

UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

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No. 75-3357

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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

HERITAGE TRUST COMPANY, JOHN R. BROMLEY,  
and H. D. WILBANKS, JR.,

Defendants-Appellants.

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Appeal from the United States District  
Court for the District of Arizona

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ANSWERING BRIEF OF THE SECURITIES  
AND EXCHANGE COMMISSION, APPELLEE

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DAVID FERBER  
Solicitor to the Commission

JOHN M. MAHONEY  
Attorney

Securities and Exchange Commission  
500 North Capitol Street  
Washington, D.C. 20549

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COUNTERSTATEMENT OF THE ISSUE

Whether the solicitation of funds from the public to purchase beneficial interests in revocable inter vivos trusts offered and sold by the defendants involved the sale of "securities," as defined in Section 2(1) of the Securities Act of 1933, where the defendants:

(a) selected the investments in which the funds solicited and obtained from the public were placed without consulting with the persons who provided the funds ("trustors") which the defendants invested; and

(b) represented to prospective investors, inter alia, that an "assured" or "guaranteed" return would be obtained on the funds placed under their control; and

(c) used the funds of some trustors to pay obligations owing to other trustors whose funds had been placed in investments where the cash flow was insufficient to satisfy the obligations.

STATUTES INVOLVED

Section 2(1) of the Securities Act of 1933, 15 U.S.C. §77b(1), provides:

"The term '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, 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, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest for, participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase any of the foregoing." 1/

Section 5(a) of the Securities Act of 1933, 15 U.S.C. §77e(a),

provides:

"Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly--

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale."

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1/ A virtually identical definition of the term "security" is set forth in Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10). For purposes of the appeal, the coverage of these two sections may be considered the same. Cf. United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 847 (1975); Tcherepnin v. Knight, 389 U.S. 332, 336, 342 (1967).

Section 5(c) of the Securities Act of 1933, 15 U.S.C. §77e(c), provides:

"It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8."

COUNTERSTATEMENT OF THE CASE

This is an appeal by defendants Heritage Trust Company ("Heritage"), John R. Bromley, its president, chairman of the board of directors, and controlling stockholder (Stip. 1, R. 380), <sup>2/</sup> and H. D. Wilbanks, Jr.,

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<sup>2/</sup> References to the record on appeal, which was transmitted to this Court on December 29, 1975, are cited as "R. \_\_\_." This record is also the record for Securities and Exchange Commission v. Heritage Trust Company, et al.; Eleanor Simpson, Applicant for Intervention-Appellant, No. 75-3514, which is on appeal before this Court.

On May 13, 1975, prior to the hearings on the Commission's motion for the appointment of a receiver, counsel for the Commission and the defendants filed an extensive stipulation of facts which was admitted for purposes of the proceeding and was intended to serve in part as the evidentiary basis for that proceeding. "Stip. \_\_, R. \_\_\_" refers to the paragraph number of the stipulation and the page of the record at which the paragraph of the stipulation appears.

Other references used herein are: "B. Tr. \_\_\_" refers to the February 26, 1974, transcript of testimony of John R. Bromley before the Securities and Exchange Commission which was filed in connection with the Commission's motion for a preliminary injunction and which is included in the record transmitted to this Court. "Tr. \_\_\_" refers to the transcripts of the hearings in the district court in May, 1975. "Gov. Exh. \_\_\_" refers to the Commission's exhibits introduced into evidence at the hearings in the district court. "Tr. A. \_\_\_" refers to the transcripts of the hearing in the district court on April 29, 1975. "Tr. E. \_\_\_" refers to the transcript of the hearing in the district court on October 6, 1975.

its director of marketing, from orders of the United States District Court for the District of Arizona (per Copple, J.), entered on July 1, 1975 (R. 500-519), August 27, 1975 (R. 609-613), and October 6, 1975 (Tr. E. 5-6), in an injunctive action which had been instituted by the Securities and Exchange Commission on July 29, 1974. The appellants seek to challenge the finding of the court below that the revocable inter vivos trusts sold by Heritage were securities. At an earlier stage of this litigation, the appellants had consented to the entry of a permanent injunction entered on October 8, 1974, against violations of the registration provisions of the Securities Act of 1933 as well as of the antifraud provisions of the Securities Act and of the Securities Exchange Act of 1934 in connection with the sale of these revocable inter vivos trusts (R. 197-207). The July 1, 1975, order specifically held that the revocable inter vivos trusts were securities and provided more specific relief with respect to the previous injunction. <sup>3/</sup>

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<sup>3/</sup> That order also refused to appoint a receiver for Heritage. By the subsequent August 27, 1975, order the district court granted this relief to the Commission. On October 6, 1975, the court denied the defendants' motion for rehearing with respect to the receiver, but stayed that portion of its order pending this appeal. Subsequently a receiver for Heritage was sought in the Arizona State Superior Court by the State Superintendent of Banks. To permit that relief, this Court on application of the Commission, joined in by the State Superintendent of Banks, granted a partial remand of this appeal in order to enable the district judge to quash that portion of the August 27 order appointing a receiver without prejudice to reinstatement on a showing of good cause. Thereafter the district court quashed that portion of its order in accordance with the terms of this Court's remand. We are advised that on April 16, 1976, the receiver appointed by the Arizona court took possession of the assets of Heritage.

The Heritage Operation

In April 1972, shortly after defendant Bromley became associated with Federal Trust Company, <sup>4/</sup> it was certified by the Superintendent of the Banks of the State of Arizona to engage in business as a trust company (R. 72, B. Tr. 22-30). Thereafter in March, 1973, defendant Bromley gained control of Federal (Tr. 378) and changed its name to Heritage in July, 1973 (R. 72, B. Tr. 22).

