In the matter of:

CAPSOURCE, INC.
Unregistered

Docket No. 19-011622
Complaint No. 335479

Respondent.

_____/

FINAL ORDER

1. This matter came before the Department of Licensing and Regulatory Affairs, Corporations, Securities & Commercial Licensing Bureau ("Department") under the Michigan Uniform Securities Act (2002), MCL 451.2101 *et seq.* (the "Act").

2. The Interim Director of the Corporations, Securities & Commercial Licensing Bureau, who is the Administrator of the Act (the "Administrator"), received the Proposal for Decision (the "PFD"), Exceptions to the PFD filed by the Department, Response to Exceptions filed by Respondent, and the entire hearing record in accordance with MCL 451.2412 and the Administrative Procedures Act of 1969, MCL 24.201 *et seq*.

3. The Administrator considered the Findings of Fact and Conclusions of Law in the PFD of Paul Smith, Administrative Law Judge, dated May 15, 2020, the Exceptions to PFD, the Response to Exceptions, and the complete hearing record.

4. The Administrator incorporates the Findings of Fact in the PFD, with exception to paragraph 31. In lieu of the Finding of Fact in paragraph 31, the Administrator finds as follows:

    a. Under Nevada law, Respondent is required to provide a Mortgage Broker Disclosure form to its investors. See 10/14/2019 Transcript pp. 91-92, 96. The form requires the investor to mark whether they received or waived the right to receive six different categories of documents prior to investing. See Respondent's Exhibit 5, pp 53-54. However, Respondent pre-marks this form to waive receipt of all documents prior to sending it to the investor for signature. See 10/14/2019 Transcript pp. 119-120. Further, if an investor requests any of six categories of documents, Respondent refuses to accept the investment. See 10/14/2019 Transcript pp. 99, 113-114, 117-120.

5. The Administrator makes the following Conclusions of Law:

    a. It is a violation of the Act to sell or offer to sell an unregistered security in Michigan. MCL 451.2301(c).

    b. An investment contract is a security subject to the requirements of the Act. MCL 451.2102c(c).

    c. An investment contract is defined as a "scheme [that] involves an investment of money in a common enterprise with profits to come solely from the efforts of others." S*EC v. W.J. Howey Co.*, 328 US 293, 299 (1946).

    d. The "profits" derived from an investment contract are those the "investors seek on their investment, not the profits of the scheme in which they invest." *SEC v. Edwards*, 540 US 389, 397 (2004).

    e. A "promise of a fixed return does not preclude a scheme from being an investment contract." *Id.* at 396. Further, any reading of *United Housing Foundation, Inc. v. Forman*, 421 US 837 (1975), that limits the definition of profits on an investment contract to the two examples cited in that case, is a mistaken application of the law that would "frustrate Congress' intent to regulate all of the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Edwards*, 540 US at 396 (internal citations omitted).

    f. The fractionalized trust deeds sold by Respondent are a scheme that involves the investment of monies from multiple individuals or entities in a common enterprise. See 10/14/2019 Transcript pp. 40-42, 70-71, 79.

    g. The fractionalized trust deeds brokered by Respondent were premised on the expectation of profits in the form of a fixed rate of return ("interest payments"). See 10/14/2019 Transcript p. 71, 140, 152; *Edwards*, 540 US at 396-97.

    h. This profit was derived solely from the efforts of Respondent in the form of arranging loans for borrowers, identifying and soliciting investors, closing the loan, servicing the loan after it closed, and resolving any issues with repayment including foreclosure, restructuring the loan, or representing investors in bankruptcy court. See 10/14/2019 Transcript p. 73-76, 120, 141-143, & 152. See *Forman*, 421 US at 839 ("[An] 'investment contract' . . . involves investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or *managerial* efforts of others." (emphasis added)).

    i. Accordingly, the fractionalized trust deeds offered by Respondent are investment contract securities within the meaning of MCL 451.2102c(c)(v) and subject to the requirements of the Act.

j. It is a violation of the Act to, in connection with the offer, sale, or purchase of a security to make an untrue statement of material fact or omit 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. MCL 451.2501(b).

k. For an omission to be material "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Industries, Inc. v Northway, Inc.* 426 US 438, 450 (1976), and see *Basic Inc. v Levison*, 485 US 224, 231-232 (1998) (adopting the legal standard in *TSC Industries, Inc.* to the determination of a material misrepresentation). "The issue of materiality may be characterized as a mixed question of law and fact . . . ." *Id.* "Only if the established omissions are so obviously important to an investor, that reasonable minds cannot differ on the question of materiality is the ultimate issue of materiality appropriately resolved as a matter of law . . . ." *Id.*

l. Respondent did not provide information to its investors about the business borrowers' ability to generate income beyond describing the real property that secured the loan and the business venture for which the borrower and guarantors sought to use that real property. See 10/14/2019 Transcript pp. 50-51, 75-76, and see Respondent's Exhibit 5, pp 57-63. Respondent also did not provide information to its investors about the financial resources of the guarantors. See 10/14/2019 Transcript pp. 51, 75-77, and see Respondent's Exhibit 5, pp 57-63.

m. However, there is no testimony or exhibits in the record that suggest a reasonable investor would consider any of Respondent's statements misleading in the absence of more detailed information about the borrowers' or guarantors' financial resources. The record also does not contain any statements that Respondent made to its investors that would be so obviously misleading in the absence of more detailed financial information about the business borrowers or guarantors, that the omission of this information can be considered material as a matter of law. None of the testimony or exhibits suggest that Respondent represented to investors that the borrowers or guarantors had resources outside of the real property that served as the collateral, or that their investment was without risk of loss.

6. Respondent is found in violation of Section 301 of the Act, MCL 451.2301.

THEREFORE, IT IS ORDERED that the following penalties authorized by section 604 of the Act, MCL 451.2604, are imposed:

A. Respondent must pay a FINE in the amount of One Hundred Ten Thousand Dollars and 00/100 Cents ($110,000.00). The fine must be paid by cashier's check or money order, with Complaint No. 335479 clearly indicated on the cashier's check or money order.

B. The fine must be made payable to the State of Michigan and be sent to the Department of Licensing and Regulatory Affairs, Corporations, Securities & Commercial Licensing Bureau, Final Order Monitoring – Securities & Audit Division, P.O. Box 30018, Lansing, Michigan 48909 within sixty (60) days from the mailing date of this Final Order.

C. Respondent must continue to Cease and Desist from offering or selling unregistered securities, including fractionalized trust deeds, to Michigan residents.

D. Failure to comply with this Order may subject Respondent to additional administrative or criminal sanctions, fines, and penalties. Under MCL 451.2508, a person that willfully violates the Act, or an order issued under the Act, is guilty of a felony punishable by imprisonment for not more than 10 years or a fine of not more than $500,000.00 for each violation or both. An individual convicted of violating a rule or order under the Act may be fined but shall not be imprisoned if the individual did not have knowledge of the rule or order.

