SUPREME COURT OF VIRGINIA

Tanner v. State Corporation Commission, 266 Va. 170

580 S.E.2d 850 (2003) · No. Record Nos. 020938, 020939, 020940 · Decided June 6, 2003

SUMMARY

The Supreme Court of Virginia, on rehearing, reconsidered portions of its earlier decision concerning whether accounts receivable agreements and promissory notes were securities subject to Virginia registration requirements. The court reaffirmed its ruling that the accounts receivable agreements were not investment contracts, but modified its treatment of notes issued under Rule 504 of Regulation D, holding that Rule 504 was promulgated under section 3(b) of the Securities Act and that such securities were not federally preempted covered securities. The case was reaffirmed as modified and remanded for reconsideration of penalties.

CASE DETAILS

COURT	Supreme Court of Virginia
WRITING FOR THE COURT	Senior Justice Roscoe B. Stephenson, Jr.; Chief Justice Hassell; Justice Lacy; Justice Koontz; Justice Kinser; Justice Lemons; Senior Justice Carrico; Senior Justice Stephenson
JURISDICTION	Virginia
DECIDED	June 6, 2003
DOCKET	Record Nos. 020938, 020939, 020940
DISPOSITION	other
PROCEDURAL POSTURE	Rehearing of consolidated appeals from judgments of the State Corporation Commission concerning violations of the Virginia Securities Act.
STANDARD OF REVIEW	The court reviewed the Commission's legal conclusions de novo, construing the applicable statutes, rules, and federal securities-law provisions. The court considered only the record presented on appeal.
PRECEDENTIAL VALUE	Published and precedential Supreme Court of Virginia opinion
PARTIES	David R. Tanner, James C. Perry, Brian W. Kreider v. State Corporation Commission

TOPICS

administrative law | judicial review of agency action | statutory interpretation | appellate procedure | commercial litigation

PRACTICE AREAS

administrative law | securities regulation | statutory interpretation | appellate procedure | commercial litigation

QUESTIONS PRESENTED

1. Whether the court's prior determination that the Accounts Receivable Purchase and Sales Agreements were not securities resulted from a mistake of fact concerning the evidence in the record.
2. Whether Rule 504 of Regulation D was issued under § 4(2) or § 3(b) of the Securities Act of 1933.
3. Whether securities issued pursuant to Rule 504 are covered securities under § 18(b)(4) of the Securities Act and therefore exempt from registration under Virginia law.

HOLDINGS

1. The court reaffirmed its prior holding that the Agreements were not investment contracts, and therefore were not securities subject to the Virginia Securities Act's registration requirements. The court rejected the Commission's attempt to rely on a letter that was not part of the appellate record.
2. Rule 504 of Regulation D was issued under § 3(b) of the Securities Act of 1933, not § 4(2).
3. Securities issued pursuant to Rule 504, which was promulgated under § 3(b), are not covered securities under § 18(b)(4) of the Securities Act. They therefore are not preempted from state registration requirements and must be registered under Code § 13.1-507.

KEY QUOTATIONS

> *"Upon rehearing, as with original appeals, we consider and make decisions based upon the record that has been brought to us."* (266 Va. at 172, 580 S.E.2d at 852)

> *"In other words, securities issued under § 3(b) are not "covered securities" and, therefore, must be registered under Code § 13.1-507."* (266 Va. at 172-173, 580 S.E.2d at 852-853)

FACTUAL BACKGROUND

The appellants sold instruments called Accounts Receivable Purchase and Sales Agreements issued by Kennsington Holding Corporation. In the original decision, the court held that the Agreements were not investment contracts under the Howey test because purchasers acquired accounts receivable and had rights relating to their collection. The case also involved promissory notes issued pursuant to Rule 504 of Regulation D, and the question whether those notes were exempt from registration under the Virginia Securities Act.

PROCEDURAL HISTORY

In the original consolidated appeals, the Supreme Court of Virginia affirmed in part and reversed in part the Commission's judgments and remanded for further consideration of penalties. The Commission petitioned for rehearing under Code § 8.01-675.2 and Rule 5:39. The court granted rehearing as to Parts V and VI, reaffirmed Part V, and modified Part VI.

