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LOOKING THROUGH FORM TO SUBSTANCE:
ARE MONTANA RESORT CONDOMINIUMS "SECURITIES"?

Gerald B. Murphy
William T. Wagner

The determination of whether or not a particular transaction constitutes a "security" is vital to the operation and effect of securities legislation. In response to the expanding reach of such legislation into hitherto untouched areas, the authors have chosen to examine the historical development of the meaning of the term "security". After submitting that the definition's evolution has resulted in transactional and jurisdictional inconsistencies, they focus upon application of securities legislation to condominium projects. The authors conclude by submitting that condominiums in Montana should not be regulated as securities, due primarily to the objectives of securities legislation and the existence of viable alternate regulation at the state and federal levels.

INTRODUCTION

The scope of securities legislation and the jurisdiction of the Securities and Exchange Commission is limited by the statutory definition of a security. The definition section of the Securities Act of 1933, \(^1\) representative of most federal and state acts, \(^2\) defines a security first by listing a number of fairly specific types of devices and arrangements, and then by including a group of more general classifications. \(^3\)

Since Congress chose to merely identify types of securities and failed to establish any standards for applying the definition, the courts have been forced to develop their own criteria for determining whether a transaction constitutes a security.

Any tracing of the historical development of the meaning of the term "security" must therefore begin with an examination of judicial attempts at developing such viable criteria. As will be shown, the invention of novel investment schemes has proved that any definition of a security must necessarily possess flexibility sufficient to allow the inter-

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\(^3\)Securities Act of 1933, 15 U.S.C. § 77b(1) defines a "security" as: . . . [A]ny 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, transferrable 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.
vention of the SEC into those areas at which securities legislation is aimed.

HISTORY

A. Development of the Meaning of a "Security"

State courts began interpreting state securities legislation in the early 1900's and their interpretations were to have a pronounced influence upon subsequent attempts by the United States Supreme Court to define a security transaction. These state statutes were termed "Blue Sky Laws" because their provisions were aimed at regulating speculative schemes that had no more basis than so many feet of blue sky. They were intended to stop the sales of shares in visionary oil wells, non-existent gold mines, and other "get-rich-quick" schemes calculated to separate credulous investors from their savings. The same theme underlies the federal securities legislation; the United States Supreme Court was not reluctant to draw upon state court interpretations of "Blue Sky Laws."

In 1920, the Supreme Court of Minnesota ruled in State v. Gopher Tire & Rubber Co. that where a corporation issued and sold certificates, whereby a purchaser would share in the profits if he paid a certain sum and assisted in promoting the sale of goods manufactured by the corporation, the transaction was within the securities laws. In reaching this decision, the court issued a caveat to all subsequent courts interpreting securities laws:

To lay down a hard and fast rule by which to determine whether that which is offered to a prospective investor is such a security as may not be sold without a license would be to aid the unscrupulous in circumventing the law.

This theme was adopted by the United States Supreme Court twenty-three years later in the first Supreme Court case to interpret the 1933 Act, SEC v. C.M. Joiner Leasing Corp. In Joiner, the defendant had engaged in a campaign to sell assignments of oil leases. The sales brochure assured the prospective investor that the Joiner Corporation was engaged in and would complete the drilling of a test well so located as to test the oil-producing possibilities of the offered leaseholds. The Court noted that defendants were not offering naked leasehold rights. They offered a chance, without delay or additional cost, to share in discovery values which might follow a current exploratory enterprise.

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7 Id., supra note 4 at 938.

8 Id., where the court stated that an investment is "'[t]he placing of capital or laying out of money in a way intended to secure income or profit from its employment. . . .'" (footnote)

The undertaking to drill a well permeated the entire transaction. The Court held this to be a security transaction which, since not registered, was in violation of the 1933 Act. The Court stated that the documents containing an offer of an economic interest in well-drilling operations possessed all the evils inherent in a security transaction at which the Securities Act of 1933 was aimed.

The Court evidenced the influence of the Gopher Tire rationale when it stated:

The reach of the [1933] Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts', or as 'any interest or instrument commonly known as a 'security'.'

