IN THE SUPERIOR COURT OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

STATE OF DELAWARE,	)	
	)	
v.	)	I.D. No. 1303009480
	)	
DAVID ATTARIAN,	)	
	)	
Defendant.	)	

Submitted: March 19, 2014
Decided: September 8, 2014

Defendant's Motion to Dismiss – DENIED

MEMORANDUM OPINION

Owen Lefkon, Esquire, Delaware Department of Justice, Carvel State Office Building, 820 N. French Street, 5th Floor, Wilmington, DE 19801. Attorney for the State.

Thomas A. Foley, Esquire, 1905 Delaware Avenue, Wilmington, DE 19806. Attorney for Defendant.

CARPENTER, J.

FACTUAL BACKGROUND

On or about April 19, 2010, the Securities Division of the Delaware Department of Justice initiated an investigation into Defendant's business activities. The investigation led to the State filing a 23-count indictment, which was returned by the Grand Jury on March 18, 2013. Within the indictment are thirteen counts based on violations of the Delaware Securities Act and ten counts alleging theft and tax evasion during various times from October 2006 through the 2009 calendar year. During that period of time, Defendant allegedly induced multiple individuals to invest money in his house-flipping business by issuing them promissory notes and promising high rates of return.

During the time period of the allegations, Defendant was a Delaware-licensed real estate agent employed by Keller Williams Realty, Inc. Defendant also maintained two side businesses: Rapid Restorations, Inc. and D&B Acquisitions, LLC. Through these side businesses Defendant bought, renovated, and sold or leased residential property for a profit. To finance these purchases and renovations Defendant received money from four individuals named in the indictment. For the transactions relevant here, promissory notes were executed and the individuals were promised large payments and/or high rates of return on their loans/investments. The promissory notes also provided that they were

secured by properties owned by Defendant; however, some of the properties were never owned by Defendant, and the securities were never perfected or were subject to prior existing liens.

The four individuals named in the indictment did not receive the promised returns and, in most cases, lost the entire value of their investments. Although both the State and Defendant provide detailed explanations of the specific transactions of each individual, the Court finds such recitation unnecessary here. The parties will be given ample time at trial to flesh out how and in what manner Defendant came upon the monies from the individuals named in the indictment, the promises made thereto, and the forms of the transactions made therewith. For purposes of the pending Motions, the Court finds such factual underpinning unnecessary for disposition and the disputed nature of those transactions will be left to the jury or the Court to sort out at trial.

DISCUSSION

Defendant's Motion to Dismiss involves two issues. First, whether the notes at issue are securities and, thus, whether Defendant is being properly pursued for securities fraud. Second, Defendant argues that the offenses occurred outside the statute of limitations and should be barred from prosecution. Each will be addressed in turn.

A. Securities Fraud

Defendant is being pursued for securities fraud charges arising under the Delaware Security Act. Within the Delaware Security Act, "security" is defined as:

> any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract, including pyramid promotion which includes any plan or operation for the sale or distribution of property, services, or any other thing of value wherein a person for a consideration is offered an opportunity to obtain a benefit which is based in whole or in part on the inducement, by himself or herself or by others, of additional persons to purchase the same or a similar opportunity; voting-trust certificate; certificate of deposit for a security; certificate of interest of participation in an oil, gas or mining title or lease or in payments out of production under such a title or lease; options on commodities; viatical settlement investment; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate, for, receipt for guarantee of, or warrant or right to subscribe to or purchase, any of the aforegoing. "Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or for some other specified period.[1]

The State argues that the promissory notes here are within this definition as either "notes" or "investment contracts."

[1] 6 *Del. C.* § 73-103.

