

NOTES

REAL ESTATE AS SECURITIES: SALES OF RESIDENTIAL SUBDIVISION LOTS

For the federal securities regulation statutes¹ to apply to the merits of any case, the subject of the action must be a "security."² Identification of securities can lead to seemingly esoteric results.³ Real property, for example, generally is not a security,⁴ but sales of undeveloped subdivi-

1. Securities Act of 1933, §§ 1-26, 15 U.S.C. §§ 77a-77z (1976); Securities and Exchange Act of 1934, §§ 1-34, 15 U.S.C. §§ 78a-78hh (1976).

2. For an excellent introduction to the definition of a "security," see Newton, *What is a Security?: A Critical Analysis*, 48 Miss. L.J. 167 (1977). Two articles have become standard guides on this issue: Hannan & Thomas, *The Importance of Economic Reality and Risk in Defining Federal Securities*, 25 HASTINGS L.J. 219 (1974); Long, *An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation*, 24 OKLA. L. REV. 135 (1971). The definition of "security" is developed at notes 16-51 *infra* and accompanying text.

For general studies of securities regulations, see L. LOSS, *SECURITIES REGULATION* (2d ed. 1961); D. RATNER, *SECURITIES REGULATION* (1978).

3. The most unusual security case is *Continental Marketing Corp. v. SEC*, 387 F.2d 466 (10th Cir. 1967), *cert. denied*, 391 U.S. 905 (1968), in which the court held a sale of live beavers to be a sale of securities. See *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) (certain life insurance policies); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) (variable annuities); *Hector v. Wiens*, 533 F.2d 429 (9th Cir. 1976) (shares in dairy cattle operations); *SEC v. MacElvain*, 417 F.2d 1137 (5th Cir. 1969), *cert. denied*, 397 U.S. 972 (1970) (sale of interest in lawsuit); *SEC v. M.A. Lundy Assocs.*, 362 F. Supp. 226 (D.R.I. 1973) (whiskey warehouse receipts); *SEC v. Chinchilla, Inc.*, [1952-1956 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 90,618 (N.D. Ill. 1953) (sale of chinchillas); *SEC v. Cultivated Oyster Farms Corp.*, [1941-1944 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 90,121 (S.D. Fla. 1939) (sale of oysters); *Longines Symphonette Soc'y*, [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,151 (SEC No-Action Letter) (commemorative medallion investment plans); *U of F Students Coop., Inc.*, [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,347 (SEC No-Action Letter) (consumer cooperative memberships). See also 25 MERCER L. REV. 733 (1974) (whiskey warehouse receipts).

See also citations listed at 1 L. LOSS, *supra* note 2, at 490 n.88 (2d ed. 1961); Hillard & Ricciardelli, *Investment Contracts Under the Colorado and Uniform Securities Acts*, 49 COLO. L. REV. 391, 423 n.164 (1978). Trading stamps, street car tokens, meal tickets, gift certificates, box tops, railroad tickets, and theater tickets are not securities. SEC Release No. 33-3890, 1 FED. SEC. L. REP. (CCH) ¶ 1041 (Jan. 25, 1958).

4. One court set forth the general rule:

We agree that land, as such, is not a security and that a land purchase contract, simply because the purchaser expects or hopes that the value of the land purchased will increase, does not fall automatically within the confines of the Securities Acts. However, we do not agree that land or its purchase necessarily negates the application of the Securities Acts.

McCown v. Heidler, 527 F.2d 204, 208 (10th Cir. 1975). Many courts have relied on Professor Loss' analysis:

sion lots may fall within the purview of securities statutes, depending on the terms and circumstances of the sales.⁵

Most cases that apply the securities laws to sales of subdivision lots have similar fact patterns. A developer subdivides a tract of unimproved land into residential lots. The price of each lot usually exceeds the land's market value, but the developer promises that land values will increase and that he will improve the subdivision. The buyers, because of their distance from the property, are unable to inspect the

[N]o "investment contract" is involved when a person invests in real estate, with the hope perhaps of earning a profit as the result of a general increase in values concurrent with the development of the neighborhood, as long as he does not do so as part of an enterprise whereby it is expressly or impliedly understood that the property will be developed or operated by others.

1 L. Loss, *supra* note 2, at 491-92. See also *United Sportfishers v. Buffo*, 396 F. Supp. 310, 313 (S.D. Cal. 1975); *SEC v. Thunderbird Valley, Inc.*, 356 F. Supp. 184, 187 (D.S.D. 1973); *Interstate Land Sales Full Disclosure Act: Hearings Before a Subcomm. of the Senate Comm. on Banking and Currency on S. 2672*, 89th Cong., 2d Sess. 84 (1966) (statement of Manuel F. Cohen, SEC Chairman); *Frauds and Quackery Affecting the Older Citizen: Hearings Before the Special Senate Comm. on Aging*, 88th Cong., 1st Sess. 486-87 (1963) (statement of William L. Cary, SEC Chairman).

5. See *Woodward v. Terracor*, 574 F.2d 1023 (10th Cir. 1978); *McCown v. Heidler*, 527 F.2d 204 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109 (D. Colo. 1976); *Hester v. Hidden Valley Lakes, Inc.*, 404 F. Supp. 580 (N.D. Miss. 1975); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045 (S.D.N.Y. 1975); *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175 (N.D. Cal. 1975); *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131 (N.D. Ill. June 27, 1974); *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022 (D.C. Super. Ct. 1973); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 384 N.E.2d 981 (1978), *cert. denied*, 100 S. Ct. 272 (1979). References in this Note to "the subdivision cases" are references to these eleven cases.

Two other cases deal only with lot purchasers' class actions under the federal securities regulations. *Gilbert v. Woods Marketing, Inc.*, 454 F. Supp. 745 (D. Minn. 1978); *Tober v. Chartina, Inc.*, 58 F.R.D. 74 (M.D. Pa. 1973). For a description of the possible significance of *Tober*, see *Timmreck v. Munn*, 433 F. Supp. at 404 & n.6. Two other cases deal with transactions related to sales of subdivision lots as securities. *Chess v. Nieport*, [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,045 (E.D. Cal. 1974) (execution of promissory note and deed of trust is not a "sale"); *SEC v. Lake Havasu Estates*, 340 F. Supp. 1318 (D. Minn. 1972) (mortgages secured by title to lots are securities (complete opinion reported at [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,348)). See also *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983 (N.D. Cal. 1978) (statute of limitations); *McCubbrey v. Boise Cascade, Inc.*, [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,414 (N.D. Cal. 1972) (suit filed). For an example of a case decided under state securities statutes, see *Florida Realty, Inc. v. Kirkpatrick*, 509 S.W.2d 114 (Mo. 1974).

Many parties have litigated the applicability of securities regulations to sales of subdivision lots, but only the cases listed above have resulted in written opinions. For an example of unreported litigation, see *Mancini v. GAC Corp.*, Civil No. 72-45-TUC-JAW (D. Ariz., filed Apr. 20, 1972). *Mancini* is described in *Hannan & Thomas, supra* note 2, at 275-76 & nn.212-13 (1974).

land or to oversee improvements.⁶ When the developer defrauds the purchasers by not fulfilling his promises, the purchasers seek recovery of damages.

Although damaged purchasers of subdivision lots may recover under several legal theories,⁷ plaintiffs bringing actions under the securities

6. See also Hannan & Thomas, *supra* note 2, at 275-76.

7. Promoters of subdivision lot sales can be held liable in civil and criminal actions under many theories if the sales are fraudulent. Possible theories, other than federal securities regulation and common-law fraud, include: the Interstate Land Sales Full Disclosure Act, 15 U.S.C. §§ 1701-1720 (1976), providing civil and criminal causes of action and requiring registration for sellers; Federal Trade Commission cease and desist orders; United States Postal Service actions against use of mails to execute fraud; state securities regulations; and state statutes related specifically to subdivision lot sales.

See generally P. SIMKO, 3 PROMISED LANDS (1978); Babcock & Feurer, *Land as a Commodity "Affected with a Public Interest,"* 52 WASH. L. REV. 289 (1977); Case & Jester, *Securities Regulation of Interstate Land Sales and Real Estate Development—A Blue Sky Administrator's Viewpoint: Part II*, 7 URB. LAW. 385 (1975); Note, *The Legislative Struggle Against Subdivision Frauds*, 13 CATH. U.L. REV. 160 (1964); Note, *Regulating the Subdivided Land Market*, 81 HARV. L. REV. 1528 (1968); Note, *Interstate Land Sales Regulation: The Case for an Expanded Federal Role*, 6 U. MICH. J. L. REF. 511 (1973); Note, *Interstate Land Sales Regulation*, 1974 WASH. U.L.Q. 123.

For an introductory analysis of the Interstate Land Sales Full Disclosure Act, see Morris, *The Interstate Land Sales Full Disclosure Act: Analysis and Evaluation*, 24 S.C.L. REV. 331 (1972). For criticism of the Act, see Note, *Cooperative Housing Corporations and the Federal Securities Laws*, 71 COLUM. L. REV. 118, 123 (1971) ("relatively innocuous").

For analyses of state securities statutes as applied to real estate, see Hansell & Neumann, *The Iowa Uniform Securities Act Exemptions Part I: The Securities Exemptions*, 2 J. CORP. L. 437 (1977); Hayes, *The New Iowa "Uniform" Securities Law*, 25 DRAKE L. REV. 267 (1975); Note, *State Securities Law: A Valuable Tool for Regulating Investment Land Sales*, 7 N.M.L. REV. 265 (1977). The real estate industry recently drafted the Federal Real Estate Securities Act and State Uniform Real Estate Securities Act to broaden securities regulation liabilities. See Note, *Shares in Privately Financed Cooperative Apartment Corporations and the Federal Securities Law after Grenader v. Spitz*, 30 RUTGERS L. REV. 432, 446-47 (1977).