E. No application for a permit, registration, licensure, relicensure, reinstatement, or renewal submitted by Respondent under the Act will be considered or granted by the Department until all final orders of the Department are fully complied with.

F. Failure to pay the fine within six months after it becomes overdue may result in its referral to the Michigan Department of Treasury for collection action against Respondent.

This Final Order is effective immediately upon its mailing.

Given under my hand at Okemos, Michigan, this 12th day of November 2020.

DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS

By: Linda Clegg

Linda Clegg, Administrator and
Interim Corporations, Securities & Commercial Licensing Bureau Director

Date mailed: November 12, 2020

STATE OF MICHIGAN
MICHIGAN OFFICE OF ADMINISTRATIVE HEARINGS AND RULES

IN THE MATTER OF:	**Docket No.: 19-011622**
Corporations, Securities & Commercial Licensing Bureau, **Petitioner**	**Case No.: 335479**
v	**Agency: Corp. Securities Commercial Licensing Bureau**
CapSource, Inc (Unregistered), **Respondent**	**Case Type: Security Division**
_____/	**Filing Type: Sanction**

Issued and entered
this 15th day of May 2020
by: Paul Smith
Administrative Law Judge

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

This matter commenced on January 23, 2019, when the Corporations, Securities & Commercial Licensing Bureau within the Department of Licensing and Regulatory Affairs (the "Bureau") issued a Notice and Order to Cease and Desist to CapSource, Inc. ("Respondent"). The Notice alleged violations of the Michigan Uniform Securities Act, as amended ("Uniform Securities Act"), MCL 451.2101 *et seq.*

Petitioner requested a hearing regarding the Notice and Order to Cease and Desist. A hearing was held and recorded before a court reporter on October 14, 2019, after which the matter remained opened to allow for closing briefs and replies. Administrative Law Judge Paul Smith presided. Assistant Attorneys General Adam Levine and James Long appeared on behalf of the Bureau. Attorneys Mark Kowalsky, Monica Loseman and Timothy Zimmerman appeared on behalf of Respondent.

ISSUE AND APPLICABLE LAW

Section 102c(c) of the Uniform Securities Act, 2008 PA 551, MCL 451.2101 *et seq.*, defines a "security," in pertinent part, as follows:

> **"Security" means a note; stock; treasury stock; security future; bond; debenture; evidence of indebtedness; certificate of interest or participation in a profit-sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting trust certificate; certificate of deposit for a security; fractional undivided interest in oil, gas, or other mineral rights; put, call, straddle, option, or privilege on a security, certificate of deposit, or group or index of securities, including an interest in or based on the value of that put, call, straddle, option, or privilege on that security, certificate of deposit, or group or index of securities; put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; an investment in a viatical or life settlement agreement; or, in general, an interest or instrument commonly known as a "security"; or a 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. All of the following apply to the term security:**
>
> * * *
>
> **(v) The term includes an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor. As used in this subparagraph, a "common enterprise" means an enterprise in which the fortunes of the investor are interwoven with those of either the person offering the investment, a third party, or other investors.**
>
> * * *

[MCL 451.2102c(c).]

The Bureau has accused Respondent of violating Section 301 of the Uniform Securities Act, which provides:

> **A person shall not offer or sell a security in this state unless 1 or more of the following are met:**
>
> **(a) The security is a federal covered security.**

> **(b) The security, transaction, or offer is exempted from registration under sections 201 to 203.**
>
> **(c) The security is registered under this act.**

[MCL 451.2301.]

The Bureau has also accused Respondent of violating Section 501 of the Uniform Securities Act, which provides:

> **It is unlawful for a person, in connection with the offer, sale, or purchase of a security or the organization or operation of a Michigan investment market under article 4A, to directly or indirectly do any of the following:**
>
> * * *
>
> **(b) Make an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.**
>
> * * *

[MCL 451.2501.]

WITNESS TESTIMONY

A summary of the testimony of the witnesses is as follows:

Mark Galliver

Galliver is an investigator of the Securities Division of the Bureau. He began looking into Respondent as a result of a different investigation. He noticed on Respondent's website that it was offering investors the opportunity to invest in fractionalized deeds of trust. He also noticed that Respondent was not listed as a securities broker or dealer in the Financial Industry Regulatory Authority ("FINRA") database. Upon Galliver's request, Respondent provided information to the Bureau. The Bureau then conducted a search and discovered that CapSource was not registered as a securities broker or dealer in Michigan. Respondent took the position that the fractionalized lending opportunities it was offering to investors, including investors located in Michigan, were not securities.

In response to the Bureau's request for more information, Respondent sent a thumb drive containing over 9,000 pages of documentation, which Galliver reviewed. Included within the documents provided to the Bureau by Respondent were documents from the eleven investments described in the cease and desist order. These investments were selected for the cease and desist order because the necessary documents were identified and included on the thumb drive. Galliver testified that the documents selected for the order were representative of other investments that were not included.

Galliver then testified about some of the specific investment deals facilitated by Respondent. The documents for the "EQ Durango loan" included a promissory note between a number of the investors (lenders) and the borrower (EQ Durango) with an interest rate of 12.5% per year. Other documents from Respondent identified a rate of return and stated that Respondent had authority to enforce any default provisions in the loan. Individual investors signed their right to enforce the loan terms over to Respondent. There were three individual guarantors on the EQ Durango deal. Respondent's documents did not provide any information to the investors about the borrower's ability to generate income or about the individual guarantors' ability to cover the guarantees. Galliver summed up Respondent's role in the transaction as soliciting investors to fund a loan that it had put together for EQ Durango. The documents for other fractionalized loans Respondent arranged for Flipping Capital III, L.L.C., Global Bio Lab, Arizona ARC, and FiveStar Management were essentially the same as the documents for the EQ Durango loan.

On cross examination, Galliver acknowledged that he was not an attorney and that he was not offering his opinion on any legal conclusions to be drawn in the matter before the Tribunal. He also acknowledged that he did not interview anyone at Respondent as part of his investigation.

Stephen Byrne

Byrne is Respondent's president. He testified that his responsibilities are origination, servicing, and collection of loans when they do not perform. Byrne agreed with general assertion that Respondent would find borrowers and then find groups of lenders and pool that money to fund mortgages. He also greed that Respondent sold investments to Michigan residents, as individual investors.

Byrne testified that Respondent evaluates applications for loans, focusing on the expertise of the principals and the nature of the project. Respondent is also responsible for monitoring the progress of the projects and enforcing the terms of the loans (which is a condition all investors must agree to before investing with Respondent). Byrne testified that the individual investors are not involved in actively managing the money or

developing the properties. Instead, Respondent decides on the resolution to pursue when a borrower is in default. Under Nevada law, Respondent is required to get approval from more than half of the investors in order to restructure a loan. Respondent does not provide financial information about the ability of the guarantors to cover the loan in case of a default. Respondent finds the borrowers and the lenders, and then closes and services the loan. Approximately $500-$700 million in funds have been invested in Respondent's trust deeds since the company's founding. At closing, the money funding the loans goes from the investors to the title company to the borrower. At no point does Respondent have possession of the loan funds.

