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COOPERATIVE HOUSING SHARES: A SECURITY OR SUBSTANTIVELY SECURE?

Cooperative housing developments historically have been plagued by fast-buck promoters, "sweetheart" leases, ineffective tenant

1. In a typical cooperative apartment project, tenants own shares in a corporation that holds title to the building. Ownership of shares entitles the holder to a lease, usually long-term, for a particular unit. Tenants pay monthly charges based on a prorated share of mortgage loan payments, maintenance costs and management expenses. See P. ROHAN & M. RESKIN, COOPERATIVE HOUSING LAW & PRACTICE §§ 1.01-.03, 2.01(4) (1974) [hereinafter cited as ROHAN]; Miller, Cooperative Apartments: Real Estate or Securities?, 45 B.U.L. REV. 465, 466 (1965) [hereinafter cited as Miller].

Condominium owners, on the other hand, hold their individual units in fee simple, while common areas are typically held in joint tenancy. This arrangement, which required state enabling legislation because of the common law prohibition against fee simple ownership of horizontal spaces, is more akin to ownership of a single family home. See ROHAN, supra, § 1.02(3).

The distinction in form of ownership can be very important to purchasers. Fee simple ownership of condominiums allows individual owners to pledge a mortgage on their property. Id. § 1.02(1), (3). Cooperatives are typically financed by a blanket mortgage, covering the entire project, in which the corporate owner is the mortgagor. Id. § 1.02(3).

Thus, shareholders in a cooperative are dependent on their fellow tenants for financial support; if one shareholder defaults on his payments, the corporation must make up the deficit by assessing other cooperative shareholders. In a condominium project, however, only the common areas are paid for by the tenants as a group. Default by a single tenant, or even several tenants, is much less likely to jeopardize the financing of an entire project. For a discussion of the difference between the two forms of community apartment ownership see id.; Note, Community Apartments: Condominiums or Stock Cooperatives?, 50 CALIF. L. REV. 299 (1962).

During the 1970's condominiums have far surpassed cooperatives in number of units, largely because of the availability of mortgage loans on individual units. 1 U.S. DEPT OF HOUSING & URBAN DEVELOPMENT, CONDOMINIUM/COOPERATIVE STUDY III-2 (1975) [hereinafter cited as HUD REPORT]. It was estimated that there were 439,000 units in cooperative projects and 1,252,000 units in condominium projects in 1975. Id. Eighty percent of the cooperative units were built before 1970; by contrast, 86% of the condominium units were built after that date. Id. Nonetheless, cooperatives remain important segments of the housing market in selected urban areas. In New York City alone, there are more than 141,000 units in cooperatives. 2 HUD REPORT, supra, appendix C, at 12.

2. In a "sweetheart" lease, a developer will transfer title to one portion of the development to the tenants while retaining another portion that is leased back to the tenants, sometimes at an inflated price. Typically, such leases have involved retention of land upon which the building sits or retention of certain recreational properties. Note, Condominium Regulation: Beyond Disclosure, 123 U. PA. L. REV. 639, 643 (1975) [hereinafter cited as Note, Condominium Regulation].
associations and understated cost estimates. Because of the form of ownership, purchasers of shares in cooperative housing corporations often must rely on developers and fellow shareholders to protect their investment. This dependency and recurring abuses have led to various proposals for consumer-oriented regulation. Most discussion has centered on whether cooperative interests are protected by existing state and federal securities laws.

In United Housing Foundation, Inc. v. Forman, the United States Supreme Court held that shares in a nonprofit cooperative housing corporation subsidized by the State of New York were not "securities" within the definitions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The Court dismissed for lack of a federal question claims by 57 residents of the massive Co-op City in New York City who were seeking damages and forced rent reduction under the

3. For a general discussion of the historical problems of cooperative housing ventures see Marks & Marks, Coercive Aspects of Housing Cooperatives, 42 ILL. L. REV. 728, 730 n.7 (1948); Miller, supra note 1, at 466-67; Note, Cooperative Housing Corporations and the Federal Securities Laws, 71 COLUM. L. REV. 118, 120-22 (1971) [hereinafter cited as Note, Cooperative Housing Corporations]; Note, Co-operative Apartment Housing, 61 HARV. L. REV. 1407, 1407-08 & n.9 (1948).

