The amendment confirms that viaticals were securities under California law before, as well as after, the enactment.

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[11] To its credit, the SEC also continued to bring enforcement actions against viatical promoters even after its setback in *Life Partners*. *See SEC v. Kearns,* SEC Litigation Release No. 16610 (June 26, 2000) (announcing issuance of injunctive relief against promoter of various securities including viatical settlements); *SEC v. Brandau,* SEC Litigation Release No. 16546 (May 9, 2000) (announcing injunctive action against principal of Florida-based viatical scheme that defrauded investors out of $80 to $130 million); *SEC v. Steinger,* SEC Litigation Release No. 15729 (May 1, 1998) (announcing settlement with principals of Mutual Benefits Corp., a $100 million fraudulent viatical sales operation); *SEC v. Laing,* SEC Litigation Release No. 15558 (Nov. 13, 1997) (announcing complaint against principal of viatical company that obtained $95 million from investors through fraud).

Numerous state courts have reached a similar conclusion when faced with challenges like the one advanced here by Shearburn. For example, in *Security Trust Corp. v. Estate of Fisher,* 797 N.E. 2d 789 (Ind. Ct. App. 2004), the Indiana securities act did not expressly include viaticals in its definition of a security during the time period relevant to the appeal, but the statute was later amended, as in this case. The court held that the amendment merely clarified existing law and that viaticals sold prior to the amendment qualified as securities under the *Howey* investment contract test. *Id.* at 795. The court observed that the statutory definition was illustrative, not exhaustive; that requiring the definition to list every conceivable type of security would render the general term "investment contract" meaningless; and, perhaps most important, that the defendant's reading would be "contrary to the Act's purpose of 'protecting the public by preventing dishonest promoters from selling financial schemes to unwary investors . . . .' " *Id.* at 794-95, *quoting Poyser v. Flora,* 780 N.E. 2d 1191, 1193 (Ind. Ct. App. 2003).

In *Siporin v. Carrington,* 23 P. 3d 92 (Ariz. Ct. App. 2001), the Arizona securities act underwent a similar amendment incorporating viaticals into the definition of a security, and the defendant launched a

similar challenge. *Id.* at 95-96. The court held that viaticals qualified as securities under the general category of investment contracts, despite the holding in *Life Partners.* And it summarily rejected the argument advanced here by Shearburn as to the effect of the statutory amendment. The court declared:

> We find it unnecessary to rehash the common debate in statutory interpretation cases concerning whether this amendment constituted a change in the law or a clarification of prior legislative intent. This amendment confirms, however, the long-standing policy of our legislature to protect the investing public.

Id. at 99; *see also Allen v. Jones,* 604 S.E. 2d 644, 610 (Ct. App. Ga. 2005) ("[W]e do not hold that the 2002 amendment should be applied retroactively. Rather, we conclude that even before the amendment, viatical contracts could qualify as 'securities' under the act."); *Rumbaugh v. Dep't of Commerce,* 800 N.E. 2d 780, 788 (Ohio Ct. App. 2003) (statutory amendment adding viaticals to definition did not *preclude* a finding that prior version of statute encompassed viaticals, so court deferred to opinion of state agency, which had asserted jurisdiction over viaticals as securities).

Through the amendment, the California legislature not only clarified the law going forward, but removed any doubt that at the

time Shearburn sold viaticals to the public, viatical investments were securities under California law.

II. The Trial Court's Order Of Restitution Against Shearburn Was Appropriate

The trial court ordered Robert N. Shearburn ("Shearburn Sr.") to bear joint and several liability for restitution in the amount of $14,512,025, for his "indispensable role in the fleecing of 221 investors." *See* Judgment, Ex. App. at 18-20. This order was appropriate under the California Code and under the general principles of equity that govern remedies for securities fraud.

A. California Law Provides For Restitution Measured By Investor Losses, In Addition To Disgorgement Measured By Ill-Gotten Gains

The California Securities Law expressly authorizes courts to award restitution, as well as disgorgement, in enforcement actions brought by the Commissioner. The plain language of the Code establishes that the intended purpose of this restitutionary remedy is making whole those who have been injured by violations of California's Securities Law. Subsection 25530(b) of the Code provides as follows:

> (b) If the commissioner determines it is in the public interest, the commissioner may include in any action authorized by subdivision (a) a claim for ancillary relief,

> including but not limited to, a claim for *restitution* or disgorgement or damages on behalf of the persons injured by the act or practice constituting the subject matter of the action . . . .

