



State of Utah
DEPARTMENT OF COMMERCE
DIVISION OF SECURITIES

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August 5, 1997

Mr. William M. Christou, Esq.
Ace Hardware Corporation
Legal Department
2200 Kensington Court
Oak Brook, Illinois 60521

Re: *Ace Hardware Corporation*
Request for Interpretive Opinion
File # A61204-50

Dear Mr. Christou:

This letter is in response to your letter dated May 6, 1997, wherein you requested an interpretive opinion from the Utah Division of Securities ("Division"). You asked the Division to opine whether the Class A and Class C stock issued by Ace Hardware Corporation (the "Company") to its franchised Dealers ("Dealers") are securities within the meaning of Utah Code Ann. § 61-1-13(24) (1997). The Division understands the relevant facts to be as follows:

- The Company operates as a retailer-owned cooperative and makes wholesale sales of hardware and related merchandise to its Dealers.
- In conjunction with their application to become a member of the cooperative, prospective Dealers must purchase one share of Class A voting stock at a price of \$1,000, and forty shares of Class C non-voting stock at a price of \$100 per share, for a total of \$5,000 of capital stock.
- Although the Class C shares do not entitle the holder to vote in regards to the management of the Company, the Class A shares do confer voting rights in proportion to the number of shares owned.
- At the end of each year, the profits made by the Company are distributed to its Dealer-shareholders as dividends based upon their respective purchases of merchandise from the Company, and not upon the number of shares of stock they own. The payment of dividends on the Company's stock is prohibited by its Certificate of Incorporation.



- The Company's stock is not traded on any securities exchange or over-the-counter market, but is sold exclusively by the Company. The stock is not transferable by the Dealer except with the consent of the Company, and in that event, it would only be transferable to another retailer of hardware whom the Company accepted as a Dealer.
- Upon termination of a Dealer's membership with the Company, all of his shares of the Company's stock are repurchased by the Company at par value.

On the basis of the foregoing facts and for the reasons stated below, it is the opinion of the Utah Division of Securities that the Class C non-voting stock is not a security under Utah Code Ann. § 61-1-13(24) (1997). Furthermore, it is the opinion of the Division that the Class A voting stock is not a security under Utah Code Ann. § 61-1-13(24) (1997).

Analysis

Section 61-1-13(24)(a)(ii) of the Utah Uniform Securities Act provides that "Security" means a "stock." No Utah court has offered an opinion determining when "stock" is not considered a security. However, section 61-1-27 of the Utah Code Ann. (1997) permits the Utah Uniform Securities Act to be "construed as to effectuate its general purpose . . . to coordinate the interpretation and administration of [Utah's securities laws] with the related federal regulation."

In *United Housing Foundation v. Forman*,¹ 421 U.S. 837, 44 L.Ed 2d 621 (1975), the Court rejected the suggestion that an instrument called stock "must be considered a security transaction simply because the statutory definition of a security includes the words 'any . . . stock.'" *Id.* at 630. Instead, the Court followed the economic characteristics test outlined in *Tcherepnin v. Knight*, 389 US 332, 336, 19 L Ed 2d 564 (1967)(holding that "in searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality"). *Id.* at 336.

In *United Housing*, the Court found that the most common economic feature of stock was "the right to receive dividends contingent upon an apportionment of profits." *United Housing* at

¹Although no Utah court has expressly applied *United Housing's* "economic characteristics" test to a case evolving Utah's Blue Sky Laws, the Utah Supreme Court has cited to *United Housing* and its principle that all stock transactions are not necessarily protected under securities law. *See Payable Accounting Corp. v. McKinley*, 667 P.2d 15, 19 (Utah 1993) (claiming that the primary purpose of the 1933 and 1934 acts was to eliminate abuses in the securities market that do not have the protections of other regulatory agencies).

Mr. William M. Christou
August 5, 1997
Page 3

631. Furthermore, the court found that the other characteristics of stock included negotiability, the capacity to be pledged or hypothecated, the conveyance of a voting right in proportion to the number of shares owned, and the ability of the stock to appreciate in value. *See Id.* at 632. These characteristics ultimately lead to the "inducement of purchase" which in the case of stock would be to "invest for profit."

