

# Allen Matkins

Allen Matkins Leck Gamble Mallory & Natsis LLP  
Attorneys at Law  
1900 Main Street, 5<sup>th</sup> Floor | Irvine, CA 92614-7321  
Telephone: 949.553.1313 | Facsimile: 949.553.8354  
www.allenmatkins.com

**Keith Paul Bishop**  
E-mail: kbishop@allenmatkins.com  
Direct Dial: 949.851.5428 File Number: 372431-00002/OC1192381.08

**Securities Act of 1933, § 2(a)(1) and § 5**  
**Securities Exchange Act of 1934, § 3(a)(10) and § 12(g)**

**Via Electronic Mail**

October 9, 2018

Office of Chief Counsel  
Division of Corporation Finance  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Re: Tesoro Viejo Master Mutual Water Company**

Dear Sir or Madam:

Tesoro Viejo Master Mutual Water Company (“**TVMMWC**”) is a mutual water company organized pursuant to the California General Corporation Law (“**GCL**”) as well as other provisions of the California Corporations Code governing mutual water companies. TVMMWC is proposing to offer shares of its common stock for sale without registration under the Securities Act of 1933, as amended (the “**Securities Act**”), and the Securities Exchange Act of 1934, as amended (the “**Exchange Act**” and together with the Securities Act, the “**Securities Acts**”).

On behalf of TVMMWC, we request that the Division of Corporation Finance (the “**Division**”) advise us that it will not recommend to the Securities and Exchange Commission (the “**Commission**”) that it take any enforcement action against TVMMWC if TVMMWC offers and sells shares of its common stock to lot purchasers, makes assessments on those shares, and permits the resale of such shares by lot owners, in the manner and under the circumstances described below, without registration of such TVMMWC shares under Section 5 of the Securities Act and Section 12(g) of the Exchange Act.

Office of Chief Counsel

October 9, 2018

Page 2

**I. Factual Background.**

**A. TVMMWC**

TVMMWC was formed generally for the purpose of selling, distributing, treating, supplying and delivering water for domestic use to owners of subdivision lots in the Tesoro Viejo master-planned community in Madera County, California (“**Tesoro Viejo**”). TVMMWC will also treat, convey and dispose of wastewater and provide reclaimed water to lots within Tesoro Viejo. Upon completion, Tesoro Viejo is expected to have 5,190 residential units in 9 distinct residential villages and approximately 3,000,000 square feet of commercial/retail space. Tesoro Viejo will also include parks, school sites, and other special uses, together with roads, related parking, trails, landscaping and supporting public and private infrastructure. Development of Tesoro Viejo is expected to take several years to complete.

TVMMWC is authorized to issue only a single class of stock, designated as “common stock.” Only those persons who are owners of lots within TVMMWC’s service area may be shareholders of TVMMWC. Pursuant to TVMMWC’s Bylaws, TVMMWC is required to issue one share for each residential or non-residential lot purchased within TVMMWC’s service area. TVMMWC’s shares will be appurtenant to the lands described in the share certificate. As such, the shares may only be transferred with those lands, except after sale or forfeiture for non-payment of delinquent assessments.<sup>1</sup> TVMMWC’s Board of Directors is authorized to levy assessments on TVMMWC’s issued and outstanding shares and to impose connection fees, rates and charges for water services made available to the shareholders of the Corporation in such amounts as may appear necessary or expedient to carry out TVMMWC’s purposes.<sup>2</sup>

TVMMWC must sell, distribute, supply or deliver water that it acquires only to owners of its shares and to the common areas owned or controlled by an owner’s association of the subdivision, provided TVMMWC may sell water to the state, or any department or agency thereof, or to any school district, or to any public agency, or, to any other mutual water company or, during any emergency resulting from fire or other disaster involving danger to public health or safety, to any person *at the same rates* as to holders of the TVMMWC’s shares.<sup>3</sup> Shareholders will be required to pay for the water that they use and will have no right to receive a fixed amount of water per share.

---

<sup>1</sup> Cal. Corp. Code §§ 14300, 14303 and 14312(a)(13)(L).

<sup>2</sup> Cal. Corp. Code § 14303 generally authorizes a corporation organized for or engaged in the business of selling, distributing, supplying or delivering water for irrigation purposes or domestic use, and not as public utility, to levy assessments upon its shares and to sell shares appurtenant to the land that have become delinquent as if not appurtenant. However, Article IV, § 5.2 of TVMMWC’s Bylaws provides that in the event a shareholder becomes delinquent in paying assessments, TVMMWC may deny or forfeit the right to receive water services but that right may not be sold or transferred without the land. This Bylaw provision is intended to comply with Cal. Corp. Code § 14312(a)(13)(L) which specifically applies to mutual water companies serving a residential subdivision, such as TVMMWC, and prohibits the sale or transfer of rights of a delinquent shareholder to receive water without the land.

