UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 01-10107-DD

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

ETS PAYPHONES, INC.,

Defendant,

and

CHARLES E. EDWARDS,

Defendant-Appellant.

On Appeal from the United States District Court
for the Northern District of Georgia

PETITION OF THE SECURITIES AND EXCHANGE COMMISSION FOR REHEARING AND REHEARING *EN BANC*

GIOVANNI P. PREZIOSO
General Counsel

MEYER EISENBERG
Deputy General Counsel

JACOB H. STILLMAN
Solicitor

SUSAN S. McDONALD
Senior Litigation Counsel

CATHERINE A. BRODERICK
Counsel to the Assistant General Counsel
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549-0606
(202) 942-0827 (Broderick)

SEC v. ETS Payphones, Inc., No. 01-10107-DD

CERTIFICATE OF INTERESTED PERSONS
AND CORPORATE DISCLOSURE STATEMENT

Pursuant to Eleventh Circuit Rule 26.1-1, the Commission submits the following as "a complete list of the trial judge(s), all attorneys, persons, associations of persons, firms, partnerships, or corporations that have an interest in the outcome of the particular case, including subsidiaries, conglomerates, affiliates and parent corporations, and other identifiable legal entities related to a party" known to Commission counsel:

Americom, Inc.

Axis Graphics, Inc.

Catherine A. Broderick, Esq.

Honorable Jack T. Camp, United States District Court for the
Northern District of Georgia

City Public Phones, Inc.

Ethan H. Cohen, Esq.

Charles E. Edwards

Meyer Eisenberg, Esq.

ETS Management Services, LLC

ETS Payphones, Inc.

ETS Payphones of California, Inc.

ETS Vending, Inc.

William P. Hicks, Esq.

IAQ Duct Doctor, Inc.

Kutak Rock LLP

Legends Communications, Inc.

Liberty Motor Sports LLC

Susan S. McDonald, Esq.

Merritt Island LLC

MSC National, Inc.

Payphone Systems Acquisitions, Inc.

Phoenix Telecom of Puerto Rico, Inc.

Pleasant Hill Properties I, LLC

Powell, Goldstein, Frazer & Murphy LLP

Giovanni P. Prezioso, Esq.

S and R Telecommunications Consultants, Inc.

W. Scott Sorrels, Esq.

Jacob H. Stillman, Esq.

Edward G. Sullivan, Esq.

TPL, Inc.

TSC Payphone Corp.

Twinleaf, Inc.

Twinleaf Media, Inc.

U.S. Securities and Exchange Commission

Michael K. Wolensky, Esq.

STATEMENT OF COUNSEL FOR THE SECURITIES AND EXCHANGE COMMISSION
REQUIRED BY 11TH Cir. R. 35-6(c)

I express a belief, based on a reasoned and studied professional judgment, that the attached panel decision is contrary to the following decisions of the Supreme Court of the United States and the precedents of this circuit and that consideration by the full court is necessary to secure and maintain uniformity of decisions in this Court: SEC v. W.J. Howey Co., 328 U.S. 293 (1946); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943); Albanese v. Florida Nat'l Bank of Orlando, 823 F.2d 408 (11th Cir. 1987); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974).

I express a belief, based on a reasoned and studied professional judgment, that this appeal involves one or more questions of exceptional importance:

1. Whether an investment is excluded from the term "investment contract" and the definition of "security" because of the promoter's promise of a fixed return, where authoritative decisions of two other circuits (see Fed. R. App. P. 35(b)(1)(B)) have held that it is not so excluded (SEC v. The Infinity Group Co., 212 F.3d 180, 187-188 (3d Cir. 2000), cert. denied, 121 S. Ct. 1228 (2001), and United States v. Carman, 577 F.2d 556, 563 (9th Cir. 1978)).

2. Whether an investment is excluded from the term "investment contract" and the definition of "security" because the investor's expected profits are "contractually guaranteed" by the promoter.

ATTORNEY OF RECORD FOR THE
SECURITIES AND EXCHANGE COMMISSION

TABLE OF CONTENTS

PAGE

CERTIFICATE OF INTERESTED PERSONS AND CORPORATE DISCLOSURE STATEMENT C1

STATEMENT OF COUNSEL FOR THE SECURITIES AND EXCHANGE COMMISSION REQUIRED BY 11th Cir. R. 35-6(c) i

STATEMENT OF ISSUES THAT MERIT EN BANC CONSIDERATION 1

STATEMENT OF THE COURSE OF PROCEEDINGS AND CASE DISPOSITION 1

STATEMENT OF FACTS 3

ARGUMENT 3

A. The panel decision involves questions of exceptional importance - removing from the protections of the securities laws many types of investments that have long been recognized as covered by those laws. 3

B. The panel's very narrow interpretation of investment contract and security conflicts with the statutory language and

TABLE OF CONTENTS (cont'd)

PAGE

purpose. 4

C. The ETS interests are investment contracts. 5

1. The panel's holding that a fixed return investment cannot be an investment contract conflicts with decisions of the Supreme Court, courts of appeals and the Commission. 6

2. The panel's second holding - the novel and unsupported view that where profits are "contractually guaranteed" investors do not rely on the efforts of others - is wrong. 11

D. The ETS interests fall within other categories in the definition of security. 13

CONCLUSION 15

STATUTORY ADDENDUM 1A

PANEL OPINION . . . .

CERTIFICATE OF SERVICE . . . .

