RECEIVED by MCOA 7/6/2022 2:21:00 PM

STATE OF MICHIGAN IN THE MICHIGAN COURT OF APPEALS

L.A. DEVELOPERS, LLC, a Florida Limited Liability Company, and DAVID BYKER, an Individual,

CORPORATIONS, SECURITIES, AND COMMERCIAL LICENSING BUREAU,

Petitioner-Appellees,

v.

STATE OF MICHIGAN, DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS
Kent County Circuit Court Case No. 20-002976-AA

Respondent-Appellant.

E. Thomas McCarthy (P28714)
John R. Oostema (P26891)
Johnathan B. Koch (P804408)
SMITH HAUGHEY RICE & ROEGGE
Attorneys for Petitioner-Appellees
100 Monroe Center, N.W.
Grand Rapids, MI 49503
(616) 774-8000
tmccarthy@shrr.com
joostema@shrr.com
jkoch@shrr.com

Dylan White Temporarily admitted pro hac vice North American Securities Administrators Association 750 First Street, NE, Suite 1140 Washington, DC 20002 dwhite@nasaa.org Brien Winfield Heckman (P76006) Assistant Attorney General Michigan Department of Attorney General Corporate Oversight Department Attorneys for Respondent-Appellant P.O. Box 30755 Lansing, MI 48909 (517) 373-7540

Court of Appeals Docket No. 358656

Daniel J. Broxup (P72868) MIKA MEYERS PLC Attorney for *Amicus Curiae* 900 Monroe Avenue NW Grand Rapids, MI 49503 (616) 632-8059 DBroxup@mikameyers.com

BRIEF OF AMICUS CURIAE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. IN SUPPORT OF STATE OF MICHIGAN, DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS - CORPORATIONS, SECURITIES, AND COMMERCIAL LICENSING BUREAU

TABLE OF CONTENTS

TABLE OF AUTHORITIES	ii
I. STATEMENT OF INTEREST OF AMICUS CURIAE	
II. SUMMARY OF ARGUMENT	2
III. ARGUMENT	4
A. The Risk Capital Factors were meant to augment Michigan's securities laws, not limit them.	4
B. The <i>Reves</i> test is consistent with the language and structure of the MUSA	10
1. There is no conflict between the "presumption" in <i>Reves</i> and the language of the MUSA	11
2. The <i>Reves</i> test is consistent with this Court's past decisions	12
3. Fixed income investments are securities under the MUSA.	13
C. The Bureau's application of the <i>Reves</i> test furthers the MUSA's principal objective to maximize uniformity among state and federal securities laws.	16
IV. CONCLUSION	20

TABLE OF AUTHORITIES

Cases

Ansorge v. Kellogg, 172 Mich App 63 (1988)
Apsey v. Memorial Hosp., 477 Mich 120 (2007)
Ascher v. Commonwealth, 408 SE2d 906 (Va Ct App 1991)
Bailey v. State, No. 08-02-00422-CR, 2008 WL 1914265 (Tex Ct App, May 1, 2008) (Unpublished)
Boo'ze v. State, No. 331,2003, 2004 WL 691903 (Del, March 25, 2004) (Table)
Bookhardt v. State, 710 So2d 700 (Fla Dist Ct App 1998)
Bucci v. Burns, No. 16-CVS-15478, 2018 WL 1975019 (NC Sup Ct, Apr. 25, 2018)
Caucus Distributors, Inc. v. Md. Sec. Comm'r, 577 A2d 783 (Md 1990)
Caucus Distributors, Inc. v. State, Dep't of Commerce and Econ. Dev., Div. of Banking, Sec. and Corps., 793 P2d 1048 (Alaska 1990)
Douglass v. Stanger, 2 P3d 998 (Wash Ct App 2000)
Elson v. Geiger, 506 F Supp 238 (ED Mich 1980)
Exchange Nat'l Bank of Chicago v. Touche Ross & Co., 544 F2d 1126 (1976)
Godair v. Place Vendome Corp. of America, 648 So2d 440 (La Ct App 1994)
Grotjohn Precise Connexiones Intern., S.A. v. JEM Financial, Inc., 12 SW3d 859 (Tex Ct App 2000)
In the Matter of the Desist and Refrain Order Issued Against: Trinity Inv. Grp., et al., OAH No. N2004050227 (Cal Dep't of Corps, Oct. 29, 2004)
In the Matter of the Desist and Refrain Order Issued To: William Benson Peavey, Jr., et al., OAH No. 201209224, 2013 WL 6054397 (Cal Dep't of Corps, Apr. 12, 2013)
Lahn v. Vaisbort, 369 P3d 85 (Or Ct App 2016)
MacCollum v. Perkinson, 913 P2d 1097 (Ariz Ct App 1996)
MacDonald v. State Farm Mut. Ins. Co., 419 Mich 146 (1984)
Mich Humane Soc. v. Natural Res. Comm'n, 158 Mich App 393 (1987)