The Delaware Supreme Court, in *Boo'ze v. State*,[2] adopted the United States Supreme Court's *Reves* test for determining whether a note is a security.[3] Although the definition of "security" includes "any notes" as securities, the *Reves* test calls for substance over form stating that, "the phrase 'any note,' must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts."[4] Therefore, when a document is entitled a note it is subject to a presumption that it is a security,[5] however, this presumption can be rebutted by proving the instrument is within, or bears a family resemblance to, certain notes that "are not properly viewed as securities" because they are not the type of instrument Congress intended to regulate under the Securities Act. Those notes include:

> (1) a note delivered in consumer financing, (2) a note secured by a mortgage on a home, (3) a short-term note secured by a lien on a small business or some of its assets, (4) a note evidencing a character loan to a bank customer, (5) a short-term note secured by an assignment of accounts receivable, (6) a note which simply formalizes an open-account debt incurred in the ordinary course of business and (7) notes evidencing loans by commercial banks for current operations.[6]

To determine whether a note bears a family resemblance to one of the above-enumerated notes, the Court will look at four factors: (1) "the motivations

[2] 846 A.2d 237 (Del. 2004) (TABLE).
[3] *Reves v. Ernst & Young*, 494 U.S. 56 (1990).
[4] *Id.* at 63.
[5] *Id.*
[6] *United States v. McKye*, 734 F.3d 1104, 1108 (10th Cir. 2013) (citing *Reves*, 494 U.S. at 65).

that would prompt a reasonable seller and buyer to enter into it,"[7] (2) "the 'plan of distribution' of the instrument,"[8] (3) the "reasonable expectations of the investing public,"[9] and (4) "whether some factors such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary."[10] This approach can be succinctly summarized as follows:

> [I]n determining whether an instrument denominated a "note" is a "security," courts are to apply the version of the "family resemblance" test that we have articulated here: A note is presumed to be a "security," and that presumption may be rebutted only by a showing that the note bears a strong resemblance (in terms of the four factors we have identified) to one of the enumerated categories of instrument. If an instrument is not sufficiently similar to an item on the list, the decision whether another category should be added is to be made by examining the same factors.[11]

With this legal context set, the Court must first determine whether it is the province of the Court to decide whether the instruments were "securities." Although the State contends this issue is one of mixed fact and law and, thus, should be left until trial, the Court finds the State's argument unpersuasive.[12] The underlying basis of this prosecution is that the documents utilized by Defendant

[7] *Reves*, 494 U.S. at 66.
[8] *Id.*
[9] *Id.*
[10] *Id.* at 67.
[11] *Id.*
[12] *Cf.* State's Response to Def.'s Mot. to Dismiss at 9-10, *State v. Attarian*, No. 1303029480 (Del. Super. Oct. 30, 2013) (citing *United States v. McKye*, 734 F.3d at 1109; *Roe v. United States*, 287 F.2d 435, 440 (5th Cir. 1961)).

are manifested within the criminal security statute. If they are not, this case collapses into a simple fraud or theft case. Therefore, to allow the case to proceed without any indication that the notes fit within the statutory framework of a "security" would be akin to allowing a drug case to proceed without some indication that the substance was illegal.[13] The determination of whether something is a "security" "must turn on the discernible characteristics of the instrument in question, as revealed by the instrument's own terms and the terms of the other transactional documents with which it operates and to which it relates."[14] Therefore, the Court must look to the underlying promissory notes for determination of whether they bear a family resemblance to non-security notes or are investment contracts. Since all of the promissory notes are nearly identical, they will be addressed together.[15]

The Court starts from the premise that the underlying instruments are all entitled "notes" and as such, are subject to the presumption that they are securities. Defendant challenges this presumption by asserting that the underlying notes bear a family resemblance to a note secured by a mortgage on a home.[16] As stated above, to determine if these notes bear a family resemblance to such, the Court

[13] *Fletcher Int'l, Ltd. v. ION Geophysical Corp.*, 2012 WL 1883040, at *1 (Del. Ch. May 23, 2012).
[14] *Id.*
[15] *See* State's Response to Def.'s Mot. to Dismiss Ex. I- L, *State v. Attarian*, No. 1303029480 (Del. Super. Oct. 30, 2013)
[16] *United States v. McKye*, 734 F.3d at 1108 (citing *Reves*, 494 U.S. at 65).

looks at (1) the motivations of the parties to enter into the note (whether they were for investment purposes); (2) the note's plan of distribution (whether it was for common trading); (3) the reasonable expectations of the investing public (that such was an investment); and (4) whether there is other non-Securities Act protection available to the alleged victims.

