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Robert S. LuJt

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unanimously to admit each other, or unless there is "gross fraud" involved. Although the shadowy area of definition under the Corporate Securities Act has been explored by many cases, and although Corporations Code section 25100 purports to exempt limited partnership interests from the Act, there still remains some doubt, in any given case, whether a permit is required for the sale of an interest in a limited partnership.

Samuel Frizell*

* Member, Second Year class.

EXPANDING THE DEFINITION OF "SECURITY": *SILVER HILLS COUNTRY CLUB v. SOBIESKI.*

Section 25008 of the Corporations Code defines a security as follows:

"Security" includes all of the following:

- (a) any stock, including treasury stock; any certificate of interest or participation; any certificate of interest in a profit sharing agreement; any certificate of interest in an oil, gas, or mining title or lease; any transferable share, investment contract, or *beneficial interest in title to property, profits, or earnings.*
- (b) any bond; any debenture; any collateral trust certificate; any note; any evidence of indebtedness, whether interest bearing or not.
- (c) any guarantee of a security.
- (d) any certificate of deposit for a security. [Italics added.]

The purpose of the Corporate Securities Act is to protect the public against the purchase of spurious and worthless securities and fraudulent investment schemes.¹ To effectuate this purpose, there has been a definite trend in the California courts liberally to construe the term "security" and to include almost any transaction which could conceivably be called an investment.² The courts will look through form to substance to determine whether a transaction comes within section 25008.³ In spite of this liberal trend, historically the courts have firmly recognized that the investor must put up money or its equivalent for a share or stake in an enterprise or venture *with the expectation of profit* before his interest can be classified as a security.⁴

¹ *People v. Syde*, 37 Cal. 2d 765, 235 P.2d 601 (1951); *Domestic and Foreign Pet. Co. v. Long*, 4 Cal. 2d 547, 51 P.2d 73 (1935); *People v. Craven*, 219 Cal. 522, 27 P.2d 906 (1933); *People v. Jacques*, 137 Cal. App. 2d 823, 291 P.2d 124 (1955).

² See Dahlquist, *Regulation and Civil Liability Under the California Corporate Securities Act*, 33 CALIF. L. REV. 343 (1945); Note, 28 CALIF. L. REV. 410 (1940); Note, 10 So. CAL. L. REV. 483 (1937); Note, 25 So. CAL. L. REV. 208 (1952); annot., 87 A.L.R. 42 (1933); annot., 163 A.L.R. 1050 (1946).

³ *People v. Sidwell*, 27 Cal. 2d 121, 162 P.2d 913 (1945); *Domestic and Foreign Pet. Co. v. Long*, 4 Cal. 2d 547, 51 P.2d 73 (1935); *People v. Rankin*, 169 Cal. App. 2d 150, 337 P.2d 182 (1959), cert. denied, 362 U.S. 905 (1960); *Oil Lease Serv. Inc. v. Stephenson*, 162 Cal. App. 2d 100, 327 P.2d 628 (1958).

⁴ Dahlquist, *Regulation and Civil Liability Under the California Corporate Securities Act*, 33 CALIF. L. REV. 343, 358 (1945); BALLANTINE AND STERLING, CALIFORNIA CORPORATIONS LAW § 479, at 621 (1949); 11 CAL. OPS. ATT'Y GEN. 81, 83 (1948).

In 1961, the Supreme Court of California, in *Silver Hills Country Club v. Sobieski*,⁵ made a bold departure from this well established rule and held that an expectation of profit to the investor was not the only test in considering what is a security.

Plaintiffs in this case had formed a partnership to organize a golf and country club. They sought to finance the purchase price of the land to be bought by selling "memberships" in the club. They planned to raise \$215,000⁶ by selling a total of 200 charter memberships for \$150 each, 300 memberships for \$200 each, and 500 memberships for \$250 each. They actually sold only 110 charter memberships for \$150 each.⁷

Both the membership application and the by-laws of the Club provided that no interest in the real or personal property of the Club was to be conferred upon or granted to a member, his only right being the *use* of the club facilities.⁸ All of the income, profits, assets and management of the Club were clearly stated to be the property of the plaintiffs and under their sole control.⁹ A member could not be expelled except for misbehavior or failure to pay monthly dues;¹⁰ and membership could be transferred, but only to persons approved by the Club.¹¹