CAL. CORP. CODE § 25530(b) (emphasis added). Furthermore, subsection 25530(c) of the Code includes a provision that deals solely with restitution. It provides that the court may require an order of restitution to be treated as a money judgment, enforceable by the defendant's victims in the same manner as other civil judgments are enforced. CAL. CORP. CODE § 25530(c). The proper measure of a restitutionary award under Section 25530 of the Code is the amount of injury to the investors, irrespective of the amount of money that a violator may have received personally from his illegal activities.

The California legislature intended this restitutionary remedy to be separate and distinct from disgorgement. As discussed above, the statute contains distinct references to both "restitution" and "disgorgement" and it includes a subsection devoted exclusively to the enforceability of just the restitution remedy. In addition, restitution and disgorgement were added to the statue at different times – the provision for "restitution or damages" pre-dated the provision for disgorgement, which did not appear until 1981. *See* Historical and Statutory Notes, WEST'S ANN. CAL. CORP. CODE §

25530 (describing 1981 amendment). This chronology supports the inference that the terms restitution and disgorgement were intended as distinct equitable remedies, to be enlisted for different purposes and to be measured by different formulas.

Finally, the California legislature elected not to impose a quantitative ceiling on the amount of restitution that the Commissioner may seek or that the court may order. And it certainly did not tie the measure of restitution to the profits or gains enjoyed by the perpetrators of securities fraud. Obviously, the drafters could have imposed such limits, and in fact, some states have done so in the context of criminal restitution authorized by statute. *See State v. Slemmer,* 738 P. 2d 281, 288 (Wash. Ct. App. 1987) (under applicable statute, "[T]he amount of restitution shall not exceed double the amount of the offender's gain or the victim's loss from the commission of the crime."); *State v. DeAngelis,* 747 A.2d 289, 292 (N.J. Sup. Ct. 2000) (under applicable statute, the restitution paid to the victim "shall not exceed the victim's loss"). The decision of the California legislature to include both forms of ancillary relief in the Securities Law, without limitation, reflects an intent to protect the

public by strengthening the remedies available for securities law violations, not limiting them as suggested by Shearburn.

This interpretation finds support in the underlying purposes of the Code. The California courts have observed that

> California's policy is to protect the public from fraud and deception in securities transactions. The Corporate Securities Law of 1968 was enacted to effectuate this policy by regulating securities transactions in California and providing statutory remedies for violations of the Corporations Code, in addition to those available under the common law.

See Hall v. Superior Court, 150 Cal. App. 3d 411, 417 (Cal. Ct. App. 1983). To effectuate this policy of investor protection, the California courts broadly interpret the Code. For example, in *Diamond Multimedia Systems, Inc. v. Superior Court,* 19 Cal. 4th 1036 (Cal.), *cert. denied,* 527 U.S. 1003 (1999), the California Supreme Court held that the Code's prohibitions against market manipulation applied in favor of out-of-state purchasers as well as California investors. *Id.* at 1065. In support of its holding, the Court observed that Section 25530(b) was unrestricted in its scope: "In subdivision (b) of Section 25530, the Corporate Securities Law of 1968 expressly permits the Commissioner of Corporations to seek relief on behalf of investors, and, like Section 25500, Section 25530, subdivision (b), contains no

language limiting 'investors' to California investors." *Id.* at 1053. Similarly, Section 25530 contains no language limiting restitution to the amounts Shearburn or any other miscreant may have taken for his own personal benefit.

Recent amendments to the Code also reflect the legislature's desire to intensify enforcement of the state's Securities Law against those who perpetrate fraud. In 2003, California strengthened the securities and commodities provisions of the Code by (1) granting the Attorney General of California the authority to enforce the securities act along with the Commissioner; (2) enhancing the means of cooperation and information-sharing available to law enforcement agencies investigating securities violations; and (3) defining a new crime for those who make false statements in the course of investigations. *See* Cal. Sen. Bill 434, Ch. 876 (approved Oct. 12, 2003).[12] The report of the Senate Judiciary Committee explains that the bill was intended to address numerous instances of securities fraud by corporations and accounting firms that had victimized the citizens of California and eroded their retirement savings. *See* SENATE

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[12] *available at* *http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_0401-0450/sb_434_bill_20031012_chaptered.html*.

JUDICIARY COMMITTEE, REPORT ON SB 434, 2003-2004 Reg. Sess., at 1 (2003). The report also incorporates statements of the Attorney General specifically highlighting the value of the remedial measures in Section 25530:

> There may be significant advantages, however, to civil rather than criminal enforcement [of the securities law] . . . Section 25530 of the state's securities fraud law allows for a broad range of civil enforcement remedies, which can be an important tool in the fight against securities and commodities fraud. For example . . . the option of seeking an injunction, restitution, disgorgement, or other equitable relief (including receivership) is available. In addition, the pursuit of substantial civil penalties can serve as an effective deterrent . . . .