For descriptions of state statutes exclusively regulating sales of subdivision lots, see Case & Jester, *supra*, at 424-28 (Minnesota statute); 12 U. RICH. L. REV. 755 (1978) (Virginia Subdivided Land Sales Act). For a table analyzing state regulation of land sales, see Note, *"Rainbow City"—The Need for Federal Control in the Sale of Undeveloped Land*, 46 NOTRE DAME LAW. 733, 758-59 (1971).

Despite diverse sources of possible regulation, many commentators insist that governmental regulation of real estate is inadequate. See Babcock & Feurer, *supra*, at 334.

Some sellers in the eleven subdivision cases, see note 5 *supra*, were challenged under other theories in separate litigation. See *Waugh v. Heidler*, 564 P.2d 218 (Okla. 1977) (possible liability under states securities regulations); *United States v. Amrep Corp.*, 560 F.2d 539 (2d Cir. 1977) (liability for mail fraud and under antifraud provisions of Interstate Land Sales Full Disclosure Act), *cert. denied*, 434 U.S. 1015 (1978); *United States v. Goldberg*, 527 F.2d 165 (2d Cir. 1975), (same), *cert. denied*, 425 U.S. 917 (1978); *Bryon v. Amrep Corp.*, 429 F. Supp. 313 (S.D.N.Y. 1977) (same); *Husted v. Amrep Corp.*, 429 F. Supp. 298 (S.D.N.Y. 1977) (liability under anti-fraud provisions of Interstate Land Sales Full Disclosure Act). See also *Heit v. Amrep Corp.*, 82 F.R.D. 130 (S.D.N.Y. 1979) (approving settlements).

statutes have particular advantages. The securities statutes permit plaintiffs to bring actions in a wide range of federal district courts⁸ and to recover damages plus interest.⁹ Moreover, the concept of "fraud" under the securities laws embraces a broader range of activities than under the common law,¹⁰ and pendent jurisdiction enables plaintiffs to assert both theories in federal court.¹¹

This Note examines a series of cases that apply federal securities laws to sales of subdivision lots. Part I presents a brief introduction to federal securities regulation and to the definition of "security." Part II reviews the application of the standard "security" definition to subdivision lots. Part III then discerns an analytic framework to determine whether sales of subdivision lots constitute securities transactions.

I. SECURITIES REGULATION: PURPOSES AND DEFINITIONS

The principal purposes of security regulation statutes are to prevent fraud and to compel full disclosure of information in securities transactions.¹² Congress enacted the earliest of the federal statutes in 1933,¹³ commencing a series of changes in the securities market to provide investors with more protection from fraud than either the common law or state statutes afforded.¹⁴ The Securities Act of 1933 and the Securities Exchange Act of 1934 provide liberal remedies for fraud in securities sales.¹⁵

8. See Securities Act of 1933, § 22(a), 15 U.S.C. § 77v(a) (1976).

9. *Id.* § 12, 15 U.S.C. § 77l.

10. See generally 3 L. Loss, *supra* note 2, at 1421-528. The federal securities statutes, for example, create liability for half-truths, but the common law may not. *Id.* at 1439.

11. Newton, *supra* note 2, at 167 n.4; see *Vanderboom v. Sexton*, 422 F.2d 1233, 1241-42 (8th Cir. 1970). The scope of pendent jurisdiction is uncertain after *Owen Equip. & Erection Co. v. Kroger*, 437 U.S. 365 (1978). Other fraud theories include common-law fraud and some causes of action listed in note 7 *supra*.

12. *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 480-81 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973); *Timmreck v. Munn*, 433 F. Supp. 396, 399 (N.D. Ill. 1977); *1976-77 Securities Law Developments*, 34 WASH. & LEE L. REV. 863, 864 (1977); 15 Hous. L. REV. 415, 421 (1978) (reviewing Seventh Circuit opinion in *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223 (7th Cir. 1977), *rev'd*, 439 U.S. 551 (1979)); 12 URB. L. ANN. 277, 286 (1976). See also H.R. REP. NO. 85, 73d Cong., 1st Sess. 3 (1933), reprinted in 2 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, item 18 (J. Ellenberger & E. Mahar eds. 1973) [hereinafter cited as LEGISLATIVE HISTORY].

13. Securities Act of 1933, ch. 38, 48 Stat. 74 (1933) (current version at 15 U.S.C. §§ 77a-77z (1976)).

14. See 1 L. Loss, *supra* note 2, at 119-21.

15. Securities Act of 1933, §§ 11, 12(2), 15, 17, 15 U.S.C. §§ 77k, 77l(2), 77o, 77q (1976); Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1976).

To invoke the statutory remedies, plaintiffs must first establish that the subject of the suit is within the definition of "security" formulated by Congress and courts.¹⁶ The Securities Act and the Securities Exchange Act define "security" by similar lists of possible securities, including "any . . . investment contract" or "instrument commonly known as a 'security.'" ¹⁷ The statutes do not specify the characteristics of securities, nor do their legislative histories provide much guidance,¹⁸

16. See note 2 *supra*.

17. Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1) (1976):

The term "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 certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, 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.

Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1976):

The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill or exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Although these definitions differ, the Supreme Court construes them together. *Tcherepain v. Knight*, 389 U.S. 332, 335-36 (1967). Regulations promulgated under the statutes do not clarify the definition of "security." See 17 C.F.R. §§ 230.100-.656, 240.0-1 to 240.31-1 (1979).

18. Courts and commentators agree that Congress provided little guidance for identifying securities. See *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 847 (1975) ("Congress did not attempt to articulate the relevant economic criteria for distinguishing 'securities' from 'non-securities.'"); *1976-77 Securities Law Developments*, *supra* note 12, at 864 ("The legislative history of the acts similarly fails to define the intended scope of a security"). The legislative history states that the Securities Act of 1933 "defines the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H.R. REP. NO. 85, 73d Cong., 1st Sess. 11 (1933), *reprinted in* 2 LEGISLATIVE HISTORY, *supra* note 12, at item 18.

This history provides an indication about the statutes' applicability to real estate transactions, although no case has presented a pertinent argument. As originally enacted, the Securities Act of 1933 included "certificate of interest in property, tangible or intangible" within the definition of "security." Securities Act of 1933, ch. 38, 48 Stat. 74 (1933) (current version at 15 U.S.C. § 77b(1) (1976)). That language does not appear in the Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1976). Congress deleted the "property" clause "as possibly involving too broad and uncertain application." H.R. REP. NO. 1838, 73d Cong., 2d Sess. 39 (1934), *reprinted in* 5 LEGISLATIVE HISTORY, *supra* note 12, at item 20.

See also H.R. 4314, 73d Cong., 1st Sess. 2 (1933), *reprinted in* 3 LEGISLATIVE HISTORY, *supra*

probably because Congress could not foresee those innovations which might give rise to a need for securities regulation protection.¹⁹

To determine whether a transaction constitutes a sale of a security, therefore, courts rely on maxims of statutory construction and on policy-oriented analyses. Courts construe the statutes broadly²⁰ in light of their remedial purposes²¹ and disregard form for substance in evaluating the alleged security's economic realities.²² The courts thus have moved from a literal approach, which required courts to find a security whenever the instrument in question was known as a "security," regardless of its other characteristics, to flexible formulae for identifying and defining securities.²³ The most salient example of a court-developed formula is the definition of "investment contract." Securities in real estate transactions have most often been investment contracts.²⁴

note 12, at item 22 (security is defined as including a "beneficial interest in title to property"); H.R. 4500, 73d Cong., 1st Sess. 4 (1933), *reprinted in* 3 LEGISLATIVE HISTORY, *supra* note 12, at item 23 (security is defined in part by "evidence of a beneficial interest in title to property"); H.R. 5480, 73d Cong., 1st Sess. 2 (1933), *reprinted in* 3 LEGISLATIVE HISTORY, *supra* note 12, at item 24 (security is defined in part as a "certificate of interest in property").

19. *See* Daniel v. International Bhd. of Teamsters, 561 F.2d 1223, 1241 (7th Cir. 1977), *rev'd*, 439 U.S. 551 (1979) ("Perhaps the main reason that pension plans are not specifically mentioned in the legislative history . . . is the fact that in the early 1930's pension plans were still a rarity."); Comment, *Application of the Federal Securities Laws to Noncontributory, Defined Benefit Pension Plans*, 45 U. CHI. L. REV. 124, 126-27 (1977). *But see* International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 563-65 (1979) (use of legislative history contrary to the findings in Seventh Circuit opinion); 27 CATH. L. REV. 364, 365 (1978) (some evidence of legislative intent to include pensions as "securities").

20. *See* Tcherepnin v. Knight, 389 U.S. 332, 336 (1967); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 353-55 (1943); SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 480-81 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973); Timmreck v. Munn, 433 F. Supp. 396, 399 (N.D. Ill. 1977); 1976-77 *Securities Law Developments*, *supra* note 12, at 866.

21. Although the statutes create criminal liabilities, the remedial aim remains the "dominant purpose." SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 353-55 (1943).

22. *See* Tcherepnin v. Knight, 389 U.S. 332, 336 (1967); *accord*, International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 558 (1979); United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 851-52 (1975).