The Commissioner of Corporations concluded that these memberships were securities and that their sale without a permit was prohibited by section 25500 of the Corporations Code.¹² Plaintiffs obtained a writ of mandate from the Superior Court setting aside an order directing them to halt the sale of memberships in the club, and the Commissioner appealed. The District Court of Appeal affirmed the Superior Court decision, saying that the membership application specifically excluded any proprietary interest in the club by its members.¹³ The instrument in question merely gave members the right to use the premises for limited purposes and was, by its own terms, revocable.¹⁴ Such a membership right was said to be nothing more than the grant of a license, not creating any estate in the club.¹⁵ Such a license is not included within the Code definition of a "security."¹⁶ The court then discussed why the interest could not be a security even if a sufficient property interest *had* passed. Citing only a few of the authorities available, the court stated that the first test in defining a security has always been "investment with the expectation of profit."¹⁷ Since there was

⁵ 55 Cal. 2d 811, 13 Cal. Rptr. 186, 361 P.2d 906 (1961).

⁶ 55 Cal. 2d at 812-13, 13 Cal. Rptr. at 187, 361 P.2d at 907.

⁷ *Ibid.*

⁸ *Silver Hills Country Club v. Sobieski*, 9 Cal. Rptr. 694 (1961). This fact does not appear in the Supreme Court opinion.

⁹ 55 Cal. 2d at 813, 13 Cal. Rptr. at 187, 361 P.2d at 907.

¹⁰ *Ibid.*

¹¹ *Ibid.*

¹² "No company shall sell any security of its own issue, except upon a sale for a delinquent assessment against the security made in accordance with the laws of this State, or offer for sale, negotiate for the sale of, or take subscriptions for any such security, until it has first applied for and secured from the commissioner a permit authorizing it so to do."

¹³ *Silver Hills Country Club v. Sobieski*, 9 Cal. Rptr. 694 (1961).

¹⁴ *Id.* at 696.

¹⁵ *Ibid.*

¹⁶ Cal. Corp. Code § 25008.

¹⁷ 9 Cal. Rptr. at 697.

to be no distribution of profits or income to the members, it was unlikely that "profit" was a motive in purchasing memberships. The use of the recreational facilities was obviously the only motivation.¹⁸

Upon appeal the California Supreme Court, in its landmark decision, reversed the District Court of Appeal by holding that the Country Club membership was a beneficial interest in title to property and that it was therefore a security within the language of subdivision (a) of section 25008 of the Corporations Code. It stated specifically that this section of the Code extended even to transactions where capital was invested without expectation of profit.¹⁹

The Supreme Court first recognized the broad definition given to a security by section 25008 and the liberal interpretation by courts seeking more effectively to protect those who risk their capital in questionable ventures.²⁰ It continued by saying that the irrevocable contractual right to use the club facilities qualified as a "beneficial interest in title to property" within the literal language of subsection (a) of section 25008.²¹

The crucial question, however, was whether the sale of these memberships was within the regulatory purpose of the Corporate Securities Act. Recognizing that there is little or no authority for including sales of a right to use existing facilities under the term "security," the court emphasized an important distinction in this case. Plaintiffs were soliciting risk capital with which to develop their business for profit. This risk to the investor was not lessened because his interest was labeled a membership.²²

While almost ignoring the profit motive criterion that had been followed for over 30 years, the court stated that the act is not limited only to those who expect a profit from their investment.²³ It found support in section 25102 of the Corporations Code which lists exemptions from the Corporate Securities Law.²⁴ The court then concluded:²⁵

[S]ince the act does not make profit to the supplier of capital the test of what is a security, it seems all the more clear that its objective is to afford those who risk their capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return on their capital in one form or another.

¹⁸ *Ibid.*

¹⁹ 55 Cal. 2d at 815, 13 Cal. Rptr. at 188, 361 P.2d at 908.

²⁰ *Id.* at 814, 13 Cal. Rptr. at 187, 361 P.2d at 907.

²¹ *Id.* at 814, 13 Cal. Rptr. at 188, 361 P.2d at 908. The court cites *Yuba River Power Co. v. Nevada Irr. Dist.*, 207 Cal. 521, 279 Pac. 128 (1929), in support of this proposition. This case is inapplicable under presently existing law and has in effect been overruled. See *Rank v. (Krug) United States*, 142 F. Supp. 1, 180, 181 (S.D. Cal. 1956).

²² 55 Cal. 2d at 815, 13 Cal. Rptr. at 188, 361 P.2d at 908.