Noyd v. Claxton, Morgan, Flockhart, & Vanliere, 186 Mich App 333 (1990)	10
People v. Breckenridge, 81 Mich App 6 (1978)	6, 10, 12, 18
People v. Cooper, 166 Mich App 638 (1987)	6, 9, 18
People v. Dempster, 396 Mich 700 (1976)	4, 17
People v. Van Zandt, 981 NYS2d 275 (NY Sup Ct 2014)	19
Perrysburg Twp. v. Rossford, 814 NE2d 44 (Ohio 2004)	12, 19
Pratt v. Kross, 555 P2d 765 (Ore. 1976)	(
Reinhart v. Boeck, 918 NE2d 382 (Ind Ct App 2009)	19
Reves v. Ernst & Young, 494 US 56 (1990)	2, 4, 11, 13
Saw Plastic, LLC v. Sturrus, No. 16-CVS-10068, 2017 WL 3686515 (NC Sup Ct, Aug. 25, 2017)	19
Schultz v. Rector-Phillips-Morse, Inc., 552 SW2d 4 (Ark 1977)	19
SEC v. C.M. Joiner Leasing Corp., 320 US 344 (1943)	
SEC v. Edwards, 540 US 389 (2004)	15
SEC v. Glenn W. Turner Enters., Inc., 474 F2d 476 (9th Cir. 1973)	6, 9, 15
SEC v. W.J. Howey Co., 328 US 293 (1946)	3, 6
Shiny Inv., LLC v. Zeoli, No. 1-20-1353, 2021 WL 5906043 (Ill Ct App, Dec. 14, 2021) (Unpublished)	19
Signature Bank v. Marshall Bank, No. A05-2337, 2006 WL 2865325 (Minn Ct App, Oct. 10, 2006)	19
Silver Hills Country Club v. Sobieski, 361 P2d 906 (Cal 1961)	9
Silvia v. Sec. Div., 810 NE2d 825 (Mass Ct App 2004)	19
State v. Friend, 40 P3d 436 (Nev 2002)	
State v. J.R.B., 239 P3d 1052 (Utah Ct App 2010)	
State v. Kelson, 345 P3d 1136 (Utah 2014)	12
State v. McGuire, 735 NW2d 555 (Wis Ct App. 2007)	12, 19
03146580 1	

State v. Tober, 841 P2d 206 (Ariz 1992)	19
Tcherepnin v. Knight, 389 US 332 (1967)	4
Thompson v. People, 471 P3d 1045 (Colo 2020)	19
United Housing Foundation, Inc. v. Forman, 421 US 837 (1975)	5
Waters v. Millsap, 465 SW3d 851 (Ark 2015)	19
<u>Statutes</u>	
15 USC § 77b(a)(1)	3
15 USC § 78c(a)(10)	3
2008 PA 551	17
MCL 451.2102c(c)	passim
MCL 451.2102c(c)(i)	passim
MCL 451.2201(g)	14
MCL 451.2202(1)(e)(ii)	14
MCL 451.2503(1)	12
MCL 451.2608(2)(b)	4
MCL 451.816 (repealed)	17
Other Authorities	
Circuit Court's February 12, 2021 Opinion and Order	10, 13, 15
Gov. William G. Milliken, Section By Section Analysis of Proposed Uniform Amendments (1977 SB 834)	
H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933)	5
NASAA 2019 Enforcement Report (Sept. 10, 2019)	2
NASAA 2020 Enforcement Report (Sept. 23, 2020)	2
Press Release, NASAA, NASAA Reveals Top Investor Threats for 2022 (Jan. 10, 2022)	2

Formula?, 18 W Rsrv L Rev 367 (1967)	
Unif. Sec. Act (1956), § 415	17
Unif. Sec. Act (1956), Official Code Comment to Sec. 101	17
Unif. Sec. Act (1956), Official Code Comment to Sec. 401(<i>l</i>)	17
Unif. Sec. Act (2002), § 102(28)(D)	10
Unif. Sec. Act (2002), § 608	18
Unif. Sec. Act (2002), Prefatory Note	18
Unif. Sec. Act. (2002). Official Comment 1 to Sec. 608	18

I. STATEMENT OF INTEREST OF AMICUS CURIAE¹

Formed in 1919, the North American Securities Administrators Association, Inc. ("NASAA") is the non-profit association of state, provincial and territorial securities regulators in the United States, Canada and Mexico. NASAA has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the US Virgin Islands. The Corporations, Securities, and Commercial Licensing Bureau of the Michigan Department of Licensing and Regulatory Affairs (the "Bureau"), the Respondent-Appellant in this proceeding, is a NASAA member.

The overriding mission of NASAA and its members is to protect investors, particularly retail investors, from fraud and abuse. NASAA's members are responsible for administering state securities laws, including by: qualifying and registering broker-dealers, investment advisers, and their agents and representatives; conducting routine and for-cause examinations and audits of registrants; and enforcing the securities laws in criminal, civil, and administrative enforcement actions. NASAA supports its members in carrying out their investor protection and regulatory duties by, *inter alia*, promulgating model rules and statutes, coordinating examination sweeps and multi-state enforcement actions, and commenting on legislative and rulemaking processes. NASAA also offers its legal analyses and policy perspectives to state and federal courts as *amicus curiae* in cases involving the interpretation of state and federal securities laws.

Like many states, Michigan has enacted a version of the Uniform Securities Act. *See* MCL 451.2101 *et seq.* NASAA's members, including the Bureau, share a common interest in ensuring that state securities laws based on the Uniform Securities Acts are interpreted correctly, and that

No part of this brief has been authored by a party or counsel to a party. No party or counsel to a party has made a monetary contribution intended to fund the preparation or submission of this brief.

03146580 1

investors are thereby protected from fraud and abuse. The need to protect investors is especially acute with regard to promissory notes, which are consistently reported as one of the top investor threats by NASAA members. *See*, *e.g.*, Press Release, NASAA, *NASAA Reveals Top Investor Threats for 2022* (Jan. 10, 2022), https://www.nasaa.org/61477/nasaa-reveals-top-investor-threats-for-2022/ (fraud related to promissory notes cited as one of the top four most frequently seen investor threats); NASAA 2020 Enforcement Report, at 7 (Sept. 23, 2020), https://www.nasaa.org/wp-content/uploads/2020/09/2020-Enforcement-Report-Based-on-2019-Data-FINAL.pdf ("In 2019, state securities regulators overwhelmingly reported that promissory notes were the products most often associated with new investigations as well as enforcement actions."); NASAA 2019 Enforcement Report, at 7 (Sept. 10, 2019), https://www.nasaa.org/wp-content/uploads/2019/11/2019-Enforcement-Report-Based-on-2018-Data-FINAL.pdf (noting that promissory notes were the "main securities product" used to facilitate the \$1.2 billion Woodbridge Ponzi scheme).

The Circuit Court's misinterpretation and misapplication of the Michigan Uniform Securities Act with respect to promissory notes is likely to severely impair the Bureau's ability to protect Michigan investors from these schemes and renders Michigan an outlier among state securities regulators. Allowing the Circuit Court's erroneous ruling to stand could undermine uniformity among state securities laws and could erode the ability of other jurisdictions to enforce their securities laws.