23. *See* United Hous. Foundation, Inc. v. Forman, 421 U.S. 837 (1975). *Forman* noted that, "[w]ith the exception of the Second Circuit, every Court of Appeals recently to consider the issue has rejected the literal approach urged by respondents." *Id.* at 849 n.14. The Second Circuit abandoned the literal approach in 1976. Grenader v. Spitz, 537 F.2d 612, 616 (2d Cir.), *cert. denied*, 429 U.S. 1009 (1976). *See also* Exchange Nat'l Bank v. Touche Ross & Co., 544 F.2d 1126, 1133 (2d Cir. 1976) ("courts have shrunk from a literal reading that would extend the reach of the statutes beyond what could reasonably be thought to have been intended").

24. Real estate transactions that may constitute sales of securities include: (1) condominiums: SEC v. Marasol Properties, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,159 (D.D.C. 1973); Lowery v. Ford Hill Inv. Co., 548 P.2d 127 (Colo. App.), *rev'd on other grounds*, 556 P.2d 1201 (Colo. 1976); SEC Release No. 5347, [1972-1973 Transfer Binder] FED. SEC. L. REP.

The "investment contract" definition evolved in a series of Supreme Court decisions.²⁵ In *SEC v. C.M. Joiner Leasing Corp.*,²⁶ respondent sold investment rights in an oil-drilling enterprise. The seller advertised the rights as investments,²⁷ but contended in court that because the sales were of real estate interests, they were subject only to state regulation.²⁸ The Court, after observing that the sales "had all the evils inherent in the securities transactions which it was the aim of the Se-

(CCH) ¶ 79,163 (Jan. 4, 1973); Berman & Stone, *Federal Securities Law and the Sale of Condominiums, Homes, and Homesites*, 30 BUS. LAW. 411 (1975); Note, *Federal Securities Regulation of Condominiums: A Purchaser's Perspective*, 62 GEO. L.J. 1403 (1974). *Contra*, Joyce v. Ritchie Tower Properties, 417 F. Supp. 53 (N.D. Ill. 1976); (2) time-sharing condominiums: Gunnar, *Regulations of Resort Time-Sharing*, 57 OR. L. REV. 31 (1977); Note, *Securities: Another Way to Regulate the Resort Development Boom*, 27 OKLA. L. REV. 104 (1974). *See also* Joyce v. Ritchie Tower Properties, 417 F. Supp. 53, 56 (N.D. Ill. 1976) (dictum); (3) cooperatives: Miller, *Cooperative Apartments: Real Estate or Securities?*, 45 B.U.L. REV. 465 (1965); Note, *Community Apartments: Condominium or Stock Cooperative?*, 50 CALIF. L. REV. 299 (1962); Note, *Cooperative Housing Corporations and the Federal Securities Laws*, 71 COLUM. L. REV. 118 (1971); Note, *Shares in Privately Financed Cooperative Apartment Corporations and the Federal Securities Law after Grenader v. Spitz*, 30 RUTGERS L. REV. 432 (1977). *Contra*, United Hous. Foundation, Inc. v. Forman, 421 U.S. 837 (1975); Grenader v. Spitz, 537 F.2d 612 (2d Cir.), *cert. denied*, 429 U.S. 1009 (1976); (4) sales on installment contracts: Coffey & Welch, *Federal Regulation of Land Sales: Full Disclosure Comes Down to Earth*, 21 CASE W. RES. L. REV. 5, 13 (1969). *See also* Nelson & Whitman, *The Installment Land Contract—A National Perspective*, 1977 B.Y.U.L. REV. 541; (5) management contracts: SEC v. W.J. Howey Co., 328 U.S. 293 (1946); Blackwell v. Bentsen, 203 F.2d 690 (5th Cir. 1953), *cert. dismissed*, 347 U.S. 925 (1954); SEC v. Orange Grove Tracts, 210 F. Supp. 81 (D. Mass. 1962); SEC v. Bailey, 41 F. Supp. 647 (S.D. Fla. 1941). *Contra*, Schultz v. Dain Corp., 568 F.2d 612 (8th Cir. 1978); Fargo Partners v. Dain Corp., 540 F.2d 912 (8th Cir. 1976); (6) real estate syndications: Davis, *Developments in Real Property Syndication*, 39 TEX. B.J. 616 (1976); Greenwood, *Syndication of Undeveloped Real Estate and Securities Law Implications*, 9 HOUS. L. REV. 53 (1971); (7) notes secured by realty mortgages: Hall v. Security Planning Serv., Inc., 371 F. Supp. 7 (D. Ariz. 1974); SEC v. Thunderbird Valley, Inc., 356 F. Supp. 184 (D.S.D. 1973); SEC v. Dell Inv. Co., No. CV-72-L-121 (D. Neb. June 5, 1972) (opinion printed at Hall v. Security Planning Serv., Inc., 371 F. Supp. at 17-26 (app. I)); and (8) undivided interests in undeveloped land: Andrews v. Blue, 489 F.2d 367 (10th Cir. 1973); SEC v. Federal Shopping Way, Inc., 433 F.2d 148 (9th Cir. 1970); SEC v. Great W. Land & Dev., Inc., [1964-1966 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,537 (D. Ariz. 1965), *remanded on other grounds*, 355 F.2d 918 (9th Cir. 1966).

25. Four Supreme Court cases analyze the investment contract issue: *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551 (1979); *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837 (1975); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). *Forman*, *Howey*, and *Joiner* involve real estate transactions.

The Court has considered the definition of "security" in only three other cases: *Tcherepnin v. Knight*, 389 U.S. 332 (1967); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959). None of these cases involves a real estate transaction.

26. 320 U.S. 344 (1943).

27. *Id.* at 346.

28. *Id.* at 352.

curities Act [of 1933] to end,"²⁹ set forth a new test to determine the applicability of the securities statute:

The test . . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. In the enforcement of an act such as this it is not inappropriate that promoters' offerings be judged as being what they were represented to be.³⁰

Because the seller promoted the interests as securities, the Court held that securities regulations applied.³¹

Three years after *Joiner*, the Court substantially elaborated on its view of investment contracts in *SEC v. W.J. Howey Co.*³² Defendant in *Howey* sold portions of an orange grove, retaining full rights to control each parcel and to share in the grove's profits.³³ The Court held that the land contracts, warranty deeds, and service contracts were investment contracts.³⁴ For purposes of the Securities Act of 1933, the Court suggested that an investment contract has four characteristics: (1) the transaction must be an investment; (2) the investment must be in a common enterprise; (3) the common enterprise must result in profits; and (4) the profits must accrue solely from the efforts of others.³⁵ *Howey* thus promulgated a flexible and objective test for identifying investment contracts, "affording broad protection to investors . . . [un]thwarted by unrealistic and irrelevant formulae."³⁶

29. *Id.* at 349.

30. *Id.* at 352-53.

31. *Id.*

32. 328 U.S. 293 (1946).

33. *Id.* at 294-97.

34. *Id.* at 297, 300.

35. *Id.* at 301. "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* In slightly different language, the opinion also defined an investment contract as "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *Id.* at 298-99.

Many courts use the latter quotation in their opinions. *E.g.*, *Woodward v. Terracor*, 574 F.2d 1023, 1024 (10th Cir. 1978); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1277 (S.D.N.Y. 1978); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109 (D. Colo. 1976); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1049 (S.D.N.Y. 1975); *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 178 (N.D. Cal. 1975); *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022 (D.C. Super. Ct. 1973). The Supreme Court, however, relies on the former quotation. *E.g.*, *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 558 (1979); *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975). This Note employs the former quotation.

36. 328 U.S. at 301.

In *United Housing Foundation, Inc. v. Forman*³⁷ and *International Brotherhood of Teamsters v. Daniel*,³⁸ the Supreme Court narrowed the scope of transactions that might be deemed "investment contracts" under the *Howey* test. *Forman* limited "profits" within the meaning of an investment contract to "either capital appreciation resulting from the development of the initial investment . . . or participation in earnings resulting from the use of investors' funds."³⁹ Because "neither of the kinds of profits traditionally associated with securities was offered to respondents," the shares of "stock" purchased from petitioner did not constitute "securities" under the Securities Acts.⁴⁰ The *Forman* Court also held that the "stock" purchased by respondents did not constitute an investment contract because respondents intended to acquire subsidized, low-cost housing through their purchases, not to make a profit.⁴¹

The Court in *Daniel* followed the *Forman* lead in these two respects. Even if pension benefits could be described properly as "profits" returned on an employee's investment in a *noncontributory*, compulsory pension plan, they would depend not on the success of an investment, but on the employee's ability to meet the vesting requirements. Thus, any "profits" would not accrue solely from the efforts of others.⁴² *Daniel* also relied on the subjective intention of the investor for identifying securities.⁴³ Because the pension plan was a relatively insignifi-

37. 421 U.S. 837 (1975). Comments on *Forman* appear at: 1975 B.Y.U.L. REV. 849; 26 CASE W. RES. L. REV. 735 (1976); 1 J. CORP. L. 639 (1976); 9 LOY. L.A.L. REV. 206 (1975); 22 N.Y.L. SCH. L. REV. 132 (1976); 12 URB. L. ANN. 277 (1976).

38. 439 U.S. 551 (1979).

39. 421 U.S. at 852.

40. *Id.* at 854.

41. *Id.* at 853, 858-60.

42. 439 U.S. at 561-62.

43. The subjective approach undermines the reliability of *Howey* or any other objective formula for identifying securities. Professor Coffey advocates the use of an objective test for another reason. An objective test should comprise the economic characteristics of securities that create the need for special fraud remedies. That test should then apply to all alleged securities. Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. RES. L. REV. 367, 403-04 (1967).