Since April, 1972, Heritage has engaged in an interstate sales campaign offering beneficial interests in revocable inter vivos trusts (R. 73). <sup>5/</sup> Individuals purchasing these interests are denominated "trustors" and Heritage acts as trustee for them pursuant to a written agreement. <sup>6/</sup> The Heritage sales campaign is conducted, in large part, by sales personnel, known as "trust counsellors," who reside in several states and are paid commissions based upon the amount of the funds which they induce investors to place with Heritage (R. 73-74).

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<sup>4/</sup> This corporation had been incorporated in Arizona in 1960 as Central Trust Company; its name was changed in 1964, but until 1972 it was "fairly dormant as a trust entity" B. Tr. 22.

<sup>5/</sup> These trusts at times are also referred to as "living trusts."

<sup>6/</sup> The Declaration of Trust Agreement which is attached to the defendants' brief in this Court was not introduced into evidence at the hearings in the district court. The Commission has attached hereto, as Attachment 1, a copy of the Declaration of Trust Agreement and related documents which were admitted to evidence at the district court hearings as Gov. Exh. 15, 15-A, 15-B, and 15-C.

In the course of extolling the advantages of these inter vivos trusts, the defendants represented, inter alia, that Heritage possessed sound and experienced investment expertise, and they emphasized that investors could earn interest income on funds placed in trust (Tr. 534) which, when invested by Heritage, would yield from 8 to 14% (Tr. 534, R. 74). Heritage in sales literature also represented that once trustors' funds are placed by it in an investment and a rate of return is established, then that rate of return is "assured" (Gov. Exh. 109).

Similarly, a form of the Declaration of Trust Agreement (Attachment 1), sub-captioned "Principal and Income Guaranteed" and used by defendants when a trustor obtains a beneficial interest in an inter vivos trust, provides in pertinent part (p. 2A, infra):

"It is the investment objective of this trust to produce a fixed income of \_\_\_% per annum on the initial contribution made herein . . . and trustee is hereby authorized and directed to invest said contribution of principal in its sole and absolute discretion . . . in order to attain such income objective or income in excess thereof . . .

"All additional contributions of principal to this trust shall produce a fixed income at such rate as shall be determined on the date of said contributions."

This document continues (p. 3A, infra):

"XVIII GUARANTEE

Heritage Trust Company hereby effects a guarantee on the basis stipulated below:

- a. Guarantees the repayment of principal contributions to the trust.
- b. Guarantees the payment of income derived from the principal contributions at the rate stated in this agreement only" (emphasis supplied).

In order to meet its obligations under the terms of the Declaration of Trust Agreement, including the guarantee clause, Heritage, as trustee, is given

"full power in its absolute discretion and without prior authority from any court to do everything necessary for the proper administration of the trust including but not limited to, the power: (a) to sell, redeem, transfer, exchange, assign, hypothecate, invest or reinvest any property belonging to the trust estate irrespective of any rule of law governing investments by fiduciaries . . . ." (Attachment 1, p. 3A) (Emphasis supplied).

After Heritage would gain control of trustors' funds, these funds were deposited into a collective bank account known as the "trust account" until transferred to another collective bank account known as the "83 account" for <sup>7/</sup> disbursement to an investment chosen by Heritage (Stip. 27, 28, R. 394). In choosing the investments in which trustors' funds were placed, the practice of Heritage in large measure was to lend those funds to various Arizona land companies <sup>8/</sup> in exchange for interest-bearing promissory notes secured by the land companies' interests in land sales contracts, notes and mortgages. <sup>9/</sup> In addition, Heritage invested trustors' funds in promissory notes of real estate limited partnerships known as "Texas wrap-arounds." <sup>10/</sup>

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<sup>7/</sup> Corporate funds of Heritage are also deposited in the "83 account" (Tr. 442).

<sup>8/</sup> These Arizona land companies are listed in Stip. 3, R. 381. Certain of these companies have been enjoined from violations of the federal securities laws. See Stip. 17, R. 391; Stip. 20, R. 392; Stip. 43, R. 409.

<sup>9/</sup> A detailed description of the manner in which these loans to Arizona land companies were made, the receipt of promissory notes from the land companies, and certain related matters is set forth in Stip. 10(a)-(k), R. 383-385.

<sup>10/</sup> See Stip. 11(a), R. 386-387, for a description of Heritage's investment practices in connection with the "Texas wrap-arounds."

Often several trustors' funds were pooled together in order to aggregate a large sum, which then would be advanced as a single loan to a borrower, either a land company or a real estate limited partnership, that executed a promissory note payable to Heritage, as trustee, for the benefit of those trustors whose funds had been lent (Tr. 536; Stip. 12(a)(ii)). <sup>11/</sup>

When the land companies or the limited partnerships make payments on these promissory notes the funds received are first deposited in the "83 account,"

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11/ See the following colloquy that occurred in the district court between counsel for the Commission and defendant Bromley (Tr. 536):

Commission Counsel "Now we have, in the stipulations, I believe No. 2, a list of the investments that the company put living trustors' funds into, and some of these are loans to Arizona land companies. Is it true that the way this works, that the company will enter into a loan agreement with a land company, which it gets a note from the company and a collateral agreement, and then puts several of its trustors into that same investment?"

Bromley Several of the trustors loan to the borrower, who has made application and entered into the documents you mentioned, yes.

Commission Counsel It's not common in living trusts to put individual trustor's funds into an individual investment that other trustors aren't involved in, isn't that right?

Bromley Yes.

Commission Counsel And it works that way with the wrap-arounds, isn't that right, you enter into one agreement for a wrap-around and then several trustors' funds would go into that one investment, is that right?

Bromley Yes."

then transferred to the "trust account," and then disbursed to individual trustors (Stip. 28, R. 394).

