



4-1-1976

Securities Regulation -- United Housing Foundation, Inc. v. Forman: The Supreme Court Refines the Howey Formula

W. Woods Doster

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Recommended Citation

W. W. Doster, *Securities Regulation -- United Housing Foundation, Inc. v. Forman: The Supreme Court Refines the Howey Formula*, 54 N.C. L. REV. 731 (1976).

Available at: <http://scholarship.law.unc.edu/nclr/vol54/iss4/12>

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sions of the Act.⁶⁷ Second, to allow minority self-help, even when the union is not aiding the minority, would be inequitable to the employer. In addition to the examples mentioned by the Court,⁶⁸ the prejudice to the employer is demonstrated by the fact that during the course of collective bargaining, an employer will make concessions in order to avoid the disruption of his business occasioned by employee picketing. To allow minority employees to picket him because of derelictions on the part of the union is to injure him doubly. Therefore, industrial peace will be preserved without undue interference with the rights of the minority employees by prohibiting minority economic pressure in accordance with the decision in *Emporium*.

The decision in *Emporium* should not be read to indicate a weakening of the Supreme Court's commitment to the eradication of racial discrimination in employment. Rather, it evidences a balancing of policy considerations, resulting in the emphasis of the smooth operation of the federal system of labor relations at what the Court views as a nominal inconvenience to the civil rights movement. If employee protection beyond that offered by the present provisions of Title VII is needed, Congressional legislation is the proper solution. The Supreme Court should not, and apparently has declined to, judicially redirect the NLRA to achieve this result.

STEVEN WILLIAM SUFLAS

Securities Regulation—United Housing Foundation, Inc. v. Forman: The Supreme Court Refines the Howey Formula

For the sixth time¹ since the passage of the Securities Act of 1933, the United States Supreme Court in *United Housing Foundation, Inc. v. Forman*² has gone in search of a workable definition of "security." The

67. For a discussion of these and other alternative remedies see Note, *Racial Discrimination in Employment and the Remedy of Self-Help: An Unwarranted Addition*, 15 WM. & MARY L. REV. 615 (1974).

68. 420 U.S. at 67-69.

1. SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943); SEC v. W.J. Howey Co., 328 U.S. 293 (1946); SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967); Tcherepnin v. Knight, 389 U.S. 332 (1967).

2. 421 U.S. 837 (1975).

Depression-era Congress that passed the 1933 Act³ left the definition⁴ unbounded in its haste to write legislation halting the virtually unregulated⁵ traffic in speculative, groundless stock.⁶ The Supreme Court must walk along the penumbra of the Act, sorting those interests which fall within its light from those without. If the interests the purchaser-litigant holds are "securities" within the Act, he gets the advantage of a federal forum⁷ and lenient fraud rules.⁸ For the issuer-litigant, inclusion in the Act means that his securities must undergo a lengthy and expensive registration or exemption process⁹ before they may reappear on the market. The Court's principal tool for distinguishing a security from other interests is the test developed in *SEC v. W. J. Howey Co.*,¹⁰ which finds a "security" whenever "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."¹¹ The Court in *Forman* refined the test so that now a transaction comes within the definitional sections of the Securities Act whenever investors are motivated to risk their capital by a *significant, realistic*¹² expectation of *substantial*¹³ profits (capital appreciation or

3. See Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29 (1959).

4. Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1) (1970) [hereinafter cited as 1933 Act]:

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 definition of "security" in the Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. 78c(a)(10) (1970) [hereinafter cited as 1934 Act], is virtually identical and for present purposes the coverage of the two Acts may be considered the same. 421 U.S. at 847 n.12.

5. By 1933, all forty-eight states except Nevada attempted in some degree to regulate the sale of securities. However, state "Blue Sky" laws, designed to halt "speculative schemes which have no more basis than so many feet of 'blue sky'," *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917), were unable to cope with interstate sales.

6. See the parade of horrors in *F. PECORA, WALL STREET UNDER OATH* (1939). Mr. Pecora was counsel to the U.S. Senate Committee on Banking and Currency during the 1933-1934 investigation of securities abuses.

7. 1933 Act, § 22(a), 15 U.S.C. § 77v(a) (1970).

8. 1934 Act, § 10b, 15 U.S.C. § 78j(b) (1970); rule 10b-5, 17 C.F.R. § 240.10b-5 (1975).

9. 1933 Act, § 5, 15 U.S.C. § 77e (1970).

10. 328 U.S. 293 (1946).

11. *Id.* at 301.

12. See text accompanying note 52 *infra*.

13. See text accompanying note 55 *infra*.

participation in earnings)¹⁴ to come solely from the efforts of others.

