SECURITIES--GUARDIAN FOUNDATION--TRADE ACCEPTANCE CERTIFICATES:

Right to service on cost plus basis and subscription to education magazine if securities within R. S. Mo. 1929, Sec. 7734c.

January 24, 1934.

FILED
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Hon. Dwight H. Brown
Secretary of State
Jefferson City, Missouri

Attention: Securities Division.

Dear Sir:

Your request for an opinion has been received by this office under date of December 18, 1933. Such request being in the following terms:

> "Please find attached hereto, letter dated December 11, 1933 from George W. Husser, Manager, Better Business Bureau of Kansas City, Mo., with affidavit of Edwin C. Pollitt, printed 'Application for Registration with the Guardian Program', photostat of receipt given Mr. Pollitt, and photostat of 'Trade Acceptance'. Also, copy of report made to the Commissioner of Securities by his Examiner and Auditor, dated December 15, 1933.
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> The question at issue is whether or not the so-called $36 subscription or memberships are 'securities' within the meaning and intent of the Missouri Securities Act, Sec. 7734 (c) R. S. 1929. If they are securities, I must attempt to regulate their sale. If they are not securities, I must avoid action in accordance with your recent ruling in re American Assurance Association, and leave any question of fraud to the local prosecuting authorities.
>
> In the opinion of the Commissioner of Securities, these $36 memberships or subscriptions are not investment contracts. Such contracts have been defined, in securities act disputes, as contracts providing for the investment of capital in a way intended to secure income or profit from its employment. (State v. Evans, 154 Minn. 90, 191 N. W. 425.)

Neither are these $36 memberships or subscriptions beneficial interests in or title to property or profits, in his opinion. The purchaser received no right to vote or aid in controlling the corporation, nor does he receive any property right in the assets of the corporation. In a ruling issued by the Attorney General of Indiana July 27, 1925, it is said-

> 'Where life membership certificates of a proposed club entitles the holder thereof to certain rights and privileges as a member of the club but does not entitle the holder to any beneficial interest in any property of business, or any stock in the organizing company, such certificates are not securities.'

The securities acts of various states do not attempt to include all classes of contracts which may be instrumentalities for the perpetration of fraud. There is evidently no hard and fast rule for determining whether a contract is a security within the purview of the blue sky law. (State v. Gopher Tire & Rubber Co., 146 Minn. 52, 177 N. W. 937.)

You have been given, above, the opinion of the commissioner of securities, that the 'Trade Acceptance' or subscription or membership which is being sold in Kansas City is not a matter within the definition of 'security' in the Securities Act.

Mr. Husser of the Better Business Bureau has a contrary view of the case, and thinks the $36 membership, subscription, trade acceptance is clearly a 'security' and should be the subject of a cease and desist order by the Commissioner of Securities. Mr. Husser's arguments are included in the letter and exhibits attached.

You are requested to favor me with your opinion in the premises."

From the documents attached to your request and referred to therein and from information supplied by members of your Department, we understand the facts in the transaction under consideration to be as follows, and our opinion will be rendered upon the assumption that these are the true facts.

Members of the public are solicited to pay the sum of $36 to a common law trust organized in Oklahoma, known as the Guardian Foundation, the application to enter into the transaction bearing caption however of "Application for Registration with the Guardian Program," although, checks are requested in such application to be made out to the Guardian Foundation, and where the entire sum is not paid in cash the note which is signed is payable to the Guardian Foundation. There is a Missouri Corporation known as Guardian Foundation of Kansas City, but this name does not appear on any of the documents furnished to us.

For the $36 so paid the applicant receives a twenty year subscription to a magazine called "The Guardian Shield" which is described as an educational publication, which is also the name of an alleged division of the American Extension Press Association, a non profit making corporation. The applicant likewise receives a document executed by C. H. Blackman & Son Funeral Directors, under the title of "interest bearing Trade Acceptance", which states that the funeral directors for value received allow the Guardian Shield, a credit in amount of $30 if used within one year, which is increased in amount each year until the tenth year when it reaches the amount of $50.00, which Trade Acceptance bears the following provision:

> "This Trade Acceptance may be used or assigned by the Guardian Shield according to any terms agreed upon by them."