Byrne explained that borrowers usually find their way to Respondent. Many are repeat borrowers with a track record borrowing through Respondent. Generally, the borrowers are a single-asset entity formed to develop a real estate project. Respondent evaluates the value of the project and the expertise of the persons doing the borrowing. The guarantors typically are the individual owners of the borrowing entity. Byrne testified that the personal guarantee is a piece of leverage for the lender; having it promotes settlement. Byrne explained that Respondent evaluates the wherewithal of the personal guarantors based on their expertise. Respondent also monitors the progress/performance of their borrower's project after the loan is made.

Byrne then testified about the individual documents that make up a fractionalized deed of trust. The investors' names are on a list that is attached to the note, the deed of trust, and the title policy. The investors do not receive any equity stake in the borrowing entity. Instead, the investment is secured by a lien recorded where the property is located. About 95% of the time, these are first liens. The loan-to-value ratio (meaning ratio of the loan amount and the property value) is disclosed to investors before they commit to the investment. Byrne described this information as a critical measure of the risk involved. Sometimes Respondent will obtain an appraisal to calculate the loan-to-value ratio, but often it will have to make a quicker determination and will not have time for a full-blown appraisal. In those cases, Respondent will get a broker's opinion on valuation of the project. Byrne then discussed a few examples of how the value of the property may be determined. Respondent's Exhibit 12, for the Five Star Management deal, was a loan summary document showing how the value of the collateral was appraised by a local broker. Respondent's Exhibit 13, is a loan summary for a different deal that used a "comparative market analysis," which showed the values of comparable properties. Byrne testified that Respondent has no affiliation with the brokers who provide the information on value. The loan-to-value ratio of a loan for a construction project is calculated based on value of property after completion.

The Loan Summary is one of the first documents an investor would see. It includes borrower's name, guarantor's name & summary, a brief description of the project, the security, the loan amount, the broker price opinion ("BPO") and/or a summary of the valuation, the loan-to-value ratio, and the loan terms. The investor must sign off on having received the information in the loan summary.

The Mortgage Broker Disclosure form is a document required by Nevada law. It is designed to help investors understand the risk involved in mortgage transactions. It discloses the investor's lien position. It discloses whether Respondent is a borrower in addition to being the broker. It discloses whether the broker has been disciplined in Nevada. The Mortgage Broker Disclosure form also discloses the minimum financial requirements for investors. Nevada law requires investors not invest more than 50% of their net worth or annual income.

Finally, the Mortgage Broker Disclosure form includes a section with check boxes addressing various additional disclosures the investor/lender may ask to see or waive. Respondent has a policy of not allowing investors to see the items listed with check boxes on the form. Respondent informs potential investors that they must waive their right to disclosure of these items if they wish to invest in a fractionalized trust deed offered through Respondent. If investors were to request additional information about the loan projects (or about the guarantors), then Respondent would tell them that the information provided in the Loan Summary, along with the other standard documents, is all the information that will be provided. Respondent provides the same standard packet of information to every investor. Byrne testified that he does not believe the information provided to investors omits anything material or misrepresented the risk in any way.

The Loan Servicing Agreement lists the things that Respondent will do to protect the investors during the term of the loan. Respondent collects origination fees from the borrower and a portion of the interest paid by the borrower (called "interest spread"). The origination fees are paid at closing. Respondent's profit from the interest spread comes later (if there is no default). Both Respondent and the investor sign the loan servicing agreement.

Byrne acknowledged that loans sometimes go into default. As soon as he becomes aware of a problem, Byrne will call the borrower to find out what the issue is and to discuss the best resolution. When a default occurs, Respondent will send letters to the investors and schedule a conference call to explain the situation, answer questions and receive feedback. The call is recorded for investors who cannot make the original call but may wish to listen later.

Gregory Herlean

Herlean is a partner at Respondent. He primarily works to find new leads. One of his responsibilities is the content of the website. In that capacity, he testified that Petitioner's Exhibit B is an accurate reflection of Respondent's website. He added that Respondent has since changed the website to be locked and only accessible with a password provided by Respondent. Herlean also explained that an investor cannot purchase directly through the website. They must work with an account executive. The account executives, who report to Herlean, find potential investors and explain the process to them. All of Respondent's account executives have mortgage licenses in Nevada. They are not licensed to sell securities.

When investors indicate interest in making a specific investment, which usually happens after multiple calls between the potential investor and the account executive, Respondent's administrative team will send out the documents that need to be notarized and returned. Herlean testified that investor's funds never go to or through Respondent. The title company handles the funds at closing. Then a loan servicing company, called WebStar, handles the interest and principal payments. Respondent does not handle client funds going in either direction. Finally, Herlean testified that Respondent has many repeat customers.

Tedd Grulke

Grulke is a Michigan resident who has invested in several fractionalized trust deeds through Respondent. He learned about Respondent through a seminar and has a regular contact there. Grulke testified that he did not believe he was investing in securities through Respondent. He understands his investments to be loans. He has invested in two of the eleven deals described in the cease and desist order (EQ Durango and Flipping Capital). When deciding whether to invest in a fractionalized trust deed, Grulke typically considers the loan-to-value ratio, the term, and the exit strategies. Grulke explained that he counts on Respondent to vet the opportunities. He explained that he did not need to see the information he waived because he relied on Respondent.

EXHIBITS

The following exhibits were offered by Petitioner and admitted into evidence at the hearing:

Exhibit A	E-mails regarding Knowles Systems, Inc. that were received by the Bureau in a separate investigation and which brought CapSource to the Bureau's attention
Exhibit B	Screenshots of CapSource website
Exhibit C	Printout from Nevada Secretary of State about CapSource
Exhibit D	Printout of CRD registry from 8/8/18
Exhibit E	Bureau letter to CapSource asking for information
Exhibit F	CapSource response to Bureau request for information
Exhibit G	Follow-up letter from Bureau to CapSource requesting further information
Exhibit H	CapSource response to Bureau's follow-up letter (with street addresses redacted by the Bureau)
Exhibit I	Letter documenting results of search for CapSource registration in Michigan
Exhibit J	Letter from the Bureau to CapSource requesting further information
Exhibit K	CapSource letter responding to Bureau request for further information
Exhibit N	CapSource documents relating to loan to EQ Durango, L.L.C.
Exhibit P	Additional CapSource documents relating to loan to EQ Durango, L.L.C.
Exhibit Q	CapSource documents relating to loan to Flipping Capital III, L.L.C.
Exhibit R	Additional CapSource documents relating to loan to Flipping Capital III, L.L.C.
Exhibit S	CapSource documents relating to loan to Global Bio Lab
Exhibit T	Additional CapSource documents relating to loan to Global Bio Lab