DISPOSITION

other

REMAND INSTRUCTIONS

Part VI of the original opinion was modified to reflect that Rule 504 was issued under § 3(b), that the notes were not covered securities, and that they were subject to registration under Code § 13.1-507. The remainder of the original opinion was reaffirmed; the Commission was to reconsider penalties on remand.

CASES CITED

- Tanner v. State Corporation Commission, 265 Va. 148, 574 S.E.2d 525 (2003)
- Securities and Exchange Commission v. W.J. Howey Co., 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946)

OPINION

STEPHENSON, J.

580 S.E.2d 850 (2003) 266 Va. 170 David R. TANNER, James C. Perry, and Brian W. Kreider, v. STATE CORPORATION COMMISSION. Record Nos. 020938, 020939, 020940. Supreme Court of Virginia. June 6, 2003. *851 Gary M. Bowman for appellants. Debra M. Bollinger, Senior Counsel (Phillip DeHaas, Counsel to the Commission; William H. Chambliss, General Counsel, on brief), for appellee.

Amicus Curiae: Securities and Exchange Commission (Giovanni P. Prezioso, General Counsel; Jacob H. Stillman, Solicitor; Randall W. Quinn, Assistant General Counsel, on brief), in support of appellee. Amicus Curiae: The North American Securities Administrators Association, Inc. (Royce O. Griffin, General Counsel; Donald G. Owens, Troutman Sanders, on brief), Richmond, in support of appellee.

Present: HASSELL, C.J., and LACY, KOONTZ, KINSER, and LEMONS, JJ., and CARRICO and STEPHENSON, S.JJ. UPON REHEARING FROM THE STATE CORPORATION COMMISSION OPINION BY Senior Justice ROSCOE B. STEPHENSON, JR. On January 10, 2003, we rendered an opinion in these consolidated appeals in which we determined whether the State Corporation Commission (the Commission) erred in finding that David R. Tanner, James C. Perry, and Brian W. Kreider violated certain sections of the Virginia Securities Act, Code § 13.1-501 et seq. (the Act).

We affirmed, in part, and reversed, in part, the Commission's judgments and remanded the case to the Commission for further consideration of penalties. Tanner v. State Corporation Commission, 265 Va. 148, 574 S.E.2d 525 (2003). Thereafter, the Commission, pursuant to Code § 8.01-675.2 and Rule 5:39, petitioned this Court for a rehearing to reconsider and withdraw the portions of the opinion that reversed its judgments.

By order entered February 28, 2003, we granted the petition as it relates to Parts V and VI of the opinion. I In Part V of the opinion in Tanner, we considered whether certain instruments entitled "Accounts Receivable Purchase and Sales Agreement" (the Agreements) issued by Kennsington Holding Corporation (Kennsington) and sold by Tanner, Perry, and Kreider are investment contracts as defined in Securities and Exchange Com'n v. W.J.

Howey Co., 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946), and, therefore, securities subject to the registration requirements of the Act. The Commission contends that, in deciding that the Agreements are not securities, we based our decision on a mistake of fact. *852 The Act defines a "security" to include an "investment contract." Code § 13.1-501.

In W.J. Howey Co., the Supreme Court ruled that "an investment contract for purposes of the Securities Act [of 1933] means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or third party." 328 U.S. at 298-99, 66 S.Ct. 1100.

In Tanner, we rejected the Commission's contention that the purchasers of the Agreements were led to expect profits solely from the efforts of others. 265 Va. at 155, 574 S.E.2d at 529. We noted that, under the terms of the Agreements, Kennsington "sells, sets over and assigns" to the purchasers certain accounts receivable; that the purchasers "shall be the absolute owner[s] of the accounts;" that Kennsington agreed to deliver to the purchasers "a detailed listing of all of the accounts [and] the work folder for each account, as available, containing all supporting documents;" and that the purchasers have "the right to assign the collection of the Accounts Receivable... to the Collection Company of their choice."

