

STATE OF COLORADO

Division of Securities
Department of Regulatory Agencies

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August 29, 2006

Eric N. Anderson
Clark, Mize & Linville, CHTD.
129 S. Eighth, P.O. Box 380
Salina, Kansas 67402-0380

**RE: The Heartland Voluntary Advertising Group Cooperative Exchange
Our File No. A-007-001**

Dear Mr. Anderson:

The staff of the Division of Securities ("Staff") is in receipt of your letter dated July 27, 2006, regarding the above-referenced matter. In your letter, you request, on behalf of The Heartland Voluntary Advertising Group Exchange (the "Company"), that the Staff confirm "that the stock in the [Company] is not a security and that [our] office will take 'no action' concerning the enforcement of any security registration requirements."

First, on the "securities" question, I would note that the Colorado legislature has adopted an exemption from the registration provisions of the Colorado Securities Act ("Act") found at §11-51-307(1)(j), C.R.S., which exempts "any security issued by a cooperative association as defined in article 55 of title 7, C.R.S.," from registration. Section 7-55-101, C.R.S., defines a cooperative association. And, §7-55-115, C.R.S. states that any cooperative association formed under this section, "or a similar law of any other state and authorized to transact business ... in this state," is exempt from our securities laws. One must ask why the legislature has adopted a securities registration exemption for such interests in two separate places if they did not consider them to be securities in the first place. Indeed, if they had set out to specifically exclude such interest, they would have done so in the definitional provisions. Based on these brief points, the staff cannot agree with your position that the interests are not securities under Colorado law.

I would note, however, that based upon the representations contained in your letter, the Company operates much like a standard cooperative association although it is formally organized as a "for profit" corporation. This distinction appears more technical than practical. If the Company was "not for profit," it appears, based on the facts in your

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letter, the Company may qualify for an exemption under either cooperation association section.

Based on the representations contained in your letter, and without taking a position whether the interests are "securities," or whether an exemption from securities registration found at §11-51-307(1)(j) C.R.S., is available, the Staff will not recommend to the Securities Commissioner that formal proceedings be initiated should the proposed offering by The Heartland Voluntary Advertising Group Cooperative Exchange be made in Colorado without benefit of securities registration in this state or in reliance on the exemption provided in the Act for cooperative associations.

It should be noted that by this letter, the Staff only expresses its opinion as to the recommendation of formal enforcement proceedings under the Act and does not purport to express any formal opinion or conclusion. Also, it should be noted that the position taken is done so based on the facts as presented, and any change in those facts or circumstances described might require a different response.

If there are any questions, please contact the undersigned.

Sincerely,



Gerald Rome
Deputy Securities Commissioner

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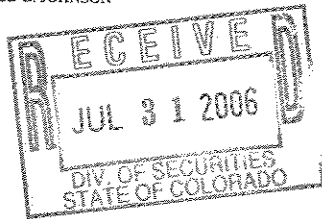
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July 27, 2006

Mr. Gerald Rome
Division of Securities
1560 Broadway St., Suite 900
Denver, CO 80202

RE: The Heartland Voluntary Advertising Group Cooperative Exchange

Dear Mr. Rome:

As per our conversation, enclosed for your review and comment is a copy of the proposed Articles of Incorporation and Bylaws for The Heartland Voluntary Advertising Group Cooperative Exchange ("Coop"), along with the \$100 filing fee. Specifically, we are requesting that your office issue a "no action" opinion letter concerning the stock to be issued by the Coop. It is our opinion that the stock is not a security and, as such, should not be subject to registration requirements.

Summary of Organization

The corporation will be organized under the Kansas Cooperative Corporation Code (K.S.A. 17-1501 et seq.) by grocers who are supplied and serviced by Affiliated Foods Midwest ("AFM") and who advertise under the AFM/Shurfine Foods banner for the purpose of affiliating to create economies of scale in product advertising. At this juncture, AFM supplies grocery stores in 12 states: Kansas, Missouri, Nebraska, Iowa, South Dakota, North Dakota, Colorado, Oklahoma, Illinois, Wisconsin, Minnesota, and Wyoming. Thus, a similar letter is being sent to the Securities Commissioner offices in each of those states soliciting a similar "no action" opinion or a "discretionary exemption" from filing requirements. Please note that at this point, the Articles of Incorporation have not yet been filed in Kansas, or any other state, because if your office suggests amendments to the Articles or Bylaws, it will be easier to modify those documents if they have not yet been filed. Ultimately, the Articles will be filed in Colorado as a foreign corporation doing business in Colorado.