Plaintiffs in *Forman* are residents of Co-Op City in the Bronx, New York City. Reputed to be the largest housing cooperative¹⁵ in the United States,¹⁶ the development's 200-acre site containing thirty-five high rise buildings and 236 townhouses is home for approximately 50,000 people. The project was built between 1965 and 1971 primarily with funds procured under the New York Private Housing Finance Law, known as the Mitchell-Lama Act.¹⁷ The Act is designed to encourage private developers to build low-cost cooperative housing by providing them with long-term low interest mortgage loans and substantial tax exemptions. In return, the developer must agree to operate the facility "on a non-profit basis," and to submit to state review of the project.¹⁸

Defendant United Housing Foundation (UHF) is a non-profit amalgam of labor unions and civic groups formed to secure decent housing for low and moderate income persons. UHF organized Riverbay Corporation to issue the Co-Op stock and to operate the project. UHF contracted with its wholly-owned for-profit subsidiary, Community Services, Inc. (CSI), to serve as general contractor for Co-Op City. The Mitchell-Lama Act allowed UHF to lease only to low income individuals who were approved by the state, with preference given to veterans, the aged and the handicapped.¹⁹ In May, 1965, Riverbay circulated an Information Bulletin²⁰ seeking to attract residents to Co-Op City. To acquire an apartment, a prospective tenant had to purchase 450 dollars worth of Riverbay stock for each room desired. There

14. See text accompanying note 51 *infra*.

15. In a cooperative, a corporation is formed to purchase an apartment building. Tenants buy stock in the corporation entitling them to a lease in the apartment building and a vote in the election of directors who manage the corporation. Miller, *Cooperative Apartments: Real Estate or Securities?*, 45 B.U.L. REV. 465 (1965). In a condominium the owner is given fee title in the unit with all the tax advantages of home ownership. The fee interest is restricted to the interior walls and the air space contained between them; all other parts of the dwelling, such as the exterior walls, are held in common ownership with the other owners. Comment, *Community Apartments: Condominium or Stock Cooperative?*, 50 CALIF. L. REV. 299, 300-01 (1962).

16. *Forman v. Community Serv., Inc.*, 366 F. Supp. 1117, 1121 (S.D.N.Y. 1973).

17. N.Y. PRIV. HOUS. FIN. LAW § 1 *et seq.* (McKinney 1962), *as amended*, (McKinney Supp. 1975).

18. 421 U.S. at 840-41.

19. *Id.* at 841 & n.1, 842.

20. The Bulletin estimated the total cost of the project, based on an anticipated construction contract with CSI, to be 283.7 million dollars. Of this sum, 250.9 million dollars (88.4 percent) was to be financed by a forty-year low interest mortgage loan from the state. The remaining 32.8 million dollars (11.6 percent) was to be raised by the sale of Riverbay stock to tenants. *Id.* at 843.

was no possibility of capital appreciation on resale of the stock since a departing tenant was required to offer the shares at their initial selling price to Riverbay or to a state-approved prospective tenant. The shares could not be pledged or encumbered and would descend, along with the apartment, only to a surviving spouse. Each apartment was entitled to one vote in the affairs of the cooperative irrespective of the number of shares owned. The Bulletin stated that after construction of the project, mortgage payments and current operating expenses would be defrayed by the tenants' monthly rent. The Bulletin estimated that the average monthly cost would be twenty-three dollars per room. Several times during construction of Co-Op City, Riverbay secured state approval and revised its contract with CSI to compensate the latter for increased construction costs and expenses not reflected in the Bulletin. To meet these increases, Riverbay procured 125 million dollars in additional mortgage loans from the state. As a result, the average monthly rental charges increased periodically, reaching almost forty dollars per room as of July, 1974.²¹

Faced with a rental charge that had skyrocketed to 73 percent above that predicted in the Information Bulletin, purchasers of the Co-Op stock sued in federal court alleging violations of section 17(a) of the 1933 Act and rule 10b-5 promulgated under the 1934 Act.²² Plaintiffs claimed that the Bulletin misrepresented that CSI would absorb any subsequent cost increases above the contract price, and that the Bulletin failed to disclose material facts about CSI.²³ Defendants (UHF, CSI, Riverbay, individual directors of these organizations, the State of New York and the State Private Housing Finance Agency) moved to dismiss for want of federal jurisdiction in that the Riverbay shares were not "securities" within the definitional sections of the federal Securities Acts.