Another commentator anticipated the subjective analysis that the Court soon adopted:

It is interesting that in more than 60 years of securities regulation in this country, we still have no clearly accepted definition of a security. In this regard we are somewhat in the same position as some of the members of the United States Supreme Court when dealing with obscenity: We can generally tell a security when we see one, on a case by case basis, but have been unwilling to attempt to give a generic definition to the term.

Long, *Interpreting the Statutory Definition of a Security: Some Pragmatic Considerations—Intro-*

cant part of an indivisible compensation package, an employee could not perceive the plan—particularly a noncontributory, compulsory plan—as an investment for the future.⁴⁴

Despite these Court-imposed restrictions on *Howey* and the criticisms by commentators⁴⁵ of that case, the *Howey* test remains the starting point for identification of investment contracts.⁴⁶ An explicit variation from *Howey* replaces the “solely from the efforts of others”⁴⁷ element with a less-stringent requirement. Seeking to preserve the antifraud statutes’ broad remedial purposes and flexibility,⁴⁸ the Ninth Circuit in *SEC v. Glenn W. Turner Enterprises, Inc.*⁴⁹ stated a new test: “whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.”⁵⁰ Most circuits have followed the Ninth Circuit’s lead.⁵¹

Fulfilling the statutes’ remedial purposes and keeping the statutes flexible enough to meet the imaginative schemes of fraudulent dealers are decisive issues in courts’ identification of securities.⁵² Many courts

duction, 6 ST. MARY’S L.J. 96, 96 (1974); *cf.* *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (regarding hard-core pornography: “I know it when I see it”).

44. 439 U.S. at 560.

45. One writer urged the abandonment of *Howey* and suggested that the *Howey* opinion allows this change. Long, *supra* note 2, at 177 & n.177. He quotes from *Howey*: “The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae.” 328 U.S. at 301. *See also Securities Regulation*, 1974 WASH. U.L.Q. 815, 815; 26 CASE W. RES. L. REV. 735, 748-49 (1976).

46. *See International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 558 (1979).

47. *See* note 35 *supra* and accompanying text.

48. *See* notes 12, 20-22, 36 *supra* and accompanying text.

49. 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973).

50. *Id.* at 482.

We hold, however, that in light of the remedial nature of the legislation, the statutory policy of affording broad protection to the public, and the Supreme Court’s admonitions that the definition of securities should be a flexible one, the word “solely” should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities.

Id. *See also* *Hector v. Wiens*, 533 F.2d 429 (9th Cir. 1976) (reaffirming the *Turner* test). For a brief description of *Turner* and related theories, see Newton, *supra* note 2, at 192-95.

51. *See* *Fargo Partners v. Dain Corp.*, 540 F.2d 912, 914-15 (8th Cir. 1976); *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975) (“it has been widely held that this reliance of the investor on the promoter need not be total”); *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 477-78 (5th Cir. 1974); *Lino v. City Investing Co.*, 487 F.2d 689, 692-93 (3d Cir. 1973). The Supreme Court has expressly reserved judgment on the *Turner* test. *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 852 n.16 (1975).

52. *See Securities Regulation*, *supra* note 45, at 815-16. *But see* *Timmreck v. Munn*, 433 F.

find innovative means of satisfying some *Howey* elements when the need to apply securities regulations arises.⁵³ Despite that flexibility, ordinary sales of land generally do not involve sales of securities.⁵⁴ Few litigants characterize land as a security,⁵⁵ and the facts of a land transaction rarely satisfy any of the *Howey* elements.⁵⁶ One court acknowledged, however, that “[a]t a certain point, a simple real estate transaction may be metamorphosed into an ‘investment contract.’”⁵⁷ Although the Supreme Court’s definition of “investment contract” is elaborate, the point at which a transaction can become a security re-

Supp. 396, 399-401 (N.D. Ill. 1977) (the securities laws must be flexible, but they should not be a “catch-all”).

53. See notes 47-51 *supra* and accompanying text. Many state courts rely on *Howey* when construing state securities regulation statutes. An important variation of *Howey* in some states is the “risk capital” theory, which allows courts to find a security if the investor risks part of the capital needed to develop the enterprise. The leading “risk capital” cases include *Silver Hills Country Club v. Sobieski*, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961); *State v. Hawaii Mkt. Center, Inc.*, 52 Hawaii 642, 485 P.2d 105 (1971). Professor Coffey developed an elaborate “security” definition incorporating the “risk capital” theory. Coffey, *supra* note 43, at 377. See generally Newton, *supra* note 2, at 195-98 (brief description of “risk capital” theory). No court has applied “risk capital” to analysis under federal securities regulations. See *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 857 n.24 (1975); *Bitter v. Hoby’s Int’l, Inc.*, 498 F.2d 183, 185 (9th Cir. 1974); *Mr. Steak, Inc. v. River City Steak, Inc.*, 324 F. Supp. 640 (D. Colo. 1970), *aff’d*, 460 F.2d 666 (10th Cir. 1972). But see *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974) (may have adopted “risk capital”); Hunt, *Madame El Khadem, the Ninth Circuit, and the Risk Capital Approach*, 57 OR. L. REV. 3, 5, 11 (1977) (six states in Ninth Circuit have adopted “risk capital”; *El Khadem* “possibly” adopted it); Note, *Shares in Privately Financed Cooperative Apartment Corporations and the Federal Securities Law after Grenader v. Spitz*, 30 RUTGERS L. REV. 432, 450-51 (1977).

54. See note 4 *supra*.

55. See *United Sportfishers v. Buffo*, 396 F. Supp. 310 (S.D. Cal. 1975); *Contract Buyers League v. F & F Inv.*, 300 F. Supp. 210 (N.D. Ill. 1969), *aff’d sub nom. Baker v. F & F Inv.*, 420 F.2d 1191 (7th Cir. 1970). See also *Prohaska v. Hemmer-Miller Dev. Co.*, 256 Ill. App. 331 (1930); *Great W. Campers Ass’n*, [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,386 (Aug. 13, 1971) (SEC No-Action Letter).

56. See note 35 *supra*. In *United Sportfishers v. Buffo*, 396 F. Supp. 310 (S.D. Cal. 1975), the court held that the parties to the land transaction did not enter a common enterprise, that the seller did not provide essential managerial efforts affecting the transaction’s value, and that Congress did not intend to bring commercial real estate transactions within the scope of securities regulation protection. *Id.* at 314.

In *Contract Buyers League v. F & F Inv.*, 300 F. Supp. 210 (N.D. Ill. 1969), *aff’d sub nom. Baker v. F & F Inv.*, 420 F.2d 1191 (7th Cir. 1970), the court held that the sellers did not control the property, that eventual capital gains were not “profits”, that Congress did not intend to apply securities regulations to installment contract land sales, and that even if securities regulations applied, the statutes could not remedy any of the buyers’ allegations. *Id.* at 224-25.

57. *United Sportfishers v. Buffo*, 396 F. Supp. 310, 313. (S.D. Cal. 1975).

mains unclear. The cases applying that definition to sales of subdivision lots illustrate the definition's complexity.

II. SALES OF LOTS IN RESIDENTIAL SUBDIVISIONS

Some buyers of subdivision lots have argued in recent years⁵⁸ that their land purchases were sales of securities.⁵⁹ Eleven cases have analyzed the argument under the federal statutes,⁶⁰ and the courts have split on the issue. Only one case held that the sale involved a security,⁶¹ four cases held to the contrary,⁶² and the remaining six cases did not decide the issue, but left open the possibility for future litigation.⁶³ Most of the opinions began with the four-element *Howey* framework of analysis for identifying an "investment contract."⁶⁴

58. The first case on point was litigated in 1973. See note 5 *supra*. The subdivision cases arise in the wake of increased investment by blue-collar and lower and middle income white-collar workers after the Second World War. Long, *supra* note 2, at 135.

59. A few commentators speculated before the first case on point that sales of undeveloped subdivision lots could be securities. Coffey & Welch, *supra* note 24, at 12; Greenwood, *supra* note 24, at 73; Morris, *supra* note 7, at 335-36; Note, *Regulating the Subdivided Land Market*, 81 HARV. L. REV. 1528, 1538 (1968). One article studied the possibility following the first case on point. Hannan & Thomas, *supra* note 2, at 274-77. A student Comment analyzed some of the earliest cases on point. Comment, *Recreational Land Subdivisions as Investment Contract Securities*, 13 HOUS. L. REV. 153 (1975).

60. See note 5 *supra*.

61. See *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022 (D.C. Super. Ct. 1973).

62. See *Woodward v. Terracor*, 574 F.2d 1023 (10th Cir. 1978); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045 (S.D.N.Y. 1975); *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175 (N.D. Cal. 1975); *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131 (N.D. Ill. June 27, 1974).

