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COMMENT

HOCKING V. DUBOIS: APPLYING THE SECURITIES LAWS TO CONDOMINIUM REALES

INTRODUCTION

Investing in non-owner occupied condominiums¹ has become increasingly popular, in part because of the expanded use² of rental pooling arrangements ("RPA").³ Typically, a real estate developer sells both the condominium and the RPA to a buyer.⁴ Because this arrangement has certain investment characteristics,⁵ it is generally considered to be the sale of a security,⁶ and therefore subject to the strict disclosure requirements of the federal securities laws.

In *Hocking v. Dubois*,⁷ the Court of Appeals for the Ninth Circuit extended this reasoning. *Hocking* held that a condominium resale coupled with the sale of an RPA from an independent third party may⁸ constitute the sale of a security if a realtor presents the arrangement to a buyer as part of the same transaction.⁹

Hocking, however, was decided by a slim majority.¹⁰ Judge Norris in dissent found that the transaction did not constitute the sale of a security.¹¹ He maintained that a security may exist only if there is an affiliation between the condominium seller and RPA operator.¹² In another

1. A condominium generally is a separately owned single unit in a multiple dwelling with common elements. See 1 P. Rohan & M. Reskin, *Condominium Law and Practice* § 1.01(1), at 1-1 to 1-5 (1989).

2. See Comment, *Looking Through Form to Substance: Are Montana Resort Condominiums "Securities"*, 35 Mont. L. Rev. 265, 273 (1974).

3. A rental pooling arrangement is an agreement by which a third party is responsible for renting and managing all the property that participates in the pool. Each owner subsequently receives a pro rata share of the rental income derived from the pool irrespective of whether the individual unit was actually rented. See *Hocking v. Dubois*, 885 F.2d 1449, 1453 n.4 (9th Cir. 1989) (en banc), cert. denied, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

4. See Rosenbaum, *The Resort Condominium and the Federal Securities Laws—A Case Study in Governmental Inflexibility*, 60 Va. L. Rev. 785, 785-86 (1974).

5. These investment characteristics generally take the form of buyers who earn a return on their condominium purchases through the managerial efforts of the developer. See *Offers and Sales of Condominiums or Units in a Real Estate Development*, Exchange Act Release No. 33-5347, 1 Fed. Sec. L. Rep. (CCH) ¶ 1049, at 2071 (Jan. 4, 1973).

6. See *id.*; *Hocking*, 885 F.2d at 1457.

7. 885 F.2d 1449 (9th Cir. 1989) (en banc), cert. denied, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

8. In order for the transaction to constitute the sale of a security, a court will still have to determine whether the transaction meets the investment contract test promulgated in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). See *infra* notes 18-34 and accompanying text.

9. See *Hocking*, 885 F.2d at 1457-58.

10. See *id.* at 1450, 1451 (6-5 decision).

11. See *id.* at 1463 (Norris, J., dissenting).

12. See *id.* at 1463-64.

dissent, Judge Wiggins asserted that absent an affiliation between the condominium seller and the RPA operator, the RPA alone could constitute the sale of a security.¹³ Consequently, he concluded that a buyer could not recover against a realtor who was not affiliated with the RPA operator.¹⁴

The *Hocking* decision contradicts the position of the Securities and Exchange Commission.¹⁵ The SEC has stated that a condominium sale coupled with an RPA constitutes the sale of a security where both agreements are offered through "persons engaged in the business of building and selling condominiums"¹⁶ and the condominium seller and RPA operator are affiliated.¹⁷

This Comment analyzes the *Hocking* decision and its effect on condominium resales and RPAs. Part I examines the definition of a security under the federal securities laws. Part II discusses the determination in *Hocking* that condominium resales sold with RPAs may constitute the sale of a security. Part III criticizes the *Hocking* decision and suggests that an affiliation should exist between the condominium seller and RPA operator before the transaction may be considered the sale of a security.

I. DEFINITION OF A SECURITY

In enacting the Securities Act of 1933 ("33 Act")¹⁸ and the Securities Exchange Act of 1934 ("34 Act"),¹⁹ Congress sought to protect investors from unscrupulous promoters of securities.²⁰ Consequently, the term "security" was broadly defined to include not only stocks and bonds, but also any investment contract.²¹

The Supreme Court first considered the scope of the term "investment

13. See *id.* at 1472 (Wiggins, J., dissenting).

14. See *id.* at 1473.

15. See Offers and Sales of Condominiums or Units in a Real Estate Development, Exchange Act Release No. 33-5347, 1 Fed. Sec. L. Rep. (CCH) ¶ 1049, at 2070 (Jan. 4, 1973).