And it likewise bears a notice that it will be credited at par to any funeral home operating under the Guardian Program and holding a franchise from an approved Guardian Foundation. Below this Trade Acceptance and upon the same document is an assignment by the Guardian Shield to the applicant, stating that such applicant is a registered holder and that this certificate must be presented by the registered holder or members of his family, dependents, etc., for credit on funeral services, and that it shall not be assigned except with the written consent of the Guardian Shield. It is our further understanding that the third benefit received by applicant is an agreement by the funeral directors to allow to the registered holder of a certificate and members of his family funeral services at cost plus 10%, although we have seen no written document setting out this contract.

The Missouri Securities Act in R. S. Mo. 1929, Section 7724 (c) provides as follows:

> "(c) The term 'security' or 'securities' shall include any note, stock, treasury stock, bond, debenture, evidence of indebtedness, transferable certificate of interest or participation, interim certificates or receipts, certificate of interest in a profit-sharing agreement, certificate of interest in an oil, gas, or mining lease, collateral trust certificate or any transferable share, investment contract, or beneficial interest in or title to property or profits, pre-organization certificate or receipts, or any other instrument commonly known as security."

The only question is whether the relationship created by the transaction above described could be designated as a security within the meaning of the above statute.

I.

THE WHOLE TRANSACTION IS ONE CONTRACT.

As was described above in the facts, three different items are furnished to each applicant when the $36 is paid to the Guardian Foundation. If any one of these three benefits constitutes a security within the meaning of the statute it would have the same effect as if it were the sole benefit furnished as far as regulation is concerned, for it is provided by R. S. Mo. Section 7724(d) that:

> "(d) Any security given or delivered with or as a bonus on account of any purchase of securities, or any other thing, shall be deemed to constitute a part of the subject of such purchase and have been sold for value."

Thus even if it is assumed that the magazine subscription would be specifically exempt even if it were a security under R. S. Mo. 1929 Section 7725(e) which provides that there is exempted from the act:

> "Any security issued by a corporation organized and operated exclusively for educational, benevolent, fraternal, charitable or reformatory purposes, and no part of the net earnings of which inures to the benefit of any private stockholder or individual."

still if either of the other two benefits furnished could be considered as security the transaction would be subject to regulation. This point arose in the case of Brownie Oil Co. of Wisconsin vs. Railroad Commission of Wisconsin, 240 N. W. 827 (Wisconsin 1932) wherein the Court said:

> "(1) It will not be necessary to consider whether the coupon book, or the good-will contract, standing alone, is a security, because we are of the opinion that the two must be treated as a single contract. The only consideration for the good-will contract is that the customer, if convenient, will make his purchases from one of plaintiff's service stations, and that he will recommend plaintiff's products to his friends and neighbors. In our judgment this is entirely too shadowy and vague to have been the intended consideration for this good-will contract. It is to be noted that the good-will contract is only entered into with those who purchase coupon books and who pay the $35. The two contracts are inseparable in the view of the plaintiff, for the purposes of sale, and the conclusion seems to us inevitable that the good-will contract is based upon the same consideration which supports the promise contained in the coupon book."

II.

IS EITHER THE TRADE ACCEPTANCE OR THE COST PLUS AGREEMENT A SECURITY?

A number of different items are defined in R. S. Mo. 1929, Section 7724(c) above set out as securities. Several of these can be immediately eliminated such as stock, treasury stock and others, and it is believed that the only relevant words and phrases in such statute are the following, "note," "bond," "debenture," "evidence of indebtedness," "transferable certificate of interest or participation," and "investment contract."

A.

NOTE, BOND, DEBENTURE, EVIDENCE OF INDEBTEDNESS.

These four items are all of the same general class as all

of them are obligations to pay. Very little difference is perceived between a note and an evidence of indebtedness since both are legally enforceable rights to collect, as are likewise bonds and debentures, although these latter two are usually secured, as a gener l rule although not always, bonds being secured by specific property and debentures not always being secured by specific property and not always indeed by any property. However, all of these four classes have this characteristic that they only in rare cases, if ever, carry with them any right to share in the profits, management or affairs of the issuer thereof, and in fact they are usually nothing more than promises to pay principal and interest at certain fixed times or at indefinite times (e.g.) demand notes or notes or bonds payable upon the happening of contingencies, or callable bonds. In at least one case it has been held that a bond or note need not be the obligation of the person offering it to the public to be a security. In the case of People vs. Leach, 106 Cal. App. 442, 200 Pac. 131--1930, affirmed Matter of Leach, 12 Pac. (2d) 3--1932, a promoter organized the "A" company to which he conveyed certain land and he then organized the "B" company in favor of which the "A" company executed and issued notes secured by mortgage on such land and the promoter then caused the "B" company to sell such notes to the public and it was held that they were securities within the California Securities Act which defines Securities as:

> "All bonds, debentures and evidences of indebtedness" * * * "excepting" * * * * promissory notes not offered to the public."