TABLE OF AUTHORITIES

CASES **PAGE**

*Abbett, Sommer & Co., Inc., 44 S.E.C. 104 (1969) 9

*Albanese v. Florida Nat'l Bank of Orlando, 823 F.2d 408 (11th Cir. 1987) 12

Meason v. Bank of Miami, 652 F.2d 542 (5th Cir. Aug. 6, 1981) 14

People v. White, 124 Cal. App. 548 (Dist. Ct. App. 1932) . . . 7

Resolution Trust Corp. v. Stone, 998 F.2d 1534 (10th Cir. 1993) 9

Reves v. Ernst & Young, 494 U.S. 56 (1990) . . . . 4, 5, 11 passim

*SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943) . . 5, 7

SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974) . . . . 5, 8, 10 passim

*SEC v. The Infinity Group Co., 212 F.3d 180 (3d Cir. 2000), cert. denied, 121 S. Ct. 1228 (2001) 8

*SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) . . . 7

SEC v. Universal Service Ass'n, 106 F.2d 232 (7th Cir. 1939) . 7

*SEC v. W.J. Howey Co., 328 U.S. 293 (1946) . . . . 2, 5, 6 passim

*SEC v. Zandford, 122 S. Ct. 1899 (2002) 4, 9

Stevens v. Liberty Packing Corp., 111 N.J. Eq. 61, 161 A. 193 (1932) 7

CASES (cont'd): **PAGE**

United Housing Found. Inc. v. Forman, 421 U.S. 837 (1975) . 9, 10

United States v. Austin, 462 F.2d 724 (10th Cir. 1972) . . . 14

*United States v. Carman, 577 F.2d 556 (9th Cir. 1978) . . 8, 9

STATUTES

Securities Act of 1933, 15 U.S.C. 77a, et seq.:

*Section 2(a)(1), 15 U.S.C. 77b(a)(1) 1

Section 7(a), 15 U.S.C. 78g(a) 13

Schedule A, item 26, 15 U.S.C. 77aa(26) 13

Securities Exchange Act of 1934, 15 U.S.C. 78a, et seq.:

*Section 3(a)(10), 15 U.S.C. 78c(a)(10) 1

STATEMENT OF ISSUES THAT MERIT EN BANC CONSIDERATION

Whether an investment is excluded from the term "investment contract" and the definition of "security" (1) because of the promoter's promise of a fixed return and (2) because the investor's return is "contractually guaranteed" by the promoter.

STATEMENT OF THE COURSE OF PROCEEDINGS AND CASE DISPOSITION

In this law enforcement action, the Commission charged that Charles E. Edwards, owner of ETS Payphones, Inc., fraudulently sold units in a payphone sale/lease/buyback program in which 10,000 investors in 38 states invested about $375 million. Edwards promoted the scheme to the general public as a safe and profitable investment – urging that the plan was "virtually recession-proof," that investors would receive "immediate, steady cash flow" (R1-1-Exh. 15 at 8) and stating in bold type "**Watch the Profits Add Up**" (R1-1-Exh. 17 at 8), but failing to disclose that ETS's operation of payphones was never profitable and that the company was on the verge of bankruptcy, for which it filed in September 2000.

The district court found for purposes of entering preliminary relief that the interests sold were securities – specifically, "investment contracts" – as defined in Section 2(a)(1) of the Securities Act, 15 U.S.C. 77b(a)(1), and Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10). The district court concluded that the ETS units were investments in a common enterprise with the investors led to expect profits through ETS's management of the payphone operations, and thus that the units met the definition of investment contract adopted in SEC v. W.J. Howey Co., 328 U.S. 293, 298-299 (1946) ("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"). See 123 F. Supp. 2d at 1352-1354. With respect to the "efforts" element, the district court made a factual finding that under the lease agreements "investors retain little, if any control" and that "Defendant [Edwards] manages, maintains, and operates the pay phones." 123 F. Supp. 2d at 1351.

Yet, a panel of this Court reversed and directed dismissal of the complaint, holding that, although an "investment of money is apparent" (Op. 5-6) and ETS investors purchased the phones "for the purpose of earning a return on the purchase price" (Op. 7), these interests did not meet the Howey test because the investors' return – the monthly "lease" payments on the phones they bought and leased back to ETS – was fixed rather than variable with ETS's profits. The panel held that a fixed return cannot constitute "profits" under Howey. Op. 7-8. The panel further held that even if the investors' fixed return were profits under Howey the ETS units still were not investment contracts because "the investors were entitled to their lease payments under their contracts with ETS" (Op. 9), reasoning:

> Because their returns were contractually guaranteed, those returns were not derived from the efforts of Edwards or anyone else at ETS; rather, [the lease payments] were derived as the benefit of the investors' bargain under the[ir] contract[s] [with ETS].

STATEMENT OF FACTS

The investment ETS sold was a package consisting of a payphone with a lease/management agreement and a buyback commitment: The investor bought a phone for $6,750 through PSA, Inc., an ETS subsidiary, leased it back to ETS for five years, and was paid a fixed return of $82 per month – a 14% return -- regardless of how much revenue his particular phone generated. R1-1-Exh. 15 at 11, Exh. 18 at 6. Under the buyback provision, ETS agreed to refund the full purchase price at the end of the five-year lease, or within 180 days of the investor's request for a refund. Id.

Investors in the ETS units were passive, with no role in managing or operating the payphones. ETS's promotional materials stated that ETS chose locations for and installed the phones, managed and maintained them, and retrieved coins from them. R1-1-Exh. 18 at 5-6.

ARGUMENT

A. The panel decision involves questions of exceptional importance -- removing from the protections of the securities laws many types of investments that have long been recognized as covered by those laws. The decision's technical, formulaic approach to the interpretation of the term "investment contract" and the definition of "security" provides an easy means for unscrupulous promoters to evade the securities laws by restricting the promised return on an investment to a fixed amount. Not only is the decision contrary to decisions of the Supreme Court and of courts of appeals, but it also significantly narrows the coverage of the securities laws. For over half a century "investment contract" has been a critical vehicle for bringing within the securities laws a host of investments that do not fit within the more specific items included in the definition of security. The panel's holding undermines the Commission's ability to carry out its mandate to protect the public from fraud and other abuses in all forms of investments, including both debt and equity securities, at a time when the need for investor protection is more apparent than ever.

B. The panel's very narrow interpretation of investment contract and security conflicts with the statutory language and purpose. Congress "enacted a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an investment." Reves v. Ernst & Young, 494 U.S. 56, 61 (1990). The words "investment contract" in no way suggest that investments with fixed returns are excluded. Moreover, "investment contract" was included in the definition as a catch-all term for investments that might not fit easily within other more specific items. Just as the specific items include fixed-return investments ("bond," "debenture," "note," and "evidence of indebtedness"), there is no justification for excluding fixed return investments from a catch-all term.