Heritage did not inform trustors in a meaningful fashion that it received a twenty per cent pre-paid "fee" <sup>12/</sup> on each transaction where trustors' funds are invested in land company promissory notes or in Texas wrap-around notes (Stip. 12, R. 387-390). <sup>13/</sup> Similarly, Heritage trustors in most cases were informed neither that certain of the Arizona land companies to which trustors' funds were loaned had been enjoined from violations of the federal securities laws <sup>14/</sup> nor that five states had entered cease and desist orders against Heritage prohibiting the sales <sup>15/</sup> of revocable inter vivos trusts in those states (Stip. 46, R. 410). In connection with the failure to disclose the federal court injunctions against certain of the Arizona land companies in which trustors' funds are invested, Heritage trustors have not been informed that the president

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<sup>12/</sup> Judge Copple found that "[Bromley] has failed to advise trustors of the 20% 'fee' practice . . . . The sales literature and the trust agreements are carefully worded to hide this practice" (R. 512-513).

<sup>13/</sup> Stipulation 12(a) provides (R. 388):

"(i) Trustor sends \$10,000 to HTC, trustee;

"(ii) HTC sends \$8,000 to investment objective and receives back a note in the amount of \$10,000 made payable to HTC as trustee for a specified trustor, or trustors, and HTC, the corporation, retains \$2,000 as its fee or the same transaction except that HTC sends the full \$10,000 to the investment objective and receives back a remittance of \$2,000 as a fee."

<sup>14/</sup> See n. 8, supra.

<sup>15/</sup> The five states are: Iowa, South Dakota, Colorado, New Mexico, and Wyoming (Stip. 45, R. 409-410). Defendants' Exhibits BB-FF are copies of the five cease and desist orders.

and controlling shareholder of two of those land companies, who also has been enjoined from violations of the federal securities laws, has been employed by Heritage and it is contemplated by defendant Bromley that this individual will be appointed treasurer of Heritage in the future (Stip. 42, R. 409). Nor were trustors whose funds had been lent to another Arizona corporation, of which defendant Bromley was an incorporator and one of the four shareholders, informed of either the loan of their funds to this corporation or defendant Bromley's relationship to the corporation (Stip. 50, 51, R. 410-411).

Finally, when borrowers became delinquent in paying their obligations on certain promissory notes held by Heritage (Stip. 10(j), R. 385; Tr. 267-268), the cash flow from these promissory notes became insufficient for Heritage to pay trustors, but Heritage consistently chose not to fore-<sup>16/</sup>close on the assets collateralizing the promissory notes. Instead, it has advanced either its own funds or the funds of other trustors to make payments to those trustors entitled to receive the payments due on the notes (Stip. 10(j), R. 385; Stip. 26(b), R. 393; Stip. 31, R. 396; Stip. 32, R. 396; Tr. 270-271; Tr. 441; Tr. 494). Trustors were not informed of the use of their funds to pay other trustors when the cash flow from certain pro-

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16/ The district judge noted:

"Instead of advising trustors of defaults in their investments [Bromley] has continued their income payments with corporate funds or with funds belonging to other trusts in order to lull them into a sense of security. He also elected to not advise the trustors with defaulted investments of his policy of 'no foreclosure of security' or even the fact of default" (R. 512).

missory notes was insufficient (Stip. 10(j), R. 385). When asked by his own counsel what was his intent "with respect to making these payments to deals where there's deficient cash flow," Mr. Bromley responded that "our intent is to turn every investment that has a problem into a solution so that there is no loss to any trust" (Tr. 494-495).

#### SUGGESTION OF MOOTNESS

There is a serious question whether the determination that the revocable inter vivos trusts are securities is properly before this Court. Prior to the orders from which this appeal has been taken, the defendants, conceding the jurisdiction of the district court (R. 207), had consented to be enjoined, inter alia, from sales of these revocable inter vivos trusts in violation of registration and antifraud provisions of the federal securities laws (see page 4, supra). Subsequently, after hearings on the Commission's motion for the appointment of a receiver for Heritage, the district court requested that the question as to whether these interests were securities be briefed, and appellants then urged that they were not securities (R. 443).

Thereafter, in its July 1, 1975, order the district court determined that these interests were securities and granted certain ancillary relief that had not been provided in the consent decree, but determined that a receiver should not be appointed. In the August 27, 1975, order, from which this appeal was taken, the Commission's renewed motion for the appointment of a receiver was granted. The defendants' motion for reconsideration and rehearing was denied by order of October 6, 1975. The notice of appeal is stated to be "from the opinion and order appointing a receiver, which order

was entered on August 27, 1975 . . . and from the order entered on October 6, 1975, denying defendants' motion for reconsideration and rehearing of the order of August 27, 1975" (R. 656). As to the order of July 1, 1975, the notice of appeal purports to be from it only "insofar as it is supportive of and essential to the order of August 27, 1975" (R. 656).

As we have seen, the issue as to the propriety of the appointment of the receiver is no longer before this Court (see footnote 3, supra). If, as appears probable from the foregoing, the only function of this appeal is to contest the appointment of a receiver for Heritage--and appellants' brief does not suggest the contrary--the appeal is moot.

We nevertheless argue the merits of the question respecting the interests involved in the event that this Court should deem that issue properly before it.

ARGUMENT

THE DISTRICT COURT CORRECTLY DETERMINED THAT  
THE REVOCABLE INTER VIVOS TRUSTS SOLD BY THE  
DEFENDANTS ARE SECURITIES

For determination of the issue of whether the beneficial interests in the revocable inter vivos trusts offered and sold by the defendants were, in view of the circumstances in which they were sold, "securities" within the purview of the federal securities laws, it bears emphasis that the Supreme Court and this Court have consistently emphasized that those laws must be construed "not technically and restrictively, but flexibly to effectuate [their] remedial purposes." Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); accord Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); Tcherepnin v. Knight, supra, 389 U.S. at 336; El Khadem v. Equity Securities Corp., 494 F. 2d 1224, 1227 (C.A. 9), certiorari denied, 419 U.S. 900 (1974); Securities and Exchange Commission v. Glenn W. Turner Enterprises, Inc., 474 F. 2d 476, 481 (C.A. 9), certiorari denied, 414 U.S. 821 (1973); Los Angeles Trust Deed & Mortgage Exchange v. Securities and Exchange Commission, 285 F. 2d 162, 168 (C.A. 9, 1960), certiorari denied, 366 U.S. 919 (1961).

