Real Estate As Securities: Sales of Residential Subdivision Lots
REAL ESTATE AS SECURITIES: SALES OF RESIDENTIAL SUBDIVISION LOTS

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


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


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


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. 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, 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.


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

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. Congress enacted the earliest of the federal statutes in 1933, 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. The Securities Act of 1933 and the Securities Exchange Act of 1934 provide liberal remedies for fraud in securities sales.

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.
14. See 1 L. Loss, supra note 2, at 119-21.
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. 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.'" The statutes do not specify the characteristics of securities, nor do their legislative histories provide much guidance.

16. See note 2 supra.

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.

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 of 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. Tcherepnin 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.


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

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").


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


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 shrunken from a literal reading that would extend the reach of the statutes beyond what could reasonably be thought to have been intended").

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


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.

27. *Id.* at 346.
28. *Id.* at 352.
The Securities Act [of 1933] to end," 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.


36. 328 U.S. at 301.
In *United Housing Foundation, Inc. v. Forman* and *International Brotherhood of Teamsters v. Daniel*, 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." 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. 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.

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. *Daniel* also relied on the subjective intention of the investor for identifying securities. Because the pension plan was a relatively insignificant

39. 421 U.S. at 852.
40. *Id.* at 854.
41. *Id.* at 835, 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

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.
51. 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.
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-


54. See note 4 supra.


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.

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

II. SALES OF LOTS IN RESIDENTIAL SUBDIVISIONS

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

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.


A. Investment

The first element of the Howey test requires a finding that the purchaser of a subdivision lot made an "investment." Although the purchaser of stock clearly intends to make an investment, the buyer of residential property may be seeking only a residence. The distinction between these transactions is the commercial-investment dichotomy. 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.

The "investment" criteria appear in most of the subdivision lot cases. Six of the eleven subdivision cases used both criteria. One case examined only the buyer's motive, and one case relied solely on the promoter's emphasis. These analyses conform to Supreme Court holdings. The Joiner Court held that "it is not inappropriate that promoters' offerings be judged as being what they were represented to be." 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. Courts can satisfy the first element of

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65. See note 35 supra and accompanying text.
66. Id.
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.
71. See Woodward v. Terracor, 574 F.2d 1023, 1025 (10th Cir. 1978).
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, advertisements, and other literature. Courts, however, have found "investment" or "commercial" emphasis in seminars for sellers or the public, instructions to salesmen, maps, oral representations to buyers, and even a General Form for Registration of Securities filed with the SEC. Most courts consider the seller's emphasis in conjunction with the buyer's motive for purchasing the land. 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, did not find a se-
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 materials\(^{91}\) 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.'"\(^{95}\)


\(^{89}\) See notes 37-44 supra and accompanying text.


\(^{92}\) *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. 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. If litigants cannot prove that the sale's character is predominately "investment" or "commercial," the general rule that real estate is not a security may compel courts to rule against plaintiffs' securities claims.

Despite the inconsistencies and complexities 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. 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-

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96. See notes 69, 85 supra and accompanying text.
97. See Timreck 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 Timreck and Davis allude to the "predominant" test; neither case clearly states the rule. The buyers in Timreck 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.").
fore, is not like a security.\textsuperscript{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.\textsuperscript{103}

B. Common Enterprise

If the buyer has made an investment,\textsuperscript{104} the \textit{Howey} test requires the buyer to make the investment in a common enterprise.\textsuperscript{105} Courts that explicitly find a common enterprise under \textit{Howey} usually confront one of two situations: a pooling of funds provided by investors,\textsuperscript{106} or investors' dependence on promoters for the success of the common enterprise.\textsuperscript{107} Seven\textsuperscript{108} of the eleven subdivision cases\textsuperscript{109} analyzed the "common enterprise" component of \textit{Howey} in terms of these two situations.

Of the four cases that used the pooling concept,\textsuperscript{110} three cases found

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

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

\textsuperscript{104} \textit{See} notes 65-103 \textit{supra} and accompanying text.

\textsuperscript{105} \textit{See} note 35 \textit{supra} and accompanying text.

\textsuperscript{106} \textit{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"). \textit{But see} SEC v. Continental Commodities Corp., 497 F.2d 516, 522 (5th Cir. 1974) (pooling is not essential).


\textsuperscript{109} \textit{See} note 5 \textit{supra}.

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

The fourth pooling case, \textit{Bubula v. Grand Bahama Development Co.},\textsuperscript{114} involved a clear example of pooling. The purchase agreement in \textit{Bubula} required lot owners to pay “a relatively small annual ‘service’ charge” for ninety-nine years to finance improvements.\textsuperscript{115} The court, however, did not find a common enterprise.\textsuperscript{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.\textsuperscript{117} Moreover, an Illinois appellate court, in \textit{Anderson v. Grand Bahama Development Co.},\textsuperscript{118} had little difficulty finding a common enterprise in a case “arising out of the same facts” as \textit{Bubula},\textsuperscript{119} although it used the dependency concept\textsuperscript{120} to find a common enterprise.\textsuperscript{121}

Three subdivision lot cases, including \textit{Anderson}, employed the dependency concept in common enterprise analyses.\textsuperscript{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 developer for the improvements.