See id. at 6.

These amendments reflect a legislative desire to expand, not restrict, the enforcement of California's Securities Law, in the interest of protecting investors. Shearburn's challenge to the trial court's restitution award conflicts with this legislative intent, as well as the plain meaning of the statute.

The trial court's interpretation of Section 25530 in fashioning relief against Shearburn Sr. is consistent with the results in other states where courts have applied a similar statutory remedy. For example, the Supreme Court of Iowa upheld an order imposing sanctions for securities fraud under a statutory provision similar to Section 25530,

which expressly allowed for restitution. *See Miller v. Pace,* 677 N.W.2d 761, 766 (Iowa 2004). Those sanctions included, as distinct remedies, restitution of investor losses, disgorgement of all commissions received from the sale of the securities at issue, civil penalties, and costs of the state's investigation. *Id.*; *see also Goettsch v. Diacide Distributors, Inc.,* 561 N.W. 2d 369, 375-76 (Iowa 1997) (remedies of rescission, restitution, and disgorgement may also be applied to aidors and abettors under Iowa securities law); *cf. Joseph v. Viatica Management, LLC,* 55 P. 3d 264, 268 (Col. Ct. App. 2002) (Colorado securities act permits Commissioner to seek "damages, restitution, disgorgement, or other equitable remedies" for violations of act); *In re Krizman,* Docket No. S-03486A-02-0000, 2003 WL 1890065, at *6 (Ariz. Corp. Comm. Mar. 24, 2003) (respondent ordered to make restitution to six identified investors "in the amount each invested," totaling $439,715.62).

The Supreme Court of Delaware also has invoked a similar statutory provision to uphold an order of restitution against a broker-dealer to compensate investors for losses suffered after they were fraudulently induced into securities transactions. *See Hubbard v. Hibbard Brown & Co.,* 633 A.2d 345, 354-55 (Del. 1993). The court

in *Hubbard* held that the statutory restitution remedy could even be applied retroactively, because the statute did not increase the defendants' liability beyond what they would have faced in a civil suit brought by the defrauded investors. *Id.* This rationale highlights the essential focus of restitution and its proper measure: requiring those who commit violations of the securities law to repair the damage done to their victims.

California's statutory restitution remedy, and the trial court's application of it in this case, are also in accord with the equitable principles governing restitution that have evolved under the case law for decades. State and federal courts have long exercised an inherent equitable authority to award restitution and disgorgement to fulfill the purposes of the securities laws and other remedial statutes, even where those statutes do not specifically provide for such relief.[13] *See, e.g., SEC v. Manor Nursing Centers, Inc.,* 458 F.2d 1082, 1103-04 (2d Cir. 1972) (order of disgorgement for benefit of defrauded investors

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[13] NASAA has found only two state cases suggesting that courts lack the inherent equitable authority to grant restitution at the request of the government. *See Ohio Dep't of Commerce v. Buckeye Finance Corp.,* 377 N.E. 2d 502, 504-05 (Ohio 1978); *Wee Mac Corp. v. State of Florida,* 301 So. 2d 101, 102 (Fla. Ct. App. 1974). In both cases, the court read the applicable securities act to preclude that particular

held proper as ancillary relief); *People v. Superior Court,* 9 Cal. 3d 283, 286 (Cal. 1973) (trial courts have inherent equitable power to order restitution under unfair competition law). Those cases have established that the purpose of restitution is to "compensate the victims of the wrongful acts." *See United States v. Lane Labs-USA, Inc.,* 324 F. Supp. 2d 547, 576 (D.N.J. 2004) (primary purpose of restitution is to compensate victims for their losses, whereas disgorgement seeks to force wrongdoer to surrender unjust enrichment; both remedies held appropriate under Food, Drug and Cosmetic Act even though not expressly authorized); *see also SEC v. Huffman,* 996 F.2d 800, 802 (5th Cir. 1993) (contrasting the functions of restitution and disgorgement, and holding that disgorgement liability was not a "debt" under Federal Debt Collection Procedures Act because its primary purpose is to wrest ill-gotten gains from the wrongdoer, not compensate victims).[14]

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form of relief. In this case, of course, the California Code expressly *provides* for restitution in Section 25530.