While the defendants contend that the Heritage inter vivos trusts are traditional trust instruments being put to "a new and novel use" and, as such, "are not to be put under an umbrella of the Security Acts"

(Br. 5), <sup>17/</sup> this facile characterization ignores the Supreme Court's recognition that proof of the existence of a security may go "outside the instrument itself," Securities and Exchange Commission v. C. M. Joiner Leasing Corp., 320 U.S. 341, 355 (1943). In that case the Supreme Court held:

"The reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,'

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<sup>17/</sup> The argument that the defendants have only offered and sold traditional trust services to the public is belied by examination of the Declaration of Trust Agreement (Attachment 1, p. 2-3A) and review of Heritage's investment practices. Moreover, the language in the Declaration of Trust Agreement evidences that the defendants have attempted to eliminate any fiduciary standard to which Heritage, as trustee, is bound. In this connection, at post-trial argument by counsel in chambers on May 19, 1975, Judge Copple noted:

"[Bromley] has written a broad trust agreement, which he's chargeable of putting ambiguities in, that gives him all the power that he would be handling as a general investor of corporate funds, as opposed to a trustee and he's taking the position that he can do just almost anything in the way of investments" (Tr. 579).

Counsel for the defendants similarly stated in his post-trial memorandum of law:

"Here again, as the Court has pointed out, the investment powers clause is broadly worded and removes the generally applicable limits on investments by the trustee. . . . By its terms the clause gives the trustee absolute discretion irrespective of any rule of law controlling fiduciary investments. To argue that self-dealing is not allowed under terms of the trust is to ignore the plain language of the trust agreement" (R. 440-441) (emphasis in original).

or as 'any interest or instrument commonly known as a security.'" Id. at 351. 18/

In any event, there is nothing particularly novel about this case. Sixteen years ago this Court decided Los Angeles Trust Deed & Mortgage Exchange v. Securities and Exchange Commission, supra, 285 F. 2d 162, where the factual pattern was strikingly similar to the instant action. In the Los Angeles Trust Deed & Mortgage Exchange action the defendants' activities facilitated the syndication of "raw, vacant and unimproved land" in California by sales of claims on small units of land to unsophisticated investors located throughout the United States. 19/ This course of conduct is hardly distinguishable from the defendants' practice here of lending funds obtained from a widespread investing public to Arizona land companies 20/ and to Texas limited partnerships promoting "undeveloped

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18/ This Court has repeatedly recognized and applied this principle. El Khadem v. Equity Securities Corp., supra, 494 F. 2d at 1227; Securities and Exchange Commission v. Glenn W. Turner Enterprises, Inc., supra, 474 F. 2d at 481; Los Angeles Trust Deed and Mortgage Exchange v. Securities and Exchange Commission, supra, 285 F. 2d at 167.

19/ See Securities and Exchange Commission v. Los Angeles Trust Deed and Mortgage Exchange, 180 F. Supp. 830, 850 (S.D. Cal., 1960), affirmed, 285 F. 2d 162, 180, where this Court held that the evidentiary record supported the district court's finding.

20/ In this connection, the district noted that while certain of the Arizona land companies had been enjoined from selling notes on subdivided blocks of undeveloped Arizona property, the defendants' placement of trustors' funds "in some of the same Arizona land company notes and mortgages which those companies had been enjoined from selling directly" enabled these companies "to do indirectly what they had been enjoined from doing directly (R. 502, 503).

land" (R. 502). The defendants in the Los Angeles Trust Deed & Mortgage Exchange case maintained that they sold only second trust deeds on specific real estate, not securities. This Court noted that "the purchaser[s were] encouraged to rely on the skill and knowledge of the appellants' officers, who were reported to check and recheck the worth of the trust deeds." Id. at 168. Moreover, "[p]urchasers were assured that it was the company's policy to repurchase any delinquent trust deed, so that the purchaser would suffer no loss if he had by chance purchased one that later defaulted." Id. After examination of the selling literature, this Court concluded (id.):

"Very few persons, particularly those unskilled in financial matters, could read the advertising of appellants without coming to the firm conclusion that by sending moneys to the appellants they would receive far more than a note secured by a second mortgage or a deed of trust on specific real estate."

Accordingly, this Court determined that the promoters were offering securities.

As we have seen (p. 6, supra), the defendants in this case, like those in the Los Angeles Trust Deed & Mortgage Exchange case, supra, 285 F. 2d 162, also "guaranteed" or "assured" payment, and numerous other representations here are comparable to those made in that case.<sup>21/</sup> Just as in the Los Angeles Trust Deed & Mortgage Exchange case, where this Court examined the totality of the defendants' activities, in the case at bar the court below reviewed the entire Heritage operation and determined that the defendants offered and sold far more than traditional trust services. For, as the court below found,

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<sup>21/</sup> Compare, e.g., the defendants' representations in the Los Angeles Trust Deed & Mortgage Exchange case, quoted at 285 F. 2d 168, n.3, with

(continued)

"the prime inducement was investment expertise, safety, and assured substantial return. It is difficult to believe that any trustor would have invested without anticipation of a safe investment and a profitable return" (R. 511). 22/

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21/ (continued)

certain of the representations of the defendants herein, as follows:

HERITAGE

LOS ANGELES TRUST DEED & MORTGAGE  
EXCHANGE

"Fixed Income: . . . the exact rate cannot be guaranteed beforehand, but it is currently 10%. Once your account is determined, it is then assured at that rate." (Gov. Exh. 109.)

"(a) . . . 'We have carefully devised a controlled program to provide you with a current 10% return on your funds . . . .'"

\* \* \*

"(m) 'The "yield" on notes selected for your account is full, firm return.'"

