STATE OF MICHIGAN

COURT OF APPEALS

PEOPLE OF THE STATE OF MICHIGAN, Plaintiff-Appellant,	UNPUBLISHED April 16, 2013
v JEFFREY RON MITCHELL, Defendant-Appellee.	No. 303432 Wayne Circuit Court LC No. 10-004448-FH

PEOPLE OF THE STATE OF MICHIGAN, Plaintiff-Appellant,	
v ROBERT ANTONIO VALERI, JR, Defendant-Appellee.	No. 303433 Wayne Circuit Court LC No. 10-004448-FH

PEOPLE OF THE STATE OF MICHIGAN, Plaintiff-Appellant,	
v ROBERT VALERI, SR, Defendant-Appellee.	No. 303434 Wayne Circuit Court LC No. 10-006488-FH

Before: WILDER, P.J., and STEPHENS and RONAYNE KRAUSE, JJ.

PER CURIAM.

Plaintiff appeals as of right the circuit court orders granting defendants' motion to quash and dismissing the charges of conducting a criminal enterprise, MCL 750.159i(1); conspiracy to sell unregistered securities, MCL 750.157a; selling unregistered securities, MCL 451.701; and

omitting material facts in connection with the sale of a security, MCL 451.501.[1] We affirm in part, reverse in part, and remand.

In 1994, defendants Mitchell and Valeri, Sr. began working together to market insurance and securities; Valeri, Jr., later joined the team. Among other things, they promoted and sold "Universal Leases" (UL). ULs were vacation programs similar to timeshare agreements: purchasers obtained the right to use a specific "Vacation Unit" in a specific resort at a specific time. Michael Kelly developed and marketed the UL through Yucatan Resorts S.A. and Resort Holdings International S.A. (RHI), corporations he owned and controlled. UL purchasers had three options: they could personally use the vacation unit themselves, they could rent it to others through their own efforts, or they could hire an ostensibly independent management company to rent the unit on the purchaser's behalf. Although no specific management company was required, only one was actually available: Majesty Travel (Majesty), which, according to the felony complaint, was owned and controlled by Kelly. All of the Michigan UL purchasers selected the latter option of hiring Majesty.

Majesty's management agreement offered leaseholders three options: payment of 60% of the amount collected by the servicing company as rental compensation for renting the unit; payment of 4% of the purchase price as "rental income"; or payment of 4% of the purchase price as "rental compensation." All three options also provide that Majesty, at the leaseholder's option, will purchase the unit from the leaseholder for the original purchase price after 36 months and pay the leaseholder a 5% yearly premium at the time of purchase. The difference between the second and third options is that the third option provides that "[a]ll compensation . . . is payable, equivalent of 9% annually."

RHI marketed and sold the UL across the nation through independent sales agents. Promotional materials marketed the UL as an investment, with the potential to generate safe and secure income. RHI represented that the UL was "suitable for IRA rollovers from 401(K), SEP, TSA, Keogh and annuity account." Nevertheless, the purchaser's receipt form states that ULs come with no investment guarantee. Defendants marketed and sold the UL in Michigan between 2002 and 2004. According to several witnesses, defendants marketed the UL as an investment opportunity with a guaranteed 9% return. During this time, the UL was not registered under the Michigan Uniform Securities Act (MUSA), MCL 451.501, *et seq*.[2] A number of people purchased ULs from defendants, who made oral representations that the ULs would pay 9% returns on the investments, generated by the management company. Some of the purchasers did, in fact, receive investment payments for a time. However, according to the felony complaint, there simply were not enough vacation units to generate the promised return, and the promised

[1] Valeri, Jr., was not charged with the latter two offenses.

[2] The Michigan Uniform Securities Act, MCL 451.501, *et seq*., was repealed effective October 1, 2009. MCL 451.2702. However, pursuant to MCL 451.2703(1), "[t]he predecessor act exclusively governs all actions, prosecutions, or proceedings that are pending or may be maintained or instituted on the basis of facts and circumstances occurring before the effective date of this act . . . "

payments were temporarily made only by using money obtained from selling more units.[3] The payments ultimately became erratic and then stopped altogether. Many of the purchasers were retirees seeking retirement income.