Comparing the characteristics of the Company's Class A and Class C stock with the characteristics of stock as outlined in *United Housing*, it is apparent that the Class C stock is not a security in a number of ways, while the Class A stock contains characteristics of both security and non-security stock. Although holding Class C stock entitles Dealers to receive annual dividends, the dividends are not distributed *pro rata* in accordance to the number of shares held by each Dealer. Instead, the distribution of Company profits are parceled in relation to the business produced for the Company by the individual Dealer and are unrelated to the stock itself.

Moreover, like the non-security stock in *United Housing*, the Class C stock is not negotiable, nor can it be pledged or hypothecated. Transferring the stock only occurs when a Dealer opens a Company franchise or when the Dealer leaves the Company. Nor does one obtain voting privileges with the Class C stock. In short, absent the economic characteristics of stock, it is reasonable to conclude that one who purchases the Class C stock is induced by the opportunity to operate a Company franchise, not to invest for profit.

In summary, as the Class C stock does not entitle the holder to receive dividends apportioned by the number of shares held, nor does it contain the other characteristics of stock, the Class C stock is not a security for the purposes of the Utah Blue Sky Law.

Unlike the Class C stock, the Class A stock does give the Dealer a vote in the management of the Company in proportion to the number of shares the Dealer owns. That the Class A stock entitles the holder to assist in the management of the Company tends to lean the "economic characteristics" analysis in favor of finding the Class A stock to be a security. Nevertheless, when considering that the Class A stock is not "negotiable, cannot be pledged or hypothecated, and cannot appreciate in value," *see id.* at 632, the preponderance of the characteristics of the Class A stock are not those which are generally associated with a stock that is also a security.

In short, even though holders of Class A stock are entitled to voting rights and dividends, the preponderance of the stock's economic characteristics do not create the type of stock that is protected by the Utah Uniform Securities Act.

Please note that this opinion relates only to the offering discussed above and shall have no value for future similar offerings. Because this opinion is based on representations made to

Mr. William M. Christou
August 5, 1997
Page 4

the Division, It should be further noted that any different facts or conditions of a material nature might require a different conclusion.

Very truly yours,

DIVISION OF SECURITIES



S. Anthony Taggart
Assistant Director

MDM



Ace Hardware Corporation

2200 Kensington Court
Oak Brook, Illinois 60521
630/990-6600

Legal Department
630/990-2780

May 6, 1997

Mr. Mark J. Griffin, Director
Department of Commerce
Division of Securities
P.O. Box 45808
Salt Lake City, UT 84145-0808

RECEIVED

MAY 08 1997

Utah Div. of Securities

Re: Ace Hardware Corporation
Entity Number: 000-6041-20
File Number: A31344-06

Dear Mr. Griffin:

Ace Hardware Corporation (hereinafter referred to as the "Company") has previously registered its Class A and Class C stock under Section 61-1-9 of the Utah Uniform Securities Act. The Company respectfully requests that the Director issue a no-action letter or similar interpretive opinion determining that shares of the Company's Class A and Class C stock are not a "security" within the meaning of Section 61-1-13(22) of the Utah Blue Sky Law.

FACTUAL BACKGROUND

The Company operates in the United States as a retailer-owned cooperative in accordance with Subchapter T of the Internal Revenue Code. As such, it makes wholesale sales of hardware and related merchandise to its independent retailer-members (hereinafter referred to as "dealers"). All of the Company's stock is owned by its dealers. In conjunction with their application to become a member of the cooperative, each prospective dealer must concurrently subscribe for one share of Class A voting stock at a price of \$1,000, and forty shares of Class C non-voting stock at a price of \$100 per share, for a total of \$5,000 of capital stock. All applications for membership and all subscriptions for shares of the Company's stock must be accepted by an executive officer of the Company at its corporate headquarters in Oak Brook, Illinois.

At the end of each year the profits made by the Company are distributed to its dealer-shareholders as patronage dividends based upon their respective purchases of merchandise from the Company, and not upon the number of shares of stock they own. The payment of dividends on the Company's stock is prohibited by its Certificate of Incorporation.