The federal securities laws are "construed 'not technically and restrictively, but flexibly to effectuate [their] remedial purposes.'" SEC v. Zandford, 122 S. Ct. 1899, 1903 (2002). Specifically with respect to the term "security," a broad reading is required because "Congress' purpose in enacting the securities laws was to regulate investments, in whatever form * * * and by whatever name," and the courts are "not bound by legal formalisms, but instead take account of the economics of the transaction." Reves, 494 U.S. at 61 (emphasis in original). See also SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943). In interpreting "investment contract" in Howey, the Supreme Court emphasized that the definition "embodies a flexible * * * principle * * * capable of adaptation to meet the * * * variable schemes devised by those who seek the use of the money of others on the promise of profits." 328 U.S. at 299. "The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae" (id. at 301) -- yet that is precisely what the panel has done in this case.

C. The ETS interests are investment contracts. This Court and others have viewed Howey as establishing that an investment contract exists when: (1) a person invests money; (2) in a common enterprise; and (3) is led to expect profits from the managerial or entrepreneurial efforts of the promoter or a third party. See, e.g., SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 477 (5th Cir. 1974).

There is no dispute that the first element of Howey is met here, since "an investment of money is apparent." Op. 6. There can be no serious question that the second element – a common enterprise – is present as well.[1] The panel's decision turned instead on its view that

[1] Among other factors, the fortunes of all investors were inextricably tied to the success of ETS's payphone enterprise as a whole. Investors would receive their monthly lease payments and could recover their purchase price when they requested it only if ETS could generate the funds to meet its obligations under the contract. Thus, a common enterprise was clearly present. See Koscot, 497 F.2d at 479.

the fixed return investors received did not constitute "profits" under Howey's third element and also on its conclusion that, even if the lease payments could be considered profits, the third element would not be satisfied because the payments were "contractually guaranteed" and thus not derived from the efforts of others. The panel's decision is incorrect in both respects.

1. The panel's holding that a fixed return investment cannot be an investment contract conflicts with decisions of the Supreme Court, courts of appeals and the Commission. The first question of which en banc review is sought is whether a fixed return can be "profits" under Howey. The panel's holding that it cannot conflicts with Howey itself, which expressly referred to "income" as a form of "profits" and cited as examples of correct investment contract decisions three involving schemes with fixed returns. Howey did not restrict investment contracts to equity securities or to investments with a variable return – a restriction that would contravene Congress's intent to encompass all arrangements involving the use of the money of others on the promise of a return. Indeed, Howey adopted the definition of "investment contract" followed by state courts in construing Blue Sky laws, a definition that used the words "income or profit." 328 U.S. at 298 ("a contract or scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment'"). The use of the word "profits" a few lines later in Howey is merely shorthand for "income or profit." This is confirmed by Howey's statements that the investors were "attracted solely by the prospects of a return on their investment" (id. at 300, emphasis added) -- without referring specifically to "profits" and without suggesting that the return cannot be fixed -- and that "it is immaterial whether the enterprise is speculative or non-speculative" (id. at 301). That Howey did not exclude fixed returns from "profits" is also confirmed by its citation with approval of three fixed return cases (328 U.S. at 298 n.4, 299 n.5): People v. White, 124 Cal. App. 548, 550-551 (Dist. Ct. App. 1932)(fixed $7,500 return on investment of $5,000); SEC v. Universal Service Ass'n, 106 F.2d 232, 237-238 (7th Cir. 1939) (expectation of "30% profit per annum"); Stevens v. Liberty Packing Corp., 111 N.J. Eq. 61, 65, 161 A. 193, 195 (1932) ("return of $56 a year upon a $175 investment").

Further, the panel's decision conflicts with Joiner and SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967), which held that whether an investment contract is involved is determined by the way the promoters presented the scheme to potential investors. See Joiner, 320 U.S. at 352-53 (result turns on "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospects"); United Benefit, 387 U.S. at 211 (same). "In the enforcement of an act such as this * * * promoters' offerings [should] be judged as being what they were represented to be." Joiner, 320 U.S. at 353. Since Edwards told prospective investors they would receive "profits" ("**Watch the Profits Add Up**"), he cannot claim that they did not expect to receive profits.

The panel's decision also is inconsistent with a Fifth Circuit decision that is binding in this Circuit. In Koscot, investors in a pyramid scheme were offered fixed payments for each new person brought into the scheme, regardless of the overall profitability of the enterprise. The investor was "sold the idea that he will get a fixed part of the proceeds of the sales [to others]. * * * What he buys is a share in the proceeds of the selling efforts of [the promoter]." 497 F.2d at 485.

The panel's decision also conflicts with decisions of two other circuits which expressly rejected the argument that a fixed return does not constitute "profits" within the meaning of Howey. In SEC v. The Infinity Group Co., 212 F.3d 180, 187-88 (3d Cir. 2000), cert. denied, 121 S. Ct. 1228 (2001), the Third Circuit rejected the argument that the fixed returns offered - a 138% or 181% return on the amount invested -- did not constitute "profits," stating that "the definition of security does not turn on whether the investor receives a variable or fixed rate of return," and noting that in Howey the Court had stated that "it is immaterial whether the enterprise is speculative or non-speculative." Similarly, in United States v. Carman, 577 F.2d 556, 563 (9th Cir. 1978), the Ninth Circuit held that the interests sold were investment contracts despite the fact that "the return was in the form of fixed interest." The package sold included a note, a service contract, and a repurchase agreement. Id. at 560. The court rejected the argument that the fixed return meant that the investors were not dependent on the promoters for profits, reasoning that the investors were dependent on the success of the enterprise -- particularly its ability to collect on the notes and to honor its buyback agreement -- to receive their returns. Id. at 563. "This risk of loss [if the enterprise failed] is sufficient to bring the transaction within the meaning of security, even where the anticipated financial gain is fixed." Id.[2]

The panel's decision also conflicts with the Commission's administrative interpretation that "investment contract" includes investments in mortgages that pay profits in the form of fixed interest payments, if accompanied by service agreements minimizing the risk of loss to investors. See Abbett, Sommer & Co., Inc., 44 S.E.C. 104, 107-109 (1969)(mortgage notes accompanied by services including investigation of property and mortgagor, collection of monthly payments for investors, and undertaking to repurchase notes). As the Supreme Court recently held, in SEC v. Zandford, 122 S.Ct. at 1903, the Commission's reasonable interpretation is entitled to deference.