The Attorney General determined that the UL was security and that it was not exempt from registration under the MUSA. Therefore, in 2009, the Attorney General charged Mitchell, Valeri, Sr., and Valeri, Jr. with conducting a criminal enterprise, MCL 750.159i(1); and conspiracy to sell unregistered securities, MCL 750.157a. The Attorney General also charged Mitchell and Valeri, Sr. with selling unregistered securities, MCL 451.701; and omitting material facts in connection with the sale of a security, MCL 451.501. Defendants argued, after being bound over, that the charges should be dismissed because, inter alia, the UL was not a "security" as defined by the MUSA. The circuit court agreed, and it also concluded that there was insufficient evidence to support Valeri, Jr.'s bindover. The Attorney General now appeals.

A circuit court's ruling on a motion to quash the information and a district court's decision to bind over a defendant are reviewed for an abuse of discretion. *People v Hotrum*, 244 Mich App 189, 191; 624 NW2d 469 (2000). "However, where the decision presents a question of law, i.e., whether the alleged conduct falls within the statutory scope of a criminal law, our review is de novo." *Id.* "Similarly, statutory interpretation is a question of law reviewed de novo on appeal." *People v Riggs*, 237 Mich App 584, 587; 604 NW2d 68 (1999). This Court reviews de novo the bindover decision of a district court "to determine whether the district court abused its discretion." *People v Henderson*, 282 Mich App 307, 313; 765 NW2d 619 (2009). An abuse of discretion occurs when the trial court's decision falls outside the range of reasonable and principled outcomes. *People v Unger*, 278 Mich App 210, 217; 749 NW2d 272 (2008).

We first conclude that, under the circumstances of this case, the ULs sold by defendants were "securities."

Former section 301 of the MUSA, MCL 451.701, makes it unlawful to offer or sell any security in this state unless it is registered under the act or is exempted under section 402, MCL 451.802. At the time defendants marketed and sold the UL, the term "security" was defined by former section 401, MCL 451.801(z), which provided in relevant part:

> "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; pre organization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or

[3] Other evidence supports the affidavit in this respect. See *United States Securities and Exch Comm v Kelly*, 545 F Supp 2d 808, 810 (ND Ill, 2008) ("[c]ontrary to the representations made to investors, however, Kelly and those under his control are alleged to have used new investor funds raised in the scheme to make illusory 'rental income' payments to the investors"), and *United States v Kelly*, Case No. 06-CR-00964 (ND Ill).

> lease; 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 foregoing. *"Security" includes any contractual or quasi contractual arrangement pursuant to which: (1) a person furnishes capital, other than services, to an issuer; (2) a portion of that capital is subjected to the risks of the issuer's enterprise; (3) the furnishing of that capital is induced by the representations of an issuer, promoter, or their affiliates which give 'rise to a reasonable understanding that a valuable tangible benefit will accrue to the person furnishing the capital as a result of the operation of the enterprise; (4) the person furnishing the capital does not intend to be actively involved in the management of the enterprise in a meaningful way; and (5) a promoter or its affiliates anticipate, at the time the capital is furnished, that financial gain may be realized as a result thereof.* [Emphasis added.]

The Attorney General argues, and we agree, that the UL, taken literally as written, does not satisfy the definition of a "security," but that defendants' oral representations should be considered part of the UL as sold.

"A security is not always an easily recognized creature." *Aldrich v McCullock Properties, Inc*, 627 F2d 1036, 1039 (CA 10, 1980). Thus, "[c]ourts interpreting securities statutes are careful to look beyond the form of a transaction to its substance, paying special attention to the economic realities of the situation[.]" *Dep't of Commerce v De Beers Diamond Investment, Ltd*, 89 Mich App 406, 410; 280 NW 2d 547 (1979).

> Whether or not a particular transaction comes within the purview of a state securities law such as the Uniform Securities Act depends on the language of the statute and the real nature of the transaction. The court must ascertain the substance of the transaction and the real intent and purpose of the parties, looking beyond labels and devices. [*People v Breckenridge*, 81 Mich App 6, 14; 263 NW2d 922 (1978) (internal citation omitted).]