16. *Id.* at 2070.

17. See SEC Amicus Curiae Brief on Rehearing En Banc at 8, *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989) (en banc), cert. denied, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023) [hereinafter *SEC Amicus Curiae Brief*].

18. See 15 U.S.C. §§ 77a-aa (1988).

19. See 15 U.S.C. §§ 78a-ll (1988).

20. See generally L. Loss, *Fundamentals of Securities Regulation 1-73* (2d ed. 1988) (tracing development of federal securities laws).

21. Section 2(1) of the 33 Act defines a security as follows:

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.

contract" in *SEC v. C.M. Joiner Leasing Corp.*²² In *Joiner*, land lessees sold interests in oil and gas leases and, in order to increase property values, promised to drill test wells nearby.²³ After determining that the securities acts did not specifically include divided interests in oil and gas properties, the Court evaluated whether the leasehold interests were investment contracts.²⁴ The Court held that the transaction was an investment contract because the appreciation that the investors sought was conditioned upon the promoter's drilling and discovering of oil in the adjacent test wells.²⁵ While *Joiner* did not specifically define an investment contract, the Court emphasized that the term should be broadly construed.²⁶

To clarify its decision in *Joiner*, the Supreme Court in *SEC v. W.J. Howey Co.*²⁷ developed a three-pronged test to determine whether an investment contract exists: "[an investment contract is] 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 third party."²⁸ Once again, the Court sought to develop a flexible approach that was "capable of adaption to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."²⁹

Subsequent decisions, while relying on the *Howey* test, have expanded its terms. For example, while the first element of the test requires an investment of money, an investor need not actually invest cash to satisfy this prong of the test.³⁰

There is disagreement, however, concerning the criteria that will satisfy the second prong of the *Howey* test—the requirement that the invest-

15 U.S.C. § 77b(1) (1988).

A virtually identical definition is contained in the 34 Act. See Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1988).

22. 320 U.S. 344 (1943).

23. See *id.* at 346.

24. See *id.* at 348-49.

25. See *id.*

26. See *id.* at 351.

27. 328 U.S. 293 (1946). In *Howey*, small orange grove plots were sold to non-residents who lacked the experience or desire to manage the groves. See *id.* at 295-96. Through an affiliated company, the promoters offered the buyers management services agreements through which the promoters would cultivate the groves and sell the fruit on the owners' behalf. See *id.* at 294-95. The Court held that the land sales and service contracts together constituted investment contracts subject to the provisions of the securities acts. See *id.* at 300.

28. *Id.* at 298-99.

29. *Id.* at 299.

30. See, e.g., *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 560 n.12 (1979) ("This is not to say that a person's 'investment,' in order to meet the definition of an investment contract, must take the form of cash only, rather than of goods and services."); *Hector v. Wiens*, 533 F.2d 429, 432 (9th Cir. 1976) ("an investment of money means only that the investor must commit his assets to the enterprise in such a manner as to subject himself to financial loss"), *cert. denied*, 434 U.S. 1016 (1978).

ment be in a common enterprise.³¹ Some decisions require "horizontal commonality," which is a pooling of assets from two or more investors into a single fund.³² Others also accept "vertical commonality," which is a relationship between investors and promoters in which the investors depend on the promoters' expertise, rather than on the fortuity of collective investments by other investors, for their profits.³³

The third element of the *Howey* test—that the investor be led to expect profits solely from the efforts of others—is sometimes overly mechanical. These decisions focus instead on whether the promoter has made *significant* managerial efforts in procuring profits for the investor.³⁴

II. THE *HOCKING* DECISION

In *Hocking*, a buyer relied on a realtor to find a condominium for an investment.³⁵ On the realtor's suggestion, the buyer purchased a unit in a resort complex.³⁶ During negotiations, the realtor informed the buyer that an RPA was available through an independent third party.³⁷ The realtor provided the buyer with information about the daily average