A further reason which would seem to make it immaterial that the promises offered to the public by the Guardian Shield or the Guardian Foundation are not obligations of the offeror but are obligations of the funeral directors would be the fact that the Guardian interests could not offer to the public promises by the funeral directors as described above without acting as agents of the funeral directors in view of the broad authority given by the funeral directors to the Guardian Shield as to assignment and offer to the public of these certificates.

As set out above, if the four classes treated in the foregoing paragraphs do not as they are generally understood, carry with them any rights to profits or management of the issuer it would seem that a right to share in the profits or management could hardly be necessary to make a relationship into a security within the statutes, or that such rights could be the test as to whether a document or relationship or contract constitutes a security or not. And yet in North Carolina, which has a statutory definition of security which is the same as that in the Missouri statute, the Supreme Court seems to feel that the absence of these elements prevents a certain right from being a security.

In the case of State vs. Heath, 199 N. C. 135--153 S. E. 855--1930, a sale was made of an exclusive right to use a certain method for selling real estate, whereby the purchaser paid a certain sum for his right, the profits and expenses to be divided according to certain fixed terms. The Court throughout the opinion seemed to regard the element of right to share in the profits of the seller as important and it was held that the sale involved was not a sale of a security under the statute. On the other hand in the Matter of Leach, 12 Pac. (2d) 3, 1932, supra, the Court took the following position as to whether or not a right to share in the profits of the seller is an essential element of a security:

> "* * * Petitioner makes the further contention that a real estate mortgage is not a security within the purview of the Corporate Securities Act of this state. In support of this contention petitioner argues that: 'The intent and purpose of the Corporate Securities Act of this state, as of all other states, was to restrict only the sale of such securities, that give the investor a right to participate in the earning or assets of a company. It was never the intent or purpose of such laws to regulate the orginary business transactions of an individual or a company, nor to restrict an individual or company in its right to sell or mortgage property owned by it, whether real or personal.' This contention was made by petitioner on his appeal before the District Court of Appeal, and it was decided adversely to him. We are satisfied with the disposition which that court made of this question. It is not necessary to repeat here the discussion of the District Court of Appeal in reaching its conclusion that real estate mortgages of the class involved herein were within the purview of the Corporate Securities Act. This discussion may be found on pages 448, 449, and 450 of the reported decision of that case. People vs. Leach, 106 Cal. App. 442, 290 P. 131, 134, 135."

Another important question to be considered is whether or not a promise to give credit in fixed amounts on further purchases is the same as a promise to pay money. Under the certificates involved in the case under consideration there is no promise to render services as opposed to paying money. On the contrary, the certificate can only be used where a purchase or purchases of funeral services are

made and the certificates are then used as credits so that these certificates fall between a strict promise to pay money and a mere promise to furnish services. Also it might be noted that aside from the question of the quality of the commodity promised, the certificate bears interest at a fixed rate. As to whether or not a promise to give credit on further purchases is the same as a promise to pay money there is likewise a split of authority. Thus in the case of Lewis vs. Creasey Corporation, 195 Kentucky 409, 248 S. W. 1046--1923, a sale made by wholesale grocers of a promise to retail grocers to furnish groceries for a twenty year period at cost plus 5%, and to give stipulated discounts and to allow the purchaser a $300 credit, the prices of these promises being $300, was held not to be a security within the Kentucky Securities Act which defined securities as "contract, stock, bonds or other securities," and the same contract was also held not to constitute a security in the case of Creasey Corporation vs. Enz Brothers, 177 Wis. 49, 187 N. W. 666--1922.