63. These cases denied the defendants' motions either for summary judgment or to dismiss the plaintiffs' complaints: *McCown v. Heidler*, 527 F.2d 204 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109 (D. Colo. 1976); *Hester v. Hidden Valley Lakes, Inc.*, 404 F. Supp. 580 (N.D. Miss. 1975); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 384 N.E.2d 981 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

64. See *Woodward v. Terracor*, 574 F.2d 1023, 1024 (10th Cir. 1978); *McCown v. Heidler*, 527 F.2d 204, 208 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1277 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 400 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,988 (D. Colo. 1976); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1049 (S.D.N.Y. 1975); *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 178 (N.D. Cal. 1975); *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131, slip op. at 3 (N.D. Ill. June 27, 1974); *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022, at 94,104 (D.C. Super. Ct. 1973); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 691, 384 N.E.2d 981, 984 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

A. *Investment*

The first element of the *Howey* test⁶⁵ requires a finding that the purchaser of a subdivision lot made an "investment."⁶⁶ Although the purchaser of stock clearly intends to make an investment, the buyer of residential property may be seeking only a residence.⁶⁷ The distinction between these transactions is the commercial-investment dichotomy.⁶⁸ A commercial transaction cannot involve a security, but an investment can. Two criteria in the residential subdivision cases determine whether the sale is on the "investment" or the "commercial" side of the dichotomy: the buyer's motive for purchasing the land and the seller's emphasis when promoting the subdivision.⁶⁹

The "investment" criteria appear in most of the subdivision lot cases. Six of the eleven subdivision cases used both criteria.⁷⁰ One case examined only the buyer's motive,⁷¹ and one case relied solely on the promoter's emphasis.⁷² These analyses conform to Supreme Court holdings. The *Joiner*⁷³ Court held that "it is not inappropriate that promoters' offerings be judged as being what they were represented to be."⁷⁴ The subdivision cases accordingly examined the actions of sellers to determine whether they promoted the lots as investments or as places of residence for buyers.⁷⁵ Courts can satisfy the first element of

65. See note 35 *supra* and accompanying text.

66. *Id.*

67. *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 852-53 (1975); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 300 (1946); *Timmreck v. Munn*, 433 F. Supp. 396, 402 (N.D. Ill. 1977).

68. The commercial-investment dichotomy developed in cases that decided whether certain notes were securities. See *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1138 (2d Cir. 1976); *Emisco Indus., Inc. v. Pro's Inc.*, 543 F.2d 38, 40 (7th Cir. 1976); *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1359-62 (7th Cir. 1975); *McClure v. First Nat'l Bank*, 497 F.2d 490, 494-95 (5th Cir. 1974).

69. See notes 70-92 *infra* and accompanying text.

70. See *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1277 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 400-02 (N.D. Ill. 1977); *Hester v. Hidden Valley Lakes, Inc.*, 404 F. Supp. 580, 584 (N.D. Miss. 1975); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1049-50 (S.D.N.Y. 1975); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 692-93, 384 N.E.2d 981, 984-85 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

71. See *Woodward v. Terracor*, 574 F.2d 1023, 1025 (10th Cir. 1978).

72. See *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022, at 94,102 (D.C. Super. Ct. 1973).

73. *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). See notes 25-30 *supra* and accompanying text.

74. 320 U.S. at 353. See note 30 *supra* and accompanying text.

75. See notes 69-72 *supra* and accompanying text.

Howey if they find that the sellers represented the land as an investment.

Courts use a variety of evidence to decide whether the promoter emphasized "investment" or "commercial" purposes in the sale of lots. They most frequently examine the seller's promotional materials: brochures,⁷⁶ advertisements,⁷⁷ and other literature.⁷⁸ Courts, however, have found "investment" or "commercial" emphasis in seminars for sellers⁷⁹ or the public,⁸⁰ instructions to salesmen,⁸¹ maps,⁸² oral representations to buyers,⁸³ and even a General Form for Registration of Securities filed with the SEC.⁸⁴ Most courts consider the seller's emphasis in conjunction with the buyer's motive for purchasing the land.⁸⁵ That motive also can be "investment" or "commercial."

Analysis of the buyer's motive is compatible with Supreme Court holdings. The Court, in its "subjective" approach,⁸⁶ did not find a se-

76. See *McCown v. Heidler*, 527 F.2d 204, 210 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 400-01 (N.D. Ill. 1977); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1049 (S.D.N.Y. 1975).

77. See *McCown v. Heidler*, 527 F.2d 204, 210 (10th Cir. 1975); *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022, at 94,102 (D.C. Super. Ct. 1973); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 692-93, 384 N.E.2d 981, 984-85 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

78. See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 400-01 (N.D. Ill. 1977); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1049 (S.D.N.Y. 1975); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 692-93, 384 N.E.2d 981, 984-85 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

79. See *McCown v. Heidler*, 527 F.2d 204, 209-10 (10th Cir. 1975).

80. *Id.* at 210. See *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022, at 94,102 (D.C. Super. Ct. 1973).

81. See *McCown v. Heidler*, 527 F.2d 204, 210 (10th Cir. 1975).

82. See *Timmreck v. Munn*, 433 F. Supp. 396, 400-01 (N.D. Ill. 1977).

83. See *id.* The contracts for sales of the lots, however, disclaimed any representations or warranties not in the contracts. *Id.* at 400. The *Timmreck* court concluded: "Possibly such a clause might be enforceable under contract law despite its clear nature as an adhesion clause. But this language must be disregarded for securities law analysis. This is particularly true where the boilerplate is likely to prove palpably false." *Id.* at 401. The *Timmreck* court found through its own investigation that the contract for the sale of property in *McCown* contained a clause disclaiming any "understanding or agreement between the parties except as expressly set forth or made a part hereof." *Id.* at 401 & n.1. That clause, however, was not at issue in *McCown*. *Contra*, *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131, slip op. at 4 (N.D. Ill. June 27, 1974): "Alleged oral misrepresentations cannot transform a document into a security to bring it within the jurisdiction of this court if the document itself does not satisfy the definition of the statute and the case law."

84. See *McCown v. Heidler*, 527 F.2d 204, 210 (10th Cir. 1975).

85. See note 70 *supra* and accompanying text.

86. See note 43 *supra* and accompanying text.

curity in *Forman*⁸⁷ or *Daniel*⁸⁸ because the litigants did not view their transactions as purchases of securities.⁸⁹ By examining the buyer's motive, lower courts in the subdivision cases adhere to the *Forman-Daniel* subjective approach. The general rule characterizes the motive as investment-oriented if the buyer claims to have purchased the lots as investments rather than as places of residence.⁹⁰ A few courts look to other evidence of the buyer's investment motives, including the seller's promotional materials⁹¹ and whether the buyer paid more than the land's market value.⁹²

Subjective analysis can create inconsistencies in securities analysis. If two parties purchase identical lots under identical terms, but only one buyer perceives the purchase as an investment, only that buyer may have a cause of action under the securities statutes. *McCown v. Heidler*⁹³ demonstrates the inconsistency. Many buyers in *McCown* had an investment motive, because 108 of the 262 lot owners in the subdivision did not expect to reside on their lots.⁹⁴ Some buyers, therefore, had fulfilled the "investment" element of *Howey*; "[t]hat other lot purchasers may be interested solely in obtaining a site on which to build their home merely indicates the duality of this 'investment/ownership package.'"⁹⁵

87. *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

88. *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551 (1979).

89. See notes 37-44 *supra* and accompanying text.

90. See *Woodward v. Terracor*, 574 F.2d 1023, 1025 (10th Cir. 1978); *McCown v. Heidler*, 527 F.2d 204, 210-11 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1277 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 402 (N.D. Ill. 1977); *Hester v. Hidden Valley Estates, Inc.*, 404 F. Supp. 580, 584 (N.D. Miss. 1975); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1049 (S.D.N.Y. 1975); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 692-93, 384 N.E.2d 981, 984-85 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

91. See *Timmreck v. Munn*, 433 F. Supp. 396, 402-03 (N.D. Ill. 1977); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1049-50 (S.D.N.Y. 1975). See generally 9 *Loy. L.A.L. Rev.* 206, 221 n.62 (1975) (regarding *Davis*: "the court also emphasized the importance of the promoters' advertising brochures as the primary indication of the purchaser's intent").

92. See *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975); *Timmreck v. Munn*, 433 F. Supp. 396, 403-04 (N.D. Ill. 1977).

93. 527 F.2d 204 (10th Cir. 1975).

94. *Id.* at 210.

95. *Id.* at 211. One commentator observed:

The *McCown* court apparently subscribes to the notion that a dual motivation of consumption and profit expectation does not preclude the existence of a security. Considering that the criteria for gauging the existence of a security are the terms of the offer in light of the investor's reasonable expectations of profit, a bifurcation of the *McCown* transaction to hold that some investors purchased a security would be inappropriate.

Newton, *supra* note 2, at 189 n.147 (emphasis in original) (citations omitted).

After deciding whether the promoter's emphasis and the buyer's motive have an "investment" or "commercial" character, courts examine both of these factors in conjunction with one another.⁹⁶ Plaintiffs can easily establish the "investment" element if the buyer and seller are on the investment side of the commercial-investment dichotomy, but if either party commingles "commercial" and "investment" reasons for executing the sale, proof is more difficult. If the transaction contains features on both sides of the dichotomy, the predominant side controls.⁹⁷ If litigants cannot prove that the sale's character is predominately "investment" or "commercial," the general rule that real estate is not a security⁹⁸ may compel courts to rule against plaintiffs' securities claims.

Despite the inconsistencies⁹⁹ and complexities¹⁰⁰ in analyzing the buyer's motive and the seller's emphasis, these tests isolate proper conditions for identifying securities. Security owners use securities primarily to generate income.¹⁰¹ The lot owner seeking only an investment uses the land primarily for income purposes; thus, the land is similar to a security. The owner residing on the lot uses that alleged security for a principal purpose other than income generation; the property, there-

96. See notes 69, 85 *supra* and accompanying text.

97. See *Timmreck v. Munn*, 433 F. Supp. 396, 403 n.4 (N.D. Ill. 1977); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1049 (S.D.N.Y. 1975). Only *Timmreck* and *Davis* allude to the "predominant" test; neither case clearly states the rule. The buyers in *Timmreck* argued that they intended to make an investment, but the court held that "[o]ther factors, such as any emphasis given to Candlewick [the subdivision] as a desirable place for the purchasers to spend *their* time, of course, may counterbalance such representations." 433 F. Supp. at 403 n.4 (emphasis in original). The buyers in *Davis* argued that the seller emphasized an investment, and the sellers argued that they advertised only residential property. The court examined the promotional literature and concluded that, "[a]lthough the two themes are interwoven throughout the brochures, defendants' promotional materials, fairly read, place more emphasis on development of a residential community than on purchase as an investment." 401 F. Supp. at 1049.