31. See *Mordaunt v. Incomco*, 469 U.S. 1115, 1115-16 (1985) (White, J., dissenting from a denial of certiorari).

32. See, e.g., *Curran v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 622 F.2d 216, 222 (6th Cir. 1980) (pooling of investor's assets essential to finding that common-enterprise element exists), *aff'd on other grounds*, 456 U.S. 353 (1982); *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 100-01 (7th Cir. 1977) (common enterprise requires multiple investors sharing assets); *Wasnowic v. Chicago Bd. of Trade*, 352 F. Supp. 1066, 1070-71 (M.D. Pa. 1972) (pooling of investor funds for common purpose results in common enterprise), *aff'd*, 491 F.2d 752 (3d Cir. 1973), *cert. denied*, 416 U.S. 994 (1974); see also L. Loss, *supra* note 20, at 189 n.1 (describing horizontal commonality as relationship among investors).

33. See, e.g., *SEC v. Continental Commodities Corp.*, 497 F.2d 516, 522 (5th Cir. 1974) (common enterprise determined by investor's dependency on promoter's expertise); *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 478 (5th Cir. 1974) (common enterprise exists where investor's profits are dependent upon promoter's efforts); *El Khadem v. Equity Secs. Corp.*, 494 F.2d 1224, 1229 (9th Cir.) (common enterprise results when investor's profits are dependent on those seeking investments), *cert. denied*, 419 U.S. 900 (1974); see also L. Loss, *supra* note 20, at 189 n.1 (describing vertical commonality as relationship between investors and promoters).

34. See, e.g., *SEC v. Aqua-Sonic Prods. Corp.*, 687 F.2d 577, 582-83 (2d Cir.) (securities-law protection extended to investors who retain limited control over investments), *cert. denied*, 459 U.S. 1086 (1982); *Baurer v. Planning Group, Inc.*, 669 F.2d 770, 778-79 (D.C. Cir. 1981) (investment contract exists where promoter's efforts are essential to project); *Lino v. City Investing Co.*, 487 F.2d 689, 692 (3rd Cir. 1973) (investment contract present even though all duties not performed by promoter); *SEC v. Glenn W. Turner Enters.*, 474 F.2d 476, 482 (9th Cir.) ("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"), *cert. denied*, 414 U.S. 821 (1973). *But see Villeneuve v. Advanced Business Concepts Corp.*, 698 F.2d 1121, 1124-25 (11th Cir. 1983) (investment contract exists only when profits are derived solely from the promoter's efforts).

35. See *Hocking v. Dubois*, 885 F.2d 1449, 1452 (9th Cir. 1989) (en banc), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

36. See *id.*

37. See *id.*

rental and assured him that the rental would be taken care of by the RPA.³⁸ Shortly after the condominium purchase, the realtor presented the buyer with the RPA agreement, which he signed.³⁹ The buyer made the installment payments due on the condominium, but forfeited his investment when the balloon payment⁴⁰ became due.⁴¹

The buyer sued the realtor, claiming that the realtor's misrepresentations⁴² caused his investment loss.⁴³ Specifically, the buyer alleged violations of Section 12⁴⁴ and Section 17⁴⁵ of the 33 Act, and Rule 10b-5⁴⁶ of the 34 Act.⁴⁷

The district court dismissed the suit, holding that the condominium resale and RPA combination was not an investment contract because the condominium purchase was not conditioned on the buyer's participation in the RPA.⁴⁸ The Court of Appeals for the Ninth Circuit reversed, holding that an "offering of a condominium with an RPA *automatically* makes the [transaction an investment contract]."⁴⁹

On rehearing en banc, the Ninth Circuit held that in order to determine whether an investment contract exists, the condominium resale and RPA must be analyzed as one transaction for the purposes of the *Howey* test.⁵⁰ *Hocking* distinguished between situations in which a realtor

38. *See id.*

39. *See id.* at 1453.

40. A balloon payment is the final payment of principal under a balloon note. A balloon note is a promissory note that generally calls for minimum payments of principal and interest at regular intervals, but requires the entire payment of principal at the end of the term. *See* M. Jennings, *Real Estate Law* 350 (2d ed. 1989).