Dicta in two Supreme Court decisions have not narrowed the "profits" described in Howey. In United Housing Found. Inc. v. Forman, 421 U.S. 837 (1975), the Court, in describing its holdings in prior "investment contract" cases, stated: "By profits, the Court has meant either capital appreciation resulting from the development of the initial investment * * * or a participation in earnings resulting from

[2] Cases involving commercial lending arrangements, such as "loan participation" agreements, e.g., Resolution Trust Corp. v. Stone, 998 F.2d 1534 (10th Cir. 1993), do not support the view that a fixed return excludes an investment from the scope of investment contract. Among other things, the transactions in those cases were commercial rather than investment in nature.

the use of investors' funds." Id. at 852. Contrary to the panel's view (Op. 7-8), Forman's reference to a "participation in earnings" did not create a new test that narrowed Howey to variable return investments. Indeed, the Court made it clear in Forman that the profit element of Howey is satisfied where "the investor is 'attracted solely by the prospects of a return' on his investment" (421 U.S. at 852) – an apt description of an investor's expectation of receiving either a variable or a fixed return. The Forman statement about profits was made, not to distinguish fixed from variable returns, but rather to distinguish the situation where an investor is attracted only by the prospects of a return on his money, which is a security, from one where "a purchaser is motivated by a desire to use or consume the item purchased," which is not. Id. at 852-853. Moreover, to conclude as the panel did that a fixed return is not a "participation in earnings" because it is not measured by the earnings of the enterprise is to give the word "participation" an unduly narrow meaning. Irrespective of the measure of the return, an investor expects a "participation" in earnings when, as here, he is led to expect that the source of his return will be the company's earnings. Cf. Koscot, 497 F.2d at 485 (describing fixed payments promised to investors as "a share in the proceeds" of the business). Edwards urged the public to invest in the ETS enterprise based on his representations that the company was profitable, recognizing that investors would expect to receive their returns from the company's earnings.

Nor was Howey's definition of an investment contract as a transaction in which an investment of money is expected to return "income or profit" narrowed by a dictum in Reves. In Reves, the Court considered the test for determining whether an interest denominated as a note is a security, concluding that the Howey test does not apply and, indeed, that "the Howey test is irrelevant to the issue before us today." 494 U.S. at 64, 68 n.4. In describing the "irrelevant" Howey test, the Court stated that "profits" had been defined "restrictively" in Howey and assumed that under Howey "a rate of interest not keyed to the earning of the enterprise" would not constitute "profits." 494 U.S. at 68 n.4. That statement, however, pertains to a matter not before the Court in Reves. Further, as discussed above, the Howey decision itself demonstrates that the Court had never adopted the restrictive view of profits the Reves opinion attributed to it. Rather, Howey shows that the Court intended to include in "profits" "income or profit" -- the same plain meaning of "profits" the Court adopted for the return on notes in Reves: "'a valuable return on an investment,' which undoubtedly includes interest." 494 U.S. at 68 n.4.

2. The panel's second holding – the novel and unsupported view that where profits are "contractually guaranteed" investors do not rely on the efforts of others – is wrong. Under Howey, the focus of the "efforts" element is not on whether profits are "contractually guaranteed," but rather on whether it is the promoter or the investors themselves who manage the enterprise expected to generate the profits. See 328 U.S. at 299-300 ("manage[ment] by [the promoters] or third parties with adequate personnel and equipment [was] essential if the investors [we]re to achieve their paramount aim of a return on their investments"). In <u>Albanese v. Florida Nat'l Bank of Orlando</u>, 823 F.2d 408, 412 (11th Cir. 1987), this Court correctly focused on the fact that the investors as a practical matter had no control over their investments, which were instead managed by the promoters. The same was found by the district court to be true in this case. <u>See</u> 123 F. Supp. 2d at 1351 (Edwards "manages, maintains, and operates the pay phones"). The panel did not conclude that the trial court's finding was clearly erroneous. Indeed, as the panel recognized, "the funds generated by the payphones helped ETS meet its [lease and buyback] obligations" (Op. 8). Yet, the panel incorrectly focused on the fact that the promise to pay was "contractually guaranteed," rather than on the fact that it was Edwards who managed the ETS enterprise, from the earnings of which investors expected to receive their returns.

Of course, the fact that the ETS investors had a "contractual" right to the promised return does not defeat the existence of an "investment contract," since that would effectively read that category out of the statute. Nor is an investment contract precluded by the "guarantee" of the return. First, even a true guarantee by a third party would not defeat the existence of an investment contract, but rather would establish the existence of an additional type of security. The Securities Act definition of security includes a "guarantee of" any of the other devices enumerated in the definition. Second, in this case the only "guarantee" was ETS's own contractual promise to pay a return, making it meaningless unless the company was able to make the promised payments. Moreover, regardless of whether the guarantee were by ETS or a third party, the investors were still dependent on the ability of the guarantor to pay, and thus their returns were dependent on the efforts of others.

If the panel's use of the term "guaranteed" referred to the fixed nature of the return, the panel's belief that a fixed return meant that investors were not dependent on the efforts of others is equally mistaken. Purchasers of fixed return investments, like purchasers of variable return investments, are dependent on the efforts of others to manage successfully the enterprise in which they invest. Indeed, the disclosure requirements applicable to public offerings of both debt and equity securities include information about the company's earnings. See Section 7(a) of the Securities Act, 15 U.S.C. 77g(a) & Schedule A, 15 U.S.C. 77aa(26). Edwards himself recognized that investors would expect to receive their returns from the earnings of the payphone operation, urging the public to invest in ETS because, he falsely claimed, the company was profitable.