The Court emphasized the importance of looking through form to substance in determining the existence of a security.

Three years later in SEC v. W.J. Howey Co., Justice Murphy, speaking for the Court, fashioned the so-called Howey test for determine the existence of a security:

An 'investment contract' under the Securities Act means 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.

The Court in stating this test appeared to be attempting to reformulate the test that had been applied in Gopher Tire, Joiner, and numerous lower federal court decisions. However, by placing the word "solely" into the third element of the test (that profits come solely from the efforts of others) the Court added a troublesome element in its attempt to state a comprehensive test. Although the Gopher Tire decision was cited by the Court as authority for the Howey test, it is interesting to note that the Gopher Tire facts would not have fit a literal application of the new test. In Gopher Tire, the solely from the efforts of others requirement would not have been met since a certificate holder was

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10 M. at 351.
11 Id. at 349.
12 Id. at 351.
14 Id. at 298-299.
19 Id. at 937-938.
appointed an agent to assist sales by word of mouth and in other ways.\textsuperscript{20}

It appears that the use of the word "solely" was prompted by the factual situation facing the Court in \textit{Howey}.\textsuperscript{21} The Howey Company offered each prospective customer, in the form of both a land sales contract and a service contract, separately deeded groves of orange trees. A purchaser was free to make arrangements for a service contract with other service companies regarding management of the groves and marketing of the fruit. The company's brochure, however, encouraged the use of Howey-in-the-Hills, Inc., which was under the management and control of the Howey Company, to manage the groves and market the oranges with a pro-rata deduction for expenses and fees. Without the consent of the company, the landowner or purchaser had no right of entry to market the crop.\textsuperscript{22} In contrast to the \textit{Gopher Tire} case, it can readily be seen that profits were in fact to come solely from the efforts of others. The Court, however, warned against a literal interpretation of its new test. The Court stated that the statutory aim of the Securities Act of 1933 embodied a "flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits."\textsuperscript{23} Although the Court warned against literal application of its formula, a number of courts have interpreted the word "solely" literally.\textsuperscript{24} The danger of a literal approach can easily be seen because the \textit{Gopher Tire} case would not have fit the \textit{Howey} test. This creates an illogical result because the \textit{Howey} formula was intended to be predicated upon the \textit{Gopher Tire} rationale.\textsuperscript{25}

The \textit{Howey} test assumed and maintained a controlling position in the realm of securities litigation for many years. That position, however, was not to be a permanent one. Recently, numerous modifications of the test's interpretation and application have served to deteriorate its impact.

\textbf{B. RECENT DEVELOPMENTS}

In their attempts to keep pace with the ever-increasing variety of schemes designed specifically to take advantage of the loophole created by the \textit{Howey} test's solely requirement, courts soon began to realize the necessity of overcoming the burden imposed by that require-
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The California supreme court initiated the first significant departure from the literal Howey test by stating a test with a new focus in Silver Hills Country Club v. Sobieski. In that case defendants offered membership interests in an unconstructed country club as a means of financing the construction costs for various club improvements. Membership interests entitled the holders thereof to use the club's facilities, but the membership application and the club's bylaws specifically provided that members would have no rights in the income or assets of the club.

The Supreme Court of California upheld the contention of the California Commissioner of Corporations that these interests constituted securities. Since no efforts were required on the part of membership interest holders, the court could have based its decision on a literal application of the Howey formula. The court, however, avoided Howey altogether. In its place, the court relied upon a novel "risk capital" test to justify the finding of a security:

[Defendants] are soliciting the risk capital with which to develop a business for profit. . . . [O]nly because the purchaser risks his capital along with other purchasers can there be any chance that the benefits of club membership will materialize. . . . [T]he [Corporate Securities] Act[s]' objective is to afford those who risk their capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return on their capital in one form or another. . . . [P]roperly so, for otherwise it could too easily be vitiated by inventive substitutes for conventional means of raising risk capital.