41. *See Hocking v. Dubois*, 885 F.2d 1449, 1453 (9th Cir. 1989) (en banc), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

42. Two of the alleged misrepresentations pertained to the condominium purchase. First, the buyer alleged that the agent misrepresented that the condominium would be purchased directly from the developer when, in fact, the buyer purchased the condominium on resale. Second, the buyer alleged that the agent overestimated the value of the condominium. *See* Joint Brief for Appellees on Rehearing En Banc at 23, *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989) (en banc), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

43. *See Hocking*, 885 F.2d at 1451.

44. *See* 15 U.S.C. § 771 (1988) (imposing civil liability for violation of registration and prospectus delivery requirements or for false and misleading statements in connection with sale of security).

45. *See* 15 U.S.C. § 77q (1988) (imposing civil liability for use of scheme to defraud, use of false statements of material fact or omission to state material fact in connection with sale of security).

46. *See* 17 C.F.R. § 240.10b-5 (1989) (imposing civil liability for use of deceptive means in order to defraud, use of false statements of material fact or failure to state a material fact in connection with purchase or sale of security).

47. *See* Joint Brief for Appellees on Rehearing En Banc at 22, *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989) (en banc), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

48. *See Hocking v. Dubois*, No. 83-823, slip op. at 3 (D. Nev. Mar. 20, 1985).

49. *Hocking v. Dubois*, 839 F.2d 560, 565 (9th Cir.) (emphasis in original), *withdrawn*, 863 F.2d 654 (1988).

50. *See Hocking v. Dubois*, 885 F.2d 1449, 1457-58 (9th Cir. 1989) (en banc), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

"merely provides information"⁵¹ regarding an RPA and cases in which the realtor presents information as "part of the same transaction."⁵² The former would not constitute an investment contract but the latter could.⁵³ Because the Ninth Circuit concluded that the realtor presented the buyer with information about the RPA as part of the same transaction, it determined that the condominium resale and RPA formed one transaction for the purposes of the *Howey* test and that an investment contract may have existed⁵⁴ if all of the *Howey* prerequisites were met.⁵⁵

The *Hocking* majority relied on *Blackwell v. Bensten*⁵⁶ to find that the condominium resale and RPA were part of the same transaction for the purposes of the *Howey* test.⁵⁷ In *Blackwell*, investors bought land to develop into small citrus groves.⁵⁸ Shortly after the purchase, the investors executed a management services contract with a management company that agreed to plant and market the citrus crop.⁵⁹ Both the seller and the management company were organized by and operated under the same ownership.⁶⁰ The investors subsequently brought an action alleging violations of the 33 Act.⁶¹ *Blackwell* held that the arrangement was an investment contract and stated that although the sales and management agreements were "separate in form and execution, [they were] closely allied in performance, as well as in personnel. They form[ed] constituent parts of what [was] essentially one transaction."⁶²

The *Hocking* court evaluated the circumstances before it in the same manner as did the *Blackwell* court.⁶³ The majority in *Hocking* agreed that the transactions were separate in form because the buyer purchased the condominium and RPA from different parties.⁶⁴ Nonetheless, because the realtor offered the condominium and RPA to the buyer as part of the same arrangement, *Hocking* concluded that the condominium resale and RPA formed one transaction for the purposes of the *Howey* test,

51. *Id.* at 1458.

52. *Id.*

53. *See id.* at 1457-58.

54. The court proceeded to apply the *Howey* test to the transaction and concluded that, for summary judgment purposes, the buyer had met the first and second prongs of the test and at least raised material issues of fact with regard to the test's third prong. *See Hocking v. Dubois*, 885 F.2d 1449, 1459-62 (9th Cir. 1989) (en banc), cert. denied, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023). Consequently, the court remanded the case to the district court for a trial on the merits. *See id.* at 1462.

55. For a discussion of the *Howey* prerequisites necessary for an investment contract to exist, see *supra* notes 27-34 and accompanying text.

56. 203 F.2d 690 (5th Cir. 1953), cert. dismissed, 347 U.S. 925 (1954).

57. *See Hocking*, 885 F.2d at 1458 n.7.

58. *See Blackwell*, 203 F.2d at 691.

59. *See id.*

60. *See id.* at 692.

61. *See id.*

62. *Id.* at 692-93.