<sup>3</sup> Cal. Corp. Code § 14300.

TVMMWC may enter into a contract with a county fire protection district to furnish water to fire hydrants and for fire suppression or fire prevention purposes at a flat rate per hydrant or other connection.<sup>4</sup>

Madera Irrigation District (“MID”) has entered into a water supply agreement with TVMMWC and an affiliate of the developers of Tesoro Viejo pursuant to which MID has agreed to supply a firm and guaranteed supply of water.<sup>5</sup> MID is a public agency established as an irrigation district under California Water Code Section 20500 *et seq.*<sup>6</sup>

TVMMWC will operate the Tesoro Viejo water system, including pipelines, hydrants, diversion and treatment facilities, and appurtenances pursuant to license agreements with the owners of those facilities. Pursuant to these agreements, TVMMWC will be solely responsible for the cost and expense of maintaining, repairing and replacing the licensed facilities as well as any alterations that may be necessary for the operation of the licensed facilities. The licensors will be permitted to assign, transfer, mortgage or otherwise encumber their interests in the license agreements and TVMMWC’s shareholders will not be entitled to share in any increase in value of the licensed facilities.

## **B. Regulation of Mutual Water Companies in California**

Historically, landowners in California have organized mutual water companies as customer-owned water providers to serve their properties.<sup>7</sup> When large landowners conveyed their property to smaller owners, the irrigation systems for those lands became vested in a large number of individual land owners. This inevitably engendered difficulties in managing and distributing the water. Landowners addressed this collective action problem by forming corporations to maintain and manage water distribution amongst the various grantees. These corporations became known as “mutual water companies”.

The California Corporations Code defines a “mutual water company” as a corporation organized for or engaged in the business of selling, distributing, supplying, or delivering water for irrigation or domestic purposes that provides in its Articles of Incorporation or Bylaws that the water shall be sold, distributed, supplied, or delivered, with certain exceptions, only to owners of its

---

<sup>4</sup> *Id.*

<sup>5</sup> As between the affiliate, Tesoro Viejo Development, Inc. (“TVD”), and TVMMWC, TVD will perform the obligations under the MID agreement and supply the water obtained from MID to TVMMWC.

<sup>6</sup> In California, a special district is a form of governmental agency that provides special, localized services, such as water, fire protection, or pest abatement, to a defined area.

<sup>7</sup> *De Boni Corp. v. Del Norte Water Co.*, 200 Cal. App. 4th 1163, 1167 (2011). Mutual water companies are not the exclusive providers of water in California. In some areas, water is supplied by municipal or investor owned utilities. TVMMWC does not expect to be regulated as a public utility because it was organized to deliver water to its shareholders at cost and intends to deliver water to no one except its stockholders, government agencies, or certain other mutual water companies (except in emergency situations). Cal. Pub. Util. Code § 2705.

Office of Chief Counsel  
October 9, 2018

Page 4

shares.<sup>8</sup> Mutual water companies are typically organized as either for-profit corporations under the California General Corporation Law (“GCL”),<sup>9</sup> or as nonprofit corporations under the California Nonprofit Mutual Benefit Corporation Law (“NMBCL”).<sup>10</sup> Whether organized under the GCL or the NMBCL, mutual water companies are also subject to Title 1, Division 3, Part 7 of the California Corporations Code.

Because TVMMWC will operate a public water system,<sup>11</sup> it will be subject to a number of additional requirements pursuant to the California Corporations Code. For example, members of TVMMWC’s Board of Directors must receive training regarding the duties of board members of mutual water companies, including, but not limited to, the duty of a corporate director to avoid contractual conflicts of interest and fiduciary duties, the duties of public water systems to provide clean drinking water that complies with the federal and California Safe Drinking Water Acts, and long-term management of a public water system.<sup>12</sup> This training must be repeated every six years. In addition, meetings of TVMMWC’s Board of Directors will be subject to open meeting requirements.<sup>13</sup> TVMMWC will also be required to make specified records available to shareholders and other eligible persons.<sup>14</sup>

The California Subdivided Lands Act regulates the offer and sale or leasing of subdivided parcels of real property in California.<sup>15</sup> Before marketing a new subdivision in California, a subdivider must obtain a “public report” from the California Department of Real Estate (“DRE”).<sup>16</sup> The public report is a disclosure document that is intended to protect consumers from misrepresentation, deceit, and fraud in the public sale or lease of subdivisions.<sup>17</sup> When a subdivider intends to provide water for domestic use to purchasers of lots within the subdivision through a mutual water company, the application for the public report submitted to the DRE must include certain

