SUPREME COURT, STATE OF COLRADO 2 East 14th Avenue Denver, CO 80203 Certiorari to the Court of Appeals, 2018CA1769 District Court, Denver County, 2009CV7181	DATE FILED: June 28, 2021 1:23 PM FILING ID: 4D49011F8ED1E CASE NUMBER: 2020SC595
Plaintiff-Appellee: **TUNG CHAN, Securities Commissioner for the State of Colorado,** **v.** **Defendants-Appellants/Cross-Appellees:** **HEI RESOURCES, INC. f/k/a HEARTLAND ENERGY, INC., CHARLES REED CAGLE, BRANDON DAVIS, HEARTLAND ENERGY DEVELOPMENT CORPORATION, JOHN SCHIFFNER, and JAMES POLLAK**	**∆ COURT USE ONLY ∆**
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BRIEF OF *AMICUS CURIAE* NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. IN SUPPORT OF PLAINTIFF/APPELLEE TUNG CHAN, SECURITIES COMMISSIONER FOR THE STATE OF COLORADO

CERTIFICATE OF COMPLIANCE PURSUANT TO C.A.R. 32(h)

I hereby certify that this brief complies with C.A.R. 29 and C.A.R. 32, including all formatting requirements set forth in these rules. Specifically, the undersigned certifies that:

The *amicus* brief complies with the applicable word limit set forth in C.A.R. 29(d).

☒ It contains **4750** words (excluding the caption page, this certificate page, the table of contents, the table of authorities, and the signature block).

The amicus brief complies with the content and form requirements set forth in C.A.R. 29(c).

I acknowledge that my brief may be stricken if it fails to comply with any of the requirements of C.A.R. 29 and C.A.R. 32.

/s/ Theodore J. Hartl
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IDENTITY AND INTEREST OF *AMICUS CURIAE* PURSUANT TO C.A.R. 29(C)(2)

Formed in 1919, the North American Securities Administrators Association ("NASAA") is the non-profit association of state, provincial and territorial securities regulators in the United States, Canada and Mexico. Plaintiff Tung Chan (the "Commissioner") is the NASAA member representative from this state. NASAA's U.S. members are responsible for administering state securities laws. The overriding mission of NASAA and its members is to protect investors – particularly retail investors – from fraud and abuse while protecting the integrity of the marketplace so that capital formation is fair and efficient.

NASAA supports its members and the investing public by promulgating model statutes and rules, coordinating multi-state enforcement actions, and commenting on legislative and rulemaking proposals. NASAA also offers its legal analyses and policy perspectives to state and federal courts as *amicus curiae* in important cases involving the interpretation of state and federal securities laws and regulations.

NASAA and its members are interested in this case because the outcome could affect the ability of regulators nationwide to bring enforcement actions where fraudsters structure investments as general partnerships to evade the securities laws. If the Court affirms a restrictive approach that presumptively excludes general

partnership interests from the definition of a security, it could weaken investor protections by providing a blueprint for those seeking to commit fraud or evade disclosure.

NASAA is also particularly concerned that an affirmance could worsen the prevalence of oil and gas frauds. These schemes are perennially on NASAA's list of the top ten investor threats.[1] The U.S. Securities and Exchange Commission ("SEC") has likewise warned that "while some oil and gas investment opportunities are legitimate, many oil and gas ventures are frauds."[2] Despite the best efforts of regulators to warn investors, oil and gas frauds continue to proliferate. Given the inherently complex and speculative nature of oil and gas ventures, it is difficult for investors to distinguish between legitimate deals and fraudulent schemes. The resolution of this case could therefore adversely impact the ability of the Commissioner and other NASAA members to protect their citizens.

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1 NASAA Top Investor Threats, *available at* https://www.nasaa.org/3752/top-investor-threats/.