The District Court granted the motion to dismiss based on "the fundamental nonprofit nature of this transaction" that presented "the insurmountable barrier to plaintiffs' claims in this federal court."²⁴ The

21. *Id.* at 845-46.

22. 15 U.S.C. § 77q(a) (1970); 17 C.F.R. § 240.10b-5 (1975) promulgated under section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b) (1970).

23. The alleged omissions are noted in 421 U.S. at 844 n.8. Plaintiffs also presented a claim against the State Financing Agency under the Civil Rights Act, 42 U.S.C. § 1983 (1970), and ten pendent state law claims. However, the resolution of the jurisdictional issue precluded a hearing on the merits of these causes. 421 U.S. at 845, 859-60.

24. 366 F. Supp. 1117, 1128 (S.D.N.Y. 1973). However, noted Judge Pierce "[I]f ever there was a group of people who need and deserve full and careful disclosure in connection with proposals for the use of their funds, it is this type of group. By law, they

Court of Appeals for the Second Circuit reversed on two grounds.²⁵ Since the Information Bulletin called the shares "stock," the Second Circuit first held that the Securities Acts, which explicitly include "stock" in their definitional sections, were literally applicable. The court reached the same result by alternatively concluding that the shares plaintiffs held were "investment contracts" under the definitional sections of the Acts as identified by the profit test developed in *Howey*.²⁶ The court of appeals found an expectation of profits sufficient to satisfy *Howey* from three sources: 1) rental reductions resulting from the income produced by commercial facilities that were also established at Co-Op City (professional offices, parking spaces and community washing machines); 2) tax deductions;²⁷ and 3) savings resulting from Co-Op City's low rent.²⁸

The Supreme Court reversed the Second Circuit, holding that the Riverbay shares were not "securities" within the Securities Acts. The majority began by calling attention to Congress' stated intent in defining the term "security" in the 1933 Act "to include . . . the many types of instruments that in our *commercial* world fall within the ordinary concept of a security."²⁹ The Court rejected a literal reading of the definitional section's inclusion of "stock," holding that form should be disregarded in favor of substance and that the emphasis should be on economic reality.³⁰ However, said the Court, the name given to an interest is not wholly irrelevant. As a matter of evidence, the name an issuer appends to the interests he sells may be relevant to show that investors justifiably assume that the federal securities laws apply. In the present case, however, "[c]ommon sense suggest[ed] that people who intend to acquire only a residential apartment . . . for their personal

would not be eligible for occupancy in Co-op [*sic*] City unless their financial resources were limited. . . . The cost of housing demands a good percentage of their incomes. Their savings are most likely to be minimal, and they probably don't have lawyers or accountants to guide them. Further, they are people likely to put a great deal of credence in statements made . . . by reputable civic groups and labor unions, particularly when the proposal is stamped with the imprimatur of the state." *Id.* at 1125.

25. 500 F.2d 1246 (1974).

26. *Id.* at 1252-53.

27. INT. REV. CODE OF 1954, § 216 allows Co-Op City tenants to deduct their proportionate share of real estate taxes paid by the cooperative housing corporation on the land and buildings, and for interest paid by the corporation on its indebtedness under the contract of acquisition, construction and maintenance. A tenant who used his apartment for business purposes could depreciate the portion of the building used in a trade or business or for the production of income.

28. 500 F.2d at 1254.

29. H.R. REP. No. 85, 73d Cong., 1st Sess. 11 (1933) (emphasis added).

30. 421 U.S. at 848, *citing* Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

use, are not likely to believe that in reality they are purchasing investment securities simply because that transaction is evidenced by something called a share of stock."³¹ The Court also held that a Riverbay share was not an investment contract since a crucial element of the *Howey* test—profit—was found lacking. The Court undertook to define profit as "capital appreciation" or a "participation in earnings resulting from the use of investors' funds."³² Two of the indicia of profit used by the court of appeals were rejected summarily. The tax benefits, said the Court, "are nothing more than that which is available to any homeowner who pays interest on his mortgage."³³ The reduced rental charge, which the Court attributed to the state's mortgage loan, "no more embodies the attributes of income or profits than do welfare benefits, food stamps or other government subsidies."³⁴ The Court admitted that income from the commercial leases "is the kind of profit traditionally associated with a security investment."³⁵ However, it found this income "far too speculative and insubstantial to bring the entire transaction within the Securities Acts."³⁶

The term "investment contract," which has become the outer edge of at least one facet of the federal definition of "securities," came into the 1933 Act via³⁷ the Uniform Sale of Securities Act.³⁸ When the

31. 421 U.S. at 851.

32. *Id.* at 852.

33. *Id.* at 855.

34. *Id.*

35. *Id.* at 856.