"[W]e assume the responsibility of protecting the assets for you and your beneficiaries by investing principal, reinvesting income and capital gains, continually reviewing the portfolio, and paying income to you and your beneficiaries as you direct." (Gov. Exh. 13.)

"(b) 'We emphasize that every attempt is made to see that your current 10% earnings are maintained through continual reinvestment.'"

"PROFESSIONAL MANAGEMENT: A corporate trustee, such as HERITAGE TRUST CO., has personnel trained to provide professional investment administration, relieving the trustor of the time consuming task of maintaining his own portfolio." (Gov. Exh. 13.)

"(c) . . . 'all these points [value of property, equity, etc.] are checked and rechecked by experts in their particular field with many years of experience.'"

22/ This finding is fully supported not only by defendants' sales literature and other materials (Gov. Exh. 109; Attachment 1, p. 2-3A), but also by defendant Bromley's own representations. Thus, with respect to the safety of the investments in which Heritage placed trustors' funds, testimony was received that defendant Bromley represented that "the investments were made with a two-for-one collateral" such that "companies wishing to borrow on short term capital . . . would be required to put up collateral on a basis of two-for-one to get the loan" (Tr. A21). But see the district court's findings that "no evidence was ever introduced that Heritage ever made such investments"; in fact, "all the evidence indicate[d] that such loans were never made" (R. 511-512).

Accordingly, it held that the interests offered and sold by the defendants herein constituted securities within the purview of the federal securities laws.

That decision was fully in accord with Securities and Exchange Commission v. W. J. Howey Co., 328 U. S. 293, 299 (1946), which held that the term "investment contract"

"embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits."

It also complied with the Supreme Court's admonition in Tcherepnin v. Knight, supra, 389 U.S. at 336, recently quoted with approval in United Housing Foundation, Inc. v. Forman, supra, 421 U.S. at 848, that

"[I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." 23/

As emphasized in the latter case (id. at 852),

"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." 24/

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23/ Cf. Marshel v. AFW Fabric Corp., [Current] CCH Fed. Sec. L. Rep. ¶95,448 (C.A. 2, February 13, 1976), where the court stated at p. 99,269 that "in determining the applicability of the federal securities law, we must look through the technical form to ascertain the substance of the transaction."

24/ This Court recently stated:

"An interest in an enterprise is an investment contract where 'the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the success or failure of the enterprise.'"

Parvin v. Davis Oil Company, 524 F. 2d 112, 115-116 (C.A. 9, 1975), quoting Securities and Exchange Commission v. Glenn W. Turner Enterprises, Inc., supra, 474 F. 2d at 485. Accord Great Western Bank & Trust v. Kotz, [Current] CCH Fed. Sec. L. Rep. ¶95,494 at p. 99,500 (C.A. 9, March 22, 1976).

Or, as stated in Securities and Exchange Commission v. W. J. Howey, supra, 328 U.S. at 301, the test for determination of the existence of an "investment contract" is

"whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."

Concededly here the profits, at least in many instances, were to come solely from the efforts of others.<sup>25/</sup> Consistent with these representations, trustors here, after tender of funds to the defendants' control, relied upon the "investment expertise" (R. 511) of the defendants in choosing those investments in which their funds were to be placed in order to produce the "high yield income" (Gov. Exh. 14) which trustors were led to expect. See pages 5-6, supra.

The defendants' protestations (Br. 12, 15) that there is neither a "communality of enterprise" nor an "investment of funds in a common venture" ignore the economic realities of the transactions between Heritage and the trustors. Heritage (pages 10-11, supra), after placement of trustors' funds, received the interest payments made by obligors on these investments, deposited such payments in the collective "83" bank account, transferred funds to the "trust" bank account, and made the disbursements owing

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25/ See the following colloquy (Tr. 535):

"Commission Counsel      Now, is it true that these investors  
rely on the efforts of the trustee to  
earn this interest income or other  
profit from the investment of their  
funds in the trust?

"Bromley                      Yes."

See also Tr. 534.

to the trustors whose funds had been placed in a particular investment chosen by Heritage. In addition, in those instances where the cash flow from specific investments was insufficient to meet the obligations owing to trustors' for whose benefit such investments were made, Heritage made the income payments due to those trustors from its own corporate funds or from the funds of other trustors.

In the case at bar, as in Los Angeles Trust Deed & Mortgage Exchange v. Securities and Exchange Commission, supra, 285 F. 2d 162, 172, the economic welfare and fortunes of trustors were "inextricably [inter]woven" with the defendants' efforts such that the requisite element of a common enterprise were properly found to exist. See also Securities and Exchange Commission v. Glenn W. Turner Enterprises, Inc., supra, 474 F. 2d at 482, n.7, which, citing Los Angeles Trust Deed and Mortgage Exchange, supra, stated that

"A common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties,"

Even more recent cases have emphasized that the requisite commonality is to be broadly viewed.<sup>26/</sup>

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<sup>26/</sup> See Hector v. Wiens, [Current] CCH Fed. Sec. L. Rep. ¶95,468 (C.A. 9, Feb. 23, 1976); El Khadem v. Equity Securities Corp., supra, 494 F. 2d at 1229; and Securities and Exchange Commission v. Koscot Interplanetary, Inc., 497 F. 2d 473, 479 (C.A. 5, 1975). In the last cited case the court noted that "the requisite commonality is evidenced by the fact that the fortunes of all investors are inextricably tied to the efficacy [of the promoters' efforts]." More recently, in Hector v. Wiens, supra, [Current] CCH Fed. Sec. L. Rep. at p. 99,374, this Court noted that "the commonality required is vertical (between the investor and the promoter) rather than horizontal (among multiple investors)."

Accordingly, there can be no doubt that what the defendants were selling was an "investment contract," which by definition in Section 2(1) is a "security."

CONCLUSION

For the foregoing reasons, the orders of the district court should be affirmed.