[14] Over the years, some courts have used the terms restitution and disgorgement interchangeably. *See, e.g., SEC v. Texas Gulf Sulphur Co.,* 446 F.2d 1301, 1309 (2d Cir. 1971) (discussing disgorgement in terms of "restitution of profits"). This potentially confusing usage arises because in some instances, the two remedies overlap. For example, funds obtained through disgorgement may in turn be used to help make victims whole, and the amount of disgorgement might

Under Section 25530 as well as the judicially fashioned principles of equity discussed above, the trial court's award of restitution against Shearburn Sr. was entirely appropriate. The court found that extensive violations of the California Securities Law had occurred in the fraudulent offer and sale of unregistered viatical investments; that at least 221 investors had lost over $14 million as a consequence of these violations; and that Shearburn had played a central – indeed an "indispensable" – role in causing that monetary harm. *See* Judgment, Ex. App. at 18-20. These circumstances are precisely those in which an award of restitution is appropriate. And the correct measure of the award is the harm to investors, irrespective

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even, in some cases, be equal to the amount necessary for full restitution. However, the concepts are distinct both conceptually and in their operation. As noted by the court in *SEC v. Huffman,* "[A] disgorgement order might be for an amount more or less than that required to make the victims whole. It is not restitution." 996 F.2d at 803; *see also SEC v. Texas Gulf Suphur,* 446 F.2d at 1308 (order requiring disgorgement of illegal profits is appropriate even if it contains no element of compensation for victims). The California courts are mindful of the potential for confusion in the terminology and of the distinctions between the two remedies. *See People v. Martinson,* 188 Cal. App. 3d 894, 900-01 (Cal. Ct. App. 1987) (commissions arising from securities law violations were part of value given by investors and were therefore payable under either a disgorgement or restitution theory).

of any amounts that Shearburn Sr. may have received and retained for his own benefit.[15]

B. The Trial Court's Judgment Is Also Justifiable Under Principles Of Disgorgement

The trial court's judgment should be affirmed even if it is viewed as one for disgorgement rather than restitution. Under the law of disgorgement, one who has played a central role in an illegal enterprise along with other persons or entities may be held jointly and severally liable for disgorgement of the full amount that the enterprise as a whole took from its victims. *See, SEC v. First Jersey Securities, Inc.,* 101 F.3d 1450, 1475 (2d Cir. 1996), and cases cited therein, *cert. denied,* 522 U.S. 812 (1997). In *SEC v. First Jersey Securities*, the SEC filed an enforcement action against a brokerage firm for

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[15] Because the trial court's judgment was an appropriate exercise of the authority to grant restitutionary relief, Shearburn's challenges predicated on theories of disgorgement fall by the wayside. For example, Shearburn's reliance on *CFTC v. American Metals Exchange Corp.,* 991 F. 2d 71 (3d Cir. 1993), for the proposition that the award is punitive because it exceeds the amount of his personal gain is misplaced. *See* Appellants' Opening Br. at 34-35, 38. The award is for restitution, not disgorgement, and restitution is not a punitive remedy. *See United States v. Lane Labs-USA, Inc.,* 324 F. Supp. 2d 547, 576 (D.N.J. 2004) ("[A]n order of restitution is not punitive where the offender has violated the law at the expense of the very consumers a restitution order seeks to make whole.") (citing *United States v. Universal Management Services, Inc.,* 191 F.3d 750, 763 (6th Cir. 1999)).

engaging in a massive scheme to defraud investors by charging excessive markups on over-the-counter stocks. After the district court granted injunctive and ancillary relief, the defendants appealed, and the Second Circuit faced an argument much like the one advanced here by Shearburn:

> Brennan contends that the district court erred in making him jointly and severally liable for disgorgement of the total amount of First Jersey's profits and should not have ordered him to disgorge more than the profits he personally received from the transactions in question.

Id. at 1475. The appellate court rejected Brennan's argument. First, the court noted that the total amount of disgorgement being ordered need only be a "reasonable approximation" of the overall proceeds causally connected to the violation. *Id.* at 1475. As to Brennan's personal liability, the court held that imposing full disgorgement liability upon him was appropriate due to his central role in perpetrating the fraud:

> Brennan is primarily liable for the frauds at issue here, having been "intimately involved" in their perpetration, and is also liable as a controlling person of First Jersey . . . . Where a firm has received gains through its unlawful conduct, where its owner and chief executive officer has collaborated in that conduct and has profited from the violations, and where the trial court has, within the proper bounds of discretion, determined that an order of disgorgement of those gains is appropriate, it is within the discretion of the court to determine that the owner-

> officer too should be subject, on a joint and several basis, to the disgorgement order.

Id.