Exhibit U CapSource documents relating to loan to Arizona ARC

Exhibit V Additional CapSource documents relating to loan to Arizona ARC

Exhibit X Additional CapSource documents relating to loan to FiveStar Management

The following exhibits were offered by Respondent and admitted into evidence at the hearing:

Exhibit 1 CapSource documents relating to Global Bio Labs LLC

Exhibit 2 CapSource documents relating to EQ Durango LLC

Exhibit 3 CapSource documents relating to 5 Star Management LLC

Exhibit 4 CapSource documents relating to America's Rehab Campuses-Arizona LLC

Exhibit 5 CapSource documents relating to EQ Durango LLC

Exhibit 6 CapSource documents relating to Flipping Capital III LLC

Exhibit 7 CapSource documents relating to EQ Durango LLC

Exhibit 8 CapSource documents relating to Global Bio Labs LLC

Exhibit 9 CapSource documents relating to Global Bio Labs LLC

Exhibit 10 CapSource documents relating to America's Rehab Campuses-Arizona LLC

Exhibit 11 CapSource documents relating to Flipping Capital III LLC

Exhibit 12 Loan summary for loan to Five Star Management

Exhibit 13 Loan summary for loan to apartment complex project in North Carolina

Exhibit 14 Broker Price Opinion for Global Bio Labs project

Exhibit 15 Loan servicing payment history on Global Bio Labs loan

Exhibit 16 Loan servicing payment history on Global Bio Labs loan

Exhibit 17 Loan servicing payment history on Global Bio Labs loan

Exhibit 18 Loan servicing payment history on EQ Durango loan

Exhibit 19 Loan servicing payment history on EQ Durango loan

Exhibit 20 Loan servicing payment history on EQ Durango loan

Exhibit 21 Loan servicing payment history on 5 Star Management loan

Exhibit 22 Loan servicing payment history on America's Rehab Campuses loan

Exhibit 23 Loan servicing payment history on America's Rehab Campuses loan

Exhibit 24 Loan servicing payment history on Flipping Capital loan

Exhibit 25 Loan servicing payment history on Flipping Capital loan

Exhibit 26 Client account opening form.

FINDINGS OF FACT

Based on the evidence and testimony offered at the hearing, the following findings of fact are established:

1. Respondent is a Nevada Corporation.

2. Stephen Byrne is Respondent's president. His conduct on behalf of Respondent is regulated by the Nevada Mortgage Lending Division.

3. Respondent's account executives are also licensed and regulated by the Nevada Mortgage Lending Division.

4. Respondent is in the business of brokering fractionalized trust deeds.

5. Investors in the fractionalized trust deeds brokered by Respondent come from all over the country, including several who were residents of Michigan at the time of their investments.

6. Respondent plays a number of roles in brokering a fractionalized trust deed, including: (i) finding a borrower with a project in need of capital, (ii) vetting the borrower's ability to complete the project and pay back the loaned capital, (iii) finding investors wishing to pool their assets to fund a single loan to the borrower, (iv) providing information to the potential investors about the project to be funded by the loan, (v) creating the documents necessary to effectuate and

secure the loan from the investors to the borrower, (vi) monitoring the progress of the project funded by the capital provided by the investors, and (vii) enforcing or restructuring the terms of the loan agreement in the event of a default.

7. The investors in fractionalized trust deeds do not receive an equity stake in the borrowing entity.

8. Typically, the entities borrowing through Respondent's fractionalized trust deeds are limited liability corporations established for the purpose of developing commercial construction projects.

9. The fractionalized trust deeds brokered by Respondent are secured by liens on the property being developed for the project. Approximately 95% of the time, the liens securing Respondent's fractionalized trust deeds are first liens.

10. In addition to having a fractionalized interest in the lien on the property securing the loan, the fractionalized trust deeds brokered by Respondent also include personal guarantees from individuals. Typically, the personal guarantees are made by the principals of the borrowing entity.

11. The fractionalized trust deeds brokered by Respondent also include title insurance policies insuring the titles to the properties securing the loans.

12. The investors who invest in the fractionalized trust deeds brokered by Respondent hope to profit by receiving a portion of the interest of the interest paid by the borrower on the loan. The investors are guaranteed a profit if the borrower does not default on the loan. The investors may lose all or some of their investment if the borrower defaults on the loan.

13. Respondent profits by receiving an origination fee paid by the borrower at the time of the closing of the loan.

14. In addition to fees, Respondent also hopes to profit by receiving a portion of the interest paid on the loan over time. This portion of the interest paid to Respondent is called the "interest spread." Respondent's ability to receive the interest spread depends on the borrower's ability to repay the loan without default.

15. At no time during the process of effectuating a fractionalized trust deed does Respondent possess or handle any of the funds coming from or going to the

investors. Funds are transferred from the investors to the borrower at a closing managed by a title company.

16. In the fractionalized trust deeds brokered by Respondent, the principal and interest owed by the borrower is collected and distributed by a loan servicing company according to loan servicing instructions that are set forth in the paperwork constituting the fractionalized trust deed.

17. In the fractionalized trust deeds brokered by Respondent, the borrower's promise to repay the loan is set forth in a promissory note from the borrower listing all of the individual investors and the portion of each individual investor's contribution to the total amount of the loan.

18. In the fractionalized trust deeds brokered by Respondent, the investors' lien interests are created and documented in a "short form deed of trust" signed by the borrower and listing all the individual investors.

19. One of Respondent's business practices in brokering a fractionalized trust deed is to vet the borrower and the guarantors and to provide information to potential investors about the nature of the project.

20. To provide information to potential investors about the project, the borrower, the guarantors, and the basic terms of the fractionalized trust deed under consideration, Respondent uses a document called a "loan summary" or "first trust deed."

21. The processes and documents used in all of Respondent's individual fractionalized trust deed transactions are substantially the same. An example of a loan summary is Respondent's Exhibit 12. An example of the entire collection of documents involved in a fractionalized trust deed brokered by Respondent, including the loan summary or first trust deed, is Respondent's Exhibit 5.

22. Respondent's loan summary documents provided to investors include the borrower's name, the guarantor's/principal's name(s) with a short biography, a brief description of the project, a description of the security, the loan amount, the broker price opinion ("BPO") or some other summary/explanation of the value of the project, the loan-to-value ratio, and the loan terms. The investor must sign off on having received the information in the loan summary before investing in a fractionalized trust deed brokered by Respondent.

23. The loan-to-value ratio is the ratio of the loan amount to the estimated value of the property securing the loan after completion of the project. Respondent understands the loan-to-value ratio to be a "critical measure" for potential investors to gauge the risk of the investment.