4. See note 1 supra.

5. The commentators differ on which level of government, federal or state, should promulgate and enforce such regulations. Professor Miller argues for state regulation of cooperatives based, in part, on inclusion of cooperative interests within the state Blue Sky provisions. He also favors substantive regulation of such factors as the length of time a developer may control a project without passing ownership and management on to the tenants. Miller, supra note 1, at 504-05. Others have argued that the federal securities statutes are the proper vehicle for regulation. See Zammit, Securities Law Aspects of Cooperative Apartments, N.Y.L.J., Jan. 8, 1973, at 1, col. 1 ("[t]he breadth and flexibility of the federal securities laws make their application to the cooperative housing area not only possible, but particularly well-suited in the curbing of abuses. . . . [T]he present criminal sanctions and civil liability provisions are sufficiently stringent to insure a high degree of compliance."); Note, Cooperative Housing Corporations, supra note 3, at 122-26. But see Note, Condominium Regulation, supra note 2, at 643 (suggesting that the protection afforded by securities laws is not appropriate for community apartment interests and advocating a federal scheme of substantive regulation attacking specific abuses, coupled with statutorily defined full disclosure provisions, id. at 646, 662-65; the abuses discussed by the commentator are in connection with condominiums but parallel those applicable to cooperatives, id. at 642-43).

6. See note 5 supra.


8. 421 U.S. at 859-60.


11. 421 U.S. at 844. Interests in a cooperative housing corporation are specifically included in the definition of a security under New York's Blue Sky Law, N.Y. GEN. BUS.
broad anti-fraud provisions of the federal securities acts.

The decision raises two important issues. The first is whether the Court departed from the remedial nature of the securities acts in failing to find that shares of a cooperative housing corporation were securities. The second is whether state and federal securities laws would provide effective consumer protection for cooperative shareholders.

Co-op City is a 15,000-unit cooperative apartment project in the Bronx. About 50,000 persons live in the 25 high-rise buildings and 236 townhouses. The project was organized, financed and built under New York’s Mitchell-Lama Act, which provided long-term, low-interest loans to cooperative housing projects. Under the statute, only low and moderate income families were eligible to purchase shares of the cooperative and to occupy units in the project. Shares were sold at $25 each and tenants were required to purchase 18 shares for each room occupied. The shares could not be resold at a profit and a tenant selling his shares was required to offer them for resale to the corporation.

Law § 352-e(1)(a) (McKinney 1968). However, plaintiffs may have been barred in the state courts by Schumann v. 250 Tenants Corp., 65 Misc. 2d 253, 317 N.Y.S.2d 500 (Sup. Ct. 1970) (permitting limited review of attorney general’s decision on sufficiency of the prospectus).


13. A third issue is whether other community apartment projects, without the peculiar nonprofit features of Co-op City, would be considered securities. See note 48 infra.

14. 421 U.S. at 840.

15. Co-op City was sponsored by United Housing Foundation (UHF), a nonprofit corporation composed of labor unions, housing cooperatives and civic groups. Id. at 841 n.2. Riverbay, a nonprofit cooperative housing corporation, was organized by UHF to own and operate Co-op City. Tenants held shares of Riverbay. Id. at 842. The contract to construct the massive project was between UHF and its wholly owned subsidiary, Community Services, Inc. As required by statute, all arrangements were approved by the State Housing Commissioner. Id.


17. Id. § 22(2).

18. Id. § 31(2)(a). Families were eligible for projects organized under the Mitchell-Lama Act if their anticipated annual income for the period of occupancy did not exceed six times the annual rental, including utilities. For families with three or more dependents, the ratio was seven to one. Id.

19. 421 U.S. at 842.