II. SUMMARY OF ARGUMENT

The Circuit Court was wrong to reject the Bureau's application of the "family resemblance" test, articulated in *Reves v. Ernst & Young*, 494 US 56 (1990) (the "*Reves* test"), to notes under the

Michigan Uniform Securities Act (the "MUSA"). Specifically, the Circuit Court erred in three primary ways.

First, the Circuit Court erred by treating the five factors listed in MCL 451.2102c(c)(i) (hereinafter, the "Risk Capital Factors") as the exclusive means to determine if an instrument is a security under the MUSA. The Circuit Court's conclusion suffers from two flaws. As an initial matter, the Court's reasoning assumes that the Legislature intended to restrict the definition of a security to five discrete factors. However, given the timing of the Legislature's addition of the Risk Capital Factors to the definition and the analytical trends in state securities law at the time, it is clear that the Legislature meant to add flexibility to the state's securities laws, not restrict them. The argument that the Risk Capital Factors comprise an exclusive test is also inconsistent with this Court's decisions applying other tests in determining what is or is not a security. Finally, this argument conflicts with the plain language of the MUSA today. In transitioning from Michigan's 1964 Uniform Securities Act to the current MUSA, the Legislature added the test articulated in SEC v. W.J. Howey Co., 328 US 293 (1946), to the definition of "security." That test is designed to answer precisely the same question as the "risk capital" test, and it is implausible that the Legislature intended one test to be exclusive of the other.

Second, the Circuit Court erred by concluding that the *Reves* test is inconsistent with the MUSA. The Circuit Court's conclusion to the contrary rests on a misinterpretation of *Reves* and the language of the MUSA in two ways. First, there is no conflict between the "presumption" in *Reves* and the language of the MUSA. Like the MUSA, the federal securities laws define the term "security" to expressly include notes, and that plain language applies "unless the context otherwise requires." *See* MCL 451.2102c(c); 15 USC § 77b(a)(1); 15 USC § 78c(a)(10). The *Reves* "presumption" was not a judicial creation, but merely a faithful reading of the plain language of

the statute. Second, the MUSA does not exclude instruments bearing a fixed rate of return from the definition of a security. To the contrary, the MUSA expressly recognizes that certain fixed income instruments are securities and defines narrow exemptions from its registration and filing requirements where the Legislature has determined that those requirements are not necessary to protect investors. Furthermore, reading the MUSA to exclude fixed income securities would lead to absurd results and drastically undermine the MUSA's goal of investor protection.

Third, the Circuit Court gives short shrift to the policy of uniformity underlying the MUSA. Uniformity among state and federal securities laws is a principal objective of the MUSA. *See* MCL 451.2608(2)(b). The Bureau's application of the *Reves* test furthers that principal objective, ensuring not only uniformity with federal law, but also uniformity with the overwhelming number of state courts that have considered the issue and chosen to apply *Reves*, in circumstances similar to those at issue in this case.

The Bureau's adoption and application of the *Reves* test was a reasonable interpretation of the statute and consistent with the MUSA's language, structure, and underlying policy. The Circuit Court erred in reversing the Bureau's final order and should be reversed.

III. <u>ARGUMENT</u>

A. The Risk Capital Factors were meant to augment Michigan's securities laws, not limit them.

Like other state and federal securities laws, the MUSA is remedial in nature and is designed to protect investors from fraud and abuse. As such, its provisions "should be construed broadly to effectuate its purposes." *Cf. People v. Dempster*, 396 Mich 700, 704 (1976) (citing *Tcherepnin v. Knight*, 389 US 332, 336 (1967)). In 1978, the Legislature amended Michigan's 1964 Uniform Securities Act to add the Risk Capital Factors to the definition of "security." *See Prince v. Heritage Oil Co.*, 109 Mich App 189, 196 (1981). Appellees contend that the Risk Capital Factors 03146580 1

are "the correct test" to determine whether a note is a security under the MUSA. *See* Appellee's Br. at 10. In other words, Appellees would urge this Court to treat these factors as the exclusive *sine qua non* of a security under the MUSA. However, this argument has no grounding either in the language of the statute or the development of state securities jurisprudence.

The Legislature did not draft or adopt the Risk Capital Factors in a vacuum. These factors represent a modified version of what was at the time a relatively new test to identify a security in the form of an "investment contract," known as the "risk capital" test. In the late 1960s and early 1970s, that test developed as an alternative to the prevailing *Howey* test, and courts in other states had begun to adopt the test under their respective statutes. Given the timing of the amendment, contemporary developments in the law (as further explained below), and the analytical trend in state securities laws, it is clear that the Legislature intended the Risk Capital Factors to augment Michigan's securities laws in light of contemporaneous reasoning that was being adopted in other jurisdictions.

The securities laws universally define the term "security" broadly. *See*, *e.g.*, *United Housing Foundation, Inc. v. Forman*, 421 US 837, 847-48 (1975) (quoting H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)) (noting that Congress "sought to define 'the term "security" in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security"). The definition "include[s] by name or description many documents in which there is common trading for speculation or investment." *SEC v. C.M. Joiner Leasing Corp.*, 320 US 344, 351 (1943). Although "[s]ome, such as notes, bonds, and stocks, are pretty much standardized and the name alone carries well settled meaning[,] [o]thers are of more variable character and were necessarily designated by more descriptive terms, such as 'transferable share,' 'investment contract,' and 'in 031465801

general any interest or instrument commonly known as a security." *Id.* State and federal courts have developed various tests to ascertain whether an instrument outside of those with standardized meanings falls within the intended scope of the securities laws.