But see *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 560 (1979) ("Even in those cases where the interest acquired had intermingled security and non-security aspects, the interest obtained had 'to a very substantial degree elements of investment contracts. . . .'"); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 91 (1959) (Brennan, J., concurring) ("while these contracts contain insurance features, they contain to a very substantial degree elements of investment contracts").

98. See note 4 *supra* and accompanying text.

99. See notes 93-95 *supra* and accompanying text.

100. *Contra*, Comment, *supra* note 59, at 164 ("The *Howey* test's first requirement of an investment of money requires almost no comment. . . . By whatever means the lots are sold, there is always present the element of an investment of money.").

101. See generally H. HENN, *HANDBOOK OF THE LAW OF CORPORATIONS* § 157 (2d ed. 1970); 18 C.J.S. *Corporations* § 194 (1939).

fore, is not like a security.¹⁰² The buyer's intentions alone, however, should not render the seller liable under securities regulations. If the seller emphasizes a sale with all the characteristics of a security, the seller can reasonably expect to incur—and should incur—extraordinary liabilities.¹⁰³

B. *Common Enterprise*

If the buyer has made an investment,¹⁰⁴ the *Howey* test requires the buyer to make the investment in a common enterprise.¹⁰⁵ Courts that explicitly find a common enterprise under *Howey* usually confront one of two situations: a pooling of funds provided by investors,¹⁰⁶ or investors' dependence on promoters for the success of the common enterprise.¹⁰⁷ Seven¹⁰⁸ of the eleven subdivision cases¹⁰⁹ analyzed the "common enterprise" component of *Howey* in terms of these two situations.

Of the four cases that used the pooling concept,¹¹⁰ three cases found

102. The Supreme Court has held that the owner's perception of the alleged security is relevant to the definitional analysis. See notes 37-44 *supra* and accompanying text.

103. The Supreme Court has held that the seller's characterization of the alleged security is relevant to the definitional analysis. See notes 26-30 *supra* and accompanying text.

104. See notes 65-103 *supra* and accompanying text.

105. See note 35 *supra* and accompanying text.

106. See *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 100 (7th Cir. 1977) (common enterprise comprises multiple investors and pooling of funds); *Milnark v. M-S Commodities, Inc.*, 457 F.2d 274, 278 (7th Cir. 1972) ("pooling of funds for a common purpose"). *But see* *SEC v. Continental Commodities Corp.*, 497 F.2d 516, 522 (5th Cir. 1974) (pooling is not essential).

107. See *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 478-79 (5th Cir. 1974); *Glen-Arden Commodities v. Costantino*, 493 F.2d 1027, 1034-35 (2d Cir. 1974); *Continental Marketing Corp. v. SEC*, 387 F.2d 466, 470 (10th Cir. 1967), *cert. denied*, 391 U.S. 905 (1968); *Los Angeles Trust Deed & Mortgage Exch. v. SEC*, 285 F.2d 162, 168 (9th Cir.), *cert. denied*, 366 U.S. 919 (1961); *Marshall v. Lamson Bros. & Co.*, 368 F. Supp. 486, 489 (S.D. Iowa 1974); *Mitzer v. Cardet Int'l, Inc.*, 358 F. Supp. 1262, 1264 (N.D. Ill. 1973). See also *Newton, supra* note 2, at 176-81 (agency theory analogy).

108. *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 403-04 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,998-99 (D. Colo. 1976); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975); *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131, slip op. at 3-4 (N.D. Ill. June 27, 1974); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 693, 384 N.E.2d 981, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

109. See note 5 *supra*.

110. See *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975); *Timmreck v. Munn*, 433 F. Supp. 396, 403-04 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,998-99 (D. Colo. 1976); *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131, slip op. at 3-4 (N.D. Ill. June 27, 1974).

a pool of funds equivalent to the price paid for the property less its fair market value at the time of sale.¹¹¹ Because the developers were to use the excess cost to improve the subdivision,¹¹² the "utilization of purchase money accumulated . . . [brought] the scheme within the 'common enterprise' definition."¹¹³

The fourth pooling case, *Bubula v. Grand Bahama Development Co.*,¹¹⁴ involved a clear example of pooling. The purchase agreement in *Bubula* required lot owners to pay "a relatively small annual 'service' charge" for ninety-nine years to finance improvements.¹¹⁵ The court, however, did not find a common enterprise.¹¹⁶ The court's refusal to find a common enterprise from this obvious form of pooling is unusual in view of the less-obvious pooling in the other cases.¹¹⁷ Moreover, an Illinois appellate court, in *Anderson v. Grand Bahama Development Co.*,¹¹⁸ had little difficulty finding a common enterprise in a case "arising out of the same facts" as *Bubula*,¹¹⁹ although it used the dependency concept¹²⁰ to find a common enterprise.¹²¹

Three subdivision lot cases, including *Anderson*, employed the dependency concept in common enterprise analyses.¹²² The dependency theory requires that the developer be obligated to improve the area after the sale of lots and that the buyers actually depend on the devel-

111. See *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975); *Timmreck v. Munn*, 433 F. Supp. 396, 403-04 (S.D.N.Y. 1978); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,998-99 (D. Colo. 1976).

112. See *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975); *Timmreck v. Munn*, 433 F. Supp. 396, 403-04 (S.D.N.Y. 1978); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,998-99 (D. Colo. 1976).

113. *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975). The same language appears in *Timmreck v. Munn*, 433 F. Supp. 396, 403-04 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 99,998-99 (D. Colo. 1976).

114. No. 73 C 3131 (N.D. Ill. June 27, 1974).

115. *Id.*, slip op. at 3-4. The court dismissed the contention that this case involved a common enterprise on the unsound reasoning that the service-charge requirement "does not give the purchasers any interest in property other than their own lots and does not provide them with the chance of future profits 'solely from the efforts of the promoter or a third party.'" *Id.*

116. *Id.*, slip op. at 3.

117. See notes 111-13 *supra* and accompanying text.

118. 67 Ill. App. 3d 687, 384 N.E.2d 981 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

119. *Id.* at 692, 384 N.E.2d at 984.

120. See note 107 *supra* and accompanying text.

121. "[Plaintiffs'] fortunes are interwoven with and dependent upon the efforts of defendants." 67 Ill. App. 3d at 693, 384 N.E.2d at 985.

122. See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (S.D.N.Y. 1978); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 693, 384 N.E.2d 981, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

oper's fulfillment of those obligations for a successful investment.¹²³ The seller's obligations can be part of an express¹²⁴ or implied contract,¹²⁵ but courts are also willing to find the obligations in implied or oral representations.¹²⁶

C. Profits

The "profits" component of the *Howey* test¹²⁷ is the most difficult of the four elements to define. *Forman*¹²⁸ narrowly defines profits as capital appreciation from the initial investment or receipt of earnings from investors' funds.¹²⁹ *Forman* adds that the prospect of receiving the "profits" must attract the investor.¹³⁰

123. See notes 107, 122 *supra*.

124. See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (10th Cir. 1978); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 693, 384 N.E.2d 981, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

125. See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (10th Cir. 1978); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 693, 384 N.E.2d 981, 985 (1978). *But see* *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975) (court apparently requires written contracts).

126. See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1277-78 (10th Cir. 1978) (investment issue cannot be decided without first considering promotional representations); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 693, 384 N.E.2d 981, 985 (1978) (obligations of developer found in seller's "promotional materials and utterances"), *cert. denied*, 100 S. Ct. 272 (1979). *But see* *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975) (court apparently requires written contracts).

127. See note 35 *supra* and accompanying text.

128. *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

129. *Id.* at 852. *Forman* states further that any "capital appreciation" must be similar to the profits in *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943), in which the investors' funds were used to finance the promoter's plans; moreover, any "participation in earnings" must be similar to the profits in *Tcherepnin v. Knight*, 389 U.S. 332 (1967), in which dividends were based on the promoter's profits. See notes 26-30 *supra* and accompanying text. The *Forman* Court implied that capital appreciation incurred on the same parcel of residential real estate could be "profits," but that state law prohibited gains on the sale of the cooperative housing in question. 421 U.S. at 854.

Happy Inv. Group v. Lakeworld Properties, Inc., 396 F. Supp. 175 (N.D. Cal. 1975), held, only one month before the Supreme Court decided *Forman*, that capital gains from sales of subdivision lots are not "profits," because "at no time until sale of the land will plaintiffs realize any actual monetary profit." *Id.* at 180 (emphasis in original). *Happy* distinguished those "profits" from the annual payments in *Howey*, the tenants' possible rent reductions in *1050 Tenants Corp. v. Jakobson*, 503 F.2d 1375 (2d Cir. 1974), and the landlord's possible rent increases in *Huberman v. Denny's Restaurants, Inc.*, 337 F. Supp. 1249 (N.D. Cal. 1972). 396 F. Supp. at 180. See *Timreck v. Munn*, 433 F. Supp. 396, 402 n.3 (N.D. Ill. 1977); 9 *Loy. L.A.L. Rev.* 206, 221 n.62 (1975). *But see* *Grenader v. Spitz*, 537 F.2d 612, 619 (2d Cir.), *cert. denied*, 429 U.S. 1009 (1976) (overruling *Jakobson*).