Regardless of how the individual investors may have characterized these transactions, there is really no dispute that the only reason that they were giving money to Defendant was to gain an investment return greater than that available through normal investment channels. They had no interest in the individual properties and had no intention to secure the money through the mortgage process. Defendant entered into the note to raise money and the victims entered into the notes to receive returns on their money solely through Defendant's actions. Thus, the notes had an investment motive for both Defendant and the alleged victims and the first prong above has been met.

The second prong, which requires the instruments be "offered and sold to a broad segment of the public"[17] is not as clear. Although Defendant contends that the transactions in question were limited to a small number of his friends and family, Defendant's actions reflect otherwise. Defendant's efforts to solicit funds

[17] *Reves*, 494 U.S. at 68.

included the creation of a power point presentation and there is every reason to believe that he was willing to accept investment money from any willing individual.[18] Although only a limited number of people ended up doing business with Defendant, such does not negate the finding that Defendant's actions evidenced intent to generate investment from anyone willing.[19] Also, the fact that Defendant's notes were with individual acquaintances, rather than sophisticated institutional investors, has been found to reflect common trading as those individuals having a legitimate need for protection by Securities laws.[20] Further, while not significant in these transactions, each note does evidence transferability by its assignment language and this has been found by the Delaware Supreme Court to be sufficient for the common trading factor.[21]

The third prong—"whether [the notes] are reasonably viewed by purchasers as investments"—is also met. The State's brief contains email correspondence and other documents prepared and distributed by Defendant to solicit funds which use the terms "investor" and "investment." Defendant contends that since the final

[18] *See* State's Response to Def.'s Mot. to Dismiss Ex. A-G, *State v. Attarian*, No. 1303029480 (Del. Super. Oct. 30, 2013).
[19] *See SEC v. Thompson*, 732 F.3d 1151, 1166 (10th Cir. 2013) (finding this factor met when the party "sought to sell its Instruments to anyone who could come up with $100,000.").
[20] *See SEC v. Global Telecom Servs.*, 325 F. Supp. 2d 94, 115 (observing that "[w]here the notes are sold to individuals, rather than sophisticated institutions, common trading has been found," and holding that the common trading factor was met where "the notes were sold to five individuals who have a legitimate need for protection by securities law") (internal citations omitted).
[21] *See* State's Response to Def.'s Mot. to Dismiss Ex. I-L, ¶ 10, *State v. Attarian*, No. 1303029480 (Del. Super. Oct. 30, 2013) ("The words 'Maker' and 'Holder' shall be deemed to include the respective heirs, personal representatives, successors, and assigns of each[.]").

notes were characterized as "loans" the investing public could not have regarded them as investments. However, changing the terminology of a transaction, after representing and soliciting for it as an investment, does not change that purchasers would reasonably view such as investments.[22] These were individuals looking for a quick and significant return on the monies given to Defendant. They were not loans significantly connected to a particular project or property nor intended to support any particular renovation project of Defendant. The only intent here was to aid Defendant in flipping properties and for the use of the money, the individuals were to be given a short term significant return.