²³ *Ibid.*

²⁴ "Except as otherwise expressly provided in this division, the Corporate Securities Law does not apply to any of the following classes of securities: (a) Any security (except notes, bonds, debentures, or other evidences of indebtedness, *whether interest-bearing or not*) issued by a company organized under the laws of this State exclusively for educational, benevolent, fraternal, charitable, or reformatory purposes and not for pecuniary profit, no part of the earnings of which inures to the benefit of any private shareholder or individual." (Emphasis added).

²⁵ 55 Cal. 2d at 815, 13 Cal. Rptr. at 188-89, 361 P.2d at 908-09.

Although there are no similar fact situations in other California cases,²⁶ an Illinois case held that a similar membership interest was not a security under their statute *even though* each member was to have a proportionate and equal undivided interest in all of the property and assets of the club, be they real, personal or mixed.²⁷ The reason for so holding was that there was a lack of expectation of income or profit as the motivation for purchase.²⁸ Other cases have reached similar conclusions.²⁹

Silver Hills has considerably expanded the concept of "securities" in California. In de-emphasizing the "profit motive" test, the Supreme Court has consequently emphasized that the nature of the investment interest, and the liberal purpose of the Corporate Securities Act, can be used exclusively in protecting investment ventures. The law does not permit a person to circumvent by sham the provisions of the Corporate Securities Act.³⁰ Artificial tests are often inadequate to deal with new schemes that threaten the public.

The "membership" interest in *Silver Hills* was apparently created with the intent that its sale would not have to be regulated by the Commissioner of Corporations. It expressly denied any interest in either the profits or the property of the club to its members. The Supreme Court realized the risk that each applicant was facing when he invested in a Country Club that was just being formed. By emphasizing this "degree of risk," and the irrevocable contractual right that each membership created, the court was able to bring the venture within the literal language and broad purpose of the Corporate Securities Act.

"Expectation of profit," however, is not dead as a factor in considering what is a security. It will still be used where it can meet the problem in question.³¹ But in addition, where profit is not the motive for investment, the courts can look at the degree of risk to the investor. If the person is risking his capital in some type of fraudulent or questionable investment scheme, the court can apply the rule in *Silver Hills* to reach an equitable result.

The older cases which developed the "profit motive" test looked to other portions of Section 25008 of the Corporations Code than the California Supreme Court did in *Silver Hills*.³² There appears to be no authority for a contrary

²⁶ An almost identical problem has, however, been analyzed by the California Attorney General and his conclusion agrees with the dissenting opinion in *Silver Hills*. 24 CAL. OPS. ATT'Y GEN. 33, 35-36 (1954).

²⁷ *Hacker v. Goldberg*, 263 Ill. App. 73 (1931).

²⁸ *Ibid.*

²⁹ *Lewis v. Creasy Corp.*, 198 Ky. 400, 248 S.W. 1046 (1923); *Creasy Corp. v. Enz Bros. Co.*, 177 Wis. 49, 187 N.W. 666 (1922).

³⁰ *People v. Yant*, 26 Cal. App. 2d 725, 80 P.2d 506 (1938).

³¹ *Craft v. Brooks*, 204 A.C.A. —, 22 Cal. Rptr. 68 (1962).

³² *People v. Davenport*, 13 Cal. 2d 681, 91 P.2d 892 (1939) (sub. sec. (b) . . .; any note; any evidence of indebtedness); *People v. Rankin*, 169 Cal. App. 2d 150, 337 P.2d 182 (1959), cert. denied, 362 U.S. 905 (1960) (sub. sec. (a) . . . any certificate of interest in a . . . mining title); *Oil Lease Service Inc. v. Stephenson*, 162 Cal. App. 2d 100, 327 P.2d 628 (1958) (sub. sec. (a), investment contract); *People v. Jacques*, 137 Cal. App. 2d 823, 291 P.2d 124 (1955) (sub. sec. (a), beneficial interest in title to . . . profits or earnings); *People v. Marr*, 46 Cal. App. 2d 39, 115 P.2d 214 (1941) (sub. sec. (a), any certificate of interest or participation); *People v. Oliver*, 102 Cal. App. 29, 282 Pac. 813 (1929) (sub. sec. (a) any stock).

interpretation of what is a "beneficial interest in title to property" within the definition of a security; so that the case can only be criticized on policy grounds. Whether the Legislature intended to include, within the Corporate Securities Act, contributions by persons who expected only the use of certain recreational facilities as a return is a matter for debate.

*Robert S. Luft**

* Member, Second Year class.