

BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Desist and Refrain
Order Issued to:

OAH No. 2012090224

WILLIAM BENSON PEAVEY, JR.,
JAMES WILKES MILNES,
J.B. LAND DEVELOPMENT, L.L.C.,
GOLDEN PACIFIC REAL ESTATE,

South San Francisco, CA

Respondents.

PROPOSED DECISION

Administrative Law Judge Jill Schlichtmann, Office of Administrative Hearings, State of California, heard this matter on January 29, 2013, in Oakland, California.

John R. Drews, Corporations Counsel, represented complainant Mary Ann Smith, Deputy Commissioner of the California Department of Corporations.

William P. Klein, Klein Law Group, represented respondent James Wilkes Milnes, who was not present. As set forth in Factual Finding 3, the remaining respondents did not timely file a notice of defense or request for hearing and therefore they were not parties in the hearing.

The record was left open to receive written closing argument in accordance with a briefing schedule. Complainant's brief was timely received and marked for identification as Exhibit 25. Respondent's brief was timely received and marked for identification as Exhibit A. The record closed and the matter was deemed submitted on February 22, 2013.

FACTUAL FINDINGS

1. The Department of Corporations is the agency responsible for enforcement of the Corporate Securities Law, Corporations Code section 25000 et seq.

Introduction

2. On May 23, 2012, the commissioner of the department issued a Desist and Refrain Order against William Benson Peavey, Jr., James Wilkes Milnes, J.B. Land Development, L.L.C. (JB Land), and Golden Pacific Real Estate. The Order demanded that respondents desist and refrain from further offer or sale in the State of California of securities including, but not limited to, investment contracts and promissory notes, unless and until said securities have been qualified under the law, or are exempt. In the opinion of the commissioner, such activity constituted the offer or sale of unqualified securities. (Corp. Code, § 25532.)¹

The Order further demanded that respondents desist and refrain from offering or selling any security in the State of California, including but not limited to investment contracts and promissory notes, by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. (Corp. Code, § 25401.)

3. Peavey, JB Land, and Golden Pacific Real Estate, did not timely file a notice of defense or request a hearing on the Desist and Refrain Order. The order is therefore final as to Peavey, JB Land, and Golden Pacific Real Estate. Milnes timely filed a request for a hearing and notice of defense, and this hearing followed.

4. The department has not qualified any offer or sale of securities by Milnes, JB Land or Golden Pacific Real Estate. The department has no record of an application for qualification, or notice of exemption, for Milnes, JB Land or Golden Pacific Real Estate.

Factual Background

5. Peavey was a principal and Milnes was the president of JB Land, which operated out of South San Francisco, California. The name "JB Land" was derived from the partners' first names, "James" and "Bill." JB Land was registered with the California Secretary of State as a domestic limited liability corporation on September 16, 2005. Peavey and Milnes were both licensed real estate brokers. Golden Pacific Real Estate was the real estate brokerage that represented JB Land in the purchase and sale of real estate.

6. Peavey, Milnes, and JB Land purchased undeveloped real estate and planned to increase the value of the land through development. JB Land solicited investors to fund its

¹ Corporations Code section 25532, subdivision (a), provides: "If, in the opinion of the commissioner, the sale of any security is subject to qualification under this law and it is being offered or sold without first being qualified, the commissioner may order the issuer or offeror of such security to desist and refrain from further offer or sale of such security unless and until qualification has been made under this law."

development projects. In accordance with JB Land's business model, investors purchased a fractional interest in a parcel of property as tenants-in-common with JB Land and other investors.

7. JB Land owned eight to nine parcels of land and at various times planned the development of a senior center, an equestrian estate, and a warehouse to be rented for storage space.

8. Milnes's primary role at JB Land was to utilize his valuation skills to identify land that would be appropriate to purchase and develop. Milnes also focused on the feasibility of developing land. Peavey recruited investors, however, Milnes met and communicated with investors regularly as well.

9. A brochure developed by Milnes and Peavey, described JB Land's investment opportunities and was provided to potential investors. The brochure described Milnes's 20 years of experience in real estate appraisal, financing, feasibility analysis, and investment consulting. It further described Milnes's experience in residential housing and subdivisions, resorts, golf courses, health clubs, spas, hotels and casino, and in leading a high volume mortgage finance company as chief executive officer.

Peavey was described as having had over 35 years of experience as a real estate attorney and broker, with a specialty in creating and managing investor portfolios. He was also described as a professional land banker who spent substantial time in Southern California growth areas to keep current with market trends.