The Articles of Incorporation contain the threshold requirements provided by Kansas statutes governing cooperative corporations. However, the statutes concerning such corporations were

promulgated nearly 100 years ago, with very few subsequent changes. Generally, the following provisions must be present in the Articles:

- **Name of the entity** (which must start with the word "The" and end with one of the following words: "association," "company," "corporation," "exchange," "society," or "union.")
- **Names and residence addresses for the persons who will form the corporation** (which must include at least 20 members)
- **The purpose of the organization** (which must include as two of its components the requirement to pay a fixed dividend on its stock and the requirement that the remainder of its profits prorated to its stockholders upon their purchases from or sales to the organization, i.e. patronage dividend)
- **Principal place of business**
- **Amount of authorized capital stock**
- **Number of shares to be issued and par value assigned to the stock**
- **Number of directors – at least 5**
- **Names and addresses of initial directors**
- **Time for which the corporation is to exist, which cannot exceed 50 years**

It is our opinion that the enclosed Articles of Incorporation meet the Kansas requirements.

As per K.S.A. 17-1512, there is not a great deal of direction given as to what must, or should, be included in the corporation's Bylaws. Thus, we have adopted general corporation Bylaws with a few modifications to reflect the following cooperative corporation concepts outlined in the statutes:

- a. Eligibility to Own Stock. Once a grocery store meets the threshold test of being affiliated with AFM, Article 2, Section 1 of the corporation's Bylaws creates the specific eligibility requirements to be met by the owner of the store before the privilege of owning stock in the corporation will be permitted. As indicated by the last bullet point of that list, a prospective stockholder must ultimately receive a favorable vote from a majority of the board of directors before the stock can be purchased.
- b. Application for Shareholder Status. Article 2, Section 2 of the Bylaws states the manner in which a prospective grocer can apply for shareholder status.
- c. No cumulative voting. Neither the Articles of Incorporation, nor the Bylaws (Article 2, Section 6) permit cumulative voting.
- d. Limitations on Transfer of Stock. Paragraph 4 of the Articles of Incorporation briefly touches on the issue of the limitations on the transfer of stock, but the details of the transfer restrictions are found in Article 5 of the Bylaws. As indicated therein, stock in the Coop cannot be freely transferred.

e. Patronage Distribution. The essence of the cooperative corporation is the method by which the patronage is divided. Article 6 of the Bylaws outlines the advertising concepts and patronage dividend distribution concepts that will be applicable to all stockholders. Specifically, the board of directors will set the specific price per case of advertised items purchased from AFM that will be paid to the shareholders as patronage. The stockholder will then receive such patronage on a monthly basis based upon the previous month's purchases.

It is our opinion that the Bylaws conform to the requirements of Kansas statutes and accurately reflect the concepts of a cooperative corporation.

Stock in Coop is Not a Security

The stock in the Coop will be available to grocers in the 12 states serviced by AFM. And, because the equity is a corporation, the ownership of that equity is referred to as "stock." However, it is our opinion that the "stock" in the Coop is not a security.

As outlined by the United States Supreme Court in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851, 95 S.Ct. 2051, 2060, 44 L.Ed.2d 621 (1975), the typical characteristics of common stock are as follows:

- the right to receive dividends contingent upon an apportionment of profits,
- negotiability,
- the ability to be pledged or hypothecated,
- voting rights, and
- the capacity to appreciate in value.

The following is an analysis of those five characteristics applied to the Coop:

1. Right to receive dividends contingent upon an apportionment of profits. As per Kansas statute, there is a fixed dividend per share of \$50 so that if there would ever be earnings and profits for distribution and if dividends were declared by the board of directors, each share of stock would be entitled to a \$50 per share dividend. However, there is a limit on the number of shares a person can own – one share for each qualifying grocery store. Thus, there is no ability for a person to acquire large numbers of shares of stock in order to realize a correspondingly large dividend. More importantly, the bulk of the earnings and profits will be distributed in the form of patronage distributions, and the patronage distributions to a stockholder will be based solely on the amount of business done by that stockholder through AFM and the Coop. Thus, there is not, in our opinion, a general right to receive dividends based upon the apportionment of profits.