63. *See Hocking v. Dubois*, 885 F.2d 1449, 1458 n.7 (9th Cir. 1989) (en banc), cert. denied, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

64. *See id.* at 1457-58.

and therefore, could constitute the sale of a security.⁶⁵

III. THE CONSEQUENCES OF THE *HOCKING* DECISION

A. *Critique of the Hocking Holding*

Hocking is unpersuasive because it is based on a misreading of *Blackwell v. Bentsen*.⁶⁶ *Blackwell* held that sales and management agreements formed one transaction for the purposes of the *Howey* test because the agreements were "closely allied in performance, as well as in personnel."⁶⁷ In *Blackwell*, the land-sale and management contracts were closely allied in performance because the development company sold the land for its income value, which was to be derived from the efforts of the management company, rather than for its intrinsic value.⁶⁸ The development company and the management services operator were closely allied in personnel because they were commonly owned.⁶⁹

In contrast, the realtor and RPA operator in *Hocking* were neither closely allied in performance nor in personnel. The realtor's performance was not tied to that of the RPA operator because the condominium purchase was not dependent on the RPA for its value. In fact, the buyer's sole investment motive for purchasing the condominium was to profit from its expected appreciation.⁷⁰ In addition, there was no affiliation between the realtor and RPA operator.⁷¹ The realtor merely informed the buyer of the RPA's existence, but had nothing to do with its terms or provisions.⁷² Under the circumstances, the condominium resale and RPA should have been considered two separate transactions for the purposes of the *Howey* test.

Hocking also established an illusory distinction between a realtor who "merely provides information" and a realtor who presents information as "part of the same transaction." The court determined that the realtor presented information about the RPA to the buyer as part of a single transaction.⁷³ The circumstances in *Hocking*, however, are indistinguish-

65. See *id.* at 1458.

66. 203 F.2d 690 (5th Cir. 1953), *cert. dismissed*, 347 U.S. 925 (1954); see *Hocking*, 885 F.2d at 1467 (Norris, J., dissenting). In addition, in the other real estate cases cited by the *Hocking* majority to support its conclusion, there was a link between the real estate seller and the management services operator that did not exist under the facts in *Hocking*. See, e.g., *SEC v. W.J. Howey Co.*, 328 U.S. 293, 294-95 (1946) (promoter sells orange groves and company under his direct common control offers to grow, harvest and sell oranges); *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1038 (10th Cir. 1980) (investor purchased land from company that promised to develop property).

67. *Blackwell*, 203 F.2d at 693 (emphasis added).

68. See *id.*

69. See *id.* at 692-93.

70. See *Hocking v. Dubois*, 885 F.2d 1449, 1473 (9th Cir. 1989) (en banc), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

71. See *id.* at 1456.

72. See *id.* at 1452.

73. See *id.* at 1458. In the course of the condominium sale in *Hocking*, the realtor advised the buyer of the availability and investment potential of the RPA, helped the

able from most real estate transactions in which the buyer needs to know about a property's income potential and the availability of management services.⁷⁴

The consequence of the *Hocking* decision is that almost every condominium resale that involves an RPA will be considered part of the same transaction for the purposes of the *Howey* test and, therefore, may implicate the federal securities laws. This result will discourage realtors from being candid and fully informed. Realtors normally possess useful information about RPAs that should be available to buyers.⁷⁵ Under *Hocking*, however, realtors who offer any information about the availability of an RPA may be engaging in the sale of an investment contract, and thus may be subject to the burdensome registration and disclosure requirements of the federal securities laws.⁷⁶ The responsibility for complying with these requirements will discourage realtors from providing investors with useful information about the availability of RPAs.⁷⁷ The federal securities laws were intended to *increase* the availability of information to investors,⁷⁸ not to discourage realtors from providing prospective buyers with as much relevant information as possible to help them make informed judgments.⁷⁹

buyer prepare the RPA application and offered to resell the condominium in the future. *See id.* at 1467 (Norris, J., dissenting).

74. *See id.* at 1467.

75. *See id.*

76. *See id.* at 1468. These requirements would obligate the realtor to pass a general securities examination and compel the realtor's agency to comply with net capital rules, reporting, record-keeping and "other regulatory provisions which serve little or no valid purpose in this context." Rosenbaum, *The Resort Condominium and the Federal Securities Laws: A Case Study in Governmental Inflexibility*, 60 Va. L. Rev. 785, 787, 797-98 (1974); *see also* Note, *Federal Securities Regulation of Condominiums: A Purchaser's Perspective*, 62 Geo. L.J. 1403, 1413-23 (1974) (discussing registration and disclosure requirements under securities acts).