---

<sup>8</sup> Cal. Corp. Code §14300. A mutual water company may sell water to the state, or any department or agency thereof, or to any school district, or to any public agency, or, to any other mutual water company or, during any emergency resulting from fire or other disaster involving danger to public health or safety, to any person at the same rates as to holders of shares of the corporations; and may enter into a contract with a county fire protection district to furnish water to fire hydrants and for fire suppression or fire prevention purposes at a flat rate per hydrant or other connection. *Id.*

<sup>9</sup> Corp. Code §§ 100 – 2319.

<sup>10</sup> Cal. Corp. Code §§ 7110 – 8910.

<sup>11</sup> A “public water system” is a system for the provision of water for human consumption through pipes or other constructed conveyances that has 15 or more service connections or regularly serves at least 25 individuals daily at least 60 days out of the year. Cal. Health & Safety Code § 116275(h).

<sup>12</sup> Cal. Corp. Code § 14301.2. Cal. Health & Safety Code § 116755.

<sup>13</sup> Cal. Corp. Code § 14305.

<sup>14</sup> Cal. Corp. Code § 14307.

<sup>15</sup> Cal. Bus. & Prof. Code §§ 11000 to 11200. The planning, design and creation of subdivisions in California is also regulated by local governments under the Subdivision Map Act. Cal. Gov. Code §§ 66410-66499.3.

<sup>16</sup> Cal. Bus. & Prof. Code § 11010. Any security of a mutual water company (other than an investment contract) offered or sold in connection with subdivided lands is exempt from qualification under the California Corporate Securities Law of 1968. Cal. Corp. Code § 25100(f).

<sup>17</sup> *In re Sidebotham*, 12 Cal. 2d 434, 436 (1938).

information, representations and assurances, including that the mutual water company's securities will be sold or issued: (i) only to purchasers of lots in the subdivision, or to successors in interest of purchasers of lots in the subdivision, and not sold or issued to the subdivider; and (ii) only after a public report has been issued by the Real Estate Commissioner.<sup>18</sup> The application must also provide assurance that the securities issued by the mutual water company are appurtenant to the land<sup>19</sup> and that an offering circular will be used in any offer and sale of securities of the mutual water company.<sup>20</sup> The offering circular must include disclosure of the following items:

- A discussion of the water supply, distribution, and fire protection system.
- A summary of the opinion of the engineer along with the engineer's consent, as required by Sections 260.504.2 to 260.504.2.4, inclusive, of Title 10 of the California Code of Regulations.<sup>21</sup>
- The area in which the mutual water company intends to provide water service.
- A discussion of the rights and duties of the security holders of the mutual water company as set forth in its articles of incorporation and Bylaws, including the consequence of failure to pay for water or assessments.
- The fact that the Articles of Incorporation or Bylaws: (i) provide that the shares or securities of the mutual water company may not be sold separately from the right to water as evidenced by the security of the mutual water company, and (ii) prohibit issuance of fractional shares or securities of the mutual water company.
- A discussion of the certificate issued by the State Director of Health Services<sup>22</sup> certifying that the water is fit for domestic use.
- The limitation imposed on salaries to be paid to personnel operating, or employed by, the mutual water company, including officers and directors.
- A discussion of the transferability of the securities, the voting rights of the security holders, access to books and records, necessary or contemplated expansion of the facilities of the mutual water company, and further subdivision of the area to be served, if applicable.
- A discussion of the subdivider's duties with respect to maintenance and repair or replacement of the water supply, distribution, or fire protection systems; and a discussion of the establishment and maintenance of the operating, repair, and replacement fund.<sup>23</sup>

---

<sup>18</sup> Cal. Corp. Code § 14312(a)(9). The developers of Tesoro Viejo will sell portions of the development to merchant homebuilders who will in turn sell finished homes to homebuyers. TVMMWC does not own, and will not sell, lots within Tesoro Viejo. Thus, the homebuilders, not TVMMWC, will apply for public reports with respect to their respective subdivisions within Tesoro Viejo.

<sup>19</sup> Cal. Corp. Code § 14312(a)(10).

<sup>20</sup> Cal. Corp. Code § 14312(a)(14).

<sup>21</sup> The content of the engineer's report is prescribed by Cal. Corp. Code § 14313.

<sup>22</sup> The statute has not been updated to reflect the transfer of this authority from the Director of Health Services to the State Water Resources Control Board.