130. "[T]he investor is 'attracted solely by the prospects of a return' on his investment." 421

Eight¹³¹ of the eleven subdivision cases¹³² analyzed "profits." The alleged profit in each case was increased land values resulting from the seller's improvements in the subdivision,¹³³ but only one of these cases explicitly held that the capital appreciation could constitute "profits."¹³⁴ The remaining cases examined the alleged profits in the context of other *Howey*-test elements, and held that capital appreciation must come from either a common enterprise¹³⁵ or the efforts of others to be considered "profits."¹³⁶

The subdivision lot cases thus restrict severely the "profits" concept¹³⁷ and fail to give "profits" an independent definition.¹³⁸ The courts' distinction between the capital appreciation of these lots and the capital appreciation that all real estate buyers expect to accrue appar-

U.S. at 852 (quoting *SEC v. W.J. Howey Co.*, 328 U.S. 293, 300 (1946)). Probably no court would strictly construe the word "solely" in this test. See notes 47-51 *supra* and accompanying text.

131. See *Woodward v. Terracor*, 574 F.2d 1023, 1026 (10th Cir. 1978); *McCown v. Heidler*, 527 F.2d 204, 209 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 400 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,998 (D. Colo. 1976); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975); *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131, slip op. at 4-5 (N.D. Ill. June 27, 1974); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 694, 384 N.E.2d 981, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

132. See note 5 *supra*.

133. See note 131 *supra*.

134. See *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 694, 384 N.E.2d 981, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

135. See *Woodward v. Terracor*, 574 F.2d 1023, 1026 (10th Cir. 1978); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975); *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131, slip op. at 3 (N.D. Ill. June 27, 1974). *Bubula* required the capital appreciation to result from an undefined type of common enterprise:

We do not doubt that they were led to expect that their investment could appreciate in value and that much of this would be due to the efforts of the developers (using plaintiffs' money to some extent). However, this is a far cry from a common enterprise in the sense of *Securities & Exchange Commission v. Glen [sic] W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973) . . .

Id. at 4-5 (citations omitted).

136. See *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 400 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,998-99 (D. Colo. 1976). Plaintiffs in *McCown*, *Timmreck*, and *Miller* alleged that the price paid for the land exceeded the property's market value. The alleged "profits" in each case were increases in land values until the market value equaled the price paid. These "profits" exceed normal real estate appreciation and could result only from the efforts of the promoters. *McCown v. Heidler*, 527 F.2d at 209, 211; *Timmreck v. Munn*, 433 F. Supp. at 400, 403; *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,998-99.

137. See notes 128-30 *supra* and accompanying text.

138. See notes 135-36 *supra* and accompanying text.

ently represents an attempt to obstruct every possibility that ordinary real estate sales can be metamorphosed into sales of securities.¹³⁹ Analysis of "profits" only in the context of the other *Howey*-test elements,¹⁴⁰ however, prevents a systematic application of the standard to the facts of each case.

D. *Solely from the Efforts of Others*

Howey requires that profits from a security result "solely from the efforts of others."¹⁴¹ Despite that stringent language, lower courts demand only that the promoter's efforts be the "undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."¹⁴² Many of the residential subdivision cases measure the seller's obligations against this more lenient standard¹⁴³ set forth in *SEC v. Glenn W. Turner Enterprises, Inc.*¹⁴⁴ These obligations range from routine improvements such as roads and sewers to construction of extraordinary facilities such as golf courses and lakes.¹⁴⁵

139. These courts may also be avoiding the difficulty of identifying and evaluating the varieties of capital appreciation. These varieties include: normal appreciation of most real estate; appreciation resulting from improvements in the subdivision; and appreciation resulting from the improvement of neighboring property. See Opinion of the Attorney General of Hawaii, [1961-1971 Transfer Binder] BLUE SKY L. REP. (CCH) ¶ 70,882 (Oct. 15, 1970).

140. See notes 135-36 *supra* and accompanying text.

141. See note 35 *supra* and accompanying text.

142. See note 50 *supra* and accompanying text.

143. See *Woodward v. Terracor*, 574 F.2d 1023, 1025 (10th Cir. 1978); *McCown v. Heidler*, 527 F.2d 204, 211 (10th Cir. 1975); *Timmreck v. Munn*, 433 F. Supp. 396, 404 n.5 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,999 (D. Colo. 1976); *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 178 (N.D. Cal. 1975).

144. 474 F.2d 476, 482 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). See notes 51-55 *supra* and accompanying text.

145. See *Woodward v. Terracor*, 574 F.2d 1023, 1025 (10th Cir. 1978) ("shopping centers, health and cultural facilities, transportation facilities, and abundant recreational opportunity, including a golf course and lake"); *McCown v. Heidler*, 527 F.2d 204, 209 (10th Cir. 1975) ("country club, an 18-hole championship golf course, stables, equestrian center, tennis courts, clubhouses and swimming pools"); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1272 (S.D.N.Y. 1978) ("swimming and other recreational facilities and provide paved roads and bus service"); *Timmreck v. Munn*, 433 F. Supp. 396, 403 n.4 (N.D. Ill. 1977) ("snowmobile trails, four sand beaches, . . . Olympic size swimming pool"); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,997 (D. Colo. 1976) ("publication of a newspaper for property owners; availability of ski, golf, boat, tennis and similar facilities for property owners; construction . . . of the base lodge, a country club, and a proposed lake, gas and telephone services; and construction and maintenance of roads"); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975) ("roads and other improvements"); *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 179 (N.D. Cal. 1975) ("roads and utilities"); *Bubula*

In their analyses of the promoters' efforts, the subdivision cases¹⁴⁶ examined either the extent of the promoters' duties¹⁴⁷ or the impact of those duties on land values.¹⁴⁸ Cases reviewing the extent of the promoter's efforts¹⁴⁹ establish a general rule that the promoters' duties must be more than "[m]inimal managerial services,"¹⁵⁰ and that "usual improvements, such as culinary water, underground sewage, curb, gutter, and the like" are not sufficient obligations to meet this element of the *Howey* test.¹⁵¹ The developers' efforts must be "undeniably significant" or "essential" to fulfill the *Turner*¹⁵² modification of *Howey*. The test is easily satisfied when the promoter has the exclusive right to develop the subdivision.¹⁵³

The second method of fulfilling the *Howey* test's fourth element is to prove that the promoter's duties will increase land values.¹⁵⁴ Plaintiffs in nine¹⁵⁵ of the eleven subdivision cases¹⁵⁶ argued that the seller's obli-

v. Grand Bahama Dev. Co., No. 73 C 3131, slip op. at 3 (N.D. Ill. June 27, 1974) ("making and maintaining common utilities and other improvements"); *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022, at 94,102 (D.C. Super. Ct. 1973) ("utilities, roadways, recreational facilities, etc."); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 690, 384 N.E.2d 981, 983 (1978) ("construction of facilities desirable for a complete community, including roads, utilities, schools, recreational facilities, parks, greenways, churches, waterways, water reserves, beaches, marinas, golf courses, shopping complexes, and resort hotels"), *cert. denied*, 100 S. Ct. 272 (1979).

146. See note 5 *supra*.

147. See notes 149-58 *infra* and accompanying text.

148. See notes 154-58 *infra* and accompanying text.

149. *Woodward v. Terracor*, 574 F.2d 1023, 1025 (10th Cir. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 403 & n.4 (N.D. Ill. 1977); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 694, 384 N.E.2d 981, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

150. *Timmreck v. Munn*, 433 F. Supp. 396, 403 n.4 (N.D. Ill. 1977). *Timmreck* uses both means of analyzing the promoter's efforts. Those efforts must extensively develop and improve the subdivision, *id.* at 403, and "substantially increase the value of the individual lots," *id.* at 400. See notes 154-58 *infra* and accompanying text.

151. *Woodward v. Terracor*, 574 F.2d 1023, 1025 (10th Cir. 1978).

152. See notes 50-51, 141-44 *supra* and accompanying text.

153. See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (S.D.N.Y. 1978); *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022, at 94,105 (D.C. Super. Ct. 1973); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 690, 694, 384 N.E.2d 981, 983, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

154. See note 148 *supra* and accompanying text.

155. See *McCown v. Heidler*, 527 F.2d 204, 209 (10th Cir. 1975); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1278 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 400 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,998-99 (D. Colo. 1976); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1049 (S.D.N.Y. 1975); *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 180 (N.D.

gations to make improvements or to maintain the property were essential to create profits in the form of increased property values. The most successful argument arose when plaintiffs alleged that the price paid for the land exceeded the land's market value; thus, the promoters' efforts were essential to increase land values until the market value matched the price paid.¹⁵⁷ As long as the purchase price exceeded the market value, the buyers risked a loss. If the market value were at least as great as the purchase price, the investors could sell the land to recover their investment.¹⁵⁸

The cases reveal two means of establishing that the promoter should provide "essential" efforts,¹⁵⁹ but regardless of the means used, the plaintiff must show the source of the promoter's obligations. The general rule is that those duties must be contractual.¹⁶⁰ The purchaser's case is strongest when a written contract stipulates the duties,¹⁶¹ but some cases hold that implied offers¹⁶² or oral representations¹⁶³—or even "utterances"¹⁶⁴—may establish the promoter's responsibility.