20. N.Y. PRIV. HOUS. FIN. LAW § 31-a (McKinney Supp. 1974). The seller, however, could recover a proportionate share of the amortized principal payments. Id.
About $32,000,000 of the total project cost of $408,700,000 was raised by the sale of shares to tenants.\textsuperscript{21} Plaintiffs charged defendants\textsuperscript{22} with violation of the anti-fraud provisions of the federal securities acts in connection with several major increases in the tenants' monthly charge. The increases were attributable to construction cost overruns and rising maintenance and management expenses. By 1974, three years after the project was completed, monthly charges were nearly double the estimates made in 1965 when the first subscriptions were solicited.\textsuperscript{23}

The definition of a security in the securities acts includes the term "stock."\textsuperscript{24} Plaintiffs argued that shares in Co-op City were called stock and represented an equity interest in a corporation; therefore, such shares should be included in the literal definition of a security.\textsuperscript{25} The Court rejected this approach, quoting from \textit{Tcherepnin v. Knight:}\textsuperscript{26} "In searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality."\textsuperscript{27} The reality, the Court said, was that Co-op City

\textsuperscript{21} When organized, the estimated cost of construction was $283,700,000. Increased construction costs led to several upward revisions of the construction contract and to increases in the mortgage loans, all of which were approved by the State Housing Commissioner. 421 U.S. at 843.

\textsuperscript{22} Defendants were UHF, Riverbay, Community Services, Inc., the State of New York, the New York Private Housing Finance Agency and several directors of the corporate defendants. \textit{Id.} at 842. In addition to violations of the securities acts, plaintiffs presented a claim against the state agency under 42 U.S.C. § 1983 (1970) (civil remedies for violation of civil rights under color of state law). That claim was dismissed by the district court for not being well-pleaded. Forman v. Community Servs., Inc., 366 F. Supp. 1117, 1132 (S.D.N.Y. 1973). See 421 U.S. at 845-46 & n.10. Ten pendant state law claims were also alleged. \textit{Id.} at 845.

\textsuperscript{23} \textit{See note 21 supra.} By 1974 the average monthly cost for a four-room apartment was $170. The 1965 Information Bulletin, designed to solicit subscriptions, had estimated the cost at $92. 421 U.S. at 843.

\textsuperscript{24} The Securities Act of 1933, § 2(1) defines a security as:
any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, . . . , transferable share, investment contract, . . . , certificate of deposit for a security, . . . 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, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.


\textsuperscript{25} 421 U.S. at 848.

\textsuperscript{26} 389 U.S. 332 (1967).

\textsuperscript{27} \textit{Id.} at 336.
shares lacked the essential characteristics of stock, in particular, "the right to receive 'dividends contingent upon an apportionment of profits.'"\textsuperscript{28}

An "investment contract" is also defined as a security under the acts.\textsuperscript{29} The reach of this term has been the subject of much litigation and critical commentary.\textsuperscript{30} In 1946 the Supreme Court in \textit{SEC v. W.J. Howey Co.}\textsuperscript{31} 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."\textsuperscript{32} In \textit{Howey}, the Court found that the sale of land in a citrus grove, coupled with a management contract, was an investment contract for purposes of the securities acts' definition.\textsuperscript{33}

The \textit{Howey} definition has been under fire for the last decade as being too restrictive.\textsuperscript{34} On occasion, courts have abandoned the \textit{Howey} test in favor of a broader, more flexible definition.\textsuperscript{35} Other courts have strained

\textsuperscript{28} 421 U.S. at 851, quoting Tcherepnin v. Knight, 389 U.S. at 339. The Court also noted that the shares were not negotiable, could not be pledged, conferred no voting rights in proportion to the number of shares owned, and did not appreciate in value. 421 U.S. at 851.

\textsuperscript{29} See note 24 supra.


\textsuperscript{31} 328 U.S. 293 (1946). The Forman Court recognized that the term "solely" in the \textit{Howey} test has been the subject of much recent discussion. 421 U.S. at 852 n.16; see notes 34-35 infra. But the Court gave no opinion on whether the term should be given broader reach than its literal meaning. 421 U.S. at 852 n.16.

\textsuperscript{32} 328 U.S. at 298-99.

\textsuperscript{33} Id.