Mr. Mark J. Griffin

May 6, 1997

Page 2

The Company's stock is not traded on any securities exchange or over-the-counter market, and is sold exclusively by the Company. No commissions are paid, either directly or indirectly, in connection with the sale of the Company's stock. The stock of the Company is not transferable by the dealer except with the consent of the Company, and in that event, it would be transferable only to another retailer of hardware and related merchandise whom the Company agreed to accept as a cooperative member with respect to a particular retail outlet. Upon termination of a dealer's membership, unless his stock is transferred as aforesaid, all of his shares of the Company's stock are repurchased by the Company at par value.

LEGAL ANALYSIS

Section 61-1-13(22) of the Utah Blue Sky Law provides that "Security" means any:

(a) note; (b) stock; (c) treasury stock; (d) bond; (e) debenture; (f) evidence of indebtedness; (g) certificate of interest or participation in any profit-sharing agreement; (h) collateral-trust certificate; (i) preorganization certificate or subscription; (j) transferable share; (k) investment contract; (l) burial certificate or burial contract; (m) voting-trust certificate; (n) certificate of deposit for a security; (o) certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease; (p) commodity contract or commodity option; or (q) 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. [Emphasis added.]

44 L.Ed.2d 621

In *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), the Supreme Court held that shares of stock entitling a purchaser to lease an apartment in a nonprofit housing cooperative were not securities within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934. The Court noted that the stock in the housing cooperative lacked the most common feature of stock: the right to receive "dividends contingent upon an apportionment of profits" [citing *Tcherepnin v. Knight*, 389 U.S. 332 (1967)]. The Court also stated that the stock did not possess other characteristics traditionally associated with stock:

Mr. Mark J. Griffin

May 6, 1997

Page 3

[T]hey are not negotiable; they cannot be pledged or hypothecated; they confer no voting rights in proportion to the number of shares owned; and they cannot appreciate in value. In short, the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit.

The stock of the Company has the same characteristics as the stock in the *Forman* case. Dealers do not purchase the shares with the expectation of receiving profits; rather, the shares are sold and purchased for membership in the cooperative. Once purchased, the shares cannot be sold, pledged, hypothecated or otherwise transferred by the dealer without the consent of the Company's Board of Directors. Thus, there is no market for the shares of the Company stock. No dividends are paid, and the financial benefits of membership in the cooperative are not determined by the number of shares owned, but rather by the dealer's purchases of merchandise from the Company. Lastly, the stock does not appreciate in value, nor is it purchased to achieve increases in value as a result of the efforts of others in managing the business.

CONCLUSION

The shares of the Company lack the qualities of an investment security. They are required merely as an incident of cooperative membership in the Company. They have no marketability and are not the type of instrument which the securities laws were designed to regulate.

Therefore, we respectfully request that the Director issue a no-action letter determining that the shares issued by the Company are not securities within the meaning of Section 61-1-13(22) of the Utah Blue Sky Law.

For the Director's information, to date, the states of Alabama, Arizona, Colorado, Connecticut, District of Columbia, Georgia, Indiana, Iowa, Kansas, Michigan, Mississippi, Missouri, Nevada, New Hampshire, New York, North Dakota, South Dakota, Texas, Vermont, Washington, West Virginia and Wisconsin have already responded favorably to the Company in like rulings or exemption letters.

Mr. Mark J. Griffin
May 6, 1997
Page 4

I have enclosed a check in the amount of \$120.00 to cover the required fee.

I have also enclosed a copy of our current Prospectus dated April 1, 1997 and a copy of a recent letter from a physician's professional corporation requesting exemption from registration and the Utah Division of Securities granting such an exemption. There are many similarities between the physician's analysis and Ace's analysis.

Thank you for your consideration in this matter. Please advise if you have any questions or require additional information.

Sincerely,

A handwritten signature in black ink, appearing to read "William M. Christou". The signature is written in a cursive style with a long horizontal stroke at the end.

William M. Christou
Attorney

Enclosures