One such test is the *Howey* test. In *Howey*, the US Supreme Court developed a four-part test to ascertain whether an instrument fell within the definition of an "investment contract." Under that test, an investment contract is "a contract, transaction or scheme whereby a person [1] invests his money [2] in a common enterprise and [3] is led to expect profits [4] solely from the efforts of the promoter or a third party." *Id.* at 298-99. The *Howey* court derived its test from the approach taken under state "blue sky" laws existing before the Securities Act of 1933, noting that "[f]orm was disregarded for substance and emphasis was placed upon economic reality." *Id.* at 298.² This framework was intended to "embod[y] 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." *Id.* at 299.

Over time, the *Howey* test became subject to criticism due to concerns that it was overly technical in its application, particularly with respect to the ostensible requirement that profits come "solely" from the efforts of others.³ *See*, *e.g.*, *Pratt v. Kross*, 555 P2d 765, 772-73 (Ore. 1976); *State v. Haw. Mkt. Center, Inc.*, 485 P2d 105, 108-11 (Haw 1971). Thus, certain courts and legal scholars developed the "risk capital" test – referred to in some cases as the "modern test," *see*, *e.g.*, *Elson v. Geiger*, 506 F Supp 238, 241 (ED Mich 1980) – aiming to make the analysis broader,

This Court applied the *Howey* test in *People v. Cooper*, 166 Mich App 638, 646-50 (1987) (citing *People v. Breckenridge*, 81 Mich App 6 (1978)). Notably, *Cooper* was decided after the Legislature included the Risk Capital Factors in the definition of "security."

The federal courts have since clarified that the word "solely" is not to be read literally. The relevant inquiry is "whether 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 Enters.*, *Inc.*, 474 F2d 476, 482 (9th Cir. 1973). *Accord Cooper*, 166 Mich App at 646-50.

more flexible, and to elevate the fundamental policy of broad investor protection in the analysis. *See*, *e.g.*, *Haw. Mkt. Center*, 485 P2d at 108-11; Ronald J. Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W Rsrv L Rev 367 (1967), available at https://scholarlycommons.law.case.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=446 5&context=caselrev.

In a 1967 article, Professor Ronald J. Coffey, then-Assistant Professor of Law at Western Reserve University, ⁴ developed an analytical framework that focused chiefly on the investor's risk of losing her initial capital investment. Among Professor Coffey's chief criticisms of *Howey* were its lack of focus on the investor's risk of loss (the "risks of an enterprise"), the ambiguity of the phrase "common enterprise," and *Howey*'s emphasis on the inducement of future "profits." *See* Coffey, *supra*, at 374-375, 375 n.42, and 377-78. Professor Coffey thus offered a five-part test, under which a security is

- (1) a transaction in which
- (2) a person (the "buyer") furnishes value (the "initial value") to another (the "seller"); and
- (3) a portion of initial value is subjected to the risks of an enterprise, it being sufficient if
 - (a) part of the initial value is furnished for a proprietary interest in, or a debt-holder claim against, the enterprise, or
 - (b) any property received by the buyer is committed to use by the enterprise, even though the buyer retains specific ownership of such property, or
 - (c) part of the initial value is furnished for property whose present value is determined by taking into account the anticipated but unrealized success of the enterprise, even though the buyer has no legal relationship with the enterprise; and

Western Reserve University and Case Institute of Technology "federated" in 1967 to form Case Western Reserve University. *See* Case W. Rsrv. Univ., *The Story of CWRU*, https://case.edu/studentlife/about/history-and-traditions/story-cwru (last visited July 4, 2022).

- (4) at the time of the transaction, the buyer is not familiar with the operations of the enterprise or does not receive the right to participate in the management of the enterprise; and
- (5) the furnishing of the initial value is induced by the seller's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above initial value, will accrue to the buyer as a result of the operation of the enterprise.

Id. at 377.

In *Haw. Mkt. Center*, the Supreme Court of Hawaii confronted the question of whether contracts for participation in a multi-level marketing scheme, under which participants would earn fixed fees and commissions primarily for recruiting other participants, was an "investment contract." 485 P2d at 106-08. Given the obvious control of the putative investors in the generation of their expected profits, the court observed that courts applying *Howey* had become "entrapped in polemics over the meaning of the word 'solely' and fail[ed] to consider the more fundamental question whether the statutory policy of affording broad protection to investors should be applied" under the circumstances. *Id.* at 108. Accordingly, and relying in part on Professor Coffey's work, the court adopted the "risk capital" test, in which an investment contract is created whenever

- (1) an offeree furnishes initial value to an offeror, and
- (2) a portion of this initial value is subjected to the risks of the enterprise, and
- (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and
- (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.

Id. at 109 (citing Coffey, *supra*, among other authorities).

At the time the Legislature added the five-factor "risk capital" test to Michigan's Uniform Securities Act, the contemporary understanding of this amendment was that it "should be read in

light of" the seminal cases on that test including Haw. Mkt. Center, 5 and that Professor Coffey's analysis was "a prime basis behind the development of this modified risk capital theory." See Gov. William G. Milliken, Section By Section Analysis of Proposed Uniform Securities Act Amendments (1977)SB19, 834), available at at https://lmdigital.contentdm.oclc.org/digital/collection/p16110coll6/id/114802/rec/1. As such, it is clear that the Legislature intended to adopt what many expected to be an improved test to determine the economic realities of a transaction to determine if a security is involved. The Legislature retained this language when it enacted the current version of the MUSA. As such, the current definition explicitly includes both the *Howey* and "risk capital" tests. MCL 451.2102c(c)(i), (v). Therefore, the trend of the Michigan Legislature has been to add flexibility and reach to Michigan's securities laws rather than to seek limitations or to harden definitions.