2 SEC, Investor Publications, *Oil and Gas Scams: Common Red Flags and Steps You Can Take to Protect Yoursel[f] [sic]* (Aug. 1, 2007), *available at* https://www.sec.gov/reportspubs/investor-publications/investorpubsoilgasscamshtm.html.

SUMMARY OF THE ARGUMENT

Like most state and federal courts, Colorado courts analyze the economic realities of a transaction to determine whether it involves the offer or sale of a security. They do not rely on the name given to an arrangement by its promoters. In particular, Colorado courts have treated the factors articulated in *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981), merely as guidance to help determine whether a general partnership interest is in fact an investment contract because the investors do not have meaningful control. Colorado courts also have not adopted a presumption that general partnership interests are not securities. Instead, they have held that an appropriate determination requires a detailed factual analysis that gives little weight to labels and terminology. This approach is consistent with controlling and persuasive authorities which hold that securities laws – particularly those that define the term "security" – must be applied flexibly to effectuate their remedial purposes.

While the Court of Appeals purports to follow an economic realities analysis, its decision below[3] is flawed because it elevates terminology over substance in three important ways. First, the lower court's decision to apply a "strong presumption" that general partnership interests are not investment contracts placed an artificial

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[3] The opinion of the Court of Appeals in *Chan v. HEI Resources et al.*, Case No. 18CA1769 (Colo. App. June 4, 2020), is referred to in this brief as "*HEI II*".

weight on its reasoning that stunted its analysis. Second, and more particularly, the lower court erred by making superficial findings that the investors' general business experience and nominal ability to replace management were sufficient to sustain a presumption that they had the powers of general partners. A fact-based economic realities analysis requires more and, if properly applied here, would have led to the conclusion that the investors did not have control of the enterprise because they did not have the specialized experience needed to run an oil and gas venture, and because the managers were in fact irreplaceable because they intentionally withheld key information from the investors. Third, the lower court's holding that economic realities outside of the *Williamson* factors need not be considered is unprecedented and unsupportable; a proper economic realities analysis requires a court to consider all relevant facts. In sum, the decision below should be reversed because it relies on presumptions that resulted in erroneous findings and conclusions.

Furthermore, this Court should reverse the decision below because it could encourage fraudsters to construct sham investments and name them as general partnerships specifically to avoid the Colorado securities laws. Of only slightly lesser concern, general partnerships could simply become the vehicle of choice for promoters seeking to hide poor investment terms from disclosure obligations. Either scenario could bring more harm to Colorado investors. This Court should preserve the flexible application of the securities laws, and the attendant rigor of fact-based

economic realities analyses, in order to discourage abuse of the general partnership structure.

ARGUMENT

I. Colorado Courts Analyze the Economic Realities of Transactions to Determine Whether They Involve Offers or Sales of Securities.

a. Colorado Courts Follow the Established Approach of Applying the Securities Laws Flexibly to Effectuate Their Remedial Purposes.

A general partnership interest is a "security" under C.R.S. §11-51-201(17) if it falls within the definition of an "investment contract." *See Feigin v. Digital Interactive Associates, Inc.,* 987 P.2d 876, 881 (Colo. App. 1999) (holding that general partnership interests in interactive video services were investment contracts). In general, to determine whether an interest in an enterprise is an "investment contract," Colorado courts follow *Howey v. SEC*, 328 U.S. 293 (1946), which holds that an investment contract is any agreement or transaction in which a person "[1] invests his money [2] in a common enterprise and [3] is led to expect profits solely from the efforts of the promoter or a third party ...." *Id.* at 298-99; *see also Lowery v. Ford Hill Inv. Co.*, 192 Colo. 125, 130 (Colo. 1976).

The question in this case is whether the investors expected profits to come from Defendants' efforts. In an appropriately formed and structured general partnership, the partners do not have such an expectation because they control the enterprise. Investors, on the other hand, rely on the enterprise's managers and promoters to generate profits for them.