\textsuperscript{34} For example, the Hawaii Supreme Court has criticized the "solely" requirement of the \textit{Howey} test:

The primary weakness of the Howey formula is that it has led courts to analyse [sic] investment projects mechanically, based on a narrow concept of investor participation. . . . Thus courts become entrapped in polemics over the meaning of the word "solely" and fail to consider the more fundamental question whether the statutory policy of affording broad protection to investors should be applied even to those situations where an investor is not inactive, but participates to a limited degree in the operation of the business. . . .


\textsuperscript{35} See, e.g., State v. Hawaii Mkt. Center, Inc., 52 Hawaii 642, 485 P.2d 105 (1971) (adopting the Coffey formula in holding that an interest in a pyramiding sales scheme was a security). For an explanation of Professor Coffey's formula see notes 40-41 and accompanying text infra.
the language of the test in applying it to specific fact patterns. 36 The primary challenger to the Howey test is the risk capital theory first expounded by Justice Traynor in Silver Hills Country Club v. Sobieski. 37 In that case, the California supreme court found that membership in a proposed country club was an investment contract under the California securities act. 38 The court reasoned that securities laws should protect an investor who was risking his capital in an enterprise over which he had no control and from which he expected material benefits. 39

Professor Coffey, writing six years after the Silver Hills case, proposed a refined test for the risk capital theory. 40 He argued that securities laws should apply to a transaction in which (1) a person furnishes initial value to another, (2) which is subjected to the risks of an enterprise, (3) if, at the time of the transaction, the buyer was neither familiar with the enterprise nor took part in its control, and (4) if the seller induced the buyer to furnish initial value by promises or representations that a "valuable benefit of some kind, over and above initial value," would accrue to the buyer. 41 Professor Coffey recognized that his test parallels the Howey definition in material respects, but he believed his formula is more consistent with the remedial nature of the securities acts. He wrote that "the essence of the new look is found particularly in [the sections] which highlight the troublesome prospect that the buyer's original value could dwindle because of the failure of an enterprise over which he exercises no control." 42

36. See, e.g., SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476 (9th Cir.), cert. denied, 414 U.S. 821 (1973) (holding that interests in pyramiding multilevel distributorships were securities under the Howey test by finding the "solely" requirement satisfied if the actions of the persons other than the investor were "those essential managerial efforts which affect the failure or success of the enterprise"). See also SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974), rev'd 365 F. Supp. 588 (N.D. Ga. 1973). The courts' adherence to the Howey test in these cases has been criticized. See Note, What is a "Security"?, supra note 30, at 830-31.


38. Id. at 815, 361 P.2d at 908-09, 13 Cal. Rptr. at 188-89. The purchaser expected no direct monetary gain from membership in the country club, only use of the facilities. Id. at 814, 361 P.2d at 908, 13 Cal. Rptr. at 187.

39. Id. at 815, 361 P.2d at 908, 13 Cal. Rptr. at 188.

40. Coffey, supra note 30, at 377.

41. Id.

42. Id. Both the Coffey test and Justice Traynor's reasoning in Silver Hills, see notes 37-39 and accompanying text supra, seem consistent with the remedial purpose of federal and state securities laws. E.g., Tcherepnin v. Knight, 389 U.S. 332, 338 (1967); SEC v. Capital Gains Research Bureau, 375 U.S. 180, 195 (1963); SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1945). See also Long, supra note 30, at 177-78 n.177.
The Second Circuit\textsuperscript{43} and the Supreme Court\textsuperscript{44} agreed that the \textit{Howey} definition controlled. The Supreme Court, however, disagreed with the court of appeals' conclusion that the shares represented investment contracts. The Second Circuit had found that shareholders expected profits from three sources: (1) the federal income tax deduction of the portion of the monthly charge attributable to interest on the mortgage loans;\textsuperscript{45} (2) the availability of housing in the project at a price significantly below the rent charged for comparable housing elsewhere;\textsuperscript{46} and, (3) the income derived by the shareholders from space rented to stores and businesses.\textsuperscript{47} The Supreme Court said that profits could be found only when there is "capital appreciation resulting from the development