10. The brochure described JB Land's mission to locate the best California real estate, create value and provide excellent returns on investment with maximum safety and security. It described strategic alliances with a network of real estate professionals who bring a steady stream of parcels to the company prior to public availability, which the company purchased with cash. The brochure further described the investment scheme as JB Land adding "substantial value to each parcel through comprehensive development plans."

11. JB Land sold promissory notes and investment contracts to various inexperienced individual investors between 2006 and 2009. The typical contract that investors signed contained a provision requiring JB Land to buy back the interest in the land sold to the investor within two years; the buy-back price in the typical contract was 150 percent of the purchase price.²

12. All of the contracts contained a provision which stated: "This contract is personally guaranteed by the principals of JB Land Development who hereby confirm their

² JB Land successfully executed a buy-back of an investor's stake in a parcel of land on one occasion. In that instance, JB Land purchased the undeveloped property and a short time later was able to sell that land for approximately twice its purchase price. The land had not been developed in any meaningful way and the increase in value was largely the result of the land having been previously undervalued.

personal liability with the following signatures.” Peavey and Milnes signed the document below the personal guarantees. Unbeknownst to the investors, Milnes and Peavey had no assets to honor these guarantees.

13. The funds received from the various investors were all deposited into the Golden Pacific Real Estate brokerage checking account. The account was not a trust account and Peavey was the only signatory. The deposits were not allocated to a particular parcel or investment opportunity. The withdrawals from the account were not allocated to the individual projects.

A review of the account between January 1, 2006, and December 21, 2009, revealed total deposits in the amount of \$5,074,844.66, and withdrawals totaling \$5,085,063.65. No checks were issued from the account. All withdrawals were either made in cash or by cashier’s check, making it very difficult to confirm the recipient of the withdrawn funds. Over \$4,000,000 in withdrawals from the Golden Pacific Real Estate checking account were untraceable.

14. Peavey was suspended by the California State Bar on August 20, 2003, having been found to have committed seven acts of misconduct including failing to report a civil judgment for fraud, failing to avoid interests adverse to a client, violating his fiduciary duty, and committing acts of moral turpitude. Peavey resigned from the State Bar on June 9, 2006, with new charges pending. The investors were not told about Peavey’s suspension, resignation, or the new allegations made by the State Bar.³

THE WONG FAMILY

15. Megan Wong is a licensed real estate broker and was familiar with Peavey through real estate circles. In 2006, Peavey recommended an investment in JB Land to Megan Wong and her husband Warren Wong, promising a guaranteed investment in the booming California real estate market. Peavey promised a 25 percent return on their investment in one year, and a 50 percent return over two years. The Wongs met with Milnes, and traveled to Kern County, California, to view the property that Peavey and Milnes told them would be developed into an equestrian estate. Milnes represented to the Wongs that he had developed golf courses and hotels, and was very experienced in developing land for commercial uses. Peavey and Milnes also met with Warren Wong’s parents, who were retired and had no income, to discuss the investment opportunity.

16. The promotional materials presented to the Wongs in early 2006, promised that JB Land 1) protected the return on investment; 2) capitalized on the special experiences and

³ On June 19, 2008, Peavey was indicted in the United States District Court for the Northern District of California on three counts of mail fraud stemming from the factual allegations underlying the State Bar proceedings. Peavey pled guilty to the charges on January 8, 2009, and on May 15, 2009, Peavey went to federal prison as a result. He was released from prison on December 3, 2010, subject to the terms of three years of supervised release.

training of its principals and professionals (which were detailed as stated in Factual Finding 9); 3) tailored each plan to achieve the highest and best land use; and, 4) increased dramatically the net worth of their investments from acquisition through completion using a safe and methodical system. These representations were important to the Wongs and influenced them to invest. In addition to the representations in the brochure, Peavey and Milnes gave verbal assurances that the investment was safe.

17. Warren and Megan Wong and Warren Wong's parents decided to invest in the property referred to as "Tehachapi Stables." The materials indicated that the 40-acre parcel of land cost \$2,000,000 and was zoned for country homes. The plan was to create a horse estate complex to supply a local demand. Fifteen two-acre horse ranches were to be partitioned, surrounding a central community facility, to include stables, a turn-out pasture, and tack room. The cost to build each unit was \$676,667, and the projected sale of each unit would be \$926,667.