To determine whether a person controls an enterprise or is dependent on the

efforts of others, Colorado courts analyze the commercial or economic realities of the transaction, *see Toothman v. Freeborn & Peters* 80 P.3d 804, 811 (Colo. App. 2002), and place emphasis "on whether or not the investor has substantial power to affect the success of the enterprise." *Id.* at 813. This approach is consistent with the U.S. Supreme Court's guidance that the test for determining whether a transaction involves an investment contract is "a flexible rather than a static principle, one that is 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." *Howey* at 299.

This Court has similarly recognized that the Colorado legislature defined the term "security" expansively "to provide the flexibility needed to regulate the various schemes devised by those who seek to use the money of others with the lure of profits." *Lowery*, 192 Colo. at 130; *accord Lorenzo v. SEC*, 139 S. Ct. 1094, 1104, 587 U.S. ___ (2019) (explaining that "Congress intended [for the federal securities laws] to root out all manner of fraud in the securities industry"); *Affiliated Ute Citizens of Utah v. U.S.*, 406 U.S. 128, 151 (1972) (holding that Securities Exchange Act of 1934 should be construed "flexibly to effectuate its remedial purposes").

Other states are in accord, and this is the established approach to interpreting and applying the securities laws. *See, e.g., Frishman v. Maginn*, 912 N.E.2d 468, 477-78 (Mass. App. Ct. 2009) (construing the Securities Act of 1933 broadly to hold an assignment contract unenforceable for selling unregistered investments to

unaccredited investors); *State v. McGuire*, 735 N.W.2d 555, 561 (Wis. 2007) (construing Wisconsin Uniform Securities Law flexibly in accordance with Congressional intent to hold that a promissory note can be a security subject to antifraud provisions); *State v. Argo,* 915 P.2d 1103, 1107 (Wash. Ct. App. 1996) (construing definition of "security" under federal securities laws and Washington Securities Act to hold that an investment contract or promissory note can be a security); *Casali v. Schultz*, 732 S.W.2d 836, 837 (Ark. 1987) (construing definition of "security" under Arkansas Securities Act to hold that interests in a general partnership in an investment banking firm were securities); *Waugh v. Heidler*, 564 P.2d 218, 220 n.2 (Okla. 1977) (construing Oklahoma Securities Act to cover aider and abettor liability for violating Act's antifraud provisions).

Given this consensus in the flexible manner by which the securities laws should be applied, and the goals courts seek to protect through flexible application of the securities laws, this Court should reject holdings, like *HEI II*, that are contrary to and undermine those principles.

b. Colorado Courts Look to Williamson for Guidance When Evaluating General Partnerships.

Williamson articulates the factors courts commonly use to determine whether a transaction, labelled as a general partnership, is in fact an investment contract by considering, among other things, whether:

> (1) An agreement among the parties leaves so little power in the hands of the partner or venture that the arrangement in fact distributes power as would a limited partnership; or (2) The partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) The partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

Williamson, 645 F.2d at 424; *see also Joseph v. Mieka Corp.*, 282 P.3d 509, 514 (Colo. App. 2012). Importantly, *Williamson* recognizes that other factors could "give rise to such a dependence on the promoter or manager that the exercise of partnership powers would be effectively precluded." *Williamson* at 424 n. 15.

c. Colorado Courts Have Not and Should Not Presume That General Partnership Interests Do Not Qualify as Securities.

In order to faithfully follow the principle that state and federal securities laws are meant to be applied flexibly, and to recognize that the Colorado Securities Act ("CSA") is a remedial statute designed to protect investors, this Court should not allow the lower courts to artificially stunt their analyses of transactions by presuming that general partnership interests do not qualify as securities.