Lastly, there is no alternative scheme which would protect the victims here. Although Defendant contends that mortgage regulations are sufficient, as the State correctly argues, state mortgage laws are not the type of alternative scheme envisioned in *Reves*. As the Delaware Supreme Court has noted, "the *Reves* court contemplates a regulatory, risk reduction scheme such as the Federal Deposit Insurance Corporation or ERISA."[23] A state mortgage recording regime is a

[22] *See Wright v. Downs*, 972 F.2d 350 (6th Cir. 1992) (TABLE) ("The Church actively solicited the notes to the public, with a high rate of interests [sic]. The public's expectation was to earn a profit. Clearly, these notes were seen by the public as investments rather than loans."); *Reves*, 494 U.S. at 68-69 ("The advertisements for the notes here characterized them as 'investments,' and there were no countervailing factors that would have led a reasonable person to question this characterization. In these circumstances, it would be reasonable for a prospective purchaser to take the [issuer] at its word."); *Griffin v. Jones*, 2013 WL 5441650, at *10 (W.D. Ky. Sept. 27, 2013) (holding that while "Defendant argues that the transactions are properly characterized as loans rather than securities . . . [b]ecause [the plaintiff] invested money expecting to get more in return, the third *Reves* factor is satisfied."); *SEC v. Mulholland*, 2013 WL 979423, at *7 (E.D. Mich. Mar. 13, 2013) ("[I]t does not matter that the demand notes indicated they were loans and not investments, because they operated as a typical investment would.").

[23] *Boo'ze v. State*, 846 A.2d 237.

limited alternative regulatory enforcement mechanism which "is not designed to regulate the distribution of promissory notes" and, thus, does not preclude the application of securities law to the underlying notes.[24] Therefore, having found all of the Reves factors present, the Court holds that the underlying promissory notes are "notes" within the definition of "security" and, thus, subject to the Delaware Securities Act.

Because the Court finds that the promissory notes here qualify as securities, the Court need not address whether they are also "investment contracts." The instruments are subject to the Delaware Securities Act as "notes" within the definition of "security."

B. Statute of Limitations

Defendant also argues two statute-of-limitations grounds for dismissal. First, Defendant argues that the tax-evasion count arising out of Defendant's alleged failure to file his 2006 tax return should be dismissed as such is outside the five year statute of limitations.[25] Defendant also argues that any securities-fraud

[24] *Id. See SEC v. J.T. Wallenbrock & Assoc.*, 313 F.3d 532, 540 (9th Cir. 2002) ("[T]he existence of limited alternative regulatory enforcement mechanisms does not obviate the need for the protection of the Securities Acts."); *Pollack v. Laidlaw Hldgs.*, 27 F.3d 808, 815 (2d Cir. 1994) ("[T]he district court erred in concluding that New York State regulations concerning mortgages afforded protection sufficient to render unnecessary the application of the federal securities laws to these mortgage participations."); *Wright v. Downs*, 972 F.2d 350 ("Michigan laws concerning the recording of deeds and mortgages are certainly not the type of regulation the Supreme Court had in mind."); *Deal v. Asset Mgmt. Grp.*, 1992 WL 212482, at *4 (N.D. Ill. Aug. 28, 1992) ("[T]he court finds no risk-reducing factor to render application of the Securities Acts unnecessary, although defendants argue that the notes were subject to the Illinois mortgage foreclosure laws and the common law of fraud.").

[25] *See* Def.'s Mot. to Dismiss at 1 (citing 11 *Del. C.* § 205).

allegations for Defendant's actions prior to March 2008 should be dismissed as outside the five-year statute of limitations set for the Delaware Securities Act.[26]

The State counters Defendant's argument stating first, that Defendant is incorrect as to the tax-evasion statute of limitations, which is actually six years.[27] Second, the State argues that, although some of the securities-fraud allegations are for conduct that began prior to March 2008, the indictment alleges a continuous scheme to defraud which ended on or about March 22, 2008 (or later). Thus, the State contends that the Grand Jury indictment on March 18, 2013 was within the five year statute of limitations.