18. Megan and Warren Wong took out a \$500,000 loan on their home to invest in Tehachapi Stables. Wong's parents also took out a \$500,000 loan on their home to invest in the project. Peavey and Milnes acted as the loan brokers on these loans. JB Land promised to make all payments on the loans for the first two years, at which time the investment funds plus 50 percent would be paid back to the Wongs.

19. On September 13, 2006, Warren and Megan Wong signed a purchase agreement with JB Land. Peavey and Milnes signed the agreement and personally guaranteed the return of the Wong's investment. The agreement states that the Wongs would borrow \$500,000 using their real estate as collateral. JB Land would arrange for the loan and would be responsible for all costs associated with the loan process, and would be solely responsible for paying all of the principal and interest due and owing on the loan. The loan would be paid in full on or before two years of the date of the agreement.

Megan and Warren Wong agreed to disburse the loan proceeds of \$500,000 to a title company for the benefit of JB Land; and would receive in return a 25 percent interest in a tenancy-in-common in a 38.93 acre parcel of land in Tehachapi, California. JB Land would establish a fund in the amount of the anticipated principal and interest payments for the \$500,000 loan, to be used exclusively for the loan payments.

Within two years of the Wong's purchase, JB Land was to buy all of Megan and Warren Wong's right, title and ownership interest in the property for \$750,000.

During the two-year period, the Wongs agreed to allow JB Land to develop, improve and/or sell the property in its sole discretion. Beyond their financial investment, the Wongs were only required, as part owners, to participate in hearings on applications as needed, to sign authorizations for JB Land, and to take other steps necessary to the development process. The agreement provided that JB Land would exercise the exclusive management and control of the property and its development and sale, and would pay all expenses associated with the process.

20. Warren Wong's parents signed a similar agreement with Peavey and Milnes on May 17, 2006.

21. The representations made to the Wongs omitted the following facts: 1) Peavey's license had been suspended by the State Bar for allegations involving fraud; 2) new charges were pending before the State Bar; 3) the investment was risky; 4) Peavey and Milnes did not have assets with which they could personally guarantee the investment; 5) the money invested would not be allocated solely to the development of Tehachapi Stables, and 6) Peavey alone would have access to the account where the investment funds were being deposited.

22. JB Land never repaid the \$1,000,000 invested by the Wong family, nor paid the 50 percent return. The land was not developed in any significant respect. In Warren Wong's opinion, their portion of the parcel is presently worthless.

HANS & ELSBETH KUFFER

23. Hans Kuffer received a postcard in the mail in April 2007, advertising an investment in JB Land. Kuffer had been looking for an investment opportunity and the investment looked attractive. He met with Peavey and Milnes in April 2007, and again in July 2007. Peavey and Milnes provided Kuffer with a brochure describing the investment opportunity in July 2007. The brochure identified Milnes as the President and Peavey as the Chief Executive Officer and described their backgrounds.

24. The JB Land brochure provided to Kuffer stated in part at page 14:

JB Land Development offers investors a 50% return on their investment within two years. This high return is realized through a contractual buy-back provision. In some cases, the buy-back will occur prior to the end of the two-year period, providing even stronger returns.

The investors own undivided interests as tenants in common with grant deeds and title insurance. The investors contract with JB Land Development to develop or otherwise add value to the land. Within two years, the investors' ownership is redeemed at a price that returns 1.5 times (a 50% increase) to their original investment. During the interim period, real estate taxes are advanced by JB with its own funds, and credited against investor's profit. JB also uses its own funds for developing and/or adding value to the land. Investors have no additional financial obligation beyond their original purchase.

25. Peavey and Milnes told Kuffer that they were able to offer such a large return on the investment (50 percent in two years) by buying land in a growth area at a bargain price,

developing the land by building a large storage warehouse for which there was great demand in the area, and bringing in tenants.

26. The brochure stated that the value of this project, referred to as the "Warehouse Operation," based upon the development of 142,000 square feet of leasable space, was \$7,000,000. It stated further that the cost of the land was \$1,000,000, and the site development, construction and associated costs brought the total project cost to \$2,300,000.

27. Peavey and Milnes told Kuffer that they would personally guarantee his investment, so there was no way he could lose his money. The personal guarantees from Peavey and Milnes, plus a deed to his interest in the property, and the development plans, made Kuffer feel secure in the investment. Kuffer and his wife went to look at the land that they were investing in, and met with an appraiser supplied by JB Land. The Kuffers would not have invested in the project if they had known that Peavey and Milnes were not going to develop the land by building a warehouse on the site.