Furthermore, Michigan courts have not treated the five-factor test as the exclusive means to identify a security under the MUSA. For example, in *Prince*, this Court found that it was "not necessary" to utilize the Risk Capital Factors and relied instead on the axiomatic "general principle" that courts must focus on the "real nature of the transaction" and the "real intent and purpose of the parties." 109 Mich App at 197. This Court held that "the purpose of executing the documents was to secure plaintiffs' investment in a risky venture, exactly the type which the Uniform Securities Act was designed to regulate," and thus the investments constituted securities. *Id.* at 199. This Court also did not apply the five-factor test in *People v. Cooper*, 166 Mich App 638 (1987), but rather applied the *Howey* test to hold that a multi-level marketing scheme involved

See also Silver Hills Country Club v. Sobieski, 361 P2d 906 (Cal 1961) (holding that membership interests in a country club were a security where the proceeds financed completion of the club, finding that the purchasers contributed "risk capital"); *Turner*, 474 F2d at 482 (noting that "[s]trict interpretation of the requirement that profits to be earned must come 'solely' from the efforts of others has been subject to criticism [and] could result in a mechanical, unduly restrictive view of what is and what is not an investment contract") (citing *Haw. Mkt. Center*).

the use of securities. *Id.* at 646-50. To argue that the five-factor test is the "correct" and therefore exclusive test – as Appellees do – is contrary to the manner in which this Court has applied the securities laws in previous cases.

Finally, while the Risk Capital Factors could arguably have been construed as the only available test when those were the only factors expressly "include[d]" within the definition, that is no longer the case in the current MUSA. Among other changes made in the 2002 Act, the drafters added language expressly including instruments meeting the *Howey* test, as interpreted in later decisions, within the definition of "security." Unif. Sec. Act (2002), § 102(28)(D). Legislature incorporated this change when it adopted the Uniform Securities Act of 2002 Act in 2008. See MCL 451.2102c(c)(v). It is wholly implausible that the Legislature intended the Risk Capital Factors in MCL 451.2102c(c)(i) to be the single "correct test" for any form of security in the definition when the Legislature explicitly included the competing *Howey* test in the definition as well. Instead, the right way to read the use of the Risk Capital Factors in the MUSA is that it is meant to be just one approach among others to help determine when an instrument is a security.

B. The Reves test is consistent with the language and structure of the MUSA.

The Circuit Court rejected the Bureau's adoption of *Reves* in part because, in the court's view, "Michigan law does not 'presume' that a note is a security under the MUSA" and "Michigan cases do not consider a fixed rate of interest . . . 'profit.'" Circuit Court's February 12, 2021 Opinion and Order ("February 12 Order") (Appellant's App'x at 11). The Circuit Court's conclusions rest on a misinterpretation of both Reves and the MUSA.

10

031465801

For these reasons, the Circuit Court's reliance on Breckenridge and Ansorge v. Kellogg, 172 Mich App 63 (1988), is misplaced. See Circuit Court's September 2, 2021 Opinion and Order (Appellant's App'x at 1-4); Circuit Court's February 12, 2021 Opinion and Order ("February 12 Order") (Appellant's App'x at 10-13). Those cases, as well as Noyd v. Claxton, Morgan, Flockhart, & Vanliere, 186 Mich App 333 (1990), interpreted materially different statutes from MUSA as it exists today, and they should be accorded little weight in this proceeding.

1. There is no conflict between the "presumption" in *Reves* and the language of the MUSA.

In *Reves*, the US Supreme Court resolved a split among the federal Courts of Appeals regarding the proper approach to determine whether a note is a security under the federal securities laws. 494 US at 64-65. After appraising the various approaches taken by the Courts of Appeals, the *Reves* court adopted the Second Circuit's "family resemblance" approach. *Id.*⁷ Under that approach, a note is presumed to be a security because it is included in the statutory definition, and that presumption may be rebutted only by showing that the note "bears a strong resemblance" to an instrument on a judicially crafted list of exceptions. *Id.* at 67.

The "presumption" in *Reves* was not a judicial creation, but merely a faithful application of the statutory text. The Second Circuit's decision in *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F2d 1126 (1976), clearly details the textual basis for its family resemblance test, including the basis for the "presumption" established by the *Reves* court. After considering and identifying the deficiencies in the various "investment versus commercial" approaches applied by federal courts, the Second Circuit concluded that "the best alternative now available may lie in greater recourse to the statutory language." *Exchange Nat'l Bank*, 544 F2d at 1137 (emphasis added). The court explained further that

The [Securities Exchange Act of 1934] says that the term "security" includes "any note . . . (excepting one) which has a maturity at the time of issuance of not exceeding nine months," and the [Securities Act of 1933] says that the term means "any note" save for the registration exemption in [15 USC § 77c(a)(3)]. These are the plain terms of both acts, to be applied "unless the context otherwise requires." A party asserting that a note of more than nine months maturity is not within the 1934 Act (or that a note with a maturity of nine months or less is within it) or that

The *Reves* court explicitly "reject[ed] the approaches of those courts that have applied the *Howey* test to notes" because that test was developed to determine whether an instrument is an "investment contract" and "[t]o hold that a 'note' is not a 'security' unless it meets a test designed for an entirely different variety of instrument would make the Acts' enumeration of many types of instruments superfluous." *Id.* (internal quotations omitted).

any note is not within the anti-fraud provisions of the 1933 Act has the burden of showing that "the context otherwise requires."

Id. at 1137-38 (emphasis added).

The MUSA defines the term "security" in substantially identical language: "unless the context otherwise requires . . . '[s]ecurity' means a note" MCL 451.2102c(c). Furthermore, unlike the federal securities laws, the MUSA explicitly allocates the burden to prove the applicability of an exception or exclusion from its terms to the person claiming it. *See* MCL 451.2503(1). Thus, contrary to the Circuit Court's decision in this case, there is no need for the courts to establish a "presumption" that a note is a security because the plain language of the relevant statute has already done so.

Other states have also recognized a similar presumption based on the same language in their own securities statutes. *See*, *e.g.*, *Perrysburg Twp. v. Rossford*, 814 NE2d 44, 47-50 (Ohio 2004) (holding that "promissory" notes and other instruments listed within the definition are "presumptively securities" and concluding based on *Reves* that the purchaser of a fixed-rate note had done so as an investment); *State v. McGuire*, 735 NW2d 555, 559 (Wis Ct App. 2007) (holding that the definition "establishe[d] the presumption that every note is a security," and concluding based on *Reves* that the investor's motive was to make a profit and a reasonable investor would have considered the transaction an investment because the promised interest rate was higher than commercial interest rates, despite a fixed rate of return); *State v. Kelson*, 345 P3d 1136, 1138 (Utah 2014) (holding that instructing a jury that "a 'note' is presumed to be a security" was merely "an accurate statement of law" and not improper burden-shifting in a criminal case).