D. The ETS interests fall within other categories in the definition of security. Since Congress intended the definition of security to "encompass virtually any instrument that might be sold as an investment" and since "the economics of the transaction under investigation," not "legal formalisms," are determinative (Reves, 494 U.S. at 60, 61), the statutory purpose would be undermined if the ETS interests are excluded from the scope of "security." Of the various securities listed in the statute, investment contract best describes the ETS interests. For this reason, the Commission's principal argument below focused on investment contract. The district court in its opinion, and the parties likewise in this Court, addressed only that term. While we believe that the ETS interests are investment contracts, we also believe, particularly if they are precluded from satisfying Howey because of the fixed return, that the economic realities here establish that the ETS interests come within one or more of the fixed return investments listed in the definition of "security." The panel erred in ordering dismissal of the complaint for lack of subject matter jurisdiction without considering – or remanding for the district court to consider – whether the interests are "securities," even if they are not investment contracts. See Meason v. Bank of Miami, 652 F.2d 542, 547, 550-551 (5th Cir. Aug. 6, 1981).

As we argued below (R4-19 at 4-6), the ETS interests may properly be characterized as "notes" or the even broader "evidences of indebtedness" (see United States v. Austin, 462 F.2d 724, 736 (10th Cir. 1972)). Unlike ordinary leases, the ETS interests were vehicles for investment and in economic substance operated like debt securities and other interests "commonly known as a security." Moreover, if analyzed as a "note" under the Reves family resemblance test, ETS's contractual obligation would fall within the definition of security. Under Reves, the presumption that a note is a security (494 U.S. at 65) can be rebutted if the note resembles certain categories of non-investment type notes (id.), none of which is involved here. In determining whether a note resembles a non-investment type note, Reves applied four factors, all of which weigh in favor of finding the ETS interests to be notes that are securities.[3]

CONCLUSION

Rehearing or rehearing en banc should be granted.

Respectfully submitted,

GIOVANNI P. PREZIOSO
General Counsel

MEYER EISENBERG
Deputy General Counsel

JACOB H. STILLMAN
Solicitor

SUSAN S. McDONALD
Senior Litigation Counsel

CATHERINE A. BRODERICK
Counsel to the Assistant General Counsel

Securities and Exchange Commission
Washington, D.C. 20549-0606

September 2002

[3] First, if the seller's purpose is to raise money for the general use of a business or to finance substantial investments "and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security.'" 494 U.S at 66. Here,"ETS's investors" bought phones "for the purpose of earning a return on the purchase price"(Op. 7), not to use the phones, and ETS raised the money to use in operating the business. Second, it is sufficient for the required "common trading" element if the interests are "offered and sold to a broad segment of the public," as were the ETS units. 494 U.S. at 68. Third, because Edwards promoted them as "investments," the ETS units meet the "fundamental essence of a 'security.'" Id. at 68-69. Fourth, there is no risk-reducing factor here that removes the need for the type of protections (disclosure and antifraud) afforded by the securities laws. Id. at 67. FTC disclosure rules with which Edwards purported to comply do not reduce risk; unlike bank or similar regulation, they do not assure ETS's ability to pay investors.

STATUTORY ADDENDUM

Section 2(a)(1) of the Securities Act of 1933
15 U.S.C. 77b(a)(1)

SEC. 2. [77b] (a) DEFINITIONS.—When used in this title, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, security future, 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, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Section 3(a)(10) of the Securities Exchange Act of 1934
15 U.S.C. 78c(a)(10)

SEC. 3. [78c] (a) When used in this title, unless the context otherwise requires—

* * * * *

(10) The term "security" means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

[PUBLISH]

IN THE UNITED STATES COURT OF APPEALS

FOR THE ELEVENTH CIRCUIT

FILED
U.S. COURT OF APPEALS
ELEVENTH CIRCUIT
AUGUST 6, 2002
THOMAS K. KAHN
CLERK

No. 01-10107

D. C. Case No. 00-02532-CV-JTC-1

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

versus

ETS PAYPHONES, INC.,

Defendant,

CHARLES E. EDWARDS,

Defendant-Appellant.

Appeal from the United States District Court
for the Northern District of Georgia

(August 6, 2002)

Before EDMONDSON, Chief Judge, HILL and LAY*, Circuit Judges.

PER CURIAM:

*Honorable Donald P. Lay, U.S. Circuit Judge for the Eighth Circuit, sitting by designation.

Charles E. Edwards appeals from the district court's grant of a preliminary injunction in favor of the Securities and Exchange Commission (SEC). The SEC alleged Edwards' company, ETS Payphones, Inc. (ETS), sold securities in violation of the registration and anti-fraud provisions of the federal securities laws. See 15 U.S.C. §§ 77e(a), 77e(c), 77q(a), 78j(b); 17 C.F.R. § 240.10b-5. The SEC alleged these securities involved "investment contracts" whereby investors purchased a pay telephone from Edwards only to lease it back to ETS for management in exchange for a fixed monthly fee. The court determined it had jurisdiction over the SEC's action and preliminarily enjoined Edwards from future violations of the securities laws. It also froze Edwards' assets in anticipation of possible future disgorgement. On appeal, Edwards urges that the transactions did not involve securities and that the SEC lacks subject matter jurisdiction. We agree.

Facts

Edwards is the principal actor in several business entities relevant to this appeal. He is the founder and majority stockholder of ETS. He is a member of its board of directors and served as its chief executive officer for most of the time period relevant to this appeal. ETS was incorporated to provide management services, i.e. placement, advertising, maintenance, coin collecting, and accounting, for owners of pay telephones.

Edwards also founded Payphone Systems Acquisitions, Inc. (PSA). PSA was a wholly owned subsidiary of ETS. PSA purchased telephone equipment and locations, which it sold at wholesale to distributors. Edwards also is the principal owner of Twinleaf, Inc., a consulting company Edwards created to provide support services to ETS.