The "risk capital" test has received measureable acceptance. Two 1971 decisions specifically based their conclusions on that test, State v. Consumer Business System, Inc. and State v. Hawaii Market Center, Inc. In the latter case, the Supreme Court of Hawaii took the opportunity to severely criticize the solely requirement of Howey when it stated:

The primary weakness of the Howey formula is that it has led courts to analyze 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.

Another example of open criticism of the Howey test occurred in Georgia Market Centers, Inc. v. Fortson where the court advocated a flexible interpretation of the Howey requirement that profits be de-

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*Id. at 909.

*Id. at 908-909.


*Id. at 108.

*Georgia Market Centers, Inc. v. Fortson, supra note 24.
rived solely from the efforts of others. The Supreme Court of Georgia stated:

It is our opinion that the definition of an investment contract given by the Supreme Court of the United States is a workable formula. . . . However, we would not mean to infer that this definition should be adhered to with such strictness that a mere token participation in an enterprise by the person investing capital would prevent the contract from being classed as a security.\footnote{Id. at 623.}

Still other courts have expressed dissatisfaction with the results of applying Howey's solely requirement. Recently, in Sanders v. John Nuveen & Co., Inc.,\footnote{Sanders v. John Nuveen & Co., Inc., 463 F.2d 1075 (7th Cir. 1972), cert. denied, 409 U.S. 1009 (1972).} the Seventh Circuit Court of Appeals adopted the Gopher Tire test\footnote{See test mentioned supra note 7.} as the holding in Howey and thus avoided the solely problem. The case involved the sale of short term notes with a maturity of less than nine months. Though such notes are specifically excluded from the definition of a security in the 1934 Act,\footnote{Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (1970).} the defendants had represented the notes as being open market paper. The court found the notes to be securities on the basis of the Gopher Tire test, though it cited Howey as its source.\footnote{Sanders v. John Nuveen & Co., Inc., supra note 34 at 1080. The SEC itself laid the foundation for the Sanders approach. In a joint release issued in 1967, the Maryland Division of Securities, the Virginia Division of Securities, the Public Service Commission of the District of Columbia, and the SEC stated: Under the Federal Securities Laws, an offering of limited partnership interest and interest in joint or profit sharing real estate ventures generally constitutes an offering of a 'profit sharing agreement' or an 'investment contract' which is a 'security' within the meaning of Section 2(1) of the Securities Act of 1933. The Supreme Court has said that an 'investment contract' is a contract, transaction or scheme whereby a person invests money in a common enterprise and is led to expect profits from the efforts of the promoter or a third party. [citing Howey]. In other words, the investor provides the capital and shares the risk and the profits; the promoter or third party manages, operates and controls the enterprise, usually without active participation on the part of the investor. SEC Securities Act Release No. 4877 (Aug. 8, 1967) [1966-1967 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 77,462. It is essential to note the absence of the word 'solely'.} It is noteworthy that amidst this anxiety shrouding the Howey test that only one vastly different formula has been propounded to replace it. Dissatisfied with the twenty-eight-year-old Howey test (then twenty years old), Professor Ronald J. Coffey of Western Reserve University formulated a policy-oriented test based upon "the essential economic considerations underlying the 'security' concept."\footnote{Coffey, The Economic Realities of a "Security": Is There a More Meaningful Formula?, 18 W.Ras.L.Rev. 367 (1967).} Coffey's basic premise is that if a transaction embodies conditions conducive to the potential abuses at which securities legislation is aimed, then the existence of certain identifiable characteristics of that transaction should necessitate a court's holding that it involves a security. His result is principally an
extension of the "risk capital" test,\textsuperscript{39} in that his formula focuses upon the existence of any significant risk to one's initial investment.