77. *See Hocking v. Dubois*, 885 F.2d 1449, 1467-68 (9th Cir. 1989) (en banc) (Norris, J., dissenting), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023); *cf.* Brief for the National Association of Realtors in Support of Petition for Rehearing En Banc at 5, *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023) (burden of compliance with federal securities law requirements will discourage real estate agents from participating in condominium sales).

78. *See* Note, *supra* note 76, at 1404.

79. *See Hocking*, 885 F.2d at 1467 (Norris, J., dissenting); *cf.* *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 849 (1975) (securities acts focus on securities sales intended to raise capital for profit-making purposes); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946) (purpose of securities acts is to regulate conduct of those "who seek the use of the money of others on the promise of profits"); Berman & Stone, *Federal Securities Law and the Sale of Condominiums, Homes, and Homesites*, 30 Bus. Law. 411, 412 (1975) (concern regarding possible misapplication of securities acts to real estate sales); Note, *supra* note 76, at 1405 (dominant purpose of the securities laws is "to regulate the various schemes devised by those who seek the use of the money of others with the lure of profits").

B. *Affiliation Between the Parties*

In determining whether a condominium resale and RPA form one transaction for the purposes of the *Howey* test, the inquiry should focus on whether there is an affiliation between the two arrangements. Normally, when real property is sold as a residence or without management services, the transaction does not involve the sale of an investment contract.⁸⁰ This is true primarily because these transactions are not "premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."⁸¹ Where real property is sold with a management-services agreement offered by the seller or a company affiliated with the seller, however, many decisions have found that an investment contract may exist.⁸²

Requiring an affiliation between the condominium seller and RPA operator establishes a precise standard that draws the line between condominium resales that may involve an investment contract and those that do not.⁸³ An investment contract will not exist when the realtor is not affiliated with anyone who provides management services, while an investment contract may exist when there is an affiliation between the condominium seller and RPA operator.⁸⁴ In contrast, *Hocking's* distinction

80. See, e.g., *Forman*, 421 U.S. at 858 (sale of cooperative apartments sold by non-profit corporation, where purchasers sought place to live, does not involve sale of investment contract); *Dumbarton Condominium Assoc. v. 3120 R Street Assoc.*, 657 F. Supp. 226, 230 (D.D.C. 1987) (investment contract does not exist where condominium seller did not promise to market or lease property on buyer's behalf); *Mosher v. Southridge Assoc. Inc.*, 552 F. Supp. 1231, 1233 (W.D. Penn. 1982) (investment contract does not exist where buyer has sole discretion to rent condominium); *Joyce v. Ritchie Tower Properties*, 417 F. Supp. 53, 56 (N.D. Ill. 1976) (condominium to be occupied by purchaser as residence does not involve sale of investment contract).

81. *Forman*, 421 U.S. at 852; see also *Bender v. Continental Towers Ltd.*, 632 F. Supp. 497, 501 (S.D.N.Y. 1986) (real estate has inherent worth whereby appreciation depends on ordinary economic variables rather than on promoters' efforts).

82. See, e.g., *SEC v. W.J. Howey Co.*, 328 U.S. 293, 300-01 (1946) (investment contract exists where promoter sells property and offers management services through affiliated company that is under direct common control of promoters); *Cameron v. Outdoor Resorts of Am., Inc.*, 608 F.2d 187, 192-93 (5th Cir. 1979) (investment contract exists where promoter sells campsites and retains exclusive right to rent campsites in owner's absence) *aff'd per curiam on rehearing*, 611 F.2d 105 (5th Cir. 1980); *Blackwell v. Bentzen*, 203 F.2d 690, 692-93 (5th Cir. 1953) (investment contract exists where developer sells property and commonly owned company offers management services), *cert. dismissed*, 347 U.S. 925 (1954); *Hodges v. H & R Investments*, 668 F. Supp. 545, 550-51 (N.D. Miss. 1987) (investment contract exists when promoter of condominium guarantees buyer minimum rental income); *Wooldridge Homes Inc. v. Bronze Tree Inc.*, 558 F. Supp. 1085, 1087-89 (D. Colo. 1983) (investment contract exists where promoter sells resort property with promise to build condominiums and provide management services to purchasers for two years); see also H. Bloomenthal, *Securities and Federal Corporate Law* § 2.04(1) at 2-26 (rev. ed. 1990) ("The constantly recurring situation that gives rise to an investment contract is the purported sale of specific property . . . accompanied by an arrangement under which the promoters . . . manage the entire operation.").