24. Depending on the nature of the project and/or the time sensitivity, the method used to determine the value for purposes of calculating the loan-to-value ratio could be a "full-blown appraisal" or a quicker method called a BPO (in which Respondent finds a broker in the local area of the project, who is not affiliated with Respondent, to give an informed opinion about the value of the project).

25. Tedd Grulke, a Michigan resident who has invested in multiple fractionalized trust deeds brokered by Respondent, testified credibly that he relies on Respondent to vet the opportunities before presenting them to investors, that he carefully reads all of the information provided by Respondent, that he understands his investments to be loans, and that when deciding whether to commit to an investment through Respondent he typically considers the loan-to-value ratio, the term of the loan, and the exit strategies.

26. Mr. Grulke has invested in two of the eleven fractionalized trust deed deals described in the January 23, 2019 Notice and Order to Cease and Desist (EQ Durango and Flipping Capital).

27. In addition to the loan summary, Respondent is required under Nevada law to provide investors with a document called the Mortgage Broker Disclosure form. A representative example of the Mortgage Broker Disclosure form is at pages 51-53 of Respondent's Exhibit 5.

28. The purpose of the Mortgage Broker Disclosure form is to disclose to investors some of the risks involved in a mortgage transaction. It sets forth a number of standard, informational disclosures about mortgage transactions and lists a number of details about the specific mortgage transaction underlying the fractionalized trust deed, such as the broker's name, the borrower's name, the property address, and the loan amount.

29. At the top of the Mortgage Broker Disclosure form, under a heading marked "IMPORTANT FACTS" are six bullet points with warnings, including the following: "There are no guarantees that you will receive your interest or principal payments" and "You could lose the entire amount of your principal investment." (Respondent's Exhibit 5, p 51).

30. A standard part of the Mortgage Broker Disclosure form is a section describing six specific categories of information that, under Nevada law, an investor may elect to receive or waive receipt of before investing in the loan. Each category of information listed on the form is followed by check boxes for "Received" or "Waived." The categories of information include (i) the loan application, (ii) evidence of the borrower's history of employment and income, (iii) a report of the borrower's credit history, (iv) an analysis by the mortgage broker of the borrower's ability to pay its monthly debts, (v) a preliminary report of the status of the title of the property used to secure the loan, and (vi) a copy of an appraisal of the property prepared by an appraiser authorized to perform appraisals in Nevada.

31. As a matter of policy, Respondent advises all investors in the fractionalized trust deeds brokered by Respondent that they must elect to waive receipt of each of the six categories of information listed on the Nevada's Mortgage Broker Disclosure form. Respondent tells investors that the only information they will receive is the information contained in the loan summary (described above in Findings 20-24) and in the other standard documents necessary to effectuate the fractionalized trust deed transaction (as exemplified by Respondent's Exhibit 5).

32. All investors in the fractionalized trust deeds brokered by Respondent are required to review and sign off on the Mortgage Broker Disclosure form required by Nevada law.

33. One of Respondent's business practices is to routinely monitor the progress of projects for which it has brokered fractionalized trust deeds. If Respondent detects evidence of a possible problem with a project, Mr. Byrne will reach out to the borrower to discuss the issue.

34. All investors in fractionalized trust deeds brokered by Respondent are required to execute special powers of attorney appointing Respondent to perform services relating to the loan underlying the fractionalized trust deed, including but not limited to initiating foreclosure proceedings, approving bankruptcy proceedings, and approving litigation proceedings. (For an example, see pages 54-55 of Respondent's Exhibit 5.) Essentially, the special power of attorney form executed by each investor gives Respondent, acting on behalf of the individual investors, the authority to enforce the terms of the loans underlying its fractionalized trust deeds.

35. On January 23, 2019, the Bureau issued a Notice and Order to Cease and Desist alleging that Respondent "offered and sold at least eleven (11) investment contract securities in Michigan."

36. Each of the fractionalized trust deed transactions described in the Bureau's January 23, 2019 Notice and Order to Cease and Desist was structured in the manner described above in these Findings of Fact. Each of these fractionalized trust deed transactions had at least one investor who was a resident of Michigan at the time of the investment.

CONCLUSIONS OF LAW

Burden of Proof

The burden of proof is on the Bureau to prove, by a preponderance of the evidence, the existence of a violation. See, e.g. *Bunce v Secretary of State*, 239 Mich App 204, 216 (1999) (holding that the proponent of an order bears the burden of proof in an administrative proceeding). However, to the extent that the Respondent claims an exemption, exception, preemption, or exclusion from the Uniform Securities Act, the burden of proof is on the exemption, exception, preemption, or exclusion. MCL 451.2503(1). In this matter, Respondent does not claim an exemption, exception, preemption, or exclusion but instead argues that its activities are outside of the scope of the act and that it did not violate the act. Accordingly, it is the Bureau's burden to prove the allegations in the Notice and Order to Cease and Desist.

Issue I: Did Respondent Offer Unregistered Securities in Michigan?

The central question before this Tribunal is whether the fractionalized trust deeds brokered by Respondent were "securities" as defined by Michigan's Uniform Securities Law. On that issue, the key facts are not in dispute. The parties agree about the mechanics of the transactions at issue. The outcome thus turns on application of Michigan law.

A. The *Howey/Forman* Test for Investment Contract Securities

The Bureau asserted in the Notice and Order to Cease and Desist, and argued at the evidentiary hearing (Tr., p 13), that the fractionalized trust deeds brokered by Respondent constituted "investment contract securities" under MCL 451.2102c(c)(v), which provides that a "security" includes "an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor."

This definition of an investment contract security in the Uniform Securities Act is consistent with, and derived from, the federal definition of an "investment contract security" established by the United States Supreme Court in *SEC v WJ Howey Co*, 328 US 293, 298-299 (1946) (explaining that "an investment contract for purposes of the Securities Act 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"). Accordingly, it is appropriate for this Tribunal to look to federal authorities for guidance, as both parties have done in their closing briefs. See *JAC Holding Enters, Inc v Atrium Capital Partners, LLC,* 997 F Supp 2d 710, 739 (ED Mich 2014); *Dept of Commerce v DeBeers Diamond Investment*, 89 Mich App 406, 410 (1979); MCL 451.2608(2)(b).

For purpose of identifying investment contract securities under the *Howey* test, the "touchstone" is "the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." See *United Housing Foundation, Inc v Forman,* 421 US 837, 852 (1975) (emphasis added). In this context, "profits to be derived from the entrepreneurial or managerial efforts of others" are generally understood to be either "capital appreciation resulting from the development of the initial investment" or "a participation in earnings resulting from the use of investors' funds." *Id.* Unlike capital appreciation or shared earnings, interest payments are not directly dependent on the entrepreneurial or managerial efforts of the borrower, but instead arise simply by virtue of borrower's legal obligation to repay the loan.