\textsuperscript{43} Forman v. Community Servs., Inc., 500 F.2d 1246, 1253 (2d Cir. 1974).
\textsuperscript{44} 421 U.S. at 852.
\textsuperscript{45} \textit{Id.} at 855. The deductions were based on \textit{INT. REV. CODE OF 1954} § 216, 26 U.S.C. § 216 (1970). The Court said: "These tax benefits are nothing more than that which is available to any homeowner who pays interest on his mortgage." 421 U.S. at 855; \textit{accord}, Eckstein v. United States, 452 F.2d 1036 (Ct. Cl. 1971).
\textsuperscript{46} 421 U.S. at 855.
\textsuperscript{47} The dissent found that tax benefits were profits to the cooperator and homeowner alike. "The difference is that the profit of the individual homeowner does not 'come solely from the efforts of others' whereas the profit from this source realized by a resident of Co-op City does." 421 U.S. at 854 (Brennan, J., dissenting). The majority concluded, however, that even if tax benefits were construed to be profits, it would be difficult to find that such benefits came "solely from the efforts of others." \textit{Id.} at 854 n.20. See also Rosenbaum, \textit{The Resort Condominium and the Federal Securities Laws—A Case Study in Governmental Inflexibility}, 60 \textit{Va. L. Rev.} 785, 795-96 (1974).

\textsuperscript{48} 421 U.S. at 855.
\textsuperscript{49} The low rent derives from the substantial financial subsidies provided by the State of New York. This benefit cannot be liquidated into cash; nor does it result from the managerial efforts of others. In a real sense, it no more embodies the attributes of income or profits than do welfare benefits, food stamps or other government subsidies.
\textit{Id.} Again, the dissent disagreed. It is simply common sense that managerial efficiency necessarily enters into the equation in the determination of the charges assessed against residents. But even to the extent that the resident-stockholders do benefit in reduced charges from government subsidies, the benefit is not for this reason any the less a profit to them.
\textit{Id.} at 861.
\textsuperscript{47} \textit{Id.} at 855. The Second Circuit found that retail stores in the project paid about $1,106,000 annually in rent. Washing machine concessions and leases of office space produced about $667,000. Tenants and others paid about $2,500,000 annually in parking fees. Community Servs., Inc. v. Forman, 500 F.2d 1246, 1254 (2d Cir. 1974). The Supreme Court believed that gross figures, without more, were unacceptable for a determination of profit since "nothing in the record suggests that the facilities in fact return a profit in the sense that the leasing fees are greater than the actual cost to Co-op City of the space rented." 421 U.S. at 856. The Court noted also, with apparent approval, the observation of one student commenting on the decision of the Second Circuit that income from these facilities could be viewed not as profit, but as "a rebate on the cost of goods and services purchased at these facilities since it appears likely that they are patronized almost exclusively by Co-op City residents." \textit{Id.}, citing 53 \textit{Texas L. Rev.} 623, 630-31 n.38 (1975).
of the initial investment . . . or a participation in earnings resulting from the use of investors’ funds . . . ." 48

Nor did the Court believe that adoption of the risk capital theory would lead to a different result. 49 It said:

Even if we were inclined to adopt such a ‘risk capital’ approach we would not apply it in the present case. Purchasers of apartments in

48. 421 U.S. at 856. The Court, in formulating this definition, said that only profits realizable in a monetary sense, through either capital appreciation or participation in earnings, were characteristics of other schemes held to be investment contracts. Id., citing SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943) (holding that the sale of oil leases with an agreement by the promoter to drill exploratory wells was an investment contract) and Tcherepnin v. Knight, 389 U.S. 332 (1967) (holding that dividends based on a savings and loan association’s profits were part of an investment contract).

In excluding Forman from this definition, the Court stated:

There is no doubt that purchasers in this housing cooperative sought to obtain a decent home at an attractive price. But that type of economic interest characterizes every form of commercial dealing. What distinguishes a security transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use. 421 U.S. at 858.

This language stressing that Co-op City tenants purchased interests in homes with no profit motivation may cast doubt on the Second Circuit’s decision in 1050 Tenants Corp. v. Jakobson, 503 F.2d 1375 (2d Cir. 1974), decided soon after the Forman decision. In Jakobson the Second Circuit distinguished Forman because tenants’ shares were not subject to the restrictions present in Co-op City and because “there is a ‘profit’ element here that was notably absent in Forman: the shareholder-tenants of 1050 Corp. have the expectation of capital appreciation on a resale of their stock.” Id. at 1378. Whether the expectation of appreciation would be sufficient to satisfy the Supreme Court after Forman may well be determined by whether a profit motive was clearly present in both the marketing and the purchase of cooperative interests.