83. See *Hocking v. Dubois*, 885 F.2d 1449, 1464 (9th Cir. 1989) (en banc) (Norris, J., dissenting), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

84. See *id.*

between a realtor who "merely provide[s] information" and a realtor who provides information as "part of the same transaction" is overbroad.⁸⁵ Realtors who do nothing more than notify prospective condominium purchasers about the availability of an RPA⁸⁶ may find themselves in federal court defending actions brought under the federal securities laws.⁸⁷

Requiring an affiliation between the condominium seller and RPA operator is supported by the SEC,⁸⁸ which has stated that "[t]he offer of real estate . . . without any collateral arrangements with the seller [of residential real estate] or others, does not involve the offer of a security."⁸⁹ In *Hocking*, the SEC maintained that "[s]ince in this case there is no suggestion of an affiliation . . . between the sellers of the condominium [or realtor] and the operator of the rental pool, the sale of the condomin-

85. See *id.* at 1466 (Norris, J., dissenting).

86. Buyers may still enjoy securities law protection when they are misled by unscrupulous RPA operators because the courts may apply the *Howey* test to the RPA itself to determine whether an investment contract exists. In this situation, the initial condominium purchase, irrespective of its relationship to any other financial arrangement, would not implicate the federal securities laws. See, e.g., *United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975) (cooperative apartments sold by non-profit corporation where purchasers sought place to live does not involve sale of investment contract); *Joyce v. Ritchie Tower Properties*, 417 F. Supp. 53 (N.D. Ill. 1976) (condominium to be occupied by purchasers as residence does not involve sale of investment contract). Once the buyer commits the use of the property to the RPA operator, however, the first prong of the *Howey* test—an investment of money—would be satisfied. See, e.g., *SEC v. W.J. Howey Co.*, 328 U.S. 293, 300 (1946) (first prong of *Howey* test satisfied by investors foregoing use of land, rather than by purchasing land that was incidental to investment); *Hocking*, 885 F.2d at 1471 (Wiggins, J., dissenting) (first prong of *Howey* test satisfied once buyer commits condominium to rental pool). The satisfaction of the second and third prongs of the *Howey* test would depend upon the type of RPA the buyer entered into and the amount of control the buyer retained over the use of his condominium. See *Hocking*, 885 F.2d at 1471 (Wiggins, J., dissenting); see also *Cameron v. Outdoor Resorts of Am., Inc.*, 608 F.2d 187, 191-93 (5th Cir. 1979) (investment contract exists where promoter is given exclusive right to rent campsite in owner's absence), *aff'd per curiam on rehearing*, 611 F.2d 105 (5th Cir. 1980). See generally Note, *The Economic Realities of Condominium Registration Under the Securities Act of 1933*, 19 Ga. L. Rev. 747, 772-75 (1985) (economic realities of investment contracts depend on type of rental agreement and amount of control retained by owner).

87. See *Hocking v. Dubois*, 885 F.2d 1449, 1465 (9th Cir. 1989) (en banc) (Norris, J., dissenting), *cert. denied*, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

88. See *SEC Amicus Curiae Brief*, *supra* note 17, at 8.

89. Offers and Sales of Condominiums or Units in a Real Estate Development, Exchange Act Release No. 33-5347, 1 Fed. Sec. L. Rep. (CCH) ¶ 1049, at 2071 (Jan. 4, 1973). The SEC has expressed this view on many occasions. For example, the SEC's Division of Corporate Finance has declined to take a "no-action" position where there was an affiliation between the developer and RPA operator. See, e.g., SEC No-Action Letter, Little Squaw Mountain Township (Apr. 25, 1973) (LEXIS, Fedsec library, Noact file) (rental pool operated by subsidiary of developer); SEC No-Action Letter, Inter-Mack-Pali Ke Kua Condominiums (Mar. 29, 1974) (LEXIS, Fedsec library, Noact file) (rental pool operated by agent employed by developer).