<sup>23</sup> Cal. Corp. Code § 14312(d).

Office of Chief Counsel

October 9, 2018

Page 6

The offering circular must include the following exhibits:

- Copies of the water company's Articles of Incorporation and Bylaws;
- Financial statements, or if the water company has not yet commenced operations, a detailed operating budget for the first six months; and
- Specimen stock certificate.<sup>24</sup>

The DRE reviews applications for public reports and will issue a public report only if the proposed subdivision meets the requirements specified in the California Subdivided Lands Act. All prospective purchasers must be given a copy of the public report and must be given a chance to read it before any binding contract is signed.<sup>25</sup> A copy of the public report must be given to any member of the public upon request.<sup>26</sup>

In addition, mutual water companies are subject to federal, state and local regulation with respect to water quality, environmental and other matters.

## II. Legal Analysis.

TVMMWC requests no-action relief with respect to a single issue: whether shares of TVMMWC common stock constitute a "securities" for purposes of the Securities Acts. We are of the opinion, for the reasons set forth below, that TVMMWC stock, if offered and sold by TVMMWC (and permitted by TVMMWC to be transferred) in the manner described above, would not constitute a "security" as that term is defined in Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act (or an "equity security" as that term is defined in Section 3(a)(11) of the Exchange Act), and therefore would not be required to be registered in compliance with Section 5 of the Securities Act and Section 12 of the Exchange Act.<sup>27</sup>

Section 2(a)(1) of the Securities Act (15 U.S.C. § 77b(a)(1)) provides that, unless the context otherwise requires:

"The term "security" means any note, stock, treasury stock, security future, security-based swap, 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 certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle,

---

<sup>24</sup> Cal. Corp. Code § 14312(e).

<sup>25</sup> Cal. Bus. & Prof. Code § 11018.1(a).

<sup>26</sup> Cal. Bus. & Prof. Code § 11018.1(b).

<sup>27</sup> Upon completion of Tesoro Viejo, TVMMWC is expected to have shares held of record by more than 2,000 persons.

option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option or privilege entered into on a national securities exchange relating to foreign currency, 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, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.”

The Supreme Court has consistently held that the definition of a security in Section 3(a)(10) of the Exchange Act “is virtually identical [to the definition in the Securities Act].”<sup>28</sup> Accordingly, the following discussion and our opinion applies equally to Section 3(a)(10) of the Exchange Act as it does to Section 2(a)(1) of the Securities Act.

Both Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act list numerous types of instruments, many of which are quite specific and clearly unrelated to shares like the TVMMWC shares. We have considered whether TVMMWC shares of common stock constitute “stock” or “investment contracts.” Based on the following legal analysis, and our view that purchasers of lots within Tesoro Viejo will acquire TVMMWC shares for the purpose of obtaining water services and not for investment purposes or with the expectation of profit, it is our opinion that the TVMMWC shares are not securities for purposes of the Securities Acts. Based on this same analysis, it is also our opinion that, because they are not securities for purposes of the Securities Acts, after their initial purchase the TVMMWC shares may be assessed and resold in connection with lands to which they pertain without registration under the Securities Acts.

1. “Stock”: Application of *Forman* Analysis

We believe that the shares to be offered and sold by TVMMWC should not be treated as the equivalent of “stock” for the purpose of applying Section 2(a)(1) of the Securities Act or as “equity securities” for the purpose of applying Section 3(a)(11) of the Exchange Act. Although the definitions of “security” Section 2(a)(1) and Section 3(a)(10) each include “stock” within the list of instruments that are securities, the United States Supreme Court in *United Housing Foundation, Inc. v. Forman* held that form should be disregarded for substance and the emphasis should be on economic reality.<sup>29</sup> Thus, not every instrument denominated as “stock” is necessarily a “security” for purposes of the Securities Acts.

The *Forman* decision involved stock issued by the owner/operator of a massive housing cooperative in New York. Persons acquiring an apartment in the cooperative were required to buy 18 shares of stock in the owner/operator at a price of \$25 per share. The shares were explicitly tied to the apartment and could not be transferred to a non-tenant. The shares also could not be pledged

---

<sup>28</sup> *Reves v. Ernst & Young*, 494 U.S. 56, 61 n.1 (1990).

<sup>29</sup> 421 U.S. 837, 848 (1975) (quoting *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)).