More specifically, the *Williamson* factors cited above have been and should continue to be viewed merely as guidance to analyze whether general partnership interests are in fact investment contracts. As the Court of Appeals for the Eleventh Circuit put it, "*Williamson* is ultimately simply a guide to determining whether the partners expected to depend solely on the efforts of others, thus satisfying the *Howey*

test." *SEC v. Merchant Capital, LLC,* 483 F.3d 747, 755 (11th Cir. 2007). Colorado courts, and other jurisdictions, have applied *Williamson* in the same way; namely, as guidance for identifying facts that *could* be relevant to determine whether an investor in a general partnership is relying upon the efforts of others for the ultimate success of the enterprise. *See Feigin*, 987 P.2d at 881-82; *Toothman*, 80 P.3d at 811-12; *People v. Robb*, 215 P.3d 1253, 1261 (Colo. App. 2009); *Consol. Mgmt. Grp., LLC v. Dep't Corps.*, 75 Cal. Rptr. 3d 795, 806 (Cal. Ct. App. 2008) (applying *Williamson* factors without imposing a presumption to find oil and gas general partnerships were securities under California law); *Nutek Info Sys., Inc. v. Ariz. Corp. Comm'n*, 977 P.2d 826, 830-32 (Ariz. Ct. App. 1998) (discussing *Williamson* burden analysis alongside the importance of economic realities of a transaction in holding that LLC interests in dispatch radio communication networks were investment contracts under Arizona Securities Act); *Ito Intern. Corp. v. Prescott, Inc.*, 921 P.2d 566, 572 (Wash. Ct. App. 1996) (stating that though Washington had not adopted *Williamson* test, first factor was met based off limited powers granted to general partners without applying *Williamson* presumption).

Although the Colorado Court of Appeals has previously indicated in dicta that general partnerships are generally not treated as securities – *see Toothman*, 80 P.3d at 811; *but see Mieka*, 282 P.3d at 514 (finding that *Toothman* court did not expressly rule on the applicability of *Williamson* presumption in Colorado) – no Colorado court

before *HEI II* has construed *Williamson* with the applied presumption. This is a significant downward departure from precedent. In a legally neutral fact-finding regime, a court would perform a fulsome consideration of all economic realities "regardless of the labels or terminology the parties used to describe it." *Life Partners, Inc. v. Arnold*, 464 S.W.3d 660, 670 (Tex. 2015). In addition to raising the threshold for an investor or regulator to show that a general partnership interest functioned as an investment contract, adopting a presumption permits a court to perform a more cursory review of the transaction at issue, and thereby disregard significant disparities in the arrangement that work to the detriment of the investors. The most pernicious effect of this departure from prior Colorado applications of *Williamson* is that it elevates form over substance by replacing a neutral legal analysis of economic realities with an analysis that favors promoters' self-serving labels. Practically speaking, that means defending parties can make lesser showings to maintain the presumption and courts are not required to analyze the facts with the same rigor.

II. The Court of Appeals in *HEI II* Misapplied the *Williamson* Guidance to the Facts of This Case.

In addition to the error of finding and applying a presumption, the Court of Appeals erred more specifically by finding that general business acumen and a nominal ability to fire managers satisfied the presumption that the investors were general partners. Indeed, because the Court of Appeals began from the premise that

its job was to determine whether Plaintiff had overcome a presumption, it overlooked facts which show that the investors did not have the needed know-how to run the business, and that they were in reality wholly dependent upon and unable to replace the managers.

a. The Investors Did Not Have Specific Experience in the Business, Which Is Necessary to Exercise Effective Control.

The Court of Appeals below erred by regarding the investors' general business knowledge as adequate and discounting the notion that industry specific knowledge is necessary to run an oil and gas venture. A general partnership interest may be a security if "the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers." *Williamson*, 645 F.2d at 424.

