Condominiums as Investment Contracts under the Securities Laws

Bamert v. Pulte Home Corp.

The federal securities laws apply only to “securities,” which Congress defined to include investment contracts. 15 U.S.C. §§ 77(b)(A)(1); 78c(a)(10). But “investment contract” is not itself defined, and so the judiciary was left to put the flesh on the statutory bones. In SEC v. W.J. Howey Co., 328 U.S. 293 (1946), the Supreme Court held that an investment contract 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.” A common question regarding investment contracts is whether a purchase agreement and management agreement of a condominium is an investment contract under the securities laws. In Bamert, the plaintiffs each bought at least one condominium unit from Pulte Home Corp., and entered into a management agreement with another company for the short-term rental of those units. The plaintiffs claimed that they were investors in a program where they would purchase condos and all the expenses relating to ownership would be paid out of rents from short-term rentals. The plaintiffs would benefit from the appreciating value of the condos, and the management company would keep any rental profits above the costs of ownership. The plaintiffs claimed that these were “investment contracts” sold in violation of various federal and state securities laws. The district court dismissed the claim, reasoning that the purchase agreements were not investment contracts and thus not subject to the securities laws.
The Eleventh Circuit reversed. The test for an investment contract is whether the contract is (1) an investment of money (2) in a common enterprise (3) made with the expectation of profits to be derived solely from the efforts of others. See SEC v. Unique Financial Concepts, Inc., 196 F.3d 1195, 1199 (11th Cir. 1999). Whether an investment is made with the expectation of profits to be derived solely from the efforts of others depends on the amount of control that the investors retain. See Albanese v. Florida National Bank of Orlando, 823 F.2d 408, 410 (11th Cir. 1987).

After the Eleventh Circuit examined the purchase agreements and the promotional materials for the whole transaction, the court concluded that the defendants were selling investment contracts.

The court first reasoned that the purchase agreements alone were not investment contracts. According to the court, the plaintiffs retained significant control under these agreements because even though they had to hold their investment for one year, they were free to reside in the units or to rent them out without contracting with the property manager. The court further reasoned that the management agreement between the plaintiffs and the management company required contractually or practically, and thus these rental agreements constituted a separate and voluntary delegation of managerial control.

Nevertheless, however, the court held that the plaintiffs sufficiently alleged that the purchase agreement and rental agreements formed a single scheme under which they were left with no significant control over their investment. For instance, the court noted, the plaintiffs adequately alleged that two employees of the rental company were agents of Pulte and that to participate in the investment scheme the plaintiffs had to contract with the management company for the management of the properties as short-term rental units.

For other federal appellate court decisions addressing whether a condominium purchase is an investment contract under the securities laws, consult Wals v. Fox Hills Development Corp., 24 F.3d 1016 (7th Cir. 1994); Revak v. SEC Realty Corp., 18 F.3d 81 (2d Cir. 1994); Hocking v. Dubois, 885 F.2d 1449 (9th Cir. 1989); and Cameron v. Outdoor Resorts of America, Inc., 608 F.2d 187 (5th Cir. 1979).