2. The Reves test is consistent with this Court's past decisions.

In *People v. Breckenridge*, 81 Mich App 6 (1978) this Court found that "the nature of the transaction between defendant and Amway [Corporation] strongly suggests a loan was made," 03146580 1

rather than notes purchased for investment purposes. *Id.* at 14. That conclusion was based in large part on the facts that the defendant sought to obtain loans from Amway to fund construction projects, that Amway made loans to the defendant in exchange for a series of short-term notes, that the notes "would [purportedly] be secured by shares in defendant's Investor's Stock Fund Account," and that the defendant later granted Amway a security interest in several thousand shares of stock of the company for which he was a manager. See id. at 9. Indeed, it would be wholly consistent to interpret this case in light of the family resemblance test articulated in *Reves* because this arrangement was a "short-term note secured by a lien on a small business or some of its assets." Reves, 494 US at 65. Rather than supporting Appellees' argument, Breckenridge shows that this Court excepts the same sorts of notes from the definition of a "security" as does federal precedent. Similarly, it would be wholly consistent to read this Court's decision in Ansorge, 172 Mich App 63 (1988), in light of the Reves test because the notes in Ansorge would likely not be securities under Reves, as "note[s] which simply formalize[] an open-account debt incurred in the ordinary course of business." See Reves, 494 US at 65; Ansorge, 172 Mich App at 65-66 (explaining that the notes in question formalized amounts owed to cherry growers for previously delivered cherries).

3. Fixed income investments are securities under the MUSA.

The Circuit Court also contends that under the MUSA, "where a note pays a fixed rate of interest, the lender's capital is not subjected to the risk of the enterprise and therefore the note is not a security." February 12 Order (Appellant's App'x at 12) (citing *Ansorge*, 172 Mich App 63). The Circuit Court is fundamentally wrong for three reasons.

First, the Circuit Court's interpretation would effectively exclude large swaths of investments paying a fixed rate of return from the definition of "security," such as US Treasury 03146580 1

bonds and privately-issued bonds, debentures, and other common debt securities, despite such instruments being expressly included within the definition in MCL 451.2102c(c). That result does not make sense. "When determining legislative intent, statutory language should be given a reasonable construction considering the statute's purpose and the object sought to be accomplished Statutes are to be construed so as to avoid absurd consequences." *Mich Humane Soc. v. Natural Res. Comm'n*, 158 Mich App 393, 401 (1987). In sum, the Circuit Court's interpretation would effectively remove the entire category of fixed income securities and investments from the scope of the MUSA. This cannot be the Legislature's intent. A plain reading of the statute – that the MUSA explicitly embraces instruments that have either variable or fixed rates of return as securities – would avoid such absurd results.

Second, the conclusion that a fixed rate of return precludes finding a security is irreconcilable with the plain language in multiple other provisions. For instance, the MUSA provides an express exemption from the statute's securities registration and filing requirements for transactions involving "a security that . . . [h]as a fixed maturity or a fixed interest or dividend," but only where certain conditions are met. MCL 451.2202(1)(e)(ii). In other words, "a security that . . . [h]as a fixed maturity or a fixed interest or dividend" must be registered or otherwise exempt before it can be sold in or from Michigan. In another provision, the MUSA expressly exempts from its registration and filing requirements "[a] security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, social, athletic, or reformatory purposes, or as a chamber of commerce, and not for pecuniary profit, no part of the net earnings of which inures to the benefit of a private stockholder or other person." MCL 451.2201(g) (emphasis added). Notably, in both instances above the MCL recognizes that these forms of fixed income instruments are securities, and from there defines narrow registration on the securities of fixed income instruments are securities, and from there defines narrow registration of the securities of fixed income instruments are securities, and from the securities of the securities of the securities of fixed income instruments are securities, and from the securities of t

exemptions. Further, nonprofit securities such as those covered by the latter exemption would necessarily fail to meet the five-factor test in MCL 451.2102c(c)(i) to the extent that, as the Circuit Court implies, a variable-rate "profit" is a prerequisite to find that the invested capital is "subject to the risk of the enterprise." *See* February 12 Order (Appellant's App'x at 12). The conflict is obvious: if such instruments can never be securities, then they can never be subject to the MUSA's registration and filing requirements and these provisions are superfluous and nugatory. *See Apsey v. Memorial Hosp.*, 477 Mich 120, 127 (2007) ("Whenever possible, every word of a statute should be given meaning" and "no word should be treated as surplusage or made nugatory.").

Since a plain reading of the statute would not exclude fixed rates of return from the definition of "security," this Court should not read such a limitation into the statute. As explained above, this interpretation would essentially exclude all fixed-income investments from the coverage of MUSA. Adherence to this interpretation would make it easy for wrongdoers to evade the MUSA by promising exorbitant fixed, rather than variable, returns. Such a result ignores statutory text and precedent in order to reach a result that is inconsistent with the goal of investor protection. *Cf. Turner*, 474 F2d at 482. This interpretation would also severely inhibit the Bureau's ability to protect some of the most vulnerable investors, such as older people, individuals experiencing diminished capacity, and others whose low risk tolerance and income needs require them to invest substantially in fixed income securities or products marketed as providing such income.