Respectfully submitted,

DAVID FERBER  
Solicitor to the Commission

JOHN M. MAHONEY  
Attorney

Securities and Exchange Commission  
Washington, D.C. 20549

April 1976

A T T A C H M E N T

ATTACHMENT 1.

Exhibit No.	15
Case No.	EW-74-519
MARKED FOR DISTRIBUTION	
APR 29 1974	
ADMITTED AND FILED	
BY	Deputy Clerk



# HERITAGE TRUST COMPANY

FORMERLY FEDERAL TRUST COMPANY

GOVERNMENT EXHIBIT 15

ATTACHMENT P. 1.



# DECLARATION OF TRUST AGREEMENT

(Principal and Income Guaranteed)

\_\_\_\_\_ and \_\_\_\_\_  
residing at \_\_\_\_\_

hereinafter known as Trustor(s), do hereby this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, declare that there has been deposited in trust, cash and/or other property which may be converted to cash at its liquidated cash value and described on trust receipt which becomes Schedule A to my trust; and direct that such property be issued or registered in the name of Heritage Trust Company, hereinafter known as trustee under this Declaration of Trust, or its nominee. All such property, together with any other property which may be converted to cash at its liquidated cash value, which may be added to or payable or accumulated with respect to such property, shall be referred to as the trust estate and shall be held by trustee, Heritage Trust Company, or successor thereto, under the following terms and conditions:

### I. INVESTMENT DIRECTION:

It is the objective of this trust to produce a fixed income of \_\_\_\_\_% per annum on the initial contribution of principal made herein and described in said trust receipt, and trustee is hereby authorized and directed to invest said contribution of principal in its sole and absolute discretion as more fully described in paragraph III, in order to attain such income objective or income in excess thereof. All such excess income, if any, shall be retained by trustee.

All additional contributions of principal to this trust shall produce a fixed income at such rate as shall be determined on the date of said contributions. Said rate shall be set forth in the "Receipt of Additional Contributions" and must be approved by both trustor(s) and trustee. All such additional contributions shall be a minimum of ONE THOUSAND DOLLARS (\$1,000.00).

### II. DISPOSITIVE PROVISIONS:

a. The trustee shall hold or distribute the income of the trust estate produced under paragraph I. and the principal of the trust estate in accordance with the Application for Benefits completed in conjunction with this trust document.

b. In the event of the death of one trustor, the trust shall continue for the benefit of surviving trustor. Assets which are held under this trust shall be administered in the same manner as covered under existing instructions; surviving trustor may alter or amend existing instructions, subject to approval of trustee.

c. Upon the death of surviving trustor, the trust shall be:

\_\_\_\_\_ Option 1. Held and administered for the benefit of the following named beneficiaries:

Name	Address
_____	_____
_____	_____
_____	_____
_____	_____

(Others named on schedule attached.)

Income and/or principal shall be distributed to said beneficiaries in equal amounts at the discretion of the trustee by mutual arrangement.

All principal and income shall be distributed free of trust upon the attainment of age twenty-five (25) by the last beneficiary named above upon their request in writing a reasonable time in advance of the expectation of such distribution.

\_\_\_\_\_ Option 2. Upon death of surviving trustor and maturity of placements made in their behalf, trust shall terminate and be distributed free of trust in equal amounts to those named above in paragraph II. c.

\_\_\_\_\_ Option 3. In case all of the above-named beneficiaries are not living at the time of the death of surviving trustor, the trust shall be distributed at the earliest opportunity to the other parties named below in equal amounts:

Name	Address
_____	_____
_____	_____

### III. POWERS OF TRUSTEE:

The trustee shall have full power in its absolute discretion and without prior authority from any court to do everything necessary for the proper administration of this trust including, but not limited to, the power: (a) to sell, redeem, transfer, exchange, assign, hypothecate, invest or reinvest any property belonging to the trust estate irrespective of any rule of law governing investments by fiduciaries; (b) to exercise any voting rights in person or by proxy and any other rights, privileges, or options with respect to any property belonging to the trust estate; and (c) to employ agents and custodians and register any property belonging to the trust estate in the name of a nominee or in unregistered form or in such other form as will permit it to pass on delivery. Trustor(s) appoint trustee to act as attorney in fact, to sign and execute in trustor(s)' behalf all instruments including stock assignments, endorsement on notes or other documents, which are represented as assets held under this trust only.

### IV. REVOCATION OF TRUST:

Trustor(s) hereby reserve the following powers: (a) from time to time to alter or amend this Declaration of Trust in any way; and (b) to revoke this Declaration of Trust in its entirety after five (5) years from the date hereof or upon mutual agreement between trustor(s) and trustee, such powers shall be exercised by written notice to Heritage Trust Company who shall have a reasonable time to act upon said notice in order to protect the assets held thereunder and upon the withdrawal of any property by trustor(s) from the trust estate by revocation or otherwise, title to such property, shall vest in and be transferred to trustor(s) free and clear of any trust.

**V. PROTECTION OF THIRD PARTIES:**

No person dealing with the trust estate in any manner shall be under any obligation to see to the application of any property paid or delivered to this trust or to inquire into the validity, expediency or propriety of any act of the trustee or into any of the provisions of this Declaration of Trust. In order to induce Heritage Trust Company to issue property in the name of Heritage Trust Company, as trustee, under this Declaration of Trust, trustor(s) hereby agree, on behalf of the trustor(s), trustor(s)' legal representatives, heirs, successors and assigns to indemnify and save harmless such entities and their respective successors and assigns from and against any and all liability, loss, cost and expense sustained or incurred by reason of any act or omission by any of them in reliance on the terms of this Declaration of Trust or any instrument purporting to revoke or amend the same, or in reliance on trustor(s)' request that such property be registered in the name of Heritage Trust Company, as trustee.

**VI. PERPETUITY OF TRUST:**

If any share of the trust estate should still be held in trust at the expiration of a period of twenty-one (21) years after the death of the surviving trustor and of all the children and issue of the trustor(s) living at the date hereof, such share shall thereupon immediately vest in and be distributed free of trust (subject to the provisions of paragraph I.) to the person or persons then entitled to the income therefrom and in such equitable proportions as the trustee may determine.

