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Corporations - Securities Regulation - Investment Contracts Under Securities Act of 1933

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CORPORATIONS—SECURITIES REGULATION—INVESTMENT CONTRACTS UNDER SECURITIES ACT OF 1933—Plaintiffs purchased tracts of twenty acres, part of a larger tract owned by the defendant, for the purpose of developing the tracts into small citrus groves. Plaintiffs also executed with defendant a care and management contract, whereby plaintiff was to give directions as to the marketing of the crops on the tract; the defendant management company was to follow these directions but would still supervise harvesting and marketing and would receive its compensation therefor. Plaintiff brought an action under the Securities Act of 1933[1] to impose civil liability for fraudulent misrepresentations and material omissions concerning the value of the land. The lower court dismissed the complaint for lack of jurisdiction on the grounds that no security was involved. On appeal, *held,* reversed. The plaintiffs were not buying land for its intrinsic value but paramount emphasis was on income to accrue; therefore the transactions constituted investment contracts as defined in the Securities Act of 1933.[2] *Blackwell v. Bentsen,* (5th Cir. 1953) 203 F. (2d) 690.

The Securities Act of 1933 is based on what have commonly been called the "blue sky" laws of the states[3] and on the recognition of the resourcefulness of the dealers in securities who have deliberately attempted to avoid the application of these laws.[4] It is therefore necessary to look to the interpretations given these state laws in order, first, to determine the definition and applications of the term investment contract as used in those laws, and second, to determine the policy behind state courts' decisions. An investment contract generally has been

[1] 48 Stat. L. 74 (1933), 15 U.S.C. (1952) §77k.
[2] 48 Stat. L. 74 (1933), 15 U.S.C. (1952) §77b(1).
[3] SEC v. Crude Oil Corp. of America, (7th Cir. 1937) 93 F. (2d) 844.
[4] SEC v. Tung Corp., (D.C. Ill. 1940) 32 F. Supp. 371.

held to be any instrument used to show the interest of purchasers who paid their money justly expecting to receive an income or profit from the investment[5] due to the efforts of others.[6] The word security in its ordinary meaning does not include simple land contracts.[7] As a result, security transactions have been clothed in the disguise of ordinary transactions in real estate.[8] The general scheme followed is that purchasers acquire title to small portions of land which are part of a larger tract that is being developed by the sellers as an integrated project for the benefit of all. The courts, aware of the subterfuge attempted, have not hesitated to look through the form to the substance of the particular transaction[9] and find that the contracts are investment contracts.[10] The federal courts have also adopted this approach in applying the Securities Act.[11] In applying the "blue sky" laws, the courts have held that the term "security" should not be construed narrowly, nor should there be laid down any inflexible definition of that term. The aim sought to be achieved through maintenance of such flexibility is the frustration of the unscrupulous—those who constantly seek means of "avoiding the law through technicalities."[12] This policy of refusing to set down a "hard and fast rule" has also been adopted by the federal courts in applications of the Securities Act.[13] The words of the statute are interpreted so as to carry out the generally expressed legislative policy.[14] In the fairly recent case of *Securities & Exchange Commission v. W. J. Howey Co.*, which involved facts strikingly similar to those of the principal case, the court held that the correct test is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of

[5] State v. The Gopher Tire & Rubber Co., 146 Minn. 52, 177 N.W. 937 (1920), 27 A.L.R. 1165 at 1172 (1923); Matter of Waldstein, 160 Misc. 763, 291 N.Y.S. 697 (1936). See also 87 A.L.R. 82 (1933) for annotation on the meaning of the term "investment contract" in the blue sky laws.

[6] Domestic & Foreign Petroleum Co. v. Long, 4 Cal. (2d) 547, 51 P. (2d) 73 (1935).

[7] People v. Anderson, 35 Cal. App. (2d) 23, 94 P. (2d) 627 (1939); People v. Davenport, 10 Cal. (2d) 345, 76 P. (2d) 117 (1938).

[8] People v. McCalla, 63 Cal. App. 783, 220 P. 436 (1923).

[9] Ibid.; Webster v. U.S.I. Realty Co., 170 Minn. 360, 213 N.W. 806 (1927); Prohaska v. Hemmer-Miller Development Co., 256 Ill. App. 331 (1930). "Contracts for the sale of portions of a tract of land . . . , with an agreement on the part of the seller to cultivate, harvest, and market the crops and divide the net proceeds with the buyer, are contracts for investments in a profit-sharing scheme within the purview of the blue sky law of this state." Syllabus, ¶1, in Kerst v. Nelson, 171 Minn. 191 at 191, 213 N.W. 904 (1927), 54 A.L.R. 495 at 508 (1928).

[10] Cf. McCormick v. Shively, 267 Ill. App. 99 (1932). That contracts to buy land and have it managed as part of a large development are not investment contracts, see State ex rel. Knott et al. v. Hemphill, 142 Fla. 728, 195 S. 915 (1940).

[11] Labels affixed to the transactions by the parties are not determinative. SEC v. Bailey, (D.C. Fla. 1941) 41 F. Supp. 647. For cases indicating that the federal courts have not been hesitant in looking through the form to discover the real nature of the transaction, see SEC v. Tung Corp., note 4 supra; SEC v. Wickham, (D.C. Minn. 1935) 12 F. Supp. 245.

[12] State v. Whiteaker, 118 Ore. 656, 247 P. 1077 (1926); Kerst v. Nelson, note 9 supra. For a more complete discussion of the point, see 26 VA. L. REV. 807 (1939).

[13] SEC v. Bailey, note 11 supra; SEC v. Crude Oil Corp. of America, note 3 supra.

[14] SEC v. Joiner Corp., 320 U.S. 344, 64 S.Ct. 120 (1943).

others. If that test be satisfied, it is immaterial whether . . . there is a sale of property with or without intrinsic value."[15] Despite the looseness of the test, which represents a continuation of the "flexible definition" policy,[16] the principal case does not satisfy its demands, since in theory the profits may not come solely from the efforts of others, but may be derived partially as a result of the "directions" the investor may give as to marketing of the crops. The court in the principal case considered this feature of the contract to be minor and non-determinative. The decision in this case is indicative of a general policy of looking to the real nature of the transaction[17] to give substantial effect to the protective civil sanctions afforded the public by the Securities Act.[18]

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[15] 328 U.S. 293 at 301, 66 S.Ct. 1100 (1945).

[16] 46 COL. L. REV. 885 (1946).

[17] See note 11 supra.

[18] See generally 26 VA. L. REV. 807 (1939); 163 A.L.R. 1043 (1946) for annotations to SEC v. W. J. Howey Co., note 15 supra.