36. *Id.* Justice Brennan, joined by Justices Douglas and White, dissented in an opinion supportive of the Second Circuit's reasoning. *Id.* at 860.

37. "With regard to the subject of definitions, I may say that we have attempted to follow the Uniform Sale of Securities Act; and so when we come to the definition of securities I think you will find that we have taken almost verbatim the language of the Uniform Sale of Securities Act." Testimony of Houston Thompson, one of the drafters of H.R. 4314 (which definition was used in the conference bill, H.R. 5480, the Securities Act of 1933). *Hearing on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 13 (1933).

38. HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 171, 173 (1929). UNIFORM SALE OF SECURITIES ACT § 1(1):

"Security" shall include any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation, or right to subscribe to any of the foregoing, certificates of interest in a profit-sharing agreement, certificates of interest in an oil, gas or mining lease, collateral trust certificate, pre-organization certificate, pre-organization subscription, any transferable share, investment contract, or beneficial interest in title to property, profits or earnings or any other instrument commonly known as a security; including an interim or temporary bond, debenture, note, certificate, or receipt for a security or for subscription to a security.

The Act was withdrawn by the commissioners in 1943 to be replaced in 1956 with the Uniform Securities Act. As of 1974 this legislation has been adopted in some form by twenty-eight states and the District of Columbia, including North Carolina. HANDBOOK

Uniform Commissioners picked up the term in 1929, it had already acquired a fixed judicial definition.³⁹ The leading case interpreting the phrase was *State v. Gopher Tire and Rubber Co.*,⁴⁰ which held that an investment contract was created whenever an issuer "sold its certificates to purchasers who paid their money justly expecting to receive an income or profit from the investment. . . ."⁴¹

The Supreme Court first confronted "investment contracts" in *SEC v. C.M. Joiner Leasing Corp.*⁴² Defendant Joiner acquired leases to 3,002 acres of McCulloch County, Texas, to drill an oil well. In order to finance drilling, Joiner offered sub-leases of parcels ranging in size from two and one-half to twenty acres. The sub-leaseholds would appreciate astronomically if oil were struck. Mr. Justice Jackson chose not to define "investment contract," holding rather that "the reach of the [Securities] Act does not stop at 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."'"⁴³ Mr. Justice Murphy crystallized the definition of investment contract three years later when he wrote the *Howey* opinion.⁴⁴ "[A]n investment contract for purposes of 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 . . ."⁴⁵

State courts began to chafe under the restrictive federal definition. Judge Traynor was the first to break away in *Silver Hills Country Club*

OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 1013, 1024 (1974). See N.C. GEN. STAT. §§ 78A-1 to -64 (1975).

39. *People v. White*, 124 Cal. App. 548, —, 12 P.2d 1078, 1081 (Dist. Ct. App. 1932).

40. 146 Minn. 52, 177 N.W. 937 (1920).

41. *Id.* at 56, 177 N.W. at 938. One can argue that the Supreme Court's restrictive definition of profit was alien to the *Gopher* court and the framers of the 1933 Act. Purchasers of certificates in *Gopher* received monetary dividends and a ten percent discount on all purchases from the issuer. Chancellor Lees arguably used the alternative form "income or profits" in his definition to distinguish cash returns (income) from non-monetary benefits (profits). However, this argument does not take into account the philosophy of Blue Sky laws, which is generally more paternalistic than that of the federal Securities Acts.

42. 320 U.S. 344 (1943).

43. *Id.* at 351.

44. 328 U.S. 293 (1946).

45. *Id.* at 298-99.

*v. Sobieski*⁴⁶ in which he developed the "risk capital" approach. Promoters in *Silver Hills* were selling memberships in a yet to be developed country club to the public. Judge Traynor held that those who risked their capital along with others in a common venture in the expectation of some benefit—not restricted to monetary profit—were entitled to the protection of California's Blue Sky law. The Supreme Court of Hawaii followed this lead in *State v. Hawaii Market Center, Inc.*,⁴⁷ with the best articulated alternative to the *Howey* test. The court held that for purposes of the Hawaii Act, an investment contract is created whenever:

"(1) An offeree furnishes initial value to an offeror, and (2) a portion of this initial value is subjected to the risks of the enterprise, and (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise."⁴⁸