Introducing his test as one which would allow a court to "distinguish a security from the generality of transactions so as to create a need for the liberal procedures, protections and remedies provided by the securities laws against fraud and half-truths,"\textsuperscript{40} Coffey's formula assumed the following form:

A 'security' is:

1. A transaction in which
2. a person ('buyer') furnishes value ('initial value') to another ('seller'); and
3. a portion of initial value is subjected to the risks of an enterprise. it being sufficient if-
   a. part of initial value is furnished for a proprietary interest in, or debt-holder claim against, the enterprise, or
   b. any property received by the buyer is committed to use by the enterprise, even though the buyer retains specific ownership of such property, or
   c. part of initial value is furnished for property whose present value is determined by taking into account the anticipated but unrealized success of the enterprise, even though the buyer has no legal relationships with the enterprise; and
4. at the time of the transaction, the buyer is not familiar with the operations of the enterprise or does not receive the right to participate in the management of the enterprise; and
5. the furnishing of initial value is induced by the seller's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above initial value, will accrue to the buyer as a result of the operation of the enterprise.\textsuperscript{41}

Although prolifically cited and discussed, the Coffey formula has not been overwhelmingly accepted. Courts continue to apply the \textit{Howey} test, either as originally stated\textsuperscript{42} or as modified by various jurisdictions.\textsuperscript{43}

Two final developments regarding the definition of a security must be noted in order to appreciate the current scope of SEC involvement. The first concerns a 1971 SEC release in which the Commission explicitly denounced blind adherence to a literal application of the \textit{Howey} formula. Perhaps influenced by the numerous judicial modifications of that formula, the SEC stated:

It must be emphasized that the assignment of nominal or limited responsibilities to the participant does not negative the existence of an investment contract; where the duties assigned are so narrowly circumscribed as to involve little real choice of action or where the duties assigned would in any event have little direct effect upon receipt by the participant of the benefits promised by the promoters, a security may be found to exist. As the Supreme Court has held, emphasis must be placed upon economic reality. [citing \textit{Howey}].\textsuperscript{44}

\textsuperscript{39}\textit{Discussed supra} notes 28-30.
\textsuperscript{40}\textit{Coffey, supra} note 38 at 376.
\textsuperscript{41}\textit{Id.} at 377.
\textsuperscript{42}See cases mentioned \textit{supra} note 24.
\textsuperscript{43}See cases mentioned \textit{supra} notes 26, 29, 30, 32, 34.
The second development is a recent Ninth Circuit decision, SEC v. Glenn W. Turner Enterprises, Inc.46 There the court decided not to read solely literally in order to find that a fraudulent scheme required registration. In Turner, the SEC had issued a preliminary injunction to prohibit the offering and selling of certain “Adventures” and “Plans” by Dare To Be Great, Inc., a Florida corporation and wholly owned subsidiary of Glenn W. Turner Enterprises, Inc. The question before the court was whether the “Adventures” or “Plans” enjoined were “securities” within the meaning of the 1933 Act. There were two elements to the “Adventures” or “Plans”: (1) the purchaser was privileged to attend seminar sessions and receive tapes, records and other material aimed at improving self-motivation and sales ability; and (2) if he purchased one of the more expensive “Adventures” or “Plans” he also received the opportunity to help sell the courses to others. If successful, the purchaser received part of the purchase price as a commission. Once an individual had purchased an “Adventure” or “Plan”, he turned his efforts toward bringing others into the organization for which he would receive a part of their financial contributions. A purchaser’s task was to bring prospective purchasers to “Adventure Meetings”.46 The court held that this transaction was within the purview of the 1933 Act, quoting Tcherepnin v. Knight47 where the Court stated: “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.”48 The Turner court approached the definition of a “security” with this admonition in mind.49 Based on the facts the court stated that all the elements of the Howey test had been met save the element requiring that profits come solely from the efforts of others.50

Because the scheme involved was, in the opinion of the court, obviously fraudulent, the court strained to find a security transaction. In looking through form to substance, the court stated:

In light of the remedial nature of the legislation, the statutory policy of affording broad protection to the public, and the Supreme Court’s admonitions that the definition of securities should be a flexible one, the word ‘solely’ should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not in form, securities.51

The court next noted that a strict interpretation of the Howey test had met with criticism, citing State v. Hawaii Market Center, Inc.52 The court rightly held that to apply a strict interpretation would allow un-

47Id. at 479.
50Id. at 481-482.
51Id. at 482.
scrupulous enterpreneurs to avoid registration by simply adding a requirement that the purchaser contribute a "modicum of effort."