**VII. CONFLICT OF LAWS CLAUSE:**

This trust has been accepted by the trustee and will be administered in the State of Arizona, and its validity, construction and all rights thereunder shall be governed by the laws of that State. If any provision of this trust agreement should be invalid or unenforceable, the remaining provisions thereof shall continue to be fully effective.

**VIII. FEES:**

The trustor(s) hereby agree to pay reasonable fees for the initiation of this trust and the annual trustee management and service fees as set forth on the Fee Schedule hereby delivered by trustee.

**IX. COMMISSIONS AND SPECIAL SERVICE FEES:**

The trustor(s) also approve whatever extraordinary or special fees or commissions said trustee may receive in connection with the aquisition, sale or disposition of any asset which may become a part of this trust. It being understood and agreed that any such extraordinary or special fees or commissions would be paid by third parties, and not parties to this agreement, and that such fees would not be charged against or become a part of the assets deposited by the trustor(s) herein. Trustee shall retain all such extraordinary or special fees or commissions.

**X. RESTRAINT AGAINST ALIENATION:**

No interest hereunder shall be transferable or assignable by any beneficiary, or be subject to the claims of his creditors.

**XI. INSURANCE POLICIES - RESERVED RIGHTS:**

With respect to any insurance policies under which trustee is designated beneficiary, the trustor(s) retain all ownership rights, including the right to change the beneficiary and the right to assign any policy to any lender, including any trustee, as security for loans to the insured, and the rights of the lender in such policies shall be superior to the rights of the trustee.

**XII. PAYMENT OF INSURANCE PREMIUMS:**

The trustee shall have no responsibility with respect to any policy during the insured's life for the payment of premiums or otherwise, except to hold them in safekeeping and to deliver them upon the insured's written request.

**XIII. RELEASE OF INSURANCE COMPANY:**

Payment to the trustee by an insurance company shall constitute a full release and discharge of the liability of such insurance company, and no insurance company need inquire into or take notice of this instrument or see to the application of any such payment.

**XIV. LITIGATION CLAUSE:**

The trustee shall not be obliged to engage in litigation to enforce payment of any insurance policy hereunder, unless it is indemnified to its satisfaction against any resulting expense and liability.

The trustee shall also not be obliged to enforce, settle, compromise, contest or abandon claims or demands in favor of or against the trust estate, unless it is indemnified to its satisfaction against any resulting expense and liability.

**XV. RETENTION:**

The trustee may retain any property transferred, devised or bequeathed to the trustee, or any undivided interest therein, regardless of any lack of diversification, risk, or non-productivity.

**XVI. BORROW:**

The trustee may borrow money and may mortgage or pledge any trust property.

**XVII. MODIFYING OBLIGATIONS:**

The trustee may enter into agreements modifying the terms of or extending the time of any obligation due or owned by the trust estate.

**XVIII. GUARANTEE:**

Heritage Trust Company hereby effects a guarantee on the basis as stipulated below:

- a. Guarantees the repayment of principal contributions to the trust.
- b. Guarantees the payment of income derived from the principal contributions at the rate stated in this agreement only.

**XIV. RESIGNATION:**

The trustee shall have the right to resign at any time, and upon such resignation the trustee shall distribute all principal and/or income in the trust estate to the trustor(s) or to a successor trustee of his choice.

IN WITNESS WHEREOF, the trustor(s) have executed this Declaration of Trust the day and year first above written:

WITNESS:

TRUSTOR(S):

(Not Valid Until Executed And:)

ACCEPTED BY:

HERITAGE TRUST COMPANY AS TRUSTEE

GOVERNMENT EXHIBIT 15-B

BY

(Authorized Officer)

ATTACHMENT P. 3

APPLICATION FOR BENEFITS UNDER  
DECLARATION OF TRUST AGREEMENT



Heritage Trust Company  
P.O. Box 25009  
919 N. 1st Street  
Phoenix, Arizona 85004

Date \_\_\_\_\_

Gentlemen:

I hereby request that you act as my Trustee for a Trust account in accordance with my instructions below, any other documents, and your rules and regulations governing this Trust.

1. You are instructed as follows:

A. Retain and accumulate income and principal in my trust until otherwise instructed.

B. Distribute income to me as follows:

(1)  Monthly, following approximately 30 to 45 days after investment is made for first check.

(2)  Quarterly, on the last day of:  
March, June, September, December

Check should be drawn in the amount of \$ \_\_\_\_\_

Payable to (Name) \_\_\_\_\_

Number and Street \_\_\_\_\_

\_\_\_\_\_ Town or City State Zip Code

2. My trust is to be opened with deposit as indicated on property receipt.

Trustor(s) Signature(s) \_\_\_\_\_

Address \_\_\_\_\_

Social Security or Taxpayer Identification Number\* \_\_\_\_\_

\*This is required by law.

U.S.A. citizen Yes \_\_\_ No \_\_\_. If no, indicate citizenship \_\_\_\_\_

Trustee reserves the right to reject this application and trust executed herewith by Trustor(s).

VERIFIED AND APPROVED BY: HERITAGE TRUST COMPANY  
AS TRUSTEE

\_\_\_\_\_  
AUTHORIZED OFFICER

WHITE-OFFICE COPY CANARY-CLIENT COPY PINK-REPRESENTATIVE COPY

INVESTMENT PURCHASE DIRECTION  
FOR PRINCIPAL AND INCOME GUARANTEED

FROM: \_\_\_\_\_ AND \_\_\_\_\_  
(Trust Account Name)

My Trust No. \_\_\_\_\_

TO: Heritage Trust Company, as Trustee and not personally  
919 North First Street, Post Office Box 25009  
Phoenix, Arizona 85002

You are hereby authorized and directed to invest in my behalf my initial contribution, made herein and described in my Trust Receipt, in a fixed income investment of \_\_\_\_\_% per annum. Heritage, as Trustee, is hereby authorized and directed to invest said contribution of principal in its sole and absolute discretion as more fully described below, in order to attain such income objective or income in excess thereof. All such excess income, if any, shall be retained by Trustee.