The *Forman* Court's definition of profit as capital appreciation or participation in earnings constitutes a rejection of the broader benefit analysis undertaken in *Silver Hills* and *Hawaii Market*. Judge Traynor in *Silver Hills* held that purchasers of the country club memberships were entitled to the protection of the securities laws "whether or not they expect[ed] a return on their capital in one form or another."⁴⁹ The Supreme Court of Hawaii adopted this reasoning when it required for application of the state Blue Sky law only that purchasers have a reasonable expectation "that a valuable benefit of some kind, over and above the initial value, will accrue"⁵⁰ Plaintiffs in *Forman* advocated a similar benefit profit analysis, urging the Court to accept as profit the savings of money that might otherwise have gone for more expensive housing and higher taxes. The Court rejected this argument, however, stating that such a finding would be overly broad, in that a desire to obtain the greatest amount at least cost "characterizes every form of commercial dealing."⁵¹

The Court's requirement and definition of "profits" in *Forman* has the effect of clarifying and constricting the already narrow *Howey* prof-

46. 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961).

47. 52 Hawaii 642, 485 P.2d 105 (1971).

48. *Id.* at 648-49, 485 P.2d at 109.

49. 55 Cal. 2d at 815, 361 P.2d at 909, 13 Cal. Rptr. at 189.

50. 52 Hawaii at 649, 485 P.2d at 109.

51. 421 U.S. at 858.

its test. The added requirement that investors be motivated to risk their capital by a *significant, realistic* expectation of a profit excludes those interests that attract consumers rather than investors. Purchasers who buy an interest with the intent to realize enjoyment through use of the interest are consumers. They cannot at the same time, the Court implied, have a significant, realistic expectation of realizing *Howey*-type profit on their investment. This follows despite the fact that many interests will show capital appreciation upon resale, regardless of use during ownership.⁵²

In discussing the net income derived from leasing Co-Op City space to commercial facilities as "too speculative and insubstantial to bring the entire transaction within the Securities Acts"⁵³ the Court served notice that only the expectation of *substantial* profits will trigger inclusion of an interest in the Acts. This introduces a threshold concept into the securities definition absent from previous cases that may give the Court and the securities bar additional headaches. The threshold of substantial profits in *Forman* was to be considered in relation to the volume of income the project generated. True, said the Court,⁵⁴ the commercial leases bring in more than one million dollars per year, but this sum is a gross income figure calculated before expenses are netted out. In any case, the majority believed that the net income from commercial leases was insignificant in relation to Co-Op City's total income. Despite the vagueness that such a threshold concept introduces, it is in harmony with the Court's purpose of looking beyond form to economic reality. Where the profit element is such a minor inducement to potential purchasers as it was in the *Forman* case, the Court does not believe that the potentially burdensome protections of the Securities Acts are warranted.⁵⁵

Among the unstated assumptions of the Court in *Forman* was the

52. An exception to this rule is the sale of interests in certain resort condominiums and cooperatives, which interests the SEC treats as securities. This result follows where the interests are offered and sold with the emphasis on the economic benefits to be derived by purchasers from the managerial interest of others through participation in a rental pool arrangement. Here the SEC apparently believes that the character of the issuer's offering is so compelling that purchasers must have a significant, realistic expectation of profit from the transaction. Release No. 5347, Securities Act of 1933, 38 Fed. Reg. 1735 (1973).

53. 421 U.S. at 856.

54. *Id.*; see note 22 *supra*.

55. The requirement of substantial profit would seem to undercut the SEC's inclusion of all resort condominium offerings which meet the tests in Release No. 5347, note 52 *supra*, in the Securities Acts. Arguably, only those plans in which the income a purchaser can receive from rental pooling is substantial qualify as securities.

idea that the Securities Acts should only take cognizance of *investment* risk taking. Since to date every family that has withdrawn from Co-Op City has received back its full original payment, the Court found that Co-Op purchasers "take no risk in any significant sense."⁵⁶ It is true that plaintiffs do risk loss of their initial investment if Co-Op City becomes bankrupt. But, said the Court, in view of the state's 375 million dollar sunken investment, "bankruptcy in the normal sense is an unrealistic possibility."⁵⁷ Plaintiffs in *Forman* risked only the loss of the benefit of their bargain, a risk the Court says is unlike the kind of fluctuating value risk associated with securities investments.⁵⁸

Another consideration that may have influenced the Court was the risk of ruinous civil liability that non-profit issuers like Co-Op City face under the Securities Acts, even if they are exempted from disclosure requirements of registration. This risk could frighten away charitable organizations from participation in similar future ventures. The most fearsome of these civil liabilities arises under rule 10b-5, promulgated under section 10(b) of the 1934 Act, which makes it illegal to engage in any manipulative or deceptive practices in connection with the sale of *any* security. The rule also forbids the making of any untrue statement of material fact, or the omission of any fact necessary to prevent a