The SEC asserts Edwards used these entities collectively to engage in a single, larger venture involving the sale of securities, specifically investment contracts. An investor would purchase a pay telephone indirectly from PSA, subject to a provision whereby the purchaser had fifteen days to cancel the transaction. Then the purchaser would lease the phone "back" to ETS for management in exchange for a fixed monthly fee. If at any time the purchaser was not satisfied with the arrangement, it could require ETS to purchase the phone for a prearranged price. Alternatively, it could cancel the lease and repossess its telephone without penalty. The SEC characterizes these transactions collectively as a "unit" sufficient to constitute a security under federal law. There is no dispute that Edwards did not register these transactions with the SEC.[1]

---

[1]We note that Edwards conferred with SEC staff in Atlanta in 1995 concerning ETS's payphone program. Edwards and his lawyers provided documents and records to the SEC and met with an SEC attorney. At that time, the record shows the SEC attorney was told the marketing and leasing aspects of ETS's business would be separated to avoid any claim that the payphone business involved a security. The SEC took no action and did not contact Edwards until the year 2000 when ETS filed for bankruptcy and reorganization.

The immediate dispute arose when, in September 2000, ETS and PSA filed a voluntary petition for bankruptcy and reorganization. As a result, ETS stopped making lease payments to the telephone owners and ceased honoring the buyback guarantees. The SEC brought this action asserting Edwards engaged in widespread fraud. Specifically, the SEC alleges Edwards' business venture was actually a "massive Ponzi scheme." It argues Edwards did not operate a legitimate business but rather fleeced his investors by misrepresenting his company as profitable when it only survived because he constantly recruited new purchasers and used their capital to satisfy ETS's obligations. The SEC asserts Edwards sustained this fraud for over five years, raising more than $300 million from over 10,000 investors, with the full knowledge that eventually the stream of new investors would dry up and only he would profit while his investors lost everything.

To prevent this perceived injustice, the SEC's suit prayed for disgorgement of any profits Edwards may have made as a result of his business dealings. The merits of this suit, however, are not before the court. We only review the district court's grant of a preliminary injunction and freeze of Edwards' assets. Edwards asserts various grounds of error, including an absence of subject matter jurisdiction and abuse of discretion in granting the injunction and asset freeze. We hold the district court lacked subject matter jurisdiction to entertain this action; under the circumstances, we need not consider the other issues.

Jurisdiction

Edwards challenges the district court's subject matter jurisdiction to grant relief to the SEC, arguing the sale of pay telephones does not involve securities under federal law. Specifically, Edwards argues these transactions did not involve investment contracts. In order to defeat a jurisdictional attack on a preliminary injunction, the SEC must establish "a reasonable probability of ultimate success upon the question of jurisdiction when the action is tried on the merits." SEC v. Unique Fin. Concepts, Inc., 196 F.3d 1195, 1198 (11th Cir. 1999) (quoting Majd-Pour v. Georgiana Cmty. Hosp., Inc., 724 F.2d 901, 902 (11th Cir. 1984)). The Supreme Court has established a three part test for determining whether a particular financial interest constitutes an investment contract and, thus, a security. In SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946), it held that an investment contract is "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 . . . ." Thus, the Supreme Court has characterized a transaction as an investment contract if it involves (1) an investment of money, (2) in a common enterprise, (3) with the expectation of profits to be derived solely from the efforts of others. We agree with the district court that an investment of money is apparent. We address the remaining requirements in turn.

A. Common Enterprise

As Edwards points out, there is disagreement among the circuits as to the requirements of the second prong of the Howey test. Most circuits that have considered the issue find it satisfied where a movant shows "horizontal commonality," that is the "pooling" of investors' funds as a result of which the individual investors share all the risks and benefits of the business enterprise. See, e.g., SEC v. Infinity Group Co., 212 F.3d 180, 188 (3d Cir. 2000).[2]

Edwards' asserts the test for a common enterprise in this circuit is not settled and urges the court to adopt horizontal commonality. Notwithstanding Edwards' argument, we believe we are bound by precedent to apply a different test for commonality, "broad vertical commonality." See SEC v. Unique Financial Concepts, Inc., 196 F.3d 1195, 1199-1200 (11th Cir. 1999); Eberhardt v. Waters, 901 F.2d 1578, 1580-81 (11th Cir. 1990); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 478-79 (5th Cir. 1974). Broad vertical commonality, the easiest to satisfy of the

[2]See also SEC v. Banner Fund Int'l, 211 F.3d 602, 614-15 (D.C. Cir. 2000); SEC v. Life Partners, Inc., 87 F.3d 536, 543-45 (D.C. Cir. 1996); Teague v. Bakker, 35 F.3d 978, 986 n.8 (4th Cir. 1994); Wals v. Fox Hills Dev. Corp., 24 F.3d 1016, 1018-19 (7th Cir. 1994); Revak v. SEC Realty, 18 F.3d 81, 87-89 (2d Cir. 1994); Newmyer v. Philatelic Leasing, Ltd., 888 F.2d 385, 391-93 (6th Cir. 1989).

alternative tests, only requires a movant to show that the investors are dependent upon the expertise or efforts of the investment promoter for their returns. We need not explore the applicability of this prong to the present case, however, in light of our holding that the last prong, "expectation of profits," clearly is unsatisfied.

B. Expectation of Profits Solely from the Efforts of Others

The SEC cannot show a reasonable probability of success on the merits because it cannot show that investors who contracted with ETS expected profits to be derived solely through the efforts of others.

The SEC argues "profits" must be understood in a general sense. It notes that, in United Housing Found. v. Forman, 421 U.S. 837 (1975), the Court stated that an investor is "'attracted solely by the prospects of a return' on his investment." Id. at 852 (quoting Howey, 328 U.S. at 300). The definition of profits, the SEC asserts, must be understood in terms of the nature of an investment. Here, ETS's investors purchased their telephones for the purpose of earning a return on the purchase price. Thus, the SEC urges, this should be enough to justify a finding of expectation of profits.

Although the simplicity of the SEC's proposed approach is naturally appealing, we must disagree. In Forman, the Court made clear that the word "profits" has a limited meaning under federal securities law. Profits, in that context, require either a participation in earnings by the investor or capital appreciation. See id. at 852 ("By profits, the Court has meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds . . . ."). In this case, there is no dispute that capital appreciation is not at issue. Moreover, the fixed lease payments paid to owners of the telephones cannot be considered participation in earnings; owners were not looking for any profit in the sense that they would receive earnings from the company. The owners certainly had no intention to share in the concomitant risk that their participation in the company's earnings would occasionally require them to share company losses. Of course, the funds generated by the payphones helped ETS meet its obligations. But this does not justify characterization as participation in earnings. Because the investors received a fixed monthly sum, the actual earnings of their telephone, or ETS, were irrelevant. ETS alone shouldered the risk of its placement of the telephones and ETS alone depended upon the earnings of its business. Thus, only ETS could reap profits as that term is understood under the federal securities law.