Cal. 1975); *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131, slip op. at 5 (N.D. Ill. June 27, 1974); *Johnson v. Suburban Land Inv. Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,022, at 94,101 (D.C. Super. Ct. 1973); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 690-91, 694, 384 N.E.2d 981, 983, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

156. See note 5 *supra*.

157. See *McCown v. Heidler*, 527 F.2d 204, 209 (10th Cir. 1975); *Timmreck v. Munn*, 433 F. Supp. 396, 400 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96, 109, at 91,998-99 (D. Colo. 1976); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 690-91, 694, 384 N.E.2d 981, 983, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

158. The court in *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975), employed a peculiar requirement. The court held that the developer's obligations must result in a distribution of profits other than eventual capital appreciation. Most courts hold that capital appreciation is a proper manifestation of the developer's obligations. See, e.g., cases cited note 157 *supra*. One commentator observed that, "Though the analysis in *Davis* may be suspect, it is nevertheless possible that the court reached the correct result." Newton, *supra* note 2, at 190.

159. See notes 147-48 *supra* and accompanying text.

160. See *Woodward v. Terracor*, 574 F.2d 1023, 1025, 1027 (10th Cir. 1978); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975); *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 179 (N.D. Cal. 1975).

161. See *McCown v. Heidler*, 527 F.2d 204, 209 (10th Cir. 1975).

162. See *Timmreck v. Munn*, 433 F. Supp. 396, 403 (N.D. Ill. 1977). See also 1 L. Loss, *supra* note 2, at 491-92.

163. See *Timmreck v. Munn*, 433 F. Supp. 396, 400 (N.D. Ill. 1977); *Miller v. Woodmoor Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,109, at 91,997 (D. Colo. 1976); *Bubula v. Grand Bahama Dev. Co.*, No. 73 C 3131, slip op. at 4 (N.D. Ill. June 27, 1974); *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 692-93, 384 N.E.2d 981, 984-85 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

164. See *Anderson v. Grand Bahama Dev. Co.*, 67 Ill. App. 3d 687, 693, 384 N.E.2d 981, 985 (1978), *cert. denied*, 100 S. Ct. 272 (1979).

The seller's obligations must also be clear and certain.¹⁶⁵ *Happy Investment Group v. Lakeworld Properties, Inc.*¹⁶⁶ best illustrates this requirement. Defendants "offered no concrete programs" and "presented no substantive plans";¹⁶⁷ they only "created the *illusion* that the subdivision would develop primarily through their managerial efforts."¹⁶⁸ The court thus concluded that sales of these subdivision lots did not constitute sales of securities, because the seller had not made "actual commitments to perform specific services."¹⁶⁹

These cases reveal the complexity of the requirement that profits derive "solely from the efforts of others."¹⁷⁰ Nevertheless, they suggest three prerequisites: first, the promoter's duties must be more than "minimal," or they must increase property values;¹⁷¹ second, the duties generally must be contractual;¹⁷² and third, the developer's duties must be specific rather than general sales-talk promises.¹⁷³ Proving these points can satisfy the final element of the *Howey* definition of "investment contract."¹⁷⁴

165. See *Timmreck v. Munn*, 433 F. Supp. 396, 403 n.4 (N.D. Ill. 1977); *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 180-81 (N.D. Cal. 1975). See also *Newton*, *supra* note 2, at 189-90.

166. 396 F. Supp. 175 (N.D. Cal. 1975).

167. *Id.* at 180.

168. *Id.* at 181 (emphasis in original).

169. *Id.* at 180-81. "A court must distinguish between mere puffery, generalizations, and other talk designed to create an 'illusion' of extensive development plans, from cases where the real burden of development is not placed upon the purchasers." *Timmreck v. Munn*, 433 F. Supp. 396, 403 n.4 (N.D. Ill. 1977). See also *Newton*, *supra* note 2, at 189. "If the promoters in *McCown* had couched their sales literature and contractual arrangements in general terms rather than spelling out specific, concrete services to be provided, the existence of a security arguably could have been avoided." *Id.*

170. See note 35 *supra* and accompanying text.

171. See notes 147-58 *supra* and accompanying text.

172. See notes 160-64 *supra* and accompanying text.

173. See notes 165-69 *supra* and accompanying text.

174. See note 35 *supra* and accompanying text. Beyond disproving these three points, defendants may defend on two other grounds. First, although the developer may have "essential" duties, the purchaser's responsibilities for the development's success may greatly exceed the developer's obligations. See *Happy Inv. Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 181 (N.D. Cal. 1975). See also *Timmreck v. Munn*, 433 F. Supp. 396, 403 n.4 (N.D. Ill. 1977). Second, although the developer's representations and duties may be specific, the developer has not created a security if the representations are puffery. See *id.* See also *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975).

III. CONCLUSION: THE EMERGING FORMULA

Recurring throughout this analysis of the *Howey* test¹⁷⁵ is the predominant difficulty of separating the *Howey* elements to give them independent meaning.¹⁷⁶ The subdivision lot cases are not as clear and structured as a standard analysis can provide. Although most of the cases examined each *Howey* element, the specific grounds for the courts' decisions are often vague. Nevertheless, the consistency of methods among the cases establishes a formula for determining whether a lot is a security. The following paragraphs discern those methods of fulfilling each *Howey* component.

"Investment": The buyer's purposes and the seller's emphasis demonstrate whether the transaction has an "investment" or "commercial" character. If the transaction is on both sides of the commercial-investment dichotomy, the predominant character prevails.¹⁷⁷

"Common Enterprise": Either the pooling theory or the dependency theory of common enterprises is applicable to analyses of lot sales. Buyers must pool funds for improvements or depend on the developer's obligations for the subdivision's success.¹⁷⁸

"Profits": The buyer's profits can be anticipated capital appreciation, but the capital appreciation must generally result from the common enterprise or from the developer's efforts.¹⁷⁹

"Solely from the Efforts of Others": The promoter must assume definite obligations, as set forth in a contract with the purchaser or in representations made to the purchaser, to perform the undeniably essential managerial efforts that affect the failure or success of the enterprise or that are necessary to increase land values until the value equals the purchase price of the land.¹⁸⁰

The foregoing analysis serves four important purposes. First, it shows that many of the cases deal with consistent fact patterns. Second, it demonstrates that these facts permit a consistent analysis of the definitional issue. Third, it provides a framework for maintaining or

175. See note 35 *supra* and accompanying text.

176. For example, most opinions in the subdivision lots cases do not clearly separate the "profits" component from either the "common enterprise" component or the "solely from the efforts of others" component. See notes 127-40 *supra* and accompanying text.

177. See notes 65-103 *supra* and accompanying text.

178. See notes 104-26 *supra* and accompanying text.

179. See notes 129-32 *supra* and accompanying text.

180. See notes 141-74 *supra* and accompanying text.

enhancing consistent analyses in future judicial decisions. Last, it isolates those facts that future litigants must either prove or disprove in similar cases.

The securities statutes apply to sales of subdivision lots not only because the facts may satisfy the *Howey* test, but also because policy considerations create a need for protection through securities regulations.¹⁸¹ The buyer who never intends to live on the lot¹⁸² perceives little difference between owning the lot and owning stock in a corporation that intends to develop the subdivision. In either situation, the buyer entrusts the developer with the investment and profits only on the sale of lots following the completed improvements. Just as the shareholder receives either dividends after the developer sells lots or capital gains when the corporation repurchases stock with profits realized from selling lots, the lot purchaser realizes a gain on the sale of the lot.¹⁸³ The shares are securities,¹⁸⁴ and the developer should not be able to circumvent securities regulation by substituting lots for shares.¹⁸⁵

Securities regulations can reach sales of lots in residential subdivisions if the facts satisfy the requirements of the *Howey* test.¹⁸⁶ Imagi-

181. Courts frequently rely on policy considerations when deciding whether federal securities regulations apply to the subjects of law suits. See notes 20-22, 29, 52 *supra* and accompanying text.

182. See notes 86-103 *supra* and accompanying text.

183. The tax consequences of these alternative arrangements, however, can make an important difference to investors. Proceeds from sales of lots by lot owners, for example, generally are ordinary income for income tax purposes under I.R.C. § 61(a)(3), but the proceeds can receive favorable capital gains treatment if the owners hold the property for more than one year pursuant to I.R.C. §§ 1202, 1222(3), 1222(11). Dividends receive ordinary income treatment under I.R.C. § 61(a)(7) as do proceeds from stock redemptions under I.R.C. § 302(a), although redemption proceeds can receive capital gains treatment under circumstances specified in I.R.C. § 302(b). See generally B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS (4th ed. 1979). The Supreme Court in *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 855 (1975), implied that the tax advantages of investment plans are not relevant for identification of securities.

184. See note 17 *supra*.

185. See generally *Penfield Co. v. SEC*, 143 F.2d 746 (9th Cir.), cert. denied, 323 U.S. 768 (1944) (whiskey warehouse receipts as securities). The *Penfield* court held:

The term "investment contract" particularly, which appears in thirty of the state acts, has been construed in a long line of cases, both federal and state, as affording the investing public a full measure of protection, whether the transaction takes one of the more normal forms of a security or whether instead the promoter clothes it with the appearance of a transaction in some species of real or personal property.

Id. at 750.

186. See note 35 *supra* and accompanying text.

native sellers may find new land-sale schemes,¹⁸⁷ but flexible securities regulations can still encompass those transactions.¹⁸⁸ Although the Supreme Court is narrowing the “security” definition,¹⁸⁹ lower courts, while adhering to the Court’s decisions, continue to bring within the statutes’ scope new types of transactions for which securities regulation protection is needed.

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187. “For years the real estate industry has played host to some of the most outrageous charlatans in the annals of American swindling.” Hannan & Thomas, *supra* note 2, at 274. Despite innovations in sales arrangements, many basic aspects of subdivision lot sales will continue. For an outline of real estate sales techniques and development activities that the federal government should regulate, see Case & Jester, *supra* note 7, at 401-06.

188. See notes 61, 63 *supra* and accompanying text.

189. See notes 37-43 *supra* and accompanying text.