The question, then, is how experienced and knowledgeable must a partner be to intelligently exercise his or her powers? The answer must be that it depends on the economic realities and intricacies of the business at issue. In this case, an analysis of the facts shows that the investors needed specialized experience in order to exercise effective control over the business. Congress realized this when it defined the term "security" in the Securities Act to include "fractional undivided interest in oil, gas, or other mineral royalty lease," 15 U.S.C. § 77b(1), and in the Exchange Act to include "participation in ... any oil, gas, or other mineral royalty

or lease." 15 U.S.C. § 78c(a)(10). Running an oil and gas venture necessarily requires: expertise in reviewing geologic surveys; knowledge of well location selection practices; an understanding of highly complex energy markets, as well as environment laws and regulations at the state and federal levels; and industry specific knowledge regarding extraction technologies.

The reliance of the Court of Appeals on *SEC v. Arcturus*, 928 F.3d 400 (5th Cir. 2019), for the proposition that courts do not require specialized experience if the evidence shows that an investor can intelligibly control his investment, *see HEI II* at ¶ 46, is misplaced because it ignores the countervailing consideration that an investor with general business acumen who is nevertheless inexperienced in the particular business at issue is much more likely to rely on the efforts of the promoters to obtain profits. *See Merchant Capital* 483 F.3d at 762. As the Fifth Circuit has stated, "consistent with the principle that substance must govern over form, we held that even where an investor formally possesses substantial powers, the third prong of the *Howey* test may be met if the investor demonstrates that he 'is so inexperienced and unknowledgeable' *in the field of business at issue* that he 'is incapable of intelligently exercising' the rights he formally possessed under the agreement." *Long v. Schultz Cattle Co.*, 881 F.2d 129, 133-34 (5th Cir. 1989) (emphasis added). Indeed, the Fifth Circuit went on to state more pointedly that "our analysis in *Williamson* [] clearly requires that the investors' knowledge and

experience be evaluated with reference to the nature of the underlying venture. Moreover ... any holding to the contrary would be inconsistent with *Howey*," *id*. at 134 n.3, and that "*Howey* itself establishe[d] that an investor's generalized business experience does not preclude a finding that the investor lacked the knowledge or ability to exercise meaningful control of the venture." *Id*. at 134-35. The *Arcturus* court altered this analysis slightly by holding that "[t]his requirement, however, should not be read to suggest that investors *necessarily* need a specialized background. If evidence shows that an investor can intelligently control his investment, then courts do not require specialized experience." *Arcturus*, 928 F.3d at 417-18 (emphasis added). The usefulness of the *Arcturus* court's observation falters in the context of businesses that cannot be run, or even properly understood, by generalists. The complex nature of oil and gas ventures makes them the sort of business that courts have recognized investors are not typically able to run, but must instead rely on expert managers. *See*, *e.g.*, *Howey*, 328 U.S. at 300 (holding that investors lacked the ability to cultivate and grow oranges); *Merchant Capital*, 483 F.3d at 763 (holding that investors were inexperienced and unable to control venture of debt purchase agreements); *Albanese v. Fla. Nat. Bank of Orlando*, 823 F.2d 408, 412 (11th Cir. 1987) (holding that investors lacked experience in placing, managing, or servicing ice machines).

Other courts are in accord with the notion that general business acumen may

be insufficient to grant an investor effective control over an enterprise. *See*, *e.g.*, *Consol. Mgmt.*, 75 Cal. Rptr. 3d at 807 (stating that industry specific knowledge standard is in line with *Howey*, purpose of the securities laws, and addresses fact that general business experience might not allow an investor to manage a specific investment); *Nutek*, 977 P.2d at 833 (requiring that investors have knowledge of specific business by holding that "[i]n short, just because one is a 'business person' does not make him or her less reliant on the expertise of others when entering a new field of endeavor"); *Corp. East Assocs. v. Meester*, 442 N.W.2d 105, 108 (Iowa 1989) (linking defendant's past real estate, not general, investment experience to *Williamson's* second factor); *Mieka*, 282 P.3d at 514-15 (referring to "the level of experience and knowledge of the partners in the partnership's business affairs" while applying *Williamson's* second factor).