28. Kuffer and his wife signed a purchase agreement with JB Land on August 31, 2007. The Kuffers agreed to invest \$300,000 to purchase a 7.5 percent tenancy-in-common interest in a 9.32 acre parcel of property located in Rosamond, California.

29. The agreement states in part, "On or before September 3, 2008, JB Land will buy all of the Kuffers' right, title and ownership interest in the subject property for \$375,000." Finally, the agreement states, "JB Land will exercise exclusive management and control of the property development and/or sale and will pay all associated costs." The Kuffers were required only to cooperate if necessary by participating in the application and hearing process, and signing any necessary authorizations, or other steps deemed necessary to assist JB Land in carrying out the development plans. Above the signatures of Peavey and Milnes, the agreement states, "This contract is personally guaranteed by the principals of JB Land Development who hereby confirm their personal liability with the following signatures."

30. Peavey and Milnes omitted the following facts when they met with Kuffer: 1) the venture was risky; 2) Peavey had been suspended by the State Bar in 2003, involving allegations of fraud; 3) Peavey had resigned from the State Bar in June 2006, in the face of additional allegations; 4) the personal guarantees from Peavey and Milnes were worthless; 5) the parcel the Kuffers were investing in had been purchased by JB Land for \$179,000; 6) Peavey alone would have access to the account where the investment funds were being deposited; and, 7) the funds the Kuffers were investing were not going to be used solely for the development of the Warehouse Operation.

31. On October 7, 2008, Hans Kuffer contacted Peavey and Milnes to inquire about the return of their investment, plus the guaranteed profit, totaling \$375,000. On October 31, 2008, Peavey informed Kuffer that due to the downturn in the economy, JB Land had shifted focus to the energy business, which he described as "recession-proof," and promised that the real estate investors would be paid within 60 days. The Kuffers were never repaid. They later learned that the land in which they own a 7.5 percent tenancy in common, was purchased for

\$179,000, and that the value of their share is \$3,850. Hans Kuffer visited the property in 2009, and the land had not been developed in any significant respect. No warehouse had been built. Hans Kuffer subsequently learned that Peavey was facing criminal charges, and that Peavey had resigned from the State Bar while enforcement proceedings were pending against him. Peavey's honesty was important to the Kuffers and they would not have made the investment if they had known that Peavey and Milnes were dishonest.

32. In 2009, Hans Kuffer asked Milnes for a list of other investors. A document provided to him by Milnes contained encrypted information that Kuffer was able to open. From the encrypted information, Kuffer made a spreadsheet of more than 35 investors in JB Land, who lost of their investments. He set about contacting the other investors.

HENRY XINYU XIANG & HANSHU DING

33. Henry Xiang, an engineer who was not experienced in real estate, saw an advertisement about an investment opportunity in June 2007. After contacting the company, Xiang met with Milnes, who described the same investment opportunity that was offered to Kuffer, the Warehouse Operation in Rosamond, California. Milnes provided Xiang with a "Letter of Value" dated June 27, 2007, signed by "Mae Naffziger, Appraiser," who valued the project at \$6,950,000. Milnes did not disclose the actual value of the parcel, which was approximately \$179,000. Milnes also told Xiang that JB Land had already identified prospective tenants for the warehouse, including NASCAR and Wells Fargo.

34. Milnes told Xiang that the return of his investment plus 25 percent was guaranteed within two years. Because Xiang had no cash available, Milnes suggested that Xiang borrow against his home. Milnes told Xiang that JB Land was offering a safe investment, with no chance of losing money, and that the investment would be personally guaranteed by Peavey and Milnes. The personal guarantee was important to Xiang. Milnes did not disclose that they did not have assets to fulfill the guarantee. Milnes also did not disclose to Xiang that Peavey had resigned from the State Bar with enforcement proceedings pending against him.

35. Xiang took a home equity loan in the amount of \$100,000 to finance an investment in JB Land. On June 25, 2007, Xiang, his wife Hanshu Ding, Milnes and Peavey signed a purchase agreement in which Xiang would invest \$100,000, and receive a 2.5 percent tenancy-in-common interest in the Warehouse Operation in Rosamond. The agreement promised that on or before July 1, 2009, JB Land would buy all of Xiang and his wife's interest in the property for \$125,000. Milnes and Peavey personally guaranteed the investment. It was also agreed that JB Land would develop, improve and/or sell the property, in its sole discretion.