The State is correct as to the tax-evasion statute of limitations. The applicable statute of limitations for tax-evasion charges brought under 30 *Del. C.* § 571 is six years. Specifically, 30 *Del. C.* § 575 states:

> No person shall be prosecuted, tried or punished for any of the various offenses arising under this subchapter unless the prosecution of such person is instituted within 3 years next after the commission of the offense, except that the period of limitation shall be 6 years for offenses arising under §§ 571, 572 and 574 of this title.[28]

Although the securities-fraud allegations are subject to a five year statute of limitations, the State argues that such does not begin to run until the course of

[26] *See id.* at 16-17 (citing 6 *Del. C.* § 7330; *redesigned as* 6 *Del. C.* § 73-503).
[27] *See* State's Response to Def.'s Mot. to Dismiss at 27 (citing to 30 *Del. C.* § 575).
[28] 30 *Del. C.* § 575 (emphasis added).

conduct alleged to have violated the Delaware Securities Act has ended.[29] As a general proposition this is true, and clearly applies to the theft offenses found in Counts 1, 5, 9, 12 and 15. However, the security related counts are based upon a particular security and it is unclear at this juncture if certain securities were paid off and new ones created or if the obligation of one simply rolled over into the next promissory note. If it is the former, there appears to be some statute of limitation issues relating to the earlier transactions. If it is the latter the State may have a valid argument. But since the Court cannot make this determination from what has been provided, it will delay it's decision on this issue until the State has presented their case-in-chief at trial. Only then will the Court have the facts it needs to make this finding.

Finally, the Court must comment that it is unclear why the State finds it necessary to dramatically complicate the case by the inclusion of the securities counts. This appears to be a straightforward theft/fraud case where the allegation

[29] The Delaware Supreme Court has found that the Delaware Securities Act is virtually identical to the federal Securities Exchange Act of 1934 and that "the similarity . . . evidences the General Assembly's intent that it be governed by similar principles." *Hubbard v. Hibbard Brown & Co.*, 633 A.2d 345, 349 (Del. 1993). Thus, the Court finds the following cases interpreting statute-of-limitations issues under the federal act very persuasive. *See, e.g.*, *United States v. Scop*, 846 F.2d 135, 139 (2d Cir. 1988) (holding that with the identical federal securities statute "evidence of continued stock purchases and sales at prices affected (or so the jury might find) by the earlier artificial trades, of the mailings of stock certificates, and of the reassurances to customers . . . was sufficient to permit a rational jury to conclude that the conspiracy and substantive scheme to defraud continued" into the limitations period); *United States v. Vilar*, 729 F.3d 62, 88 n.22 (2d Cir. 2013) (holding that the defendants, under the federal securities statute, "continued to engage in conduct aimed to reassure investors and prevent them from redeeming their investments within the five-year limitations period"). *See also* 11 *Del. C.* § 205(f) ("An offense is committed either when every element occurs, or, if a legislative purpose to prohibit a continuing course of conduct plainly appears, at the time when the course of conduct or the defendant's complicity therein is terminated. Time starts to run on the day after the offense is committed.").

is that Defendant took money from four individuals without the means to repay them or by misrepresenting his ability to repay their investment. The Court can reasonably surmise why securities counts have been included but it questions the wisdom of that decision. The facts of this case as presented during these motions reflects a difficult and challenging case to establish. The Court would suggest that those who are actually going to try this case use their prosecutorial discretion to present the State's strongest case undiluted by extraneous charges.

CONCLUSION

For the foregoing reasons, Defendant's Motion to Dismiss is **DENIED.**[30]

IT IS SO ORDERED.

/s/ William C. Carpenter, Jr.
Judge William C. Carpenter, Jr.

[30] Defendant filed a Motion to Sever on July 16, 2013, arguing that the tax-evasion charges covered a broader period of time than the securities-fraud allegations and would taint the jury's consideration of him. At oral argument, the Court expressed concerns on the breadth of the tax-evasion allegations and the likelihood that such would need to be severed to afford Defendant a fair trial. In response thereto, the State agreed to only proceed on the tax-evasion charges to arising out of the alleged securities fraud. Therefore, as this action negates Defendant's arguments as to severance, the Motion to Sever has become moot.