The court's holding in *Turner* was not a major attempt to redefine the essential nature of a security nor did it represent any real departure from the *Howey* test. The court merely refused to apply dogmatically the *Howey* test where it would have led to an unrealistic result.

The courts continue to struggle with the *Howey* test and undoubtedly some will use the techniques discussed *supra* to avoid the unrealistic results that a literal application may yield. When confronted with this problem the courts should heed the directive of the *Howey* court and look through form to substance.

**APPLICATION OF SECURITIES LAW TO CONDOMINIUMS**

A. Development

Tax advantages and utilization of management services have contributed to the increased popularity of both residential and resort condominiums. Accompanying this development is a growing trend toward the renting of non-owner occupied units, particularly as to resort condominiums. Since this trend embodies investment characteristics, it has drawn the attention of the SEC.

The Commission early found that where condominiums were sold in connection with a "rental pooling agreement" the transaction would require registration under the Securities Act of 1933. Developers sought to avoid registration due to the expense and time involved and were successful in many instances by avoiding any mention of a pooling arrangement.

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55"...[A]n ever-increasing share of the condominium market is being taken up by leisure-oriented developments, located predominantly in ski areas and traditional vacation states..." [such as Montana]. *Rohan, The Securities Law Implications of Condominium Marketing Programs Which Feature a Rental Agency or Rental Pool*, 2 CONN.L.REV. 1 (1969).
56A "rental pooling agreement" typically provides for the pooling of all rental income which is distributed on a prescribed basis, notwithstanding the fact that some units remain vacant.
Divergent rulings on the subject of whether or not certain rental agreements were within the purview of the 1933 Act prompted the Commission to issue Securities Act Release No. 33-5347 in 1973.\(^6\) The stated purpose of the release was to alert developers engaged in building and selling condominiums of their responsibilities under securities legislation. The SEC noted that recent interpretations of the *Howey* test had indicated that the expected return to investors need not be *solely* from the efforts of others. For this reason, the Commission stated that an investment contract could be present in situations where an investor was not wholly inactive, but even participated to a limited degree in the operation of the business. Although the Commission noted the fact that recent decisions had modified the *solely* requirement, it returned to the traditional *Howey* test when it stated:

Condominiums, coupled with a rental agreement will be deemed to be securities if they 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, or a third party designated or arranged for by the promoter, in renting the units.\(^6\)

The Commission then set forth its guidelines. It decided that the offering of condominium units in conjunction with any one of the following would cause the offering to be regarded as the offering of a security in the form of an investment contract:

1. The condominiums, with any rental arrangement or other similar service, are offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter, from rental of the units;
2. The offering of participation in a rental pool arrangement; and
3. The offering of a rental or similar arrangement whereby the purchaser must hold his unit available for rental for any part of the year, must use an exclusive rental agent or his otherwise materially restricted in his occupancy or rental of his unit.\(^6\)

The Commission further stated that an owner of a condominium may, without registering, enter into a non-pooled rental arrangement with an agent not required to be used as a condition to the purchase.\(^6\) Furthermore, a continuing affiliation between the project developers or promoters and the project by reason of maintenance arrangements will not, in the opinion of the SEC, make the unit a security.\(^6\)

In direct contrast with the joint release issued in 1967 where the *solely* requirement was deleted,\(^6\) the guidelines contained in SEC Release No. 33-5347 clearly revitalize that requirement of the *Howey* formula. Under its newly promulgated guidelines, the SEC will require

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\(^6\)Id.
\(^6\)Id.
\(^6\)Id. (whether or not the agent is affiliated with the offeror).
\(^6\)Id.
registration of an offering only if a prospective purchaser must enter into a rental pooling agreement whereby his return will be earned solely through the efforts of others. Registration is not required, however, if the purchaser's return on his investment is to be realized by his own efforts. The SEC will not intervene if the purchaser either rents his unit himself or has the option of choosing a rental agency, whether or not independent of the developer-offeror. The effect of this revitalization of the solely requirement is to allow a developer to circumvent SEC regulation by allowing the purchaser to participate in rental arrangements. Such an effect leads to unrealistic results since the substance of a transaction should prevail over its form.