Office of Chief Counsel

October 9, 2018

Page 8

or encumbered; and they descended, along with the apartment, only to a surviving spouse. No voting rights attached to the shares as such. Participation in the affairs of the cooperative appertained to the apartment, with the residents of each apartment being entitled to one vote irrespective of the number of shares owned. When residents became unhappy with increased rental charges, they sued the owner/operator of the cooperative, asserting, among other things, claims under the anti-fraud provisions of the Securities Acts. The defendants moved to dismiss on the grounds that federal jurisdiction was lacking because the shares of stock were not “securities” within the meaning of the Securities Acts.

At the outset, the Supreme Court in *Forman* rejected any suggestion that the transaction, evidenced by the sale of shares called “stock,” must be considered a security transaction simply because the statutory definition of a security includes the words “any stock.”<sup>30</sup> In finding that the shares in the owner/operator were not securities, the Supreme Court observed:

“In the present case respondents do not contend, nor could they, that they were misled by use of the word ‘stock’ into believing that the federal securities laws governed their purchase. Common sense suggests that people who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock. These shares have none of the characteristics “that in our commercial world fall within the ordinary concept of a security.” H.R. Rep. No. 85, *supra*, at 11. Despite their name, they lack what the Court in *Tcherepnin* deemed the most common feature of stock: the right to receive “dividends contingent upon an apportionment of profits.” 389 U.S., at 339. Nor do they possess the other characteristics traditionally associated with stock: they 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.”<sup>31</sup>

In sum, the U.S. Supreme Court in *Forman* focused on whether purchasers would be likely to believe that in reality they were acquiring investment securities. The Supreme Court further identified the following five characteristics as being traditionally associated with stock:

1. the right to receive dividends;
2. negotiability;

---

<sup>30</sup> 421 U.S. at 848.

<sup>31</sup> 421 U.S. at 851.

3. the ability to be pledged or hypothecated;
4. voting rights in proportion to the number of shares owned; and
5. the ability to appreciate in value.<sup>32</sup>

Purchasers will be buying real estate, not investing in a security.

TVMMWC will issue shares only in connection with the initial purchase and sale of lots in Tesoro Viejo. The right evidenced by mutual water company shares is a right to receive water and this right is primarily a right in real property.<sup>33</sup> As such, each issuance of a TVMMWC share will be an inextricable part of a real estate purchase transaction and should not be regarded as the separate issuance of a security. As described above, the offer and sale of subdivision lots by TVMMWC is subject to comprehensive regulation by the DRE. Purchasers will acquire TVMMWC shares not for the purpose of investing in TVMMWC, but in order to obtain water services to their lots. TVMMWC shareholders will be required to pay TVMMWC for the cost of water services and will be subject to possible assessments on their shares as authorized by TVMMWC's Board of Directors.<sup>34</sup> These rights and obligations have none of the characteristics that come within the concept of a security in the commercial world. Rather, they strongly support the conclusion that purchasers will engage in real estate transactions and not investments in a security.<sup>35</sup> Accordingly, we believe that no justifiable basis exists for concluding that purchasers will believe, or be misled into believing, that they are purchasing investment securities simply because they are receiving something called a share of "stock" in connection with the purchase of their lots. Our conclusion is consistent with the Division's favorable response to the no-action letter request submitted by CommunitySun, LLC involving the offer and sale of real estate interests in a solar condominium facility.<sup>36</sup>

TVMMWC will not be permitted to pay dividends.

The Supreme Court in *Forman* cited its earlier decision in *Tcherepnin* for the proposition that the most common feature of stock is the right to receive "dividends contingent upon an apportionment of profits." TVMMWC is statutorily prohibited from distributing any gains, profits or dividends to its shareholders, except upon dissolution.<sup>37</sup>

---

<sup>32</sup> 421 U.S. at 851. *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 (1985) (citing *Forman* and rejecting the "sale of business" doctrine).

<sup>33</sup> *Valley View Mutual Water Co. v. Browne*, 104 Cal. App. 2d 177, 180 (1951).

<sup>34</sup> All assessments will be subject to Cal. Corp. Code § 423.

<sup>35</sup> *Grenader v. Spitz*, 537 F.2d 612, 617 (2<sup>nd</sup> Cir. 1976) ("In fact, the continuing obligation to pay a monthly rental fee to maintain the tenancy of the lessee strongly supports the conclusion that this was basically a real estate transaction and not an investment in a security.")

<sup>36</sup> *CommunitySun, LLC* (August 29, 2011).

<sup>37</sup> Cal. Corp. Code § 14301.