Even in the event the investors' return could be considered profits, the final Howey prong cannot be satisfied because the investors did not expect profits to be derived solely from the efforts of others. The parties dispute the level of control over the telephones the investors retained under the leaseback agreements. See Albanese v. Florida Nat'l Bank of Orlando, 823 F.2d 408, 410 (11th Cir. 1987) ("If the investor retains the ability to control the profitability of his investment, the agreement is no security."). The SEC asserts the investors desired their telephones to be passive investments; Edwards urges the investors' right to cancel the lease and repossess their telephones, or not contract with ETS at all for that matter, constitutes sufficient control under the Albanese standard. In our opinion, however, the determining factor is the fact that the investors were entitled to their lease payments under their contracts with ETS. Because their returns were contractually guaranteed, those returns were not derived from the efforts of Edwards or anyone else at ETS; rather, they were derived as the benefit of the investors' bargain under the contract.

Because the SEC cannot satisfy the requirements of the Howey test to prove the existence of a security, we hold the district court did not have subject matter jurisdiction under the federal securities laws. The decision of the district court issuing a preliminary injunction and asset freeze is REVERSED with directions to dismiss the SEC's complaint for lack of subject matter jurisdiction.

LAY, Circuit Judge, concurring:

I concur with the judgment set forth in the majority opinion. The SEC cannot carry its burden to prove that Edwards' lease program involved an expectation of profits to be derived solely from the efforts of others. Consequently, there is no investment contract under SEC v. W.J. Howey Co., 328 U.S. 293 (1946), and no subject matter jurisdiction.

I write separately, however, to state my disagreement with that portion of the opinion which reaffirms broad vertical commonality as the test for common enterprise in the Eleventh Circuit. For the reasons set forth below, I respectfully submit that horizontal commonality is the only valid test for a common enterprise. Moreover, the SEC cannot carry its burden to prove horizontal commonality, and therefore, subject matter jurisdiction also is absent on this basis.

Requiring proof of horizontal commonality is the only logical approach to understanding the concept of a common enterprise. In Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 622 F.2d 216 (6th Cir. 1980), the court set forth the widely accepted justification for this position. Proof of horizontal commonality is required because requiring only proof of broad vertical commonality makes Howey's third prong–expectation of profits to be derived from the efforts of others–superfluous. Curran, 622 F.2d at 221-24 (citing Milnarik v. M-S

Commodities, Inc., 457 F.2d 274, 275-77 (7th Cir.), cert. denied, 409 U.S. 887 (1972) (Stevens, J.)). "[N]owhere in Howey or later Supreme Court decisions is it intimated that ['common enterprise'] is somehow redundant of other elements of the definition of a security." Id. at 224 (quoting Berman v. Bache, Halsey, Stuart, Shields, Inc., 467 F.Supp. 311, 319 (S.D Ohio 1979)). Consequently, only a requirement of horizontal commonality is consistent with the Howey test for an investment contract.[1] Indeed, in its arguments in a case out of the First Circuit, the SEC concedes that this reasoning is correct and broad vertical commonality is an inappropriate test for Howey's common enterprise requirement. See Brief for Appellant Securities and Exchange Comm'n at 28 n.11, SEC v. SG Ltd., 265 F.3d 42 (1st Cir. 2001) (Nos. 01-1176, 01-1332) ("The Commission has also long taken the position that broad vertical commonality is not an appropriate test because it collapses the second prong of the

[1]The Sixth Circuit relied a great deal on the decision of the Seventh Circuit in Milnarik, 457 F.2d 274, written by then-Judge Stevens. The Curran court, following the reasoning of Milnarik, observed:

> [W]e believe that no horizontal common enterprise can exist unless there also exists between discretionary account customers themselves some relationship which ties the fortunes of each investor to the success of the overall venture. Thus in our view the finding of a vertical common enterprise based solely on the relationship between promoter and investor is inconsistent with Howey.

Curran, 622 F.2d at 223-24.

Howey test (common enterprise) into the third prong (profits to come from the efforts of others).") .

The SEC responds that analysis of the present case under a requirement of horizontal commonality is inappropriate, however, because this circuit requires only proof of broad vertical commonality under SEC v. Unique Financial Concepts, Inc., 196 F.3d 1195, 1199-1200 (11th Cir. 1999); Eberhardt v. Waters, 901 F.2d 1578, 1580-81 (11th Cir. 1990); and SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 478-79 (5th Cir. 1974). The majority opinion finds this argument controlling. With all due respect to the law of this circuit, which I am bound to follow as a visiting judge, I must respectfully disagree that this panel is bound by precedent to require only proof of broad vertical commonality.

To the extent the SEC relies on Unique Financial Concepts and Eberhardt, the SEC's argument is unpersuasive. In these cases, the respective panels relied on a prior panel opinion in Villeneuve v. Advanced Bus. Concepts Corp., 698 F.2d 1121 (11th Cir. 1983), for the proposition that the Eleventh Circuit adheres to the broad vertical commonality test. Such reliance is misplaced.[2] The Villeneuve panel decision was vacated in an en banc decision. 730 F.2d 1403, 1404 (11th Cir. 1984).

---

[2]The district court in the present case likewise mistakenly relied on the Villeneuve panel decision.

The en banc court did not address that part of the panel opinion where the court adhered to the broad vertical commonality test and, thus, did not reinstate the panel's decision in that respect. When the full circuit court vacates a panel decision and hears a case en banc, the panel opinion and judgment are totally vacated and, thus, have no precedential value in whole or in part. See 11th Cir. R. 26(k). The only binding authority is the decision of the en banc court and the opinion supporting that decision. Cf. United States v. Rice, 635 F.2d 409, 410 n.1 (5th Cir. 1981) (noting that a vacated panel decision "constitutes no precedent"). As such, Unique Financial Concepts[3] and Eberhardt, erroneously relying on the vacated panel decision in Villeneuve, offer no precedent for the proposition that the Eleventh Circuit requires only proof of broad vertical commonality.