2. Negotiability. As per Article 5, Section 1 of the Bylaws, the stock in the corporation is not transferable. If at any time the owner of the stock ceases to meet the eligibility criteria to own stock (as stated in Bylaws, Article 2, Section 1) or otherwise

loses control of the entity that owns the Coop stock, the corporation can force either a redemption of the stock or the transfer of the stock to an eligible person. Thus, there is no free transferability or negotiability of the stock.

3. Ability to be pledged or hypothecated. Because of the restrictions on who is eligible to own stock and the general restrictions on the transfer of such stock, as stated in the Bylaws, it is our opinion that the stock cannot be pledged or hypothecated by a stockholder as collateral for a debt.

4. Voting Rights. There are indeed voting rights granted to the owners of the stock in the corporation. Those rights are one vote per share with no cumulative voting rights.

5. The capacity to appreciate in value. Because the redemption of the stock is at its par value and the stock cannot be freely sold, it is our opinion that there is no capacity for the stock to appreciate in value. The only time whereby a stockholder could possibly receive more in return for his/her stock than the \$200 purchase/redemption price would be upon the final dissolution and liquidation of the Coop. If the Coop has any retained earnings upon dissolution, those stockholders owning stock at the time of dissolution will receive a pro-rated share of the remaining assets, as would be the case with any for-profit entity upon dissolution. Other than that isolated scenario, however, there is no ability for the stock to appreciate in value.

In addition, the risk of loss in this case is minimal. The purchase price for the stock is \$200 and the redemption price is \$200.

Based upon the above analysis it is our opinion that the stock in the Coop does not meet the *Foreman* criteria as a "security". The Court in *Forman* concluded that although the equity in that case was called "stock," the owners were not likely to believe that they were purchasing investment securities and that the inducement to purchase that stock was solely to acquire the rights to certain accommodations and not to invest for a profit.

In addition to the *Forman* criteria, the United States Supreme Court in *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946) established the following criteria whereby an "investment contract" could be considered as security:

If a person:

- invests money,
- in a common enterprise,
- and is led to expect profits,
- solely from the efforts of the promoter or third party.

In the case of the Coop, the stock is purchased by persons, they will certainly be investing money in a common enterprise, and they will have an expectation of the distribution of profits, but such profits will not be created solely from the efforts of a promoter or third party. The cooperative

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corporation concept is such that the profits are distributed in the form of patronage. Thus, the distribution of profits is based solely on the efforts of the investor not the efforts of the promoter or third party.

It is our opinion that the stock in the Coop is not a security because it fails to meet the *Howey* test as an investment contract.

Conclusion

As indicated above, the corporation is being organized as a Kansas entity, however, there will be stockholders in up to 12 states. The purpose of the Coop is to allow similarly situated independent grocers to band together to create economies of scale for advertising purposes. All owners of stock in the entity must purchase a certain amount of their products from AFM, which will create some degree of uniformity of products being offered for sale to the consumer. In short, the essence of the Coop is more of a "club" to which certain grocers can become members. By incorporating the "club," the owners create a more formal organization that should give them *bona fides* in their advertising programs. However, in creating the more formal organization, which includes the issuance of "stock" to memorialize the membership in the organization, the issue of whether that "stock" is a "security" is triggered.

It is our opinion, based upon the above arguments, that the stock in the Coop is not a security and should not be subject to the various regulatory requirements attendant to securities. Before proceeding to filing the Articles of Incorporation and Bylaws, initially with Kansas, and then in the other 11 states, we are seeking a "no action" opinion from your office that hopefully confirms that the stock in the Coop is not a security and that your office will take "no action" concerning the enforcement of any security registration requirements. We fully understand, however, that any such letter is contingent upon the Articles and Bylaws being signed in their current form. And, upon filing the Articles in Colorado, we will provide a file-stamped copy to your office for your files. We will also provide to a copy of the signed Bylaws after they are executed.

Please review this letter and the enclosed corporate documentation and respond accordingly. If there is additional information that you need to assist you in making your decision, please do not hesitate to contact me at the address or telephone number listed above. Our understanding is that your office endeavors to provide "no action" opinion letters within 30 days after your receipt of such a request.

We look forward to your response.

Very truly yours,

CLARK, MIZE & LINVILLE, CHTD.

By 
Eric N. Anderson