Given that the appropriate test articulated by many courts is not general business acumen, but specialized experience in the industry of the venture, *HEI II* misapplied the analysis and should have focused on the investors' knowledge and experience in the operation of oil and gas ventures.

Relatedly, this Court should also consider Defendants' indiscriminate solicitation of investors without regard for their experience in oil and natural gas ventures, *see* CF, p. 09644, a factor which strongly indicates that Defendants were looking for passive investors, not partners who could meaningfully and intelligently

exercise the rights of true coventurers. The Eastern District of Texas considered this issue. In *SEC v. Sethi Petroleum, LLC*, 229 F.Supp.3d 524 (E.D. Tex. 2017), *aff'd*, 910 F.3d 198 (5th Cir. 2018), the court held that the broad solicitation of "potential investors, and the investors' lack of knowledge at the time of the investment, [made] it [] clear that investors did not have the necessary experience in oil and gas to manage their own investment." *Id*. at 537. The same is true here.

The Court of Appeals' position that general business acumen is sufficient to maintain the presumption that an investor has meaningful control is misplaced and fails to comport with Colorado's economic realities approach. More consistent with Colorado law are precedents which hold that investors should in fact have the specific experience needed to run the business at issue.

b. The Investors Had No Real Ability to Replace the Defendants as Managers.

With respect to control over management of the partnership, the Court of Appeals held that "what ultimately matters is whether the partners realistically could exercise their power to replace the manager if they wanted to do so." *HEI II* at ¶ 52. The court placed a heavy emphasis on a wooden, inflexible interpretation that the sole consideration is whether, on paper, these disparate investors could somehow band together to wrest control from the Defendants. *Id*. However, removal powers alone are not sufficient. The investors must be able to control the venture once the Defendants are removed, or to replace the Defendants without the business collapsing

from a lack of collective knowledge. *See Williamson*, 645 F.2d at 423 (noting that even knowledgeable investors "may be left with no meaningful option when there is no reasonable replacement for the investment's manager ... [in such a situation] a legal right of control would have little value if the partners were forced to rely on the managers unique abilities").

Here, the Defendants made themselves irreplaceable by restricting the investors' access to information and providing illusory control over menial aspects of the venture. *See* CF, pp. 09644, 06973. Other courts have found that similar deficiencies render the persons at issue to be mere investors rather than partners. *See Sethi*, 229 F.Supp.3d at 538; *Merchant Capital*, 483 F.3d at 763. Defendants retained mineral rights, provided incomplete investment information including failing to disclose more than 27,000 dry wells in the operating area, refused or ignored requests for names and contact information for other investors, obscured the identity of the managing venturer's key personnel and ownership interests, removed financial data from drilling reports, hid budget and cost information from investors, refused to provide investors with access to financial information, and did not inform investors that a contractual provision allowed Defendants to arbitrarily set and control the amount raised per venture, which meant they were not at risk of losing money if a well did not produce. *See Petitioner Tung Chan Petition for Writ of* Certiorari, Court of Appeals Case No. 2018CA1769 at 4; *Rome v. HEI* Resources, Order of Judgement

for Case No. 2009CV7181 at11-17, 22-25, 27-29.

Incredibly, the Court of Appeals did not include these factors in its analysis, and simply stated without justification that the only necessary inquiry is whether the investors could replace the manager. *HEI II* at ¶ 52. That abdication of rigorous factual analysis demonstrates the failures of a presumption-based approach; the Court of Appeals did not analyze the very facts which show that the investors merely had nominal but illusory control over the venture. A close look at the facts shows that Defendants acted as the sole source of information and limited the investors' ability to obtain relevant facts, making it impossible for the investors to exercise their "control" and remove the manager without the investment falling apart. *See Sethi* at 538; *Williamson* at 424.