In the Wisconsin case the Court, although in the statutes "bonds" * "notes or other obligations or evidence of indebtedness," were defined as securities, seemed to feel that the absence of the right to share in rights or profits of the company prevented the contract from being a security. The Court said:

> "* * * *In the contract in question there is no obligation to pay money on the part of the plaintiff. Its obligation is to render a certain service to the defendant for a period of 20 years, which service it has fully rendered up to the date of the suit. The service consisted in selling its goods to the member for cost plus a very small per cent of profit. The member acquired no rights either in the capital or profits of the company. The contract would be fully discharged by plaintiff rendering the specified service for the required length of time. It is clear that our Railroad Commission correctly held, as the evidence shows, that the contract in question does not come within the purview of the statute." * * *"

However, in the case of State vs. Evans, 154 Minnesota 95, 191 N. W. 425--1923, where the statute defines Securities as "stocks, bonds, investment contracts or other securities," it was held that a contract to buy an undescribed piece of land in a certain subdivision with an option to receive back the purchase price with a bonus, or to apply the investment plus interest to building on the property, the seller to lend the balance of money necessary for building, there being no promise by the purchaser to make any fixed number of payments, was a security, this contract really being in effect

as far as the purchases were concerned, a promise to give credit on certain subsequent purchases just as is the certificate in the case under consideration. However, there was a further element in the Minnesota case of a right to receive back the money in the event the purchase was not made which might distinguish it from the instant case.

In the case of Brownie Oil Co. vs. Railroad Commission, 240 N. W. 827 (Wis.) 1932 supra, this distinguishing element between the last cited case and the instant case was not present and it was held that the issued instrument was a security. In the Brownie Oil Company case the company issued coupon books for $35 each, entitling the owner to a credit of one half cent per gallon on gasoline purchased at the company's stations, and twenty-five cents per gallon on oil purchased, and the company also entered into a good-will contract whereby the purchaser agreed to recommend the company's gas to his friends and to use it when convenient, and the comp ny agreed to pay one half cent per gallon on all gasoline sold by it to a trustee for distribution to the holders of these good-will contracts. The Court says of the contract as follows:

> "* * * *The contract stipulates that it does not represent any indebtedness of the plaintiff; that the one-half cent per gallon is to be charged to advertising expense and payable out of gross sales. It is further provided that the owner of the contract has no interest in the present or future profits, capital, or assets of the plaintiff, or any lien thereon.* * * *"

The contract expressly attempts to remove itself from the various characteristics which have been relied upon by various courts as the distinguishing characteristics of securities. The Court held that these contracts were securities and this case seems very closely in point because as above discussed it does not seem to make any difference whether the obligation is one of the issuer or of someone else.

B.

TRANSFERABLE CERTIFICATE OF INTEREST OR PARTICIPATION.

The Trade Acceptance in question was transferable when originally issued by the funeral directors but was registered by the Guardian Shield before being transferred so that probably it is immaterial as to whether it is a certificate of interest or participation. However, aside from this element of transferability there

seems to be no interest in the business either of the funeral directors or the Guardian Shield or right to participation in such business, so probably this definition would not apply to the document in question. The fact that the member has paid to the Guardian Foundation a certain amount of money, a part of which has gone into the business of the funeral directors, and that the member has very definite interest in the continued solvency and operation of the funeral directors because only if these continue can he receive his credit from them would seem to be too remote to make such interest or the document representing it a certificate of interest or participation, although the fact that the interest if any would be in the funeral director's business and not in the business of the Guardian Foundation or the Guardian Shield would seem to be immaterial. People vs. Leach supra.

C.

INVESTMENT CONTRACTS.

As was stated above the statutory definition of Security in North Carolina is the same as that in Missouri, and the North Carolina Act was adopted in 1927, two years before the Missouri Act, although no indication has been found that the Missouri Law was taken from the North Carolina Act.

In the case of State vs. Heath, 199 N. C. 135, 153 S. E. 855, 1930, supra, the Supreme Court of North Carolina discussed the meaning of the term "investment contract." The Court said:

> "* * * The term is not defined in the act, but it implies the apprehension of an investment as well as of a contract. The word "investment" has no technical definition, and its meaning in particular cases is often determined by its relation to the context. It has been variously defined as the conversion of money into property from which a profit is to be derived in the ordinary course of trade or business; an expenditure for profits; the placing of capital to secure an income from its use. We have found comparatively few cases in which the meaning of "investment contract" has been given. In State v. Gopher Tire & Rubber Co. 146 Minn. 52, 177 N. W. 937, 938, the Supreme Court of Minnesota in analyzing a statute denouncing "investment contract" said: 'The placing of capital or laying out of money in a way intended to secure income or profit from its employment is an "investment" as that word

> is commonly used and understood. If defendant issued and sold its certificates to purchasers who paid their money justly expecting to receive an income or profit from the investment, it would seem that the statute should apply. The certificate set out in the case recited this provision: 'That defendant will annually set aside as a bonus to certificate holders all of its excess earnings after paying operating expenses, fixed charges and dividends to stockholders, the same as be distributed at its option in the form of preferred stock.'
>
> The definition of "investment contract" in the case just cited, was adhered to in State v. Evans, 164 Minn. 95, 191 N. W. 425, 27 A. L. R. 1165, in which the contract gave to the purchaser an option to surrender his contract and take back the money he had paid, with a bonus of $70 for each $1,000, from the profits obtained on the sale of contracts. It was adhered to in State v. Ogden, 164 Minn. 435, 191 N. W. 916, in which the "unit holders" were to participate in profits in proportion to their holdings, and in State vs. Bushard, 164 Minn. 455, 205 N. W. 370, the defendant was to participate in profits as the result of his investment, and eventually to receive certificates of corporate stock." * * * * * * * * * *
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> The contract does not contemplate the placing of Freeman's money with the partners in a way intended to secure an income from its employment by them in the conduct of the business.
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> The result is obvious. In our opinion the contract included in the special verdict is not an "investment contract" within the terms of the statute upon which the indictment is drafted. And by the same reasoning we are led to the conclusion that the contract is not a "certificate of interest in a profit-sharing agreement." * * * * * * * *

The meaning of the word "contract" in the Kentucky statute was discussed in the case of Lewis vs. Creasey Corporation, 198 Kentucky 408, 248 S. W. 1046, 1923, supra, the contentions in this case raised the issue being as follows:

> * * * "It is the contention of plaintiff that the word 'contract' as used in the statute, viewed

> from the standpoint of its connection, has only a restricted meaning, and has reference only to security contracts, which latter it is argued were the only class of contracts that the statute attempted to regulate, and in which the company or individual dealt, and to procure which the purchaser invested his money or property.
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> On the other hand defendant, through his counsel, argues that the word 'contract' in the statute means more than what is ordinarily understood as a security investment, and that it is broad enough to cover all classes of contracts which may be an instrumentality for the perpetration of fraud and in which one may invest his money or property.*****

And the Court decided the term Security

> ** * * *means the investment of funds in a designated portion of the assets or capital of a concern, with the view that the latter by using and operating with, the investment will earn a profit for the investor. In other words, it carries with it the idea that the investor will earn his profit through the efforts of others than his own. It thus includes bonds, stock certificates, shareholder certificates, and other similar investments, but its definition does not include interest income from the lending of money, or the profits which one might make by his own efforts as the result of any ordinary commercial contract which he might enter into.* * * **

The three opinions of Attorneys General which have passed on the question as to whether or not these contracts are securities have not likewise been in accord. The exact contract here in question or at least the contract of the Guardian Foundation as it was operating in Oklahoma was declared not to be a security by an opinion of the Attorney General rendered March 18, 1932, and a certificate of service of a mortuary company entitling its holder to a funeral for $60 was declared not to be a security in an opinion of the Attorney General of Oregon rendered on April 28, 1930. But in an opinion handed down August 20, 1926, the Attorney General of Utah declared that such a "certificate of service" which gave the owner a right to a funeral on a "cost plus basis" but no right in the voice of the affairs of the company was a "certificate of interest" or "indebtedness" and a

security, and apparently this contract did not even involve a right to receive a credit in a fixed amount on such funeral.

III.

CONCLUSION.

After analyzing the above opinions we have come to the conclusion that since there is no authority at all in the State of Missouri on this point (although the Securities Act does apply to associations and common law companies, Schmidt vs. Stortz, 208 Mo. A. 439, 236 S. W. 694--1922, State vs. Hudson, 214 Mo. A. 280, 259 S. W. 877--1924) and since the authorities in other states are so scanty and fail to be in sufficient harmony to justify the laying down of any general principles of law on the subject, that the matter of treating the certificate in question as a security or not should be a matter of administrative policy with your department, that you would not be subject to criticism in the event you decided to take either position, and that therefore it is the opinion of this department that you are free either to treat these certificates as securities and to take jurisdiction or to refuse to treat them as securities and decline to take jurisdiction.

Respectfully submitted,

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APPROVED:

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