In this matter, the fractionalized trust deeds brokered by Respondents were commercial loans. The investors provided funds to borrowers to develop real estate projects with the expectation of a return in the form of interest. These transactions differed from ordinary commercial loans only in the facts that (1) multiple lenders pooled their funds together (instead of a single lender) and (2) they appointed the Respondent to enforce the terms of the loans on their behalf in the event of default. These differences are not enough to turn a commercial loan into an "investment contract security." Unlike investors seeking profits solely from capital appreciation or earnings, whose fortunes are entirely dependent on the success or failure of the venture, the investors in Respondent's fractionalized trust deeds were provided some measure of security through both the liens on the real property underlying the loans and the borrowers' contractual obligations to repay the principal plus interest.

While the legal definition of "security" is broad and flexible, there does not appear to be any state or federal legal authority for the proposition that a commercial loan secured by a lien on real property—whether fractionalized or not—can constitute an "investment

contract security." The Bureau relies on *Reves v Ernst & Young*, 494 US 56 (1990), for the proposition that interest can be "profits" for purpose of analyzing whether a transaction amounts to an "investment contract security." In fact, *Reves* stated precisely the opposite, in dicta, noting that courts have applied a more restrictive test for what constitutes "profits" for purposes of analyzing "investment contracts" under *Howey* and *Forman*. See *id* at 68, n 4.

The Bureau also relies on *SEC v Edwards*, 540 US 389 (2004). Although *Edwards* acknowledged that the *Howey/Forman* test was not intended to be rigidly applied, and that it could include within the definition of an "investment contract" a transaction that promised a fixed rate of return, the *Edwards* Court did not hold that a commercial loan can be an "investment contract security." The transaction at issue in *Edwards* involved payphone leases that promised a fixed rate of return. *Id* at 391-392, 397. The investors sued when the payphones failed to produce enough revenue to pay the promised returns. *Id.* Thus, while the promised return in *Edwards* was to be fixed, it was still intended to come from "revenue" and was not a promise to pay a loan secured by a lien on real property.

Finally, the Bureau relies on *Michelson v Voison*, 254 Mich App 691 (2003), for the proposition that Respondent's mere act of finding and vetting the borrowers was enough to establish that it's fractionalized trust deeds produced "profits" derived primarily from the work of others. The *Michelson* case is inapposite because it interpreted an earlier, now repealed, version of the securities act. More importantly, *Michelson* also did not consider the question whether a transaction constituted an "investment contract security" under *Howey/Forman*; nor did it address the question whether interest on a loan constituted an "expectation of profits" within the meaning of the *Howey/Forman* test. To the extent that older cases, pre-dating Michigan's current Uniform Securities Act, may be relevant and merit consideration, the Court of Appeals held, in *Ansorge v Kellogg*, 172 Mich App 63, 71 (1988), that a promissory note bearing a fixed interest rate was not an "investment" (and, hence, not a "security"), but instead was a "loan" because the payment obligation did not depend on the profits of the recipient of the funds. The facts and issue in *Ansorge, supra*, were closer and more relevant to those in the present matter than were the facts and issue in *Michelson, supra*.

In sum, the fractionalized trust deeds brokered by Respondents were not premised on the expectation of "profits" in the form of either capital appreciation, participation in earnings, or any other similar profit accruing from the managerial or entrepreneurial efforts of others, as is required for an investment contract security under the *Howey/Forman* test. Instead, the investors pooled their funds to make commercial loans to borrowers that were secured by liens on real property. The investors expected

material gain in the form of interest paid on the loans by the borrowing entities. These profits did not depend directly on the extent of the commercial success of the borrowing entities, but instead were based exclusively on the promise to pay interest made by the borrower at closing (and secured by liens on real estate). Therefore, the fractionalized trust deeds brokered by Respondent do not satisfy the "touchstone" requirement of the *Howey/Forman* test for investment contract securities. There was no "expectation of profits" within the meaning of MCL 451.2102c(c)(v).

B. The *Reves* "Family Resemblance" Test for Notes

Apart from its argument that Respondent offered investment contract securities, the Bureau has also suggested—for the first time in its closing brief—that Respondent's fractionalized trust deeds may be classified as securities under the "family resemblance" test used in *Reves, supra*, to determine whether a "note" constitutes a security.

The United States Supreme Court has recognized that the test to be applied to a "note" is entirely different from the test to be applied to an "investment contract security." See *Reves, supra* at 64. Because the Bureau has identified Respondent's fractionalized trust deeds as "investment contract securities" in the Notice and Order to Cease and Desist, and has proceeded against Respondent on that basis at the hearing, it would not be appropriate to now consider a new theory after the evidentiary hearing has already been completed.

In any event, a fractionalized trust deed of the sort at issue in the present matter clearly is not a "note," but instead is a multiparty transaction involving a variety of documents. Although it is true that one of the key documents in the process is a promissory note made from the borrower to the lenders (to which the Respondent is not a party), the focus of this matter has been on the whole transaction brokered and administered by the Respondent and not simply on a single component part signed by the third-party borrower.

To now determine, in a fair manner, whether the promissory notes included within the broader fractionalized trust deed transactions brokered by Respondent constituted "securities" offered by Respondent would require a new charging document and a new hearing.

C. Respondent did not violate Section 301 of the Uniform Securities Act

Because the fractionalized trust deeds brokered by Respondent were not securities under the Uniform Securities Act, Respondent did not violate MCL 451.2301, which by its terms applies only to "securities."

Issue II: Did Respondent Mislead Investors?

Because the fractionalized trust deeds brokered by Respondent were not securities under the Uniform Securities Act, Respondent did not violate MCL 451.2501, which by its terms applies only to "securities."

Even if the fractionalized trust deeds brokered by Respondent were securities, this Tribunal would conclude that the Bureau had failed to establish a violation of Section 501. By its plain terms, MCL 451.2501(b) requires either an "untrue statement of a material fact" or the omission of a material fact that renders "misleading" other statements made by the actor.

The Bureau does not allege that Respondent made any untrue statements. Instead, the Bureau's argument that Respondent violated MCL 451.2501(b) is based on an argument that its omission of material financial information about the borrowers and the guarantors caused Respondent's statements promising its investors a specific rate of return to be misleading. This argument fails because the Bureau has not established that Respondent ever *promised* its investors a specific rate of return. Nor did the Bureau present evidence to establish what information a "reasonable investor" would need to see in order to avoid being misled by Respondent's statement about the expected yield.