In this regard, the US Supreme Court's decision in *SEC v. Edwards*, 540 US 389 (2004), is instructive. In that case, the court considered the Court of Appeals' holdings that (1) the "profits" prong of the *Howey* test requires "either capital appreciation or a participation in the earnings of the enterprise, and thus [excludes] schemes . . . offering a fixed rate of return," and (2) 03146580 1

the requirement that the expected return be "derived solely from the efforts of others" was not satisfied when the purchasers had a contractual entitlement to the return. *Edwards* 540 US at 392-93. The Supreme Court held that the lower courts had erred in both respects. To the first point, the Court found that "[t]here is no reason to distinguish between promises of fixed returns and promises of variable returns [because,] [i]n both cases, the investing public is attracted by representations of investment income" *Id.* at 394. The Court further noted that "investments pitched as low-risk (such as those offering a 'guaranteed' fixed return) are particularly attractive to individuals more vulnerable to investment fraud, including older and less sophisticated investors." *Id.* To the latter point, the Court explained that "[t]he fact that investors have bargained for a return on their investment does not mean that the return" is not dependent on successful management of the enterprise by others. *Id.* at 397. This is akin to the "risks of the enterprise" prong of the five-factor "risk capital" test in MCL 451.2102c(c)(i).

In sum, the MUSA does not exclude investments from the definition of a security, nor from the intended reach of the Michigan's securities laws, solely on the basis that they offer fixed rates of return. Indeed, the MUSA's plain language includes certain such investments as securities. This Court should not read such a limitation into the statute.

C. <u>The Bureau's application of the Reves test furthers the MUSA's principal objective to maximize uniformity among state and federal securities laws.</u>

When the Michigan Legislature adopts the language of a uniform or model act, "it is evident that the Legislature [is] cognizant of, and in agreement with, the policies which underlie the model act['s] language." *MacDonald v. State Farm Mut. Ins. Co.*, 419 Mich 146, 151 (1984). In this case, the Legislature has adopted not one, but two versions of the Uniform Securities Act.

Specifically, the Legislature has, at different times, adopted the Uniform Securities Act of 1956 (the "1956 Act") and the Uniform Securities Act of 2002 (the "2002 Act").

In 1964, Michigan enacted a "Uniform Securities Act," replacing Michigan's then-40-year-old "blue sky" law. *See Dempster*, 396 Mich at 704. The 1964 statute "substantially follow[ed] the language of the [1956 Act]." *Id. See also* MCL 451.816 (repealed) ("This act shall be known and may be cited as the 'uniform securities act.""). In 2008, the Legislature enacted the MUSA, specifically adopting the 2002 Act and repealing the 1964 statute. 2008 PA 551 (Appellee's App'x at 401a).

The 1956 Act⁸ was developed "to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this act with the related federal legislation." Unif. Sec. Act (1956), § 415. Although the 1956 Act was not wholly identical to the federal securities statutes, it nonetheless substantially borrowed several provisions. *See*, *e.g.*, Unif. Sec. Act (1956), Official Code Comment to Sec. 101 ("This section is substantially [SEC Rule 10b-5], which in turn was modeled upon § 17(a) of the Securities Act of 1933, except that the rule was expanded to cover the purchase as well as the sale of any security"), Official Code Comment to Sec. 401(*l*)⁹ ("This subsection [defining the term 'security'] is identical with § 2(1) of the Securities Act of 1933, 15 USC § 77b(1), ¹⁰ except for oil, gas and mineral interests and the addition of the last sentence [excluding insurance products].").

The 1956 Act, as amended in 1958 by the National Conference of Commissioners on Uniform State Laws and from time to time by NASAA, is available at https://www.nasaa.org/wp-content/uploads/2011/08/UniformSecuritesAct1956withcomments.pdf.

NASAA amended the 1956 Act in 1981 to add a definition of the term "investment adviser representative" in subsection (g). As a result, the definition of "security" was shifted to subsection (m).

The National Securities Markets Improvement Act of 1996 ("NSMIA") added subsection (b) to this section of the Securities Act of 1933. *See* Pub. L. No. 104-290, § 106 (Oct. 11, 1996). Pre-1996 references to section 2(1) of the Securities Act of 1933 should be read to refer to Section 2(a)(1) of that statute as it exists today.

The 2002 Act¹¹ was developed in large part "to modernize the Uniform Securities Act" as a result of "a combination of the new federal preemptive legislation, ¹² significant recent changes in the technology of securities trading and regulation, and the increasingly interstate and international aspects of securities transactions." Unif. Sec. Act (2002), Prefatory Note at 1. In the 2002 Act, one of the drafters' "key aspiration[s]" was "drafting language to achieve the greatest practicable uniformity, given differences in state practice." *Id.* at 2. Although the 2002 Act was "a new Uniform Securities Act," rather than an "[a]mendment of the earlier 1956 Act... several sections of [the 2002 Act] are identical or substantively identical to sections of the 1956 Act...." *Id.* at 1. As with the 1956 Act, the objective of uniformity in federal and state securities laws was a "principal objective" of the 2002 Act. Unif. Sec. Act (2002), § 608 and Official Comment 1. *See also id.*, Prefatory Note at 3 ("Section 608 articulates in greater detail than the 1956 Act's Section 415 the objectives of uniformity, cooperation among relevant state and federal governments and self-regulatory organizations, investor protection and, to the extent practicable, capital formation.").

Given both the uniformity of language among state and federal securities laws, and the explicit policy prescriptions to apply those laws in a uniform fashion, it is not uncommon for Michigan courts interpreting the MUSA to rely on interpretations given by other state and federal courts to similar provisions. *See*, *e.g.*, *Cooper*, 166 Mich App at 646-50 (applying the US Supreme Court's *Howey* test, as further interpreted by federal courts); *Breckenridge*, 81 Mich App at 16-17

_

The 2002 Act is available at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=04ece01b-d3d9-751d-9925-e5c4ca6c104f&forceDialog=0.

 $^{^{12}}$ See, e.g., NSMIA, Pub. L. No. 104-290, \S 103; Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353 (Nov. 3, 1998).

("[T]he similarity of the purpose and provisions of the state and Federal securities statutes, particularly those purposes and provisions pertinent to the facts at hand, cannot be ignored. Interpretation of one offers valuable guidelines as to the interpretation of the other.").