This is in accord with SEC Securities Act Release No. 5347 (Jan. 4, 1973). Aiming primarily at resort condominiums, the Commission said that federal securities laws would apply to “the offer and sale of condominium units, or other units in a real estate development, coupled with an offer or agreement to perform or arrange certain rental or other services for the purchaser.” The release stresses the situations in which interests “are offered and sold through advertising, sales literature, promotional schemes or oral representations which emphasize the economic benefits to the purchaser to be derived from the managerial efforts of the promoter . . . in renting the units.” Id. (emphasis added).

49. 421 U.S. at 857 n.24.

Co-op City take no risk in any significant sense. If dissatisfied with their apartments, they may recover their initial investment in full. . . . [I]n view of the fact that the State has financed over 92% of the cost of construction and carefully regulates the development and operation of the project, bankruptcy in the normal sense is an unrealistic possibility.”

This analysis, however, seems to ignore the fact that state-financed projects are subject to failure just like privately funded projects if income can no longer meet expenses. In fact, foreclosure proceedings were commenced against Co-op City a short time after the Supreme Court ruled on the case. 51

Professor Coffey’s analysis presents a different view of cooperative ownership. He suggests that there is a risk factor even though a cooperative shareholder is getting back a valuable commodity in the form of a long-term lease in exchange for his initial investment. 52 Coffey reasons that purchasers who supplied the initial value for a project did so in anticipation of the future value of a successful community apartment venture. 53 The facts in Forman indicate that risks are present in a cooperative project and may significantly affect future value. 54 As Justice Traynor wrote in Silver Hills: “Only because [the buyer] risks his capital along with other purchasers can there be any chance that the benefits . . . will materialize.” 55

Despite an appealing argument based on the risk capital theory for inclusion of cooperative interests under the umbrella of securities regulation, the question remains whether such a result would provide desirable consumer protection. This depends largely on whether full disclosure would effectively protect cooperative shareholders’ interests.

50. 421 U.S. at 857 n.24.
51. Bankruptcy is a very real possibility for Co-op City. The New York State Housing Finance Agency began foreclosure action against the massive development in August 1975. About 11,500 of the more than 15,000 tenants had refused to pay an increase of 25 percent in the monthly assessment, leading to an $8,500,000 deficit in payment on the mortgage notes. The increase was attributable to rising maintenance and fuel costs. Other state-financed projects also have faced difficulty because of rising maintenance costs, even without rent strikes. 3 HOUSING & DEV. REP.—CURRENT DEV. 286 (1975).
52. Coffey, supra note 30, at 399-400.
53. Id. Even with the required risk, however, many cooperative projects should not come under the purview of the securities acts in Coffey’s view. This is because each tenant in a smaller cooperative has a measure of control over the entire project. Id. In the factual setting of Forman such control is not present. Each of the more than 15,000 tenants had a single vote in corporate affairs. 421 U.S. at 842.
54. See note 51 supra.
55. 55 Cal. 2d at 815, 361 P.2d at 908, 13 Cal. Rptr. at 188.
Full disclosure, the major requirement of federal and most state securities laws,\(^{56}\) has been criticized as ineffective in many commercial settings.\(^{57}\) Disclosure can be effective among sophisticated parties. But it can be particularly ineffective when an unsophisticated consumer is dealing directly with a sophisticated seller. Even if the seller fully discloses the nature of the transaction, the consumer may still come away with little knowledge of what he has purchased and what risks he is taking.\(^{58}\)

This analysis seems particularly appropriate in considering interests in living units.\(^{59}\) A ""sweetheart"" lease, weak tenant-corporation bylaws or an exorbitant mortgage loan, even if fully disclosed, nonetheless can catch an unsuspecting purchaser by surprise and severely impair his interests.\(^{60}\)