Id. at 154, 574 S.E.2d at 528. With respect to the operation of the Agreements, we said the following: The sole evidence relating to the operation of the Agreements was the testimony of Harold J. Bailey, who had purchased accounts receivable owed to an entity called "The Legal Society." Bailey received a UCC-1 financing statement related to his purchase that showed the legal name of the debtor.

He was furnished an information packet, including an explanation of "how the entire system [of accounts receivable financing] works." Although Bailey, by a separate agreement, engaged Summit Financial Services to be his collection agent, nothing in the record suggests that Bailey was not free to proceed directly against The Legal Society to collect the accounts receivable.

Id. at 155, 574 S.E.2d at 528-29. Upon rehearing, the Commission contends that we mistakenly "relied on the fact that... Bailey had received a UCC-1 financing statement related to his investment." The Commission so contends notwithstanding that Bailey testified that he "got a financing statement." Further, the record contains the information packet furnished to Bailey informing him that, "[o]nce the receivables have been verified, Kennsington then files a UCC-1 on them in the name of the client."

(Emphasis added.) Nonetheless, the Commission, in an attempt to vitiate this evidence in the record, attached to its petition for rehearing a copy of an alleged letter from Kennsington to Bailey.[1] This document is not a part of the record, and we will not consider it. Upon rehearing, as with original appeals, we consider and make decisions based upon the record that has been brought to us.

Accordingly, we reaffirm our decision in Part V of the opinion in Tanner. II In Part VI of the opinion in Tanner, we considered whether certain promissory notes, which were issued pursuant to Rule 504 Regulation D, are exempt from registration under the Act.

The Commission contends that our ruling that the notes are exempt from registration was based upon a mistake of law. We agree. We erred in concluding that Rule 504 Regulation D was issued under the authority of § 4(2) of the Securities Act of 1933 (the Securities Act), 15 U.S.C. § 77d(2) (2000). Based upon this erroneous conclusion, we held that the notes were exempt from the Act's registration requirements pursuant to § 18(b)(4) of the Securities Act, 15 U.S.C. § 77r(b)(4).

We are persuaded now that Rule 504 Regulation D was issued under the authority of § 4(2) of the Securities Act of 1933 (the Securities Act), 15 U.S.C. § 77d(2) (2000). Based upon this erroneous conclusion, we held that the notes were exempt from the Act's registration requirements pursuant to § 18(b)(4) of the Securities Act, 15 U.S.C. § 77r(b)(4).

We are persuaded now that Rule 504 Regulation D was issued under the authority of § 3(b) of the Securities Act, 15 U.S.C. § 77c(b).[2] Indeed, the Rule itself references *853 § 3(b), and the adopting release for Regulation D states that Rule 504 "provides an exemption under section 3(b) of the Securities Act." Securities Act Release No. 33-6389, 47 Fed.Reg.

11251 (March 16, 1982). Further, we are persuaded that § 18(b)(4) of the Securities Act does not preempt state law with respect to transactions exempt from registration pursuant to rules issued under § 3(b). In other words, securities issued under § 3(b) are not "covered securities" and, therefore, must be registered under Code § 13.1-507.[3] III For the reasons stated above, Part VI of the opinion in Tanner will be modified.

The remainder of the opinion will be reaffirmed. Reaffirmed, as modified. NOTES [1] In this letter, Kennsington purportedly informed Bailey that "a UCC-1 has been filed in the name of Kennsington." Therefore, according to the Commission, "the investors had to depend entirely upon Kennsington" to collect on their investments.

[2] Although the Commission made the argument, in Tanner, that securities issued under Rule 504 are not "covered securities," it did not cite § 3(b) of the Securities Act as authority to support its argument until it filed its petition for rehearing.

[3] The appellants contend that, even if the notes should have been registered, they should not be held accountable due to the complexity of the issue. While we agree that the issue is complex, especially to a lay person, our function is limited to correctly construing the applicable statutes, rules, and regulations. It well may be, however, that, when the Commission reconsiders penalties on remand, it will take into account the appellants' contention.