The Loan Summaries or First Trust Deeds provided by Respondent to its prospective investors stated an interest rate that the loan would yield, but it did not promise that this rate would be received under all circumstances. (Respondent's Exhibit 5, p 58). Respondent also provided all of its prospective investors with a Mortgage Broker Disclosure form indicating that "There are no guarantees that you will receive your interest or principal payments" and "You could lose the entire amount of your principal investment." (Respondent's Exhibit 5, p 51). Because Respondent did not promise that investors would definitely receive a guaranteed return on their investment—as asserted by the Bureau—Respondent's failure to provide additional information about the borrowers and the guarantors (over and above the information included in its loan summary) could not have rendered the alleged promise misleading, as would be required for a violation of MCL 451.2501(b). It was apparent from the material provided that an investment did not absolutely guarantee a set rate of return under any circumstances. Respondent merely described the rate of return that would be received if the borrower did not default. This assertion was not rendered misleading by the omission of any other information.

Much of the Bureau's argument focused on Respondent's practice of requiring investors to waive the information described on the Nevada Mortgage Broker Disclosure form. The question whether mandating waiver on the mortgage broker disclosure form is

appropriate under Nevada law is not relevant to the question whether the information provided to investors amounts to fraud under Michigan's Section 501. There is no evidence in the record that Respondent asked its investors to waive compliance with Michigan's Uniform Securities Act.

CERTIFICATION OF THE TRANSCRIPT

The transcript of the October 14, 2019 hearing is a complete and accurate record of the testimony and arguments made at the hearing.

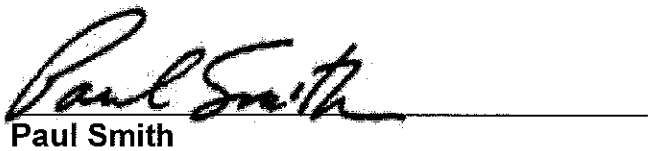
PROPOSED DECISION

This Administrative Law Judge ("ALJ") disagrees in the assessment of the Bureau set forth in the January 23, 2019 Notice and Order to Cease and Desist that Respondent violated the Uniform Securities Act in the manners alleged. The Bureau has not established that the fractionalized trust deeds brokered by Respondent were "securities" within the meaning of the Uniform Securities Act. It is the proposed decision of the ALJ that the Administrator, the Department of Licensing and Regulatory Affairs, issue an appropriate order rescinding the underlying Notice and Order to Cease and Desist.

EXCEPTIONS

If a party chooses to file Exceptions to this Proposal for Decision, the Exceptions must be filed within twenty-one (21) days aft the Proposal for Decision is issue and entered. If an opposing party chooses to file a Response to the Exceptions, it must be filed within fourteen (14) days after the Exceptions are filed. All Exceptions and Responses to Exceptions must be file with the:

Michigan Administrative Hearing System
Department of Licensing and Regulatory Affairs
Cadillac Place Annex
3026 W. Grand Blvd., Suite 2-700
Detroit, MI 48202
Fax: (313) 456-4790



Paul Smith
Administrative Law Judge

PROOF OF SERVICE

I certify that I served a copy of the foregoing document upon all parties and/or attorneys, to their last-known addresses in the manner specified below, this 15th day of May 2020.

Jill Willis

Jill Willis
Michigan Office of Administrative Hearings and Rules

VIA ELECTRONIC DELIVERY

Aaron W. Levin
Assistant Attorney General
Corporate Oversight Division
LevinA@michigan.gov

Kim Breitmeyer
Corporations, Securities & Commercial
Licensing Bureau, Regulatory Compliance
breitmeyerk@michigan.gov

Mark L. Kowalsky
Jaffe Raitt Heuer & Weiss
mkowalsky@jaffelaw.com

STATE OF MICHIGAN
DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS
CORPORATIONS, SECURITIES & COMMERCIAL LICENSING BUREAU

In the Matter of: Complaint No. 335479

CAPSOURCE, INC.
Unregistered

Respondent.
_____/

Issued and entered
This 23rd day of January, 2019

NOTICE AND ORDER TO CEASE AND DESIST

Julia Dale, the Director ("Administrator") of the Corporations, Securities & Commercial Licensing Bureau (the "Bureau"), pursuant to her statutory authority and responsibility to administer and enforce the Michigan Uniform Securities Act (2002), 2008 PA 551, as amended, MCL 451.2101 *et seq.* ("Securities Act"), hereby orders CapSource, Inc. ("Respondent") to cease and desist from offering and selling unregistered securities and to cease and desist from continuing to directly or indirectly make any untrue statements of material fact, or omit to state material facts necessary in order to make statements made, in the light of the circumstances under which they were made, not misleading, contrary to the Securities Act. Respondent is notified of the opportunity to request a hearing in this matter.

I. BACKGROUND

A. The Respondent

1. CapSource, Inc. was incorporated in Nevada in or around 2003. It is not registered in any capacity pursuant to the Securities Act in Michigan, nor has it registered any securities offerings pursuant to the Securities Act in Michigan.

B. Findings of Fact

1. The Bureau conducted an investigation of Respondent's activities in the securities industry in Michigan.

2. The investigation developed evidence that Respondent offered and sold fixed-interest pooled mortgage investments which were "investment contract" securities to multiple Michigan investors. Respondents would identify appropriate businesses to be borrowers, collect money from multiple investors, pool the funds, offer loans to the businesses, and pay back investors as borrowers paid back the loans. The following transactions involved Michigan investors:

Borrower	Investor	Amount	Rate of Return
EQ Durango, LLC	SA	$13,000	7%
EQ Durango, LLC	PH	$9,100	9%[1]
EQ Durango, LLC	TG	$24,100	7.8%[2]
Flipping Capital III, LLC	DS	$26,500	7% or 9%[3]
Flipping Capital III, LLC	TG	$75,000	9%
Global Bio Labs, LLC	RA	$50,000	5%
Global Bio Labs, LLC	PH	$10,000	7%
Global Bio Labs, LLC	VJ	$12,000	8%
America's Rehab Campuses-Arizona, LLC	FJ	$150,000	8%
America's Rehab Campuses-Arizona, LLC	KD	$50,000	8%
5 Star Management, LLC	BC	$10,400	8%

3. The investment contracts offered and sold in Michigan were not registered pursuant to the Securities Act, nor has Respondent identified any applicable exemption, exception, preemption, or exclusion from the Securities Act.

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[1] Investment documents promised a 7% rate of return, but payments were calculated at 9%.
[2] Investment documents promised a 10% rate of return, but payments were calculated at 7.8%.
[3] Investment documents, including a loan servicing agreement and an advertising brochure, promise both rates of return, so it is unclear which rate was intended.

4. Respondent represented to investors that they would receive certain rates of return in exchange for providing capital to be pooled and loaned to business borrowers. Respondent failed to identify how any of those business borrowers would generate income sufficient to pay the promised rates of return, or whether the businesses were even capable of generating such income. A reasonable investor might consider it important to his or her investment decision to know how or if a business could generate income sufficient to repay the investor's investment.

5. Respondent represented to investors that the loans to the business borrowers would be guaranteed by various individuals. Respondent failed to provide any financial information about the individual guarantors to demonstrate that they had sufficient resources for the guarantee to be meaningful to the investors. A reasonable investor might consider it important to his or her investment decision to know that a guarantor of a loan which the investor participates in funding has sufficient resources for the guarantee to have any meaning.