The only exception to the SEC's approach was *Embarcadero*, SEC No-Action Letter, [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 80,956 (Dec. 3, 1976), where the Division declined to take a "no-action" position in a condominium resale although there appeared to be no affiliation between the seller of the condominium and the rental pool

ium was not a transaction that involved an investment contract."⁹⁰ Traditionally, courts accord considerable weight to SEC views governing the applicability of the securities laws.⁹¹

Although it is apparent that an affiliation must exist between the condominium seller and RPA operator for a joint transaction to constitute the sale of an investment contract, it is essential to define what type of affiliation between the parties is necessary for the sales and management agreements to form one transaction for the purposes of the *Howey* test.⁹² Clear connections between the condominium seller and RPA operator should be scrutinized carefully. For example, a selling arrangement between the realtor and RPA operator may establish a clear connection between the parties where the realtor, while selling the condominium to the buyer, also receives a commission from the RPA operator for selling an RPA to the buyer.⁹³ An agency relationship between the realtor and RPA operator, in which the realtor has the authority to bind the RPA operator to an agreement with the buyer, may also establish a sufficient connection between the parties for the sales and management agreements to form one transaction for *Howey* purposes.⁹⁴ Finally, a proper link between the parties may also be established through the presence of companies that are closely allied in performance and personnel, such as management companies under the direct common control⁹⁵ of or owned⁹⁶ by sales companies.

operator. The present SEC staff, however, disagrees with that result. *See SEC Amicus Curiae Brief, supra* note 17, at 14 n.5.

When no affiliation was present between the condominium seller and management services operator, the SEC has taken a no-action position. *See, e.g.,* SEC No-Action Letter, Terrace Hills Condominium (Sept. 29, 1983) (LEXIS, Fedsec library, Noact file) (optional rental pool available from an entity that has no business relationship with developer).

90. *SEC Amicus Curiae Brief, supra* note 17, at 11.

91. *See* United Housing Found., Inc. v. Forman, 421 U.S. 837, 858 n.25 (1975); Saxbe v. Bustos, 419 U.S. 65, 74 (1974); Investment Co. Inst. v. Camp, 401 U.S. 617, 626-27 (1971); Hocking v. Dubois, 885 F.2d 1449, 1465 (9th Cir. 1989) (en banc) (Norris, J., dissenting), cert. denied, 58 U.S.L.W. 3657 (U.S. Apr. 17, 1990) (No. 89-1023).

92. *See* Note, *Profits in Paradise: When Resort Condominiums Qualify as Investment Contracts*, 19 Golden Gate U.L. Rev. 177, 232 n.317 (1989).

93. *See, e.g.,* Hocking, 885 F.2d at 1463 (Norris, J., dissenting) (suggesting that sales and management agreements form one transaction under *Howey* test when selling arrangement exists between realtor and RPA operator); *SEC Amicus Curiae Brief, supra* note 17, at 8.

94. *See, e.g.,* Hocking, 885 F.2d at 1469 (Wiggins, J., dissenting) (suggesting that sales and management agreements form one transaction under the *Howey* test where agent has authority to bind RPA operator to agreement with buyer).

95. *See, e.g.,* SEC v. W.J. Howey Co., 328 U.S. 293 (1946) (investment contract present where promoter sells property and offers management services through affiliated company that is under direct common control of promoters).

96. *See, e.g.,* Blackwell v. Bentsen, 203 F.2d 690 (5th Cir. 1953) (investment contract exists where developer sells property and commonly owned company offers management services), cert. dismissed, 347 U.S. 925 (1954).

CONCLUSION

In *Hocking v. Dubois*, the Ninth Circuit held that an investment contract may exist when a condominium resale is coupled with the sale of an RPA from an independent party. This conclusion is unfounded. In its analysis, the Ninth Circuit misread precedent, created illusory distinctions, and established a standard that will unfairly burden realtors with federal securities registration and disclosure requirements.

As an alternative to the approach taken in *Hocking*, subsequent decisions should focus on whether there is a sufficient affiliation between the condominium seller and RPA operator such that the arrangement may be considered one transaction for the purposes of the *Howey* test. This approach will help to insure that realtors are not unfairly subjected to the requirements of the federal securities laws.

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