Office of Chief Counsel

October 9, 2018

Page 10

*The TVMMWC shares will not be “negotiable”.*

TVMMWC’s shares will be appurtenant to the land purchased by homebuyers in the Tesoro Viejo. As such, the shares may only be transferred with the lands to which they pertain. Because the shares are inseparable from the land, they will not be “negotiable” as that term is commonly understood.<sup>38</sup>

*The TVMMWC shares may not be pledged or hypothecated apart from the land.*

As discussed above, TVMMWC shares may not be transferred apart from the lands to which they pertain.

*Voting rights effectively appertain to the lot.*

Although each share of TVMMWC stock will be entitled to one vote per share (except in the case of cumulative voting for the election of directors), the right to vote will be effectively limited to the lot to which the share appertains because only one share will be issued in respect of a lot, regardless of the number of owners of that lot.<sup>39</sup> This is similar to the situation in *Forman* where participation in the affairs of the cooperative appertained to the apartment (although the shares carried no voting rights). Unlike the typical corporate stock, there is no way for someone to accumulate TVMMWC shares (and hence voting rights) without purchasing additional lots within Tesoro Viejo.

*Any appreciation in value will be inseparable from the real estate.*

The TVMMWC shares are not expected to appreciate in value for several reasons. *First*, TVMMWC will deliver water at cost to its shareholders and will deliver water to no one other than its shareholders, government agencies or certain other mutual water companies (as described above).<sup>40</sup> *Second*, TVMMWC will not, and may not, pay dividends to its shareholders. *Third*, no

---

<sup>38</sup> *Black’s Law Dictionary*, 10th Edition, defines “negotiability” as “[t]he capability of commercial paper to have its title transferred by indorsement and delivery, or by delivery alone, so that the transferee has a rightful claim on it.” Black’s explains that “[n]egotiability (which pertains to commercial paper) differs from assignability (which pertains to contracts in general) because an assignee traditionally takes title subject to all equities, and an assignment is not complete without notice to the debtor, whereas an indorsee takes free of all equities and without any notice to the debtor.” Alternatively, Black’s defined “negotiability” as “[a] written instrument’s capability of being transferred by delivery or indorsement when the transferee takes the instrument for value, in good faith, and without notice of conflicting title claims or defenses.”

<sup>39</sup> The GCL requires that shareholders have voting rights with respect to certain matters. Pursuant to the GCL, a shareholder will generally have the right to vote for the election of directors and other matters for which shareholder approval is required under the GCL such as amendment of the corporation’s articles of incorporation.

<sup>40</sup> As required by Cal. Corp. Code § 14312(a)(13)(B), Article V, § 5.1 of TVMMWC’s Bylaws provides that the rates and charges for water must bear a reasonable relationship to the cost of furnishing water and maintaining the system. This constrains the amount of revenues that TVMMWC may derive from the delivery of water. Consistent with Cal. Corp. Code § 14300, Section 4.1 of the Bylaws permits the sale of water to specified categories of

Office of Chief Counsel

October 9, 2018

Page 11

secondary market will exist for the sale of shares independent of the land. *Fourth*, the shares will provide the right to purchase water services and will be assessable. Although it is theoretically possible that the value of a TVMMWC share may appreciate over time, the potential for appreciation in value is a common attribute of many forms of property (such as real estate) that are clearly outside of the scope of the Securities Acts. Importantly, any appreciation in the value of TVMMWC shares would be inseparable from the real estate to which those shares appertain because the shares may not be transferred separately from the land. Therefore, the theoretical possibility of appreciation alone does not support a conclusion that the TVMMWC shares are the equivalent of “stock” and therefore “securities” under the Securities Acts.<sup>41</sup>

Our opinion that the TVMMWC shares are not “stock” is consistent with the Division’s response to analogous situations in which purchasers were motivated by the desire to use or consume a benefit. See, for example, the following no-action letters: *LA Fan Club Membership Program* (June 28, 2017) and *Erica Enders, LLC* (November 21, 2006) (fan club memberships); *CommunitySun, LLC* (August 29, 2011) (solar condominiums); *Coral Beach & Tennis Club* (December 22, 2011) (tennis club memberships); and *Entheos Audiology Cooperative, Inc.* (June 2, 2004) (common stock in purchasing cooperative).