36. Xiang did not receive any return on his investment. The value of his interest in the Rosamond property is currently less than \$10,000.

37. On July 27, 2011, the United States Bankruptcy Court, for the Northern District of California, issued a memorandum of decision and judgment in an adversary proceeding

initiated by Xiang and Ding, seeking damages in the amount of \$125,000 plus interest, punitive damages, attorney's fees and costs, and a determination that the debt was not dischargeable in the bankruptcy proceedings pursuant to section 523 of title 11 of the United States Code.

The court found that JB Land raised \$2,695,200 from investors on the Warehouse Operation project in Rosamond, and that of that money, \$400,000 was used for various development activities including clearing the land, installing cyclone fencing, and beginning the process of grading the land. The court was unable to determine where the remaining \$2,295,200 went, other than that it was not allocated to fund development of the parcel.

The court concluded that Milnes's debt to Xiang was not dischargeable because Milnes had provided misleading documents to Xiang (the JB Land brochure which Milnes edited) during their initial meeting. Due to Milnes's representations, Xiang's investment was obtained on the promise that it would be aggregated with other funds from other purchasers of interests in the parcel, matched with the appropriate real estate, and used to develop or otherwise add value to the land. In actuality, JB Land did not earmark Xiang's funds to a specific development project, rather it used a portion of the funds to aid development of various proposals, therefore, the brochure statement was a misrepresentation.

The court also found that Milnes's verbal statements to Xiang at the initial meeting contained misrepresentations. Milnes represented that the investors' funds would be used to construct a warehouse and lease the storage space, and also emphasized the low risk nature of the investment. Milnes contended that because Xiang was purchasing an interest in real estate at a "bargain price," if development faltered, their investment would be secured by that interest, which was estimated at \$4,000,000. However, the value of the land was closer to \$179,000 and Xiang paid \$100,000 for a 2.5 percent interest.

The court found that Milnes knowingly made the following verbal misrepresentations: 1) the investment would be used to develop the parcel and construct the warehouse, when in fact, the funds were used for various purposes; 2) the investment was low-risk, when in fact the investment was subject to the complicated and risky development process; 3) the investment was secure because they had purchased an interest in real estate at a "bargain price," when in fact the price paid for the real estate could only be justified if the property was fully developed.

The court further found that Milnes likely had actual knowledge of the misrepresentations contained in the JB Land brochure in its entirety, but at a minimum demonstrated a reckless disregard for the truth by failing to confirm the accuracy of its contents, and by presenting the investment as a low-risk investment. The court also found that Milnes had induced Xiang to invest based upon verbal and written misrepresentations, which were designed to make the investment opportunity more attractive and reduce fears of risk. Therefore, the court found Milnes intended to deceive Xiang. Xiang's debt was not discharged.⁴

⁴ The department filed a motion to collaterally estop Milnes from attacking the findings of the bankruptcy court in this action. Official notice was taken of that court's findings and

DENNIS & DENISE POOR & KITTYHAWK

38. Dennis and Denise Poor signed a purchase agreement with JB Land dated March 26, 2007, in which they agreed to invest \$50,000 in exchange for a 16.7 percent tenancy-in-common interest in a 1.26 acre parcel in Rosamond, California. Peavey and Milnes agreed that within two years, JB Land would buy the interest back for \$70,000. JB Land was to develop, improve and/or sell the property at its sole discretion. Milnes and Peavey personally guaranteed the Poores' investment.

39. On March 18, 2008, Dennis Poor, as president of Kittyhawk Products, and Denise Poor, signed an agreement by which Kittyhawk would invest \$100,000 and the Poores would invest \$50,000, in exchange for a 3.75 percent tenancy-in-common interest in the 9.32 acre parcel in Rosamond, California. JB Land promised that on or before February 15, 2009, it would buy all of the interests of Kittyhawk for \$125,000, and the interests of the Poores for \$62,500. The Poores and Kittyhawk agreed that JB Land would have the sole discretion to develop, improve and/or sell the property. The contract was personally guaranteed by Peavey and Milnes.

40. Neither the Poores nor Kittyhawk received any return on the investments.

PHILLIP DIEP

41. On May 7, 2007, Phillip Diep signed a purchase agreement with JB Land by which he would invest \$500,000, in exchange for a 50 percent tenancy-in-common interest in the Warehouse Operation project in Rosamond. JB Land promised that on or before December 31, 2007, it would buy all of his interest in the property for \$675,000. Diep agreed that JB Land would have the sole discretion to develop, improve and/or sell the property. The contract was personally guaranteed by Peavey and Milnes.

42. Diep has not received any return on his investment.

JUNE FUJI

43. On June 8, 2006, June Fuji signed a purchase agreement with JB Land by which she would invest \$50,000 in exchange for a 33.4 percent tenancy-in-common interest in a residential building lot in Tehachapi, California. JB Land promised that within two years, it

judgment. Milnes offered no evidence in this proceeding, however, in his closing brief, he argues that the misrepresentations to Xiang were made after the contract was signed. The doctrine of collateral estoppel bars relitigation of issues argued and decided in prior proceedings. To the extent that Milnes is attempting to relitigate whether he made misrepresentations to Xiang, he is estopped from doing so because 1) the issue is identical to that decided in the bankruptcy court, 2) it was actually litigated in that forum, 3) it was necessarily decided there, and 4) the judgment is final. (See, *Pacific Lumber Co. v. State Water Resources Control Bd.* (2006) 37 Cal.4th 921, 943-944.)

would buy all of her interest in the property for \$75,000. Fuji agreed that JB Land would have the sole discretion to develop, improve and/or sell the property. The contract was personally guaranteed by Peavey and Milnes.

44. Fuji received no return on her investment.

JOSEPH & MICHELLE CANATSEY

45. On December 24, 2007, Joseph and Michelle Canatsey signed a purchase agreement with JB Land in which they would invest \$100,000, in exchange for a 2.5 percent tenancy-in-common interest in Warehouse Operation project in Rosamond, California. JB Land promised that on or before May 20, 2008, JB Land would purchase the Canatseys' interest in the property for \$120,000. The Canatseys agreed that JB Land would have the sole discretion to develop, improve or sell the property. The contract was personally guaranteed by Peavey and Milnes.

46. The Canatseys received no return on their investment.

MARK MISTAL

47. On March 15, 2006, Mark Mistal signed a purchase agreement with JB Land in which he would invest \$28,750 for a 50 percent tenancy-in-common interest in a residential building lot in Tehachapi, California. JB Land promised that within two years, JB Land would purchase Mistal's interest in the property for \$45,000. Mistal agreed that JB Land would have the sole discretion to develop, improve or sell the property. The contract was personally guaranteed by Peavey and Milnes.

48. On June 4, 2006, Mistal signed a purchase agreement with JB Land in which he would invest \$30,000 for a 20 percent tenancy-in-common interest in a residential building lot in Tehachapi, California. JB Land promised that within two years, JB Land would purchase Mistal's interest in the property for \$45,000. Mistal agreed that JB Land would have the sole discretion to develop, improve or sell the property. The contract was personally guaranteed by Peavey and Milnes.

49. Mistal received no returns on the investments.

Milnes's Evidence

50. Milnes elected not to appear at hearing or present any evidence in his defense.

LEGAL CONCLUSIONS

Did Milnes violate Corporations Code section 25110 by offering and selling unqualified, non-exempt securities in issuer transactions?

1. It is unlawful in California for any person to offer or sell any security in an issuer transaction unless such sale has been qualified or unless the transaction is exempt. (Corp. Code, § 25110.) California law defines the term “security” broadly. It means “any note; stock; treasury stock; membership in an incorporated or unincorporated association; 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; . . . or, in general, any interest or instrument commonly known as a ‘security’ . . .” (Corp. Code, § 25019.) The purpose of such a broad definition is “to protect the public against spurious schemes, however ingeniously devised, to attract risk capital.” (*Silver Hills Country Club v. Sobieski* (1961) 55 Cal.2d 811, 814.)

2. To establish a violation of Corporations Code section 25110, the department must establish an offer and/or sale involving a security that occurred in California linked to an issuer transaction and that the offer was not qualified with the department. Milnes carries the burden of proof if he claims that the security or transaction is exempt from qualification. (Corp. Code, § 25163.) The evidence established that the offers made by Milnes were not qualified by the department. (Factual Finding 4.) No evidence of an exemption was established by Milnes. (Factual Findings 4 and 50.)

3. Since California Corporate Securities law was patterned after the Federal Securities Act of 1933, federal decisions interpreting that Act in defining the term “security” should be consulted. (*People v. Schock* (1984) 152 Cal.App.3rd 379, 387.)

THE PURCHASE AGREEMENTS ENTERED INTO BETWEEN THE INVESTORS AND JB LAND CONSTITUTED “INVESTMENT CONTRACTS” AS DEFINED IN SECTION 25110

4. An “investment contract,” as used in Corporations Code section 25110, 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 a third party. (*S.E.C. v. W.J. Howey* (1946) 328 U.S. 293.) In *Howey*, the investors were offered units of a citrus grove development coupled with a contract for cultivating, marketing and remitting the net proceeds to the investor. The United States Supreme Court held that a corporation that offered the opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by the corporation, to persons who resided in distant locations and who lacked the equipment and experience to operate the citrus grove, through service and land sale contracts, which served as a method of determining the investors’ shares of profits, were offering “investment contracts,” within the meaning of the federal Securities Act. (See also, *People v. Schock, supra*, 152 Cal.App.3rd 379, [sale of fractional interests in promissory notes, and secured transaction involving series of promissory notes

constitute securities where transactions involved group of small individual investors who relied primarily on skill and services of company to supervise enterprise and protect investors]; *McCown v. Heidler* (1975) 527 F.2d 204 [sale of undeveloped lots by developer in real estate project constituted an “investment contract” where developer touted project as having substantial investment potential, where investors did not reside on land, and without substantial improvements pledged by developers the lots would not have a value consistent with the purchase price].)

In this matter, JB Land solicited investors for financial investments in a tenancy-in-common ownership of land with JB Land. JB Land touted the substantial investment potential and guaranteed significant rates of return. The parcels were to be significantly developed solely by JB Land in order to yield a value consistent with, or greater than, the purchase price. The investors expected, and were promised, profits from the venture. The investors and JB Land were involved in a common enterprise to develop parcels of land for profit through the efforts of JB Land. Therefore, the purchase agreements constituted “investment contracts” as used in Corporations Code section 25019, and the agreements were securities.

THE NOTES ENTERED INTO BETWEEN THE INVESTORS AND JB LAND CONSTITUTED SECURITIES

5. The department also argues that the investment contracts issued by JB Land, Milnes and Peavey, constituted “notes” as used in Corporations Code section 25019. The notes, in the form of investment contracts, promised to pay the investor a sum certain within a specified period of time, in consideration of the payment of money by the investor. The department argues that the inherent value to the investor was the unrealized development value of the property, which was to be developed and realized exclusively through the management and control of JB Land, while the investor would have no further obligation.

6. In *Reves v. Ernst & Young* (1990) 494 U.S. 56, in order to raise money to support its general business operations, the Farmer's Cooperative of Arkansas and Oklahoma sold uncollateralized and uninsured promissory notes payable on demand by the holder. Marketed as an “Investment Program,” the notes paid a variable interest rate higher than that of local financial institutions. After the Cooperative filed for bankruptcy protection, the investors sought to invoke the anti-fraud provisions of the federal securities law.

Under *Reves*, the analysis begins with a rebuttable presumption that a note is a security within the meaning of the 1934 Securities Act unless it falls into certain judicially created categories of financial instruments that obviously are not securities, or if the note in question bears a “family resemblance” to notes in those categories. (*Id.* at 65; See also, *McNabb v. S.E.C.* (2002) 298 F.3d 1126, 1132.) In applying the “family resemblance” test, courts look to four factors: (1) the motivations that would prompt a reasonable buyer and seller to enter into the transaction in question; (2) the plan of distribution of the instrument; (3) the reasonable expectations of the investing public; and (4) whether the existence of an alternate regulatory scheme significantly reduces the risk of the instrument.

Here, the first factor is satisfied because JB Land sold the notes to raise capital to develop the parcels, and the investors purchased the notes to earn a profit in the form of interest. Thus, the transaction constituted an investment in a business enterprise.

If the notes are sold to a broad segment of the public, the second factor (common trading) is established. If the notes are not sold to a broad segment of the public, the plan of distribution must be weighed against the purchaser's need for protection of the securities laws. (*McNabb v. S.E.C.* (2002) 298 F.3d 1126, 1132.) Here, the purchasers of the notes were unsophisticated and inexperienced investors, and in need of the securities law protection. (Factual Finding 11.)

The third *Reves* factor involves the reasonable expectations of the investor. The investors here were promised that due to the experience and business savvy of the principals, the parcels would be developed into profitable businesses and they would receive a 50 percent return on their investment within two years. (Factual Findings 9 through 11.) Lenders do not normally receive 50 percent returns on loans. The reasonable expectations of an investor being offered what Peavey and Milnes offered was that it was an investment, not a loan.

The final factor in the *Reves* analysis involves whether risk-reducing factors, such as an alternate regulatory scheme, are available to safeguard the investors. Here, the investors were given deeds to their interests in the parcels, and personal guarantees by the principals. However, their interests in the undeveloped parcels were significantly less than what they had paid, and the personal guarantees of Peavey and Milnes were worthless. (Factual Findings 12.) There is no alternative regulatory scheme to render the applications of the securities laws unnecessary. Under these circumstances, there were no risk-reducing factors and the securities laws should be invoked.

7. Considering the four *Reves* factors in this matter, the contracts sold by Peavey and Milnes may also be considered securities under the definition of "notes" as that term is used in Corporations Code section 25019, and are therefore subject to qualification under the California Corporate Securities Law of 1968. The notes were being offered and sold without being qualified in violation of Corporations Code section 25110.⁵

⁵ Milnes alleges in his closing brief that a statute of limitation contained in Corporations Code section 25507 applies in this matter. However, this statute of limitation, as stated on its face, applies only to actions to enforce civil liability. This is not an action to enforce civil liability, and therefore this statute of limitation does not apply here. Milnes also cites a statute of limitation contained in section 25506, which limits the time to enforce liabilities created under sections 25550, 25501 and 25502. Since this is not an action to enforce a liability under those sections, this statute of limitation also does not apply.

Did Milnes violate Corporations Code section 25401 by making misrepresentations or by omitting to state material facts?

8. It is unlawful in California to make untrue statements of material facts or to omit material facts when offering to sell or selling a security. (Corp. Code, § 25401.) Information is material if there is a substantial likelihood that a reasonable investor would consider it important in making a decision as to whether to invest. (*Insurance Underwriters Clearing House, Inc. v. Natomas Co.* (1986) 184 Cal.App.3d 1520, 1526.)

9. The evidence established that when offering the securities, Milnes and Peavey failed to disclose that:

- 1) Peavey was suspended from the practice of law by the California State Bar on August 20, 2003, for committing seven acts of misconduct including failing to report a civil judgment for fraud, failing to avoid an interest adverse to a client, violating his fiduciary duty, and committing acts of moral turpitude;
- 2) Peavey resigned from the California State Bar on June 9, 2006, with new charges pending against him;
- 3) Peavey and Milnes were unable to honor the personal guarantees that they had offered;
- 4) Milnes would not monitor the funds invested, and had no control over the account into which their funds were deposited;
- 5) The invested funds would not be used exclusively for the development of the parcel in which it was invested; and,
- 6) The investment was risky.

(Factual Findings 12 – 14, 21, 30 and 34.)

There is a substantial likelihood that a reasonable investor would consider all of these omissions to be important in reaching a decision on whether to invest.

10. In addition, the evidence established the following misrepresentations by Milnes to Xiang:

- 1) Xiang's investment would be aggregated with other funds from other purchasers of interests in the parcel, matched with the appropriate real estate, and used to develop or otherwise add value to the land;

- 2) the investment was secure because they had purchased an interest in real estate at a "bargain price," when in fact the price paid for the real estate could only be justified if the property was fully developed; and,
- 3) the investment would be used to develop the parcel and construct the warehouse, when in fact, the funds were used for various purposes;

(Factual Findings 33, 34 and 37.)

11. These misrepresentations were also made to Kuffer and the Wongs (although in the Wongs' case, the parcel was to be developed into an equestrian estate rather than a warehouse). (Factual Findings 16, 21, 24, 27 and 30.)

12. In the sale of securities by JB Land, Milnes failed to disclose material facts and made untrue statements of material facts, in violation of Corporations Code section 25401.

Conclusion

13. The evidence established that cause exists to affirm the commissioner's Desist and Refrain Order of May 23, 2012 against respondent James Wilkes Milnes.

ORDER

The Order to Desist and Refrain, issued against James Wilkes Milnes, by the Commissioner of Corporations on May 23, 2012, is affirmed.

DATED: 3/12/13

JILL SCHLICHTMANN
Administrative Law Judge
Office of Administrative Hearings

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ERRATA SHEET

(Changes to Proposed Decision –James Wilkes Milnes)

- 1) On page 1 of the proposed decision, paragraph number one of the Factual Findings, line 2, insert “of 1968” after “Corporate Securities Law”.
- 2) On page 8 of the proposed decision, paragraph number thirty two of the Factual Findings, line 4, delete “of” after “who lost”.