The Bureau's application of the *Reves* test furthers these fundamental goals. In addition to being consistent with federal securities law, the Bureau's approach is consistent with courts in at least twenty-one other states that have adopted or applied *Reves* to notes under their respective securities statutes.¹³ In contrast, the Circuit Court's and the Appellees' interpretation of the MUSA

¹³

See, e.g., Caucus Distributors, Inc. v. State, Dep't of Commerce and Econ. Dev., Div. of Banking, Sec. and Corps., 793 P2d 1048, 1055 (Alaska 1990); MacCollum v. Perkinson, 913 P2d 1097, 1104 (Ariz Ct App 1996); Thompson v. People, 471 P3d 1045, 1048-49 (Colo 2020) (finding a fixed-rate note to be a security); Boo'ze v. State, No. 331,2003, 2004 WL 691903, at **2-3 (Del, March 25, 2004) (Table); Bookhardt v. State, 710 So2d 700, 701 (Fla Dist Ct App 1998); Shiny Inv., LLC v. Zeoli, No. 1-20-1353, 2021 WL 5906043, at **15-17 (III Ct App, Dec. 14, 2021) (Unpublished); Reinhart v. Boeck, 918 NE2d 382, 392-96 (Ind Ct App 2009); Godair v. Place Vendome Corp. of America, 648 So2d 440, 444-45 (La Ct App 1994) (holding that the trial court properly found that a fixed-return note was a security); Caucus Distributors, Inc. v. Md. Sec. Comm'r, 577 A2d 783, 788-91 (Md 1990) (applying Reves and rejecting the argument that "the repayment of principal plus a fixed rate of interest is not an expectation of profits"); Silvia v. Sec. Div., 810 NE2d 825, 831-32 (Mass Ct App 2004); Signature Bank v. Marshall Bank, No. A05-2337, 2006 WL 2865325, at **6-7 (Minn Ct App, Oct. 10, 2006); State v. Friend, 40 P3d 436, 437-38 (Nev 2002); People v. Van Zandt, 981 NYS2d 275, 279-81 (NY Sup Ct 2014) (finding that the issuer of fixed-rate notes had failed to overcome the presumption); Bucci v. Burns, No. 16-CVS-15478, 2018 WL 1975019, at *10 (NC Sup Ct, Apr. 25, 2018) ("The [N.C. Securities Act] further defines "[s]ecurity" to include "any note," which raises a rebuttable presumption that every note is a security[.]") (internal citations omitted); Saw Plastic, LLC v. Sturrus, No. 16-CVS-10068, 2017 WL 3686515, at **7-8 (NC Sup Ct, Aug. 25, 2017) (applying Reves); Rossford, 814 NE2d at 49; Lahn v. Vaisbort, 369 P3d 85, 96 (Or Ct App 2016); Grotjohn Precise Connexiones Intern., S.A. v. JEM Financial, Inc., 12 SW3d 859, 868-70 (Tex Ct App 2000) (finding that "[a] favorable interest rate indicates that profit was the primary goal of the lender"); Bailey v. State, No. 08-02-00422-CR, 2008 WL 1914265, at **2-4 (Tex Ct App, May 1, 2008) (Unpublished), (finding that "[fixed-rate] certificates of deposit . . . issued by an offshore, shell bank with no federal regulation and no insurance are securities"); State v. J.R.B., 239 P3d 1052, 1055-58 (Utah Ct App 2010) (applying Reves "without deciding whether Utah should adopt that test," and accepting that Utah's statute establishes a presumption that every note is a security); Ascher v. Commonwealth, 408 SE2d 906, 917-19 (Va Ct App 1991); Douglass v. Stanger, 2 P3d 998 (Wash Ct App 2000); McGuire, 735 NW2d at 567. See also In the Matter of the Desist and Refrain Order Issued To: William Benson Peavey, Jr., et al., OAH No. 201209224, 2013 WL 6054397, at **11-12 (Cal Dep't of Corps April 12, 2013); In the Matter of the Desist and Refrain Order Issued Against: Trinity Inv. Grp., et al., OAH No. N2004050227, at *44 (Cal Dep't of Corps, Oct. 29, 2004), available at https://dfpi.ca.gov/wp-content/uploads/sites/337/2014/01/trinity-OAH-Amended-Decision.pdf. But see Waters v. Millsap, 465 SW3d 851, 858 (Ark 2015) ("declin[ing] to adopt the Reves test because [the Reves] factors are embraced within our flexible, all-inclusive Schultz test"); Schultz v. Rector-Phillips-Morse, Inc., 552 SW2d 4, 10 (Ark 1977) (holding that Arkansas courts should "determine in each instance from a review of all of the facts, whether" the instrument is a security within the scope of the statute); State v. Tober, 841 P2d 206, 207-08 and n.5 (Ariz 1992) (holding that "we do not need the [risk capital] test, the Reves test, or any variant to tell us when a note is not a security" for purposes of enforcement of statutory provisions prohibiting the sale of unregistered securities, but leaving open whether the *Reves* test, or other judicially created tests, apply to enforcement of the antifraud provisions).

would make Michigan an outlier among state securities regulators and undermines one of the core policies of the statute. As explained above, neither the MUSA's language nor its structure support, let alone compel, such a result.

IV. <u>CONCLUSION</u>

The Bureau's application of the *Reves* family resemblance test was consistent with the language, structure, and underlying policy of the MUSA. In rejecting the Bureau's approach, the Circuit Court misconstrued the MUSA and failed to take into account much of the statute's plain language and its fundamental policy of uniformity among state and federal securities laws. For the reasons explained above, this Court should reverse the Circuit Court and uphold the Bureau's interpretation of the law.

Respectfully submitted,

MIKA MEYERS, PLC Attorney for *Amicus Curiae*

DATED: July 6, 2022

Daniel J. Broxup (P72868) 900 Monroe Ave. NW Grand Rapids, MI 49503 (616) 632-8000

Dylan White Assistant General Counsel North American Securities Administrators Association 750 First Street, NE, Suite 1140 Washington, DC 20002 dwhite@nasaa.org

* Temporarily admitted pro hac vice