Similarly, although decisions of lower federal courts are not binding on us, we agree with the Tenth Circuit's reasoning:

> Central to this test [of the definition of a security] is the promotional emphasis of the developer. Characterization of the inducement cannot be accomplished without a thorough examination of the representations made by the defendants as the basis of the sale. Promotional materials, merchandising approaches, oral assurances and contractual agreements were considered in testing the nature of the product in virtually every relevant investment contract case. An action should not be dismissed where, as here, the plaintiffs reasonably alleged the existence of investment intent and common enterprise and where nothing in the complaint precludes the finding of a security. [*Aldrich*, 627 F2d at 1039-40 (citations omitted).]

The plain language of the statute also shows that it proper for us to look at defendants' oral representations and assurances in promoting the UL to determine whether it is a security. The statute includes phrases such as: (1) "induced by the representations of an issuer," (2) "give 'rise to a reasonable understanding,'" "does not intend," and "anticipate at the time." MCL 451.801(z). These phrases clearly indicate that courts must look beyond the written agreements when determining whether a transaction involves a security within the meaning of the MUSA.

It is obvious that the purchasers furnished capital to RHI, unambiguously satisfying the first element. The remaining elements depend at least in part on defendants' representations or the way in which Kelly and his companies actually implemented the UL. The second element requires that "a portion of that capital is subjected to the risks of the issuer's enterprise." MCL 451.801(z). Formally, each purchaser's capital was only linked to the success or failure of their own efforts through the marketing company of their individual timeshares. However, as a practical matter, each purchaser's capital was apparently being converted into ersatz income payments to prior investors. This raises profound doubt that defendants were aware of Kelly's fraudulent behavior, particularly because defendants were themselves personally invested in the UL program and recommended it even to their own family members. Nevertheless, each purchaser's capital was essentially dependent on Kelly's and RHI's effective "Ponzi scheme" continuing to function. Looking to the reality of the situation rather than the glossy sales puffery in the written materials, each investor's capital was subjected to the risks of the issuer's enterprise.

This is consistent with the Office of Financial and Insurance Regulation (OFIR) stance on risk as it relates to timeshares. OFIR Release No. 98-1-S discusses the sale of timeshares as securities in Michigan. The release includes a discussion of the five-part test as applied to timeshares and states in relevant part:

> 1. All timeshare offerings on which the Bureau has taken a no-action position failed to meet the risk capital test. No portion of the purchaser's money was, " . . . subjected to the risk of the issuer's enterprise . . . " That is, completion of the developer's timeshare project was not dependant on the proceeds of the timeshares sold. This was accomplished in any combinations of ways, typically: a) those proceeds were kept in escrow until completion of the project; b) a builder's bond covered the completion of the project; c) the developer utilized its own funds with or without established lines of credit with various lending institutions. [OFIR Release No. 98-1-S, p 2.]

Therefore, risk, as it pertains to timeshares, relates to the success or failure of timeshare project. The purchaser's capital is at risk only when completion of the timeshare project is dependent on the proceeds of the timeshares sold. Under those circumstances, there is a direct link between the investor's capital and success of the project. RHI was using the UL proceeds to directly fund its ongoing scheme to continue defrauding more investors. Therefore, there was a direct link between the value of each UL to the success or failure of RHI. The financial success of each UL was independent of the efforts of the owner and the management company.

The third factor requires that "the furnishing of that capital is induced by the representations of an issuer, promoter, or their affiliates which give 'rise to a reasonable

understanding that a valuable tangible benefit will accrue to the person furnishing the capital as a result of the operation of the enterprise.'" MCL 451.801(z). Several witnesses testified during the preliminary examination and stated that defendants marketed the UL as an investment with a guaranteed 9% return. Although the 9% return was ostensibly to come via the management company, the management company does not appear to have been a *meaningfully* independent entity under the circumstances. The purchasers would have been reasonable in believing that the management company's efforts were part of the UL "enterprise." Clearly, they purchased the ULs expecting to receive a benefit therefrom.