2. “Investment Contract” or “Instrument Commonly Known as a Security”:  
Application of *Howey* Analysis

Because the TVMMWC shares do not fall plainly within the usual concept or definition of “stock,” as set forth in Section 2(a)(1) of the Securities Act or Section 3(a)(10) of the Exchange Act, we have considered whether the TVMMWC shares would otherwise be deemed “securities” by reason of being “investment contracts” or “instruments commonly known as securities” for purposes of Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act. In *Landreth*,<sup>42</sup> the Supreme Court suggested that the proper test for determining whether a particular instrument that is not clearly within the definition of “stock” as set forth in Section 2(a)(1), or that otherwise is of an unusual nature, is an “investment contract” or an “instrument commonly known

---

persons who are not shareholders of TVMMWC (such as the state, government agencies, school districts and other mutual water companies). Although revenues derived from sales of water to these entities may reduce water costs to shareholders, any such reduction is not an “expectation of profit” within the meaning of *Securities and Exchange Commission v. W.J. Howey, Co.*, 328 U.S. 293 (1946). Like the leasing fees in *Forman*, the sales of water to third parties are limited by statute and are properly viewed as incidental to the purchase of a lot within the Tesoro Viejo development.

<sup>41</sup> Upon dissolution and winding up, TVMMWC’s then shareholders would be entitled to the remaining corporate assets after all known debts and liabilities have either been paid or adequately provided for. Cal. Corp. Code § 2004. TVMMWC Articles of Incorporation do not limit its duration to a specified term. It is therefore presently unknown if, or when, TVMMWC will be dissolved and wound up. It is also unknown whether any assets would be available for distribution to shareholders should TVMMWC be dissolved. We note that the Division has granted no-action requests to companies with liquidation provisions in their organizational documents. See, e.g., *Entheos Audiology Cooperative, Inc.* (June 2, 2014) and *Coral Beach & Tennis Club* (Dec. 22, 2011).

<sup>42</sup> 471 U.S. at 689.

Office of Chief Counsel

October 9, 2018

Page 12

as a security” is the economic realities test set forth in *Howey*. In evaluating the economic realities of a transaction, “[t]he test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.”<sup>43</sup> The *Howey* test, as explained by the Supreme Court in *Forman*, “embodies the essential attributes that run through all of the Court’s decisions defining a security.”<sup>44</sup> We believe that applying the *Howey* test to the TVMMWC shares demonstrates that those shares do not constitute an “investment contract” or other “instrument commonly known as a security” as those terms are used in Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act because the purchase of TVMMWC shares does not represent an investment in a common enterprise where a person is led to expect profits arising from the efforts of others.

#### Investment of Money

TVMMWC expects to issue and sell its shares for consideration, not to exceed \$10 per share, to be determined by its Board of Directors. For this reason, an investment of money under the *Howey* test may exist here.

#### Expectation of Profits

While TVMMWC shares will be acquired with money, the persons to whom TVMMWC shares will be offered will be informed not to regard the shares as an investment nor to expect to derive “profits” from the ownership of those shares. TVMMWC shares will not be marketed as investments for profit, nor will they be described to lot purchasers as anything other than a means of obtaining the water services for their lots. Specifically, the offering circular will disclose:

- TVMMWC shares will be offered and sold only to persons acquiring lots;
- TVMMWC shares may only be transferred with the land;
- No market exists or will exist for the sale of the shares apart from the resale of the land;
- TVMMWC will not, and may not, pay dividends; and
- Lot purchasers should not view or purchase the TVMMWC shares as an investment or expect to derive any profits from ownership of those shares.

In *Forman*, the Supreme Court elaborated on the “profits” aspect of the *Howey* test:

“By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, as in [*SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943)], *supra* (sale of oil leases conditioned on promoters’ agreement to drill exploratory well), or a participation in earnings resulting from the use of investors’ funds, as in *Tcherepnin v. Knight*, *supra* (dividends on the investment based on

---

<sup>43</sup> 328 U.S. at 301.

<sup>44</sup> 421 U.S. at 852

Office of Chief Counsel

October 9, 2018

Page 13

savings and loan association's profits). In such cases the investor is 'attracted solely by the prospects of a return' on his investment. *Howey, supra*, at 300. By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—to occupy the land or to develop it themselves,' as the *Howey* Court put it, *ibid.*—the securities laws do not apply. *See also Joiner, supra.*"<sup>45</sup>

In the present situation, we believe TVMMWC shares will be purchased purely to obtain water services without any reasonable expectation of profit. TVMMWC will not pay any dividends or other distributions to its shareholders. In addition, shareholders will be required to pay for water and may be subject to assessment of their shares. Thus, no lot purchaser could have a reasonable expectation of profit flowing solely from ownership of a TVMMWC share. Applying the motivation analyses set forth in *Forman* and *Howey* and cited above, we believe this is a situation where the securities laws should not apply given that the "purchaser is motivated by a desire to use or consume the item purchased" and quite literally, "occupy the land" and use the water.