One alternative to regulation under the securities laws is the type of legislation passed recently in Florida.\(^{61}\) That state has adopted signifi-

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57. "[T]here has been in the securities field a rising belief that disclosure as a philosophy of federal securities regulation may not be enough, that more stringent measures are necessary to protect the public against the blandishments of the huckster, the lures of quick riches, the irrationalities that often intrude into the securities markets." Sommer, Random Thoughts on Disclosure as "Consumer" Protection, 27 BUS. LAW. 85 (1971). See also REPORT ON DISCLOSURE TO INVESTORS, supra note 56, at 55-57; Kripke, The Myth of the Informed Layman, 28 BUS. LAW. 631, 632 (1973); Note, Condominium Regulation, supra note 2, at 666-69.

58. Cf. Kripke, supra note 57, at 632 ("My theme is that the theory that the prospectus can be and is used by the lay investor is a myth."). This critique of full disclosure requirements may be less important in states that allow their commissioners of corporations more latitude in determining whether the proposed security offering should be registered. Some states give the commissioners power to determine whether the offering is fair, just and equitable before registration. See, e.g., CAL. CORP. CODE § 25140 (Deering Supp. 1975); MO. REV. STAT. ANN. § 409.306(a)(2)(E)(ii) (Vernon Supp. 1976); N.H. REV. STAT. ANN. §§ 421:27, 421:29 (1968); OHIO REV. CODE ANN. § 1707.13 (Page 1964).

59. Cf. Case & Jester, Securities Regulation of Interstate Land Sales and Real Estate Development—A Blue Sky Administrator's Viewpoint: Part II, 7 URBAN LAW. 385, 443 (1975) (the full disclosure provisions of the Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1701-20 (1970), are ineffective in regulating sales of land because of "the inherent incapacity of full disclosure and private enforcement mechanisms, no matter how well constructed, to deal with the economic realities of the problem without additional support from, if not principal emphasis upon, substantive administrative regulation").

60. A second issue in considering the effectiveness of securities regulation is whether the state and federal regulatory agencies are capable of handling the peculiar problems presented by community apartments. See Note, Cooperative Housing Corporations, supra note 3, a, at 124.

61. FLA. STAT. ANN. §§ 711.01-.72 (Supp. 1975).
cant substantive requirements for cooperatives, whether publicly or privately financed. The legislation, encompassing both cooperatives and condominiums, is a "balance of direct substantive regulation and the more typical disclosure provisions." As an example of its substantive requirements, the statute provides a specific timetable for assumption of control by tenants. It provides also for cancellation of contracts and agreements that were made before the tenants assumed control. Regardless of whether cancellation is possible, the statute requires that all contracts and agreements be "fair and reasonable." Recreational facilities or other common areas subject to "sweetheart" leases may be purchased by the tenant corporation at its option, at a price set by agreement or by arbitration. If monthly assessments set by the corporation board exceed 115% of those for the previous year, tenants may call a special meeting and may adopt a new budget.

The Florida statute also provides for regulation of deposits placed in escrow, with criminal penalties for misuse of funds. For the consumer, there is a right to damages and rescission if there is "reasonable reliance upon any material statement or information that is false or misleading published by or under authority from the developer." The Florida statute, although perhaps not as stringent as it could be in certain respects, is a good attempt at setting specific minimum standards for community apartments, whether cooperatives or condominiums. Other states have some of the substantive provisions in

64. Id. § 711.66(5).
65. Id.
66. Id. § 711.63(7)(a). Arbitration would be conducted under the Florida Arbitration Code, id. §§ 682.01-.22.
67. Id. § 711.44.
68. Id. § 711.67.
69. Id. § 711.71(1). These anti-fraud provisions are substantially different from the federal provisions, see note 12 supra, primarily in regard to the necessity in Florida of "reasonable reliance" and the apparent lack of a remedy in the case of an omission of a material fact. Fl. Stat. Ann. § 711.71 (Supp. 1975). The anti-fraud provisions seem to be the weakest link in the Florida regulatory scheme. Cf. Florida Sale of Securities Law, id. §§ 517.01-.33 (1972), which specifically adopts the federal anti-fraud provisions.
70. See note 69 supra.
71. The Florida statute has been criticized as inadequate by one commentator, insofar as it continues to rely in part upon full disclosure for consumer protection. Note, Condominium Regulation, supra note 2, at 671-74. The author urges instead that a permit system be established under a state regulatory body, whereby experts in the administrative agency would have the power to approve a specific project. To achieve uniformity,
their basic condominium legislation, but none has a similar scheme of substantive regulation for cooperatives.