All additional contributions of principal of this trust shall produce a fixed income at such rate as shall be determined on the date of said contributions. Said rate shall be set forth in the "Receipt of Additional Contributions" and must be approved by both Trustor(s) and Trustee. All such additional contributions shall be a minimum of One Thousand Dollars (\$1,000.00).

The Trustee shall have full power in its absolute discretion and without prior authority from any court to do everything necessary for the proper administration of this trust including, but not limited to, the power: (a) to sell, redeem, transfer, exchange, assign, hypothecate, invest or reinvest any property belonging to the trust estate irrespective of any rule of law governing investments by fiduciaries; (b) to exercise any voting rights in person or by proxy and any other rights, privileges, or options with respect to any property belonging to the trust estate; and (c) to employ agents and custodians and register any property belonging to the trust estate in the name of a nominee or in unregistered form or in such other form as will permit it to pass on delivery. Trustor(s) appoint trustee to act as attorney in fact, to sign and execute in trustor(s)' behalf all instruments including stock assignments, endorsement on notes or other documents, which are represented as assets held under this trust only.

In the direction of the investments hereon, I understand that Heritage Trust Company may receive a fee (points) from the borrowers - this fee is to be paid by the borrowers and will not lower the amount of my principal. This will cover all costs, expenses, commissions, legal fees, accounting fees, etc., but however is not limited to any of these. I further direct Heritage to share with the Account Representative and Regional Manager listed below with whatever fees or commissions Heritage received on the purchase for my Trust Fund.

DATED: \_\_\_\_\_

TRUSTORS:

\_\_\_\_\_  
Account Representative

\_\_\_\_\_  
Regional Manager

\_\_\_\_\_  
Accepted by HERITAGE TRUST COMPANY  
As Trustee

ATTACHMENT P. 5

BY \_\_\_\_\_  
Authorized Officer



# HERITAGE TRUST COMPANY

## FEE SCHEDULE FOR DECLARATION OF TRUST AGREEMENT PRINCIPAL AND INCOME GUARANTEED

- A. CREATION FEE:
1. \$50.00
  2. If Successor Trustee: \$150.00
- B. BASIC ANNUAL FEE: Minimum \$100.00
- C. WHEN TRUSTEE HAS FULL INVESTMENT MANAGEMENT AUTHORITY:
- Based on fair market value of securities and cash at each quarterly evaluation.
- 5/10 of 1% on first \$500,000  
3/10 of 1% on next \$1,000,000  
3/10 of 1% on all over \$1,500,000
- D. WHEN TRUSTEE ACTS UNDER TRUSTOR'S INSTRUCTION, OR WHEN SECURITIES CONSIST ONLY OF MUTUAL FUNDS:
- Based on fair market value of securities and cash, or net asset value of Mutual Funds.
- 4/10 of 1% on first \$500,000  
3/10 of 1% on next \$500,000  
1/10 of 1% on all \$1,000,000
- E. WHEN TRUSTEE PERFORMS CUSTODIAL AND ACCOUNTING SERVICE (CONVERTIBLE TRUST):
- 3/10 of 1% on first \$500,000  
2/10 of 1% on next \$500,000  
1/10 of 1% on all \$1,000,000
- Amount in excess of \$2,000,000 will be on a negotiated basis.
- F. PROMISSORY NOTES AND MORTGAGES:
- Basic Annual Fee, Plus  
3/4 of 1% unpaid principal balance at beginning of fee period, and  
2% of gross proceeds received in the event of foreclosure under a mortgage.
- G. BUSINESS INTEREST: A reasonable additional fee will be charged for managing or participating in the management of businesses. The fee will be based on such factors as the type, size and condition of the business involved, the responsibilities assumed and nature and extent of services performed.

H. URBAN REAL ESTATE: In lieu of Basic Annual Fee:  
Commercial real estate: 3/4 of 1% of market value  
Residential real estate: 3/4 of 1% of market value  
Non-Income Producing real estate: reasonable charge based on Trustee's responsibilities and duties.

I. FARM AND RANCH LANDS: In lieu of Basic Annual Fee:  
Cultivated lands: 3/4 of 1% of market value  
Uncultivated lands: 3/4 of 1% of market value  
Non-Income Producing lands: reasonable charge based on Trustee's responsibilities and duties.

J. PURCHASES/OR SALES OF REAL PROPERTY:  
Heritage shall be entitled to participate in any commissions or fees relative to such transactions.

K. COMMISSIONS AND SPECIAL SERVICE FEES:  
The Trustor(s) approves whatever extraordinary or special fees or commissions said Trustee may receive in connection with the acquisition, sale or disposition of any asset which may become a part of this trust. It being understood and agreed that any such extraordinary or special fees or commissions would be paid by third parties, and not parties to this agreement, and that such fees would not be charged against or become a part of the assets deposited by the Trustor(s) herein. Trustee shall retain all such extraordinary or special fees or commissions.

L. TERMINATION OR DISTRIBUTION FEE:  
Reasonable compensation for transfer of assets costs.

M. REPORTS WILL BE MADE AS FOLLOWS:  
Quarterly on cash statements  
Semi-Annually on asset statements  
Investment review annually  
Extra Statements: \$50.00 each

The preceding schedule of fees is hereby approved.

Dated this \_\_\_\_ day of \_\_\_\_\_, 197\_\_.

ACCEPTED BY TRUSTEE:  
HERITAGE TRUST COMPANY

TRUSTOR(S):  
\_\_\_\_\_  
\_\_\_\_\_

BY \_\_\_\_\_

TITLE \_\_\_\_\_