B. Evaluation of the SEC's Position

The guidelines set forth in SEC Release No. 33-5347 are misdirected for three principal reasons. First, the guidelines are not indicative of, nor responsive to, the overall objectives of securities legislation. Second, no consideration is given to the fact that transactions which meet the prescribed guidelines may already be regulated by alternate agencies. Third, application of the guidelines to condominium projects serves to reaffirm the solely requirement of the Howey test.

1. Objectives of Security Legislation

The overriding objective of securities law is the protection of investors. In seeking to attain this objective, the 1933 Act provides for full and fair disclosure of all material facts to investors in connection with distributions of securities by issuers. The 1933 Act, remedial legislation requiring liberal interpretation, was designed to "promote full disclosure of information thought necessary to informed investment decisions." Therefore, the existence of a security, assuming no exemptions are available, requires registration with the SEC. The registration process serves only to inform the investor about the offeror's status; the critical investment choice remains with the investor.

In light of these statutory objectives, it appears that the SEC's condominium guidelines are misdirected. Because of the effect of viable alternate regulatory provisions, no meaningful distinctions as to the necessity of protecting prospective condominium purchasers can be drawn between the following examples: (1) where the purchaser is required to participate in a rental pooling arrangement operated by a developer, and (2) where the purchaser may rent the unit himself or employ the services of an independent rental agency.

67Tcherepnin v. Knight, supra note 47 at 336.
2. **Alternative Regulation**

In the realm of condominium developments, there exists legislation which serves to perform the function of the SEC—namely, the protection of the investor. In Montana, the Unit Ownership Act\(^*\) vests the Department of Business Regulation with the task of regulating condominium projects.

Beginning with a comprehensive definition section,\(^6\) the Act provides for protective disclosure requirements. The following eight provisions are posited as being representative of the type of extensive protective mechanisms which serve to fulfill objectives parallel to securities legislation:

1. In order to comply with the provisions of the Act, the owners or lessees must execute, acknowledge and record a declaration. Prior to recording the instrument with the county clerk and recorder, it must be approved by the Department of Revenue. Approval of a declaration, the elements of which are set forth in R.C.M. 1947, §§ 67-2314(1)-(8), requires that all state taxes and assessments have been paid.\(^7\)

2. Floor plans of the building(s) described in a declaration must be recorded simultaneously with the declaration. The plans must be certified by a registered architect or a registered professional engineer.\(^8\) A 1973 amendment to the Act provides for the refund of purchasers' funds if there are any unapproved alterations in these plans.\(^9\)

3. Of units are conveyed or leased prior to completion of the building's construction, R.C.M. 1947, § 67-2303.1 requires that all moneys from the sale or lease of the units are to be placed in an escrow account. No disbursements may be made from such fund until completion of the building and all common elements or until compliance with provisions (4) and (5).

4. In order to use purchasers' funds for the construction costs of the condominium project, a developer must file a written notice of intention to sell with the Department of Business Regulation. Such

\(^*\) R.C.M. 1947, §§ 67-2301—2344.

\(^6\) R.C.M. 1947, § 67-2302. The following definitions are especially significant:

(5) 'Condominium' means the ownership of single units with common elements located on property submitted to the provisions of sections 67-2301 to 67-2342.

(12) 'Project' means a real estate condominium project; a plan whereby a condominium of two (2) or more units located on property submitted to the provisions of 67-2302 to 67-2342, are offered or proposed to be offered for sale.

\(^7\) R.C.M. 1947, § 67-2317(1), (2).

\(^8\) R.C.M. 1947, § 67-2319.

\(^9\) R.C.M. 1947, § 67-2303.4(1).
notice shall "fully disclose all material facts on a form prescribed by the department." 73

(5) After receipt of an intention to sell, the department shall inspect the project and examine the accounts and records of the developer. A report of its inspection shall be on file and available for public inspection in the office of the director of the department.74 After the filing of the inspection report and the recording of the declaration, the department shall issue its final report based upon the above data and six essential disclosure provisions.75 If after the issuance of a final report, any circumstances occur which would render the report misleading as to purchasers or if the developer proposes to materially change the project, R.C.M. 1947, § 67-2305.5(2) provides that sales shall be halted until the department has been furnished with sufficient information to issue a supplementary report.