\textsuperscript{114} No. 73 C 3131 (N.D. Ill. June 27, 1974).

\textsuperscript{115} \textit{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.’” \textit{Id.}

\textsuperscript{116} \textit{Id.}, slip op. at 3.

\textsuperscript{117} See notes 111-13 supra and accompanying text.


\textsuperscript{119} \textit{Id.} at 692, 384 N.E.2d at 984.

\textsuperscript{120} See note 107 supra and accompanying text.

\textsuperscript{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.

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

C. Profits

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

123. See notes 107, 122 supra.
127. See note 35 supra and accompanying text.
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.

130. "[T]he investor is 'attracted solely by the prospects of a return' on his investment." 421
Eight of the eleven subdivision cases analyzed "profits." The alleged profit in each case was increased land values resulting from the seller's improvements in the subdivision, but only one of these cases explicitly held that the capital appreciation could constitute "profits." 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 enterprise or the efforts of others to be considered "profits."

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

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.


132. See note 5 supra.

133. See note 131 supra.


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).


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. Analysis of "profits" only in the context of the other Howey-test elements, 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." 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." Many of the residential subdivision cases measure the seller's obligations against this more lenient standard set forth in SEC v. Glenn W. Turner Enterprises, Inc. These obligations range from routine improvements such as roads and sewers to construction of extraordinary facilities such as golf courses and lakes.

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.
144. 474 F.2d 476, 482 (9th Cir.), cert. denied, 414 U.S. 821 (1973). See notes 51-55 supra and accompanying text.
In their analyses of the promoters' efforts, the subdivision cases\textsuperscript{146} examined either the extent of the promoters' duties\textsuperscript{147} or the impact of those duties on land values.\textsuperscript{148} Cases reviewing the extent of the promoter's efforts\textsuperscript{149} establish a general rule that the promoters' duties must be more than "[m]inimal managerial services,"\textsuperscript{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 \textit{Howey} test.\textsuperscript{151} The developers' efforts must be "undeniably significant" or "essential" to fulfill the \textit{Turner}\textsuperscript{152} modification of \textit{Howey}. The test is easily satisfied when the promoter has the exclusive right to develop the subdivision.\textsuperscript{153}

The second method of fulfilling the \textit{Howey} test's fourth element is to prove that the promoter's duties will increase land values.\textsuperscript{154} Plaintiffs in nine\textsuperscript{155} of the eleven subdivision cases\textsuperscript{156} argued that the seller's obli-

\textsuperscript{146} See note 5 supra.
\textsuperscript{147} See notes 149-58 infra and accompanying text.
\textsuperscript{148} See notes 154-58 infra and accompanying text.
\textsuperscript{150} Timmreck v. Munn, 433 F. Supp. 396, 403 n.4 (N.D. Ill. 1977). \textit{Timmreck} uses both means of analyzing the promoter's efforts. Those efforts must extensively develop and improve the subdivision, \textit{id.} at 403, and "substantially increase the value of the individual lots," \textit{id.} at 400.
\textsuperscript{151} Woodward v. Terracor, 574 F.2d 1023, 1025 (10th Cir. 1978).
\textsuperscript{152} See notes 50-51, 141-44 supra and accompanying text.
\textsuperscript{154} See note 148 supra and accompanying text.
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.\textsuperscript{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.\textsuperscript{158}

The cases reveal two means of establishing that the promoter should provide "essential" efforts,\textsuperscript{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.\textsuperscript{160} The purchaser's case is strongest when a written contract stipulates the duties,\textsuperscript{161} but some cases hold that implied offers\textsuperscript{162} or oral representations\textsuperscript{163}—or even "utterances"—may establish the promoter's responsibility.

\textsuperscript{156} See note 5 \textit{supra}.\n

\textsuperscript{158} The court in \textit{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. \textit{See}, e.g., cases cited note 157 \textit{supra}. One commentator observed that, "Though the analysis in \textit{Davis} may be suspect, it is nevertheless possible that the court reached the correct result." \textit{Newton}, \textit{supra} note 2, at 190.

\textsuperscript{159} See notes 147-48 \textit{supra} and accompanying text.


\textsuperscript{161} See \textit{McCown v. Heidler}, 527 F.2d 204, 209 (10th Cir. 1975).


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

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 test\textsuperscript{175} is the predominant difficulty of separating the Howey elements to give them independent meaning.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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

\textsuperscript{175} See note 35 supra and accompanying text.
\textsuperscript{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.
\textsuperscript{177} See notes 65-103 supra and accompanying text.
\textsuperscript{178} See notes 104-26 supra and accompanying text.
\textsuperscript{179} See notes 129-32 supra and accompanying text.
\textsuperscript{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. The buyer who never intends to live on the lot 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. The shares are securities, and the developer should not be able to circumvent securities regulation by substituting lots for shares.

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

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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. EURICH, 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.

Kenneth D. Crews

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.