The position of the Court of Appeals is a significant deviation from established federal and Colorado law. The problem with such an approach has already been recognized by this Court when it previously held that an analysis which fails to take into account the economic realities of control, or lack thereof, would allow a promoter or manager to "avoid the applicable securities laws by simply including in their contracts provisions that give investors minimal opportunities to view business records and promised future involvement in the management of the proposed business opportunity." *Lawrence v. People,* 486 P.3d 269, 276 (Colo. 2021). Such a result is incompatible with the admonitions of this Court and the U.S. Supreme Court to focus

on the facts of each case to determine the economic realities of the transaction at issue. *See id.*; *Tcherepnin v. Knight,* 389 U.S. 332, 336 (1967).

c. Colorado's Economic Realities Approach Should Not Be Limited to Willamson's Non-Exhaustive Factors.

The Court of Appeals also erred by limiting its analysis to the three factors laid out in *Williamson*. *See HEI II* at ¶¶ 53-60. *Williamson* itself militates against this idea by stating that the three factors were the only ones "implicated by the facts of this case," and that "this is not to say that other factors could not also give rise to such a dependence on the promoter or manager that the exercise of partnership powers would be effectively precluded." *Williamson*, 645 F.2d at 424 & n.15. Colorado courts have not limited themselves to *Williamson's* factors, again retaining the "flexibility needed to regulate the various schemes devised by those who seek to use the money of others with the lure of profits." *Lowery*, 556 P.2d at 1205. In at least two cases, Colorado courts have included broad economic realities beyond *Willaimson*'s non-exclusive factors. *See Mieka* 282 P.3d at 514-15 (citing *Feigin*, 987 P.2d at 881). *Williamson* did not design a rigid framework to limit economic realities and shoehorn those considerations into its three factors. Limiting the economic realities test in this way neither aligns Colorado law with state or federal law, nor addresses the considerations under CSA § 11-51-101(3), to seek coordination in the application of the CSA.

d. Affirming the HEI II Opinion Could Enable Frauds and Encourage Unscrupulous Actors to Exploit the Lower Court's Reliance on Form Over Substance.

The very point of law cited above – in which courts scrutinize the economic realities of general partnership arrangements to determine whether investors truly have the control expected of general partners – is to nullify the unscrupulous tactic of structuring fraudulent enterprises to avoid application of the securities laws. Applying a presumption that favors issuers and promoters undermines both developed caselaw and the remedial intention of the CSA itself.

More practically, it could incentivize fraudsters who are already schooled in the arts of avoidance and deception to take advantage of a weakening of Colorado law. That in turn could draw fraudulent schemes to Colorado and make its citizens more likely to be victimized.

Of slightly lesser concern is the prospect that managers and promoters will structure ventures as general partnerships to avoid securities law disclosure requirements. While not necessarily fraudulent, arrangements designed to avoid disclosure obligations can also harm investors by obscuring risks and relieving managers from pressure of doing the work necessary to bring profits to an enterprise.

CONCLUSION

The Colorado Securities Act is designed to redress harms inflicted by bad actors and those who prey on the unknowledgeable and uninformed. *HEI II* significantly

alters Colorado law by enacting a heretofore unadopted presumption that general partnership interests are not securities. *HEI II* goes further by diluting the business acumen factor from industry specific knowledge to general business experience, and by emphasizing the nominal ability to replace a manager over the realities that prevented the investors from doing so. This Court should reject *HEI II's* imposition of a presumption and changes to the *Williamson* factors, and reaffirm a full economic realities approach to reviewing transactions in order to serve the underlying purpose of the CSA.

Last, to bring these considerations to the practical fore, it is important to recognize that oil and gas fraud is already a perennial problem. Colorado prosecutors and securities regulators need the strongest legal tools at their disposal to deter fraud and abuse of the general partnership form. Maintaining existing caselaw principles that flexibly apply securities provisions through unrestrained analyses of the economic realities of transactions is the best way to further the remedial purposes of the CSA, to limit transactions structured as general partnerships simply to avoid disclosure obligations, and to keep fraudsters out of Colorado.

Respectfully Submitted,

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