(6) A developer may not enter into a binding contract for the sale or lease of a unit until:

(a) the department's final report (and all supplementary reports, if any) have been given to the purchaser;

(b) a prospective purchaser has been given the opportunity to read the report(s); and

(c) a prospective purchaser has executed a receipt for the report(s). 76

(7) The Act further provides for specific provisions which must be included in a condominium deed or lease.77

72R.C.M. 1947, § 2303.2(1), (2).
73Id.
74R.C.M. 1947, § 67-2303.5(1) (a) requires that the following be filed with the department:
(i) a verified statement showing all costs involved in completing the project, including land, ground lease payments and equipment lease payments, real property taxes, construction costs, architect, engineering, and attorneys fees, financing costs, provisions for contingency, and other costs which must be paid on or before the completion of construction of the building;
(ii) a verified estimate of the time of completion of construction of the total project;
(iii) satisfactory evidence of sufficient funds to cover the total project cost from purchasers funds, equity funds, interim or permanent loan commitments, or other sources;
(iv) a copy of the executed construction contract;
(v) satisfactory evidence of a performance bond of not less than one hundred percent (100%) of the cost of construction with a reliable surety company;
(vi) if purchasers funds are to be used for construction, an executed copy of the escrow agreement for the escrow funds required under section 67-2303.1 for financing construction.
75R.C.M. 1947, § 67-2303.6(1).
76R.C.M. 1947, § 67-2322 provides that the deed or lease of a unit shall contain:
(1) A description of the land, the name of the property, and the recording index numbers and date of recording of the declaration.
(2) The unit designation of the unit.
(3) The use for which the unit is intended.
(4) The percentages of undivided interest in the common elements appertaining to the unit.
Lastly, R.C.M. 1947, § 67-2343 vests the Department of Business Regulation with both investigative and injunctive powers in the event the department has satisfactory evidence indicating that any person has violated any provision of the Act.[78]

Both the extensive disclosure requirements and the investigative-injunctive powers granted the department serve to afford adequate protection to potential purchasers of condominium units in Montana. Comparable requirements at the federal level are contained in the Interstate Land Sales Full Disclosure Act,[79] the provisions of which may also apply to condominium projects. In summary, there exist viable alternative means of regulating the sale or lease of Montana resort condominiums. Compliance with the provisions of the Unit Ownership Act appear to dispel the necessity of requiring duplicate, or even triplicate, duties of disclosure.

C. Erosion of the "solely" Requirement

As developed earlier, Howey's solely from the efforts of others requirement has been modified or ignored by numerous courts. Courts have lessened its impact in order to supply needed protection to investors in various transactions.

The new SEC condominium guidelines have resurrected and strengthened the solely requirement. A reversion to a strict application of that requirement serves to defeat the intent of securities legislation. By affording the condominium purchasers the opportunity to rent their units themselves or to select independent rental agencies, developers will be able to evade the consequences of SEC intervention. It appears that the SEC has ignored the fact that any formula which purports to guide courts in determining whether or not a particular transaction constitutes a security should be broad and flexible enough to fulfill the remedial purposes of security legislation.

CONCLUSION

With the resurrection of the solely requirement many courts will continue to struggle with a literal application of the Howey test. Hopefully, most courts will seek to avoid unrealistic results and look through form to substance. In any event Montana resort condominiums should not be regulated as securities. The existence of alternate regulation affording investors adequate protections precludes the necessity of SEC involvement.

(5) Any further details the grantor and grantee or lessor and lessee may consider desirable.

*Furthermore, R.C.M. 1947, § 67-2344 provides that any person violating any provision of the Act is guilty of a misdemeanor and is punishable by a fine not exceeding one thousand dollars ($1,000.00) or by imprisonment for not more than one (1) year, or both.