We recognize that TVMMWC shares might theoretically increase in value, but any such increase in value would be inseparable from the value of the lots to which they appertain because the shares may only be transferred with the land. Moreover, all prospective lot purchasers will be informed that the shares will be appurtenant to the land and will be informed in writing that they should not acquire TVMMWC shares as an investment for profit.

In *International Brotherhood of Teamsters v. Daniel*,<sup>46</sup> the Supreme Court concluded that a noncontributory, compulsory pension plan does not satisfy investment prong of the *Howey* test. In reaching this conclusion, the Supreme Court focused on whether plan participants "chose to give up a specific consideration in return for a *separable* financial interest with the characteristic of a security".<sup>47</sup> In this case, the TVMMWC shares are inseparable from the lots to which they pertain. No one can become a TVMMWC shareholder without purchasing a lot.

We believe that these facts could not create in the mind of any reasonable purchaser an "expectation of profit in the sense found necessary in *Howey*."<sup>48</sup> Rather, we believe that the expectation of purchasers will be to acquire water services for their lots. Furthermore, we believe the most obvious reason that TVMMWC shares are not securities is that they represent an opportunity to purchase water services as opposed to something any buyer would reasonably view as a security.

---

<sup>45</sup> 421 U.S. at 852-53.

<sup>46</sup> 439 U.S. 551 (1979).

<sup>47</sup> 439 U.S. at 559 (emphasis added).

<sup>48</sup> 421 U.S. at 856-57.

Office of Chief Counsel

October 9, 2018

Page 14

### Common Enterprise

The Commission has expressed the view that it does not believe a “common enterprise” is a distinct requirement for an investment contract under the *Howey* test. We believe an argument can be made that there is no common enterprise under the circumstances presented here because the principal value of TVMMWC shares is the personal, nonmonetary value resulting from the Member’s ability to receive water services at cost and courts analyzing the common enterprise requirement focus on whether a relationship exists *with respect to an economic venture*.<sup>49</sup> Nevertheless, we recognize that a common enterprise may be deemed to exist under the present circumstances. Given the Commission’s view that a “common enterprise” is not a distinct requirement for an investment contract under the *Howey* test, we have not provided a detailed analysis of commonality.

Under these facts, the TVMMWC shares should not be considered to be “securities” under the *Howey* analysis.

In *Daniel*, the Supreme Court found that the existence of comprehensive legislation governing the use and terms of employee pension plans severely undercut all arguments for extending the Securities Acts to noncontributory, compulsory pension plans.<sup>50</sup> Likewise in *Reves*, the Supreme Court found that an instrument is less likely to be considered a “security” when some other factor, such as the existence of another regulatory scheme, significantly reduces the risk.<sup>51</sup> As described above, the California DRE comprehensively regulates the offer and sale of shares of mutual water companies in connection with the subdivision of real estate. We believe that the existence of this regulatory regime strongly supports the conclusion that mutual water company shares were not the type of instrument that Congress intended to be regulated as securities.

### **III. Conclusion.**

In view of the foregoing, we respectfully request your confirmation that the Division will not recommend any enforcement action to the Commission if the TVMMWC shares are offered and sold in the manner described herein without registration under the Securities Acts.

---

<sup>49</sup> While the Supreme Court did not expressly mention what constitutes a common enterprise, the Court’s opinion in *Howey* does indicate that the common enterprise envisioned by the Court was one where the aim of the investors was an economic return on their investment. 328 U.S. at 300 (“A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments.”).

<sup>50</sup> 439 U.S. at 569-70.

<sup>51</sup> 494 U.S. at 67.

Allen Matkins Leck Gamble Mallory & Natsis LLP  
Attorneys at Law

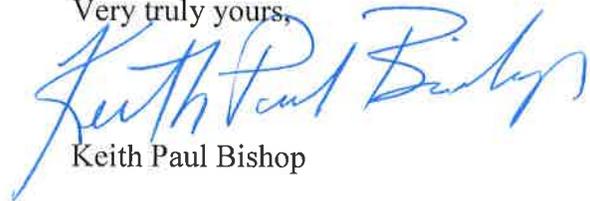
Office of Chief Counsel

October 9, 2018

Page 15

Subject to completion of the initial residences in Tesoro Viejo and the DRE's approval of the public report, TVMMWC plans to commence offering shares promptly upon receipt of a response from the Division, in the event the Division grants this request. If for any reason you conclude that you cannot respond affirmatively to our request, we would appreciate the opportunity to discuss the matter with you prior to the preparation of your response and ask that you call the undersigned at (949) 851-5428.

Very truly yours,

A handwritten signature in blue ink that reads "Keith Paul Bishop". The signature is written in a cursive, flowing style.

Keith Paul Bishop

KPB:kp