II. RELEVANT STATUTORY PROVISIONS

1. Section 102c(c) of the Securities Act, MCL 451.2102c(c), defines "Security", in part, as:

> a note; stock; treasury stock; security future; bond; debenture; evidence of indebtedness; certificate of interest or participation in a profit-sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting trust certificate; certificate of deposit for a security; fractional undivided interest in oil, gas, or other mineral rights; put, call, straddle, option, or privilege on a security, certificate of deposit, or group or index of securities, including an interest in or based on the value of that put, call, straddle, option, or privilege on that security, certificate of deposit, or group or index of securities, put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, an investment in a viatical or life settlement agreement; or, in general, an interest or instrument commonly known as a "security"; or a 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…
>
> ***
>
> (v) The term includes an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor. As used in this subparagraph, a "common enterprise" means an enterprise in which the fortunes of

the investor are interwoven with those of either the person offering the investment, a third party, or other investors…

2. Section 301 of the Securities Act, MCL 451.2301, states:

   A person shall not offer or sell a security in this state unless 1 or more of the following are met:

   (a) The security is a federal covered security.
   (b) The security, transaction, or offer is exempted from registration under sections 201 to 203.
   (c) The security is registered under this act.

3. Section 503(1) of the Securities Act, MCL 451.2503(1), states:

   In a civil action or administrative proceeding under this act, a person claiming an exemption, exception, preemption, or exclusion has the burden to prove the applicability of the exemption, exception, preemption, or exclusions.

4. Section 501 of the Securities Act, MCL 451.2501, states:

   It is unlawful for a person, in connection with the offer, sale, or purchase of a security or the organization or operation of a Michigan investment market under article 4A, to directly or indirectly do any of the following:…

   (b) Make an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading…

III. CONCLUSIONS OF LAW

1. Respondent, CapSource, Inc., offered and sold at least eleven (11) investment contract securities in Michigan, and has not identified a relevant exemption, exception, preemption, or exclusion from Securities Act registration requirements, contrary to section 301 of the Securities Act, MCL 451.2301.

2. Respondent, CapSource, Inc., represented to Michigan investors that it would pay specific rates of return on their investments based upon income from interest payments made to it by business borrowers. Respondent omitted statements regarding the financial ability of the business borrowers to create income sufficient to pay the interest necessary to generate the

investment returns. The statements regarding the business borrower's ability to generate the income necessary to pay the investment returns to Michigan investors were material, necessary to make other statements made not misleading, and were omitted, contrary to section 501(b) of the Securities Act, MCL 451.2501(b).

3. Respondent, CapSource, Inc., represented to Michigan investors that the loans it made to business borrowers would be guaranteed by individual guarantors. Respondents omitted statements regarding the financial condition of the individual guarantors and their abilities to pay the guarantees should the business borrowers fail to satisfy loans in a manner sufficient to repay investors. The statements regarding the guarantors' actual abilities to guarantee the loans to the business borrowers were material, necessary to make other statements made not misleading, and were omitted, contrary to section 501(b) of the Securities Act, MCL 451.2501(b).

IV. ORDER

IT IS THEREFORE ORDERED, pursuant to section 604 of the Securities Act, MCL 451.2604, that:

A. Respondent shall immediately CEASE AND DESIST from continuing to offer or sell unregistered securities, and from, in connection with the offer or sale of securities, directly or indirectly making any untrue statements of material fact or omitting to state material facts necessary in order to make other statement made, in the light of the circumstances under which they were made, not misleading, contrary to the Securities Act.

B. Pursuant to section 604(2) of the Securities Act, this Notice and Order to Cease and Desist is IMMEDIATELY EFFECTIVE.

C. In her Final Order, the Administrator, under section 604(4) of the Securities Act, MCL 451.2604(4), intends to impose civil fines of $330,000.00 against Respondent.

D. Pursuant to section 508 of the Securities Act, MCL 451.2508, a person that willfully violates the Securities Act, or an order issued under the Securities Act, is guilty of a felony punishable by imprisonment for not more than 10 years or a fine of not more than $500,000.00 for each violation, or both. An individual convicted of violating a rule or order under this act may be fined, but shall not be imprisoned, if the individual did not have knowledge of the rule or order.

E. The Administrator retains the right to pursue further administrative action against Respondent under the Securities Act if the Administrator determines that such

action is necessary and appropriate in the public interest, for the protection of investors and is authorized by the Securities Act.

V. NOTICE OF OPPORTUNITY FOR HEARING

Section 604 of the Securities Act, MCL 451.2604, provides that Respondent has 30 days beginning with the first day after the date of service of this Notice and Order to Cease and Desist to submit a written request to the Administrator asking that this matter be scheduled for a hearing. If the Administrator receives a written request in a timely manner, the Administrator shall schedule a hearing within 15 days after receipt of the request. The written request for a hearing must be addressed to:

Corporations, Securities & Commercial Licensing Bureau
Regulatory Compliance Division
P.O. Box 30018
Lansing, MI 48909

VI. ORDER FINAL ABSENT HEARING REQUEST

A. Under section 604 of the Securities Act, MCL 451.2604, the Respondent's failure to submit a written request for a hearing to the Administrator within 30 days after the service date of this **NOTICE AND ORDER TO CEASE AND DESIST** shall result in this order becoming a **FINAL ORDER** by operation of law. The **FINAL ORDER** includes the imposition of the fines cited described in section IV.C., and the fine amounts set forth below will become due and payable to the Administrator within sixty (60) days after the date this order becomes final:

$330,000.00 – CapSource, Inc., under section 604 of the Securities Act, MCL 451.2604.

B. CIVIL FINE payments should be payable to the STATE OF MICHIGAN and contain identifying information (e.g., names and complaint numbers) and mailed to the following address:

Corporations, Securities & Commercial Licensing Bureau
Final Order Monitoring
P.O. Box 30018
Lansing, MI 48909

C. Failure to comply with the terms of this Order within the time frames specified may result in additional administrative penalties, including the summary suspension or continued suspension of all registrations held by Respondent under the Securities Act, the denial of any registration renewal, and/or the denial of any future applications for registration, until full compliance is made. Respondent may voluntarily surrender or withdraw a registration under the Securities Act; however, the surrender or

withdrawal will not negate the summary suspension or continued suspension of the relevant registrations or any additional administrative proceedings if a violation of this Order or the Securities Act occurred.

D. Failure to pay the civil fines within six (6) months after this Order becomes final may result in the referral of the civil fines to the Michigan Department of Treasury for collection action against Respondent.

DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS
CORPORATIONS, SECURITIES & COMMERCIAL LICENSING BUREAU

Julia Dale
Director, Corporations, Securities &
Commercial Licensing Bureau

1/23/19
Date