The Third Circuit Court of Appeals reached a similar result in a case involving a fraudulent public stock offering. In *SEC v. Hughes Capital Corp.,* 124 F.3d 449 (3d Cir. 1997), one of the main participants in the fraud insisted that she had received only a small fraction of the overall proceeds from the scheme and that her disgorgement liability should be limited accordingly. *Id.* at 455. The appellate court rejected her argument, holding that an order imposing joint and several liability for disgorgement upon all defendants was warranted because:

> the defendants all collaborated in a single scheme to defraud Hughes' investors through the bogus initial offering and the subsequent sale of warrants. They enjoyed a "close relationship" with each other through their connection to Hughes, the other corporations used in the scheme, and the nominee accounts used to perpetrate the scheme.

Id. The court in Hughes further observed that the burden rests with the wrongdoers to establish, if possible, that the liability is capable of apportionment, but it also cautioned that the district court enjoys broad discretion in determining whether joint and several liability for the full amount should be imposed upon each defendant. *Id.*

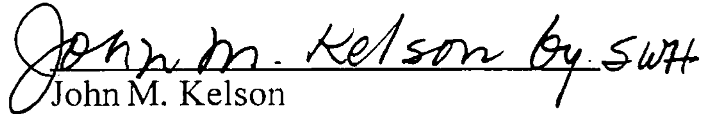
The rule applied in these cases provides an alternative ground for affirming the trial court's imposition of liability against Shearburn Sr. The trial court expressly found that Shearburn Sr.'s operation "collected $14,512,000 in the sale of unregistered securities from 221 investors," Judgment, Ex. App. at 18, and Shearburn Sr. has never denied that at least this amount was received from those investors. Accordingly, as a threshold matter, the trial court's judgment represents a "reasonable approximation" of the total revenues of the illegal operation. In addition, the trial court found that Shearburn was the central figure in the sales operation, noting repeatedly that he was "indispensable." *See id.* at 18-20. Finally, the trial court found that "Shearburn profited handsomely from his misdeeds, reaping over $3 million from bilked investors." *Id.* at 19. Under the rule set forth in *First Jersey* and *Hughes,* these findings justify imposing joint and several *disgorgement* liability upon Shearburn for the same amount that the court ordered under a *restitution* analysis. In this case, the result is the same, and the trial court's judgment can be affirmed on this basis as well.[16]

[16] The holding in *First Jersey Securities* suggests that a wrongdoer intimately involved in an illegal scheme should bear joint and several liability for disgorgement of the full amount of the operation's

CONCLUSION

For the reasons discussed above, the judgment of the court below should be affirmed.

Respectfully submitted,



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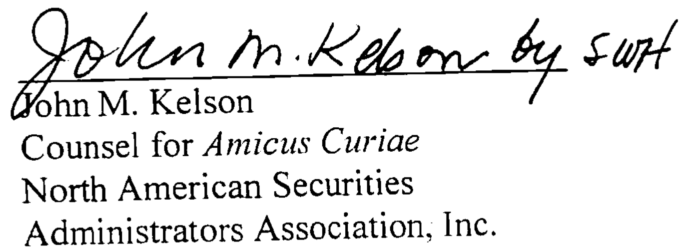
revenues, regardless of whether or not there is credible evidence showing an apportionment of each defendant's personal gains. *Hughes,* on the other hand, suggests that defendants must at least be given an opportunity to establish an apportionment of liability. Even under the more generous rule adopted *Hughes,* Shearburn Sr. would still bear joint and several liability for $14 million, because he never adduced proof of his income. The trial court found that "Shearburn never got a W-2 or 1099 form, and he did not produce any documents establishing his actual income at trial even though he accrued *over* $3 million in cashier's checks from Palmieri." Judgment, Ex. App. at 18 (emphasis added). Accordingly, Shearburn could not be said to have carried his burden on apportionment of his gains for purposes of limiting his disgorgement liability.

CERTIFICATE OF COMPLIANCE
WITH WORD LIMIT

1. In accordance with Rule 14(c) of the California Rules of Court, undersigned counsel hereby certifies that this brief contains 12,142 words, including footnotes, as measured by "Word 2000," the computer program used to prepare the brief.



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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 6th day of September, 2005, a copy of the foregoing BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., AS *AMICUS CURIAE* IN SUPPORT OF THE PEOPLE OF THE STATE OF CALIFORNIA, filed in Appeal No. D045555, was served by next day delivery service, on each of the following persons, at the following addresses:

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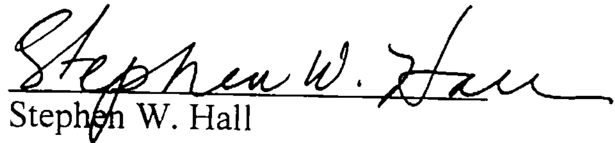

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