The only question concerning the court's authority to require proof of horizontal commonality comes from Koscot, a case out of the Fifth Circuit, which arguably binds the court notwithstanding the intervening repudiation of the theory it espoused.[4] Koscot, however, is no longer good law and, therefore, we are not bound

---

[3]It should be noted that, notwithstanding its purported reliance on broad vertical commonality, the Unique Financial Concepts court based its decision on the fact that the "investors' funds [were to] be pooled and apportioned proportionately by Appellants to each account." 196 F.3d at 1200. Thus, the court actually relied on the proofs necessary to show horizontal commonality.

[4]In Bonner v. City of Prichard, 661 F.2d 1206, 1209 (11th Cir.1981) (en banc), this court adopted as binding precedent all decisions of the former Fifth Circuit handed down prior to October 1, 1981.

by it. See Smith v. GTE Corp., 236 F.3d 1292, 1303 n.11 (11th Cir. 2001) ("Subsequent panels are not bound by prior decisions where there has been a change in the controlling law as a result of a subsequent . . . Supreme Court decision . . . .").[5] This court has twice noted–prior to the overruled panel decision in Villeneuve–that it "has yet to decide whether Koscot and the line of cases following it conflict with Howey and [United Housing Found. Inc. v. Forman, 421 U.S. 837 (1975)]." Phillips v. Kaplus, 764 F.2d 807, 816 n.9 (11th Cir. 1985) (citing Villeneuve, 730 F.2d at 1404 n.2). I believe that Koscot does conflict with Howey, per the analysis above, and Forman.

In Forman, 421 U.S. at 852, the Supreme Court reiterated that an investment contract required "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." It also stated, however: "The focus of the [Securities] Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors." 421 U.S. at 849. Koscot's broad vertical commonality test, which would include within

---

[5]In fact, in Long v. Schultz Cattle Co., Inc., 896 F.2d 85, 88 (5th Cir. 1990), the Fifth Circuit has indicated a willingness to review the vertical commonality test in an appropriate case.

the purview of a common enterprise even relationships between independent individual "investors" and a single "promoter," is antithetical to the Forman Court's notion that the federal securities laws focus on the protection of broader capital markets. Moreover, as discussed in the majority opinion, the Forman Court limited the definition of profits to capital appreciation or a participation in earnings. See id. at 852. These types of financial return are much more likely to be associated with participation in the broader capital markets where investors' funds are pooled in a single enterprise. In the present case, there was no pooling of money in a common venture; thus, it is my opinion that this case does not fit within Forman's understanding of common enterprise.

When the horizontal commonality test is applied to these facts, it is clear that the SEC also cannot carry its burden to show a common enterprise under Howey. The SEC asserts horizontal commonality can be found in the fact that Edwards operated a "massive Ponzi scheme." I disagree. The typical Ponzi scheme involves a fraudulent business venture where early investors are paid off by funds obtained from later investors, rather than the business itself, with the intent of using that early "success" to entice further investment in the sham venture. See Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340, 343-44 n.1 (3d Cir. 2001) (citing Black's Law Dictionary 1180 (7th ed. 1999)). The fact that a fledgling business uses capital rather than earnings to pay debts, however, does not automatically indicate a Ponzi scheme. It is widely recognized in the commercial world that new businesses often do not show a profit in their early years; the only way to pay debt frequently is through the recruitment of new capital. Thus, it is the nature of the business as a sham which is the crucial consideration. Here, the record indicates that ETS made a good faith effort to run a legitimate business. It dutifully managed the phones it leased for the duration of its existence and continues to do so today under its reorganization plan. At its height, it had offices in twenty-eight states and Mexico and employed 550 people. Neither fact indicates that ETS was a fraudulent enterprise, "[un]supported by any underlying business venture," see Bald Eagle Area Sch. Dist. v. Keystone Fin. Inc., 189 F.3d 321, 323 n.1 (3d Cir. 1999) (internal citation omitted), as the SEC would have us believe.

Apart from allegations of a Ponzi scheme, the SEC cannot show horizontal commonality on the facts presented. ETS entered into distinct contracts with each investor; it did not pool their funds. See Curran, 622 F.2d at 222 (finding a pooling of investors' interests essential to a finding of common enterprise). The success of one investor's contract had no direct[6] impact on the success of any other; the

[6]The SEC argues all "investors" in ETS shared the risk that it would go bankrupt and become unable to make lease payments; thus, it argues they are all "intertwined." This argument should be rejected as casting far too broad a net, contrary to the Court's teaching in United Housing Found. v.

investors were not "inextricably intertwined." SEC v. SG Ltd., 265 F.3d 42, 52 (1st Cir. 2001); Union Planters Nat'l Bank of Memphis v. Commercial Credit Bus. Loans, Inc., 651 F.2d 1174, 1183 (6th Cir. 1981). The investors were entitled to a guaranteed lease payment; only ETS bore the risk of failure and it alone would have enjoyed the benefits had its business prospered. Every indication is that there was no horizontal commonality inherent in Edwards' lease program. Consequently, subject matter jurisdiction fails on this basis as well.

Forman, 421 U.S. 837, 857 n.24 (1975) (stating that mere "risk of involvency . . . 'differ[s] vastly' from the kind of risk of 'fluctuating' value associated with securities investments") (internal citation omitted).

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 01-10107-DD

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

ETS PAYPHONES, INC.,

Defendant,

and

CHARLES E. EDWARDS,

Defendant-Appellant.

CERTIFICATE OF SERVICE

I hereby certify that on September 19, 2002, I caused the required number of copies of the foregoing petition to be served on the Clerk's Office of the United States Court of Appeals for the Eleventh Circuit via Federal Express next-day delivery, and further caused two copies to be served by next-day delivery to counsel for appellant, addressed as follows:

Michael K. Wolensky, Esq.
Ethan H. Cohen, Esq.
Laura J. Sauriol, Esq.
Kutak Rock, LLP
225 Peachtree Street, N.E., Suite 2100
Atlanta, Georgia 30303

Susan S. McDonald