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ATTORNEY GENERAL OPINION NO. 83- 164

The Honorable Elwaine Pomeroy
Senator, 18th District
1415 Topeka Avenue
Topeka, Kansas 66612

Re: Corporations -- Securities -- Definition of
"Security"; Continuing Care Contracts Not
Included

Synopsis: A continuing care contract by which a person receives living accommodations, meals and health care for the payment of consideration upon entrance and periodically thereafter is not an investment contract or evidence of indebtedness so as to bring it under the definition of security in K.S.A. 17-1252(j), and the offeror of such contracts is not subject to the registration and disclosure requirements of the Kansas Securities Act, K.S.A. 17-1252, et seq. Cited herein: K.S.A. 17-1252(j), 1983 House Bill No. 2251, 15 U.S.C.A. §80a-2(a)(36).

* * *

Dear Senator Pomeroy:

As Chairman of the Special Committee on Judiciary, you request our opinion on a question concerning the scope of the definition of "security" found in the Kansas

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Securities Act. Specifically, you inquire whether the definition includes continuing care contracts by which a person receives living accommodations, meals and health care services in return for the payment of an initial consideration and perhaps periodic payments thereafter. Your inquiry is made in the context of 1983 House Bill No. 2251, which would require individuals offering such contracts to register with the Insurance Commissioner and meet certain disclosure requirements. In determining whether this type of legislation is needed, the committee wishes to know the extent to which such contracts are presently regulated by existing law, hence your inquiry.

The definition of the term "security" is found in the Kansas Securities Act, K.S.A. 17-1252 et seq., at K.S.A. 17-1252(j), and closely resembles that of the Federal Securities Act definition, 15 U.S.C.A. §80a-2(a)(36). The subsection states:

"'Security' means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificates; thrift certificates or investment certificates, or thrift notes issued by investment companies; certificate of deposit for a security; certificate of interest in oil and gas royalties; leases or mineral deeds; 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, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. 'Security' does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period." (Emphasis added.)

While many of the terms included in the above are ones for which standard definitions exist (i.e., stocks, bonds, mineral deeds, investment certificates, and so forth), two of the broader terms included in the definition of security are "evidence of indebtedness" and "investment contract." A review of the relevant case law from Kansas and elsewhere indicates that the application of one of these two terms gives rise to a majority of securities litigation. State v. Hodge, 204 Kan. 98, 460 P.2d 596 (1969), State ex rel. v. Colby, 231 Kan. 498, 646 P.2d 1071 (1982). In that the terms appear to be the only ones which could be susceptible of interpretation so as to include continuing care contracts, an examination of how they have been construed will indicate whether such care contracts can be included under the scope of the Act.

In State v. Hodge, supra, the defendant sold written instruments which evinced the existence of a debt. In finding that these instruments, even though termed promissory notes, were subject to the Act as being evidence of indebtedness, the court found that the activities of both the promoter and buyer were part of the investment process; that is, the investment of funds in contemplation of making a profit through the efforts of persons other than the investor. 204 Kan. at 104. The promise made by the promoter was for the payment of money above and beyond that which was invested, a fact which led the court to find that such promises also could be termed "investment contracts" under the Act. Whatever the label assigned, the essence of a security existed, namely the investment of money with the expectation of realizing a profit through the efforts of persons other than the investor. State v. Hodge, supra, 204 Kan. at 103; S.E.C. v. Howey Co., 328 U.S. 293, 90 L.Ed.2d 1244, 66 S.Ct. 1100 (1946).

In the case of State ex rel. v. Colby, supra, the court stated that the determination of whether a particular financial relationship constitutes an "investment contract" hinged on whether the contractual arrangement involves an investment of money in a common enterprise with profits to come from the efforts of others. 231 Kan. at 504.

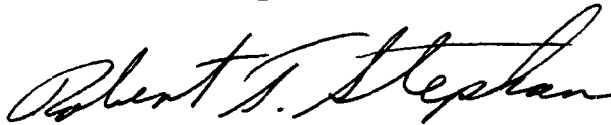
By "profits," the courts have meant either capital appreciation resulting from the development of the initial investment [S.E.C. v. C. M. Joiner Leasing Corp., 320 U.S. 344, 88 L.Ed. 88, 64 S.Ct. 120 (1943)], or a participation in earnings resulting from the use of investors' funds [Tcherepnin v. Knight, 389 U.S. 332, 19 L.Ed.2d 564, 88 S.Ct. 548 (1967)]. We note that the "solely from the efforts of others" requirement of Howey, supra, has been modified by some courts so that the dispositive issue becomes one of a lack of managerial control, rather than any control at all. This test, the so-called "risk-capital" standard, appears to have been adopted at least implicitly by the Kansas Supreme Court in Colby, supra, 231 Kan. at 503-504.

In our opinion, neither the evidence of indebtedness nor the investment contract concepts can be applied to a continuing care contract of the type described in 1983 House Bill No. 2251, at section 1(a). Admittedly, parts of the test for a security may be met. For example, in those cases where the facility has not yet been constructed, the value of the contract is left dependent upon proposed or promised future development. Colby, supra, 231 Kan. at 502. Additionally, there is little doubt that control over the furnishing of the services is in the hands of the promoter, not the investor, using either the Howey or the risk-capital tests. However, the profit element is missing, for the investor seeks to receive services and accommodations, not a fiscal return on the money invested. This situation is therefore analogous to that in United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 44 L.Ed.2d 621, 95 S.Ct. 2051 (1975), where the sale of stock issued by a housing cooperative was found to not constitute a security transaction. The stock had none of the features of an investment, in that it paid no dividends, could not be sold or pledged, and did not appreciate in value. Additionally, the purpose of a purchaser was to secure housing, rather than make an investment for profit. We find these same factors present here, and believe they support our conclusion that continuing care contracts are not subject to regulation under those statutes governing securities transactions.

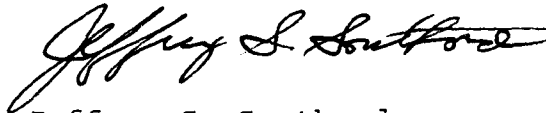
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In conclusion, the definition of the term "security" found at K.S.A. 17-1252(j) includes, among other things, "evidence of indebtedness" and "investment contracts." As applied by courts, both of these terms involve the payment of a consideration by an investor in exchange for the promoter's promise of profit in the future. This profit may be in the form of money, such as interest or dividends, or as increased value in the form of capital appreciation, but does not include the furnishing of services. Accordingly, a continuing care contract by which a person receives living accommodations, meals and health care for the payment of consideration upon entrance and periodically thereafter is not an investment contract or evidence of indebtedness so as to bring it under the definition of security in K.S.A. 17-1252(j), and the offeror of such contracts is not subject to the registration and disclosure requirements of the Kansas Securities Act, K.S.A. 17-1252, et seq.

Very truly yours,



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