The decision in *Forman*, with its emphasis on the nonprofit nature of a state-assisted housing project, may do little more than heighten the debate on whether privately financed community apartment interests should be considered securities. Despite the academic appeal of this issue, it begs the more important question. Securities regulation provides certain remedies, but it does not necessarily encourage adequate housing for consumers. By statutorily defining certain minimum standards and providing financial assistance to those states that adopt the same or more stringent standards, the author suggests that the federal government adopt minimum standards and provide such federal legislation would be similar to the proposed Condominium Consumer Protection Act (which was not drafted to include cooperatives) introduced in August 1975 by Senators Proxmire, Brooke and Biden. S. 2273, 94th Cong., 1st Sess. (1975).

The need for establishing federal minimum standards is not clear. Recent surveys showed that complaints most often cited by tenants and tenant associations were: (1) shoddy and sloppy construction, (2) covenants and restrictions that were difficult to understand, (3) insufficient soundproofing, (4) inadequate parking, and (5) substandard maintenance and management. Most of those complaints relate to specific provisions of the community apartment project itself and seem to be inappropriate subjects for federal regulation. Nor is it clear that these problems are sufficiently severe to warrant establishment of a federal system of regulation. Ninety-five per cent of condominium and cooperative owners surveyed recently said they were satisfied or very satisfied with their homes. It may be significant that nowhere in the HUD REPORT, supra note 1, on condominiums and cooperatives is federal legislation advocated by the agency.

The statistics cited above should not be read as negating the need for substantive regulation. The same surveys indicated that 26.9% of all unit holders felt they had been misled in various respects by the developers, particularly regarding maintenance, management and recreation costs. Thirty-four per cent of all owners said developers' estimates of common expenses were significantly low. The number complaining about insufficient estimates increased as family income decreased.

For a compilation of state condominium statutes see 1 HUD REPORT, supra note 1, Table VI-1, at VI-27 to VI-117. This legislation has been described as generally inadequate. Note, Condominium Regulation, supra note 2, at 646-50. For a discussion of state and federal regulation applicable to various aspects of cooperatives see ROHAN, supra note 1, at §§ 3.01-.06(5).

The line between a real estate offering, in its simple form clearly outside the scope of the securities acts, and an investment contract involving real estate is often difficult to draw. See 1 Loss, supra note 12, at 492-94; Coffey, supra note 30, at 399-400; Miller, supra note 1; Note, Cooperative Housing Corporations, supra note 3; Note, Condominium Regulation, supra note 2, at 650-56.

The impact on cooperative developers of the type of legislation discussed herein, see notes 61-69 and accompanying text supra, is difficult to gauge. The Florida statute did not become effective until Oct. 1, 1974, Fla. Laws 1974, c. 74-104, § 19, and it is doubtful
ards in community apartment projects, legislatures would go far toward making these forms of housing even more attractive and beneficial to the consumer.

David W. Martin

that the statute will have a significant effect on cooperatives since few have been built in that state since 1970. Florida has about 9% (or 40,000) of the nation's stock of cooperative units. I HUD REPORT, supra note 1, Table III-13, at III-17. Only 5000 units were built in the 16-state southern region between 1970 and 1974, id., Table III-11, at III-13, and it is doubtful that the number built in 1975 is significant.

Statutes based on the Florida model should not deter development. The substantive regulation is minimal and should not add significantly to a developer's costs. The disclosure provisions, Fla. Stat. Ann. § 711.69 (Supp. 1975), may involve additional cost, but the increase should not be significant.

The substantive regulations may change developers' sources of profits. Instead of permitting a developer to rely on long-term management contracts and extended leases, substantive regulations like Florida's will require that a developer take his profits directly from the sale of cooperative shares.