The fourth factor requires that "the person furnishing the capital does not intend to be actively involved in the management of the enterprise in a meaningful way." MCL 451.801(z). The UL technically gives the owner three options of use in regard to the vacation unit, personal use, rent it through his own efforts, or hire a third party management company to rent it. Every leaseholder in Michigan elected to hire a management company, and it appears that the ULs were not marketed in such a way to encourage any other choice. Thus, in a very narrow sense, each leaseholder was involved the management of his own unit. There is no evidence, however, that any leaseholder intended to be involved beyond the hiring of a management company. Moreover, though each leaseholder had the *theoretical* right to chose any management company, defendants presented the leaseholder with only one option for a hiring a management company only one such company was actually available; and again, that company was not truly independent of RHI. Therefore, it is unlikely that the leaseholders intended to be involved in the management of the enterprise in a meaningful way, and it seems also unlikely that RHI intended the leaseholders to be involved, either.

The final factor requires that "a promoter or its affiliates anticipate, at the time the capital is furnished, that financial gain may be realized as a result thereof." MCL 451.801(z). There is no evidence in the record even suggesting that defendants were aware, or even suspicious, of the fraudulent nature of the UL program. As noted above, quite the contrary, and it seems that defendants themselves are also victims of Kelly's scheme to defraud UL purchasers. Nonetheless, the evidence here shows that defendants, as promoters of the ULs, did anticipate when they sold the ULs that the purchasers would reap financial rewards from doing so.

We therefore conclude that the ULs at issue here, *as presented and sold*, were "securities" within the meaning of the MUSA. The circuit court erred in concluding otherwise. We do not hold that timeshares are securities per se, but that timeshares are securities if presented and sold as such, as in this case.

However, the trial court correctly dismissed several charges. In Count I, defendants were charged with conducting a criminal enterprise/racketeering, MCL 750.159i(1). MCL 750.159i(1) provides that "[a] person employed by, or associated with, an enterprise shall not knowingly conduct or participate in the affairs of the enterprise directly or indirectly through a pattern of racketeering activity." A "pattern of racketeering" must include at least two incidents of racketeering. MCL 750.159f(c). '"[R]acketeering' means committing, attempting to commit, or aiding or abetting" in any of several enumerated offenses for financial gain. MCL 750.159g. "Hence, the prosecution must normally prove the commission of each element of the predicate acts of racketeering, in addition to the other elements of racketeering, in order to prove a

racketeering violation." *People v Martin*, 271 Mich App 280, 290; 721 NW2d 815 (2006), aff'd 482 Mich 851 (2008).

The predicate acts of racketeering listed in the felony information are violations of MCL 451.501, MCL 451.701, and 451.809. Violations of MCL 451.501 and MCL 451.701 are not among the offenses enumerated in MCL 750.159g.[4] Therefore, violations of these sections cannot serve as predicate racketeering acts. MCL 750.159g ('"racketeering' means committing, attempting to commit, or aiding or abetting" in any of several enumerated offenses for financial gain). Although MCL 451.809[5] was enumerated in MCL 750.159g(g), it was merely a penalty provision. MCL 451.809 did not itself proscribe any conduct; therefore, it could not itself be violated. Consequently, even if defendants violated MCL 451.501 or 451.701, as principals or as an aiders and abettors, the evidence would still be insufficient to establish probable cause that they committed a pattern of racketeering activity. As a matter of law, the Attorney General failed to state an offense under 750.159i(1).

Therefore, the district court abused its discretion when it bound defendants over to the circuit court on the charge of conducting a criminal enterprise. The circuit court's order dismissing Count I is affirmed.

The Attorney General also charged defendants with conspiracy to sell unregistered securities. The information alleges that defendants did "conspire . . . together with one another and others to commit the offense of offering and/or selling unregistered securities in violation of MCL 451.701, contrary to MCL 750.157a." "Conspiracy is a specific-intent crime, because it requires both the intent to combine with others and the intent to accomplish the illegal objective." *People v Mass*, 464 Mich 615, 629; 628 NW2d 540 (2001). "For intent to exist, the defendant must know of the conspiracy, know of the objective of the conspiracy, and intend to participate cooperatively to further that objective." *People v Turner*, 213 Mich App 558, 570; 540 NW2d 728 (1995), overruled in part on other grounds by *Mass*, 464 Mich at 627-628.

Former MCL 451.701 provided that it was unlawful to offer or sell a security in this state unless it is registered, exempt from registration, or constitutes a federally covered security. Although it contained no intent requirement, the penalty provision provided that "[a]ny person who *willfully* violates section . . . 301(1) . . . shall upon conviction be fined not more than $25,000 for each violation, or imprisoned not more than 10 years, or both." MCL 451.809(1) (emphasis added). Therefore, to be criminally liable for selling unregistered securities in violation of MCL 451.701, a defendant must willfully violate the section. See *People v Mitchell*, 175 Mich App 83, 88; 437 NW2d 304 (1989). The MUSA does not define "willful," but in the context of former MCL 451.501(2) and (3),[6] this Court has explained:

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[4] Pursuant to 2002 PA 124, the version of MCL 750.159g in effect at the relevant times.

[5] Pursuant to 2000 PA 494, Sec 409, the version of MCL 451.809 in effect at the relevant times.

[6] Pursuant to 2000 PA 494, "It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly: . . . (2) To make any untrue statement of a

> To willfully violate subsection 101(2) this defendant must have intended the omission which was found to be material and misleading. To willfully offend subsection 101(3) he must have intended to engage in the course of conduct found to operate as a fraud. In addition, this defendant must have known or recklessly failed to discover facts that rendered his conduct violative of those subsections. It is insufficient that he could have discovered the facts by due care. On the other hand, he need not have acted with the conscious purpose to mislead or defraud. It is also unnecessary that he know his conduct violated the law. [*Id*. at 88.]

Consequently, "willful" refers to a defendant's conduct itself being intentional, not to a defendant's knowledge of the significance of that conduct. In other words, it is a defendant's acts themselves that must be intentional and knowing.

However, "willfulness," and thus the irrelevance of defendants' awareness that they were selling unregistered securities, is only relevant to the imposition of a penalty pursuant to MCL 451.809(1) for a violation of former MCL 451.701. Defendants were charged with conspiring to sell unregistered securities pursuant to MCL 750.157a. Consequently, defendants must have specifically intended to accomplish the objective of selling unregistered securities and been aware that such an illegal sale was, in fact, the objective. See *People v Justice*, 454 Mich 334, 346 n 21; 562 NW2d 562 (1997). As discussed, the evidence in the record strongly suggests that none of the defendants were aware that the ULs were even a scam, let alone securities, unregistered or otherwise. Indeed, the record suggests that defendants were reasonably misled by RHI to believe that the ULs were *not* securities. We therefore conclude that the record simply does not support a finding of probable cause to believe that defendants had the requisite specific intent to commit the charged conspiracy offense.

Therefore, the district court abused its discretion when it bound defendants over to the circuit court on the charge of conspiring to sell unregistered securities. The circuit court's order dismissing the charges is affirmed to the extent that it encompasses dismissal of Count II.

However, we conclude that the trial court erred in dismissing the remaining charges—against Mitchell and Valeri, Sr., only—on the basis of entrapment by estoppel. Entrapment by estoppel generally applies where, inter alia, a defendant acts in reliance on a government official's representation that particular illegal conduct is legal. See *People v Pierce*, 272 Mich App 394, 399-400; 725 NW2d 691 (2006). Defendants argue that they relied on a memorandum drafted by Matthew Curtis, a securities investigator for OFIR, that concluded that the sales of ULs did not violate the MUSA. However, defendants sold almost all of the sold ULs prior to the date of that memorandum. Furthermore, the record is devoid of evidence that defendants were aware of the memorandum. Defendants also contend that they relied on an investigation conducted by Linda Green, and insurance investigator for OFIR. Her conclusion that there was no violation of the MUSA was not made until several months after the last UL sale occurred.

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material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading. (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

There can be no entrapment by estoppel because defendants could not have relied on something of which they had no knowledge.

The circuit court's orders quashing the information is affirmed as to the charges of conducting a criminal enterprise and conspiracy to sell unregistered securities. The circuit court's orders quashing the information is reversed as to the remaining charges. The matter is remanded for further proceedings consistent with this opinion as the trial court deems necessary and appropriate, including consideration of any other issues not discussed in this opinion. We do not retain jurisdiction.

/s/ Kurtis T. Wilder
/s/ Cynthia Diane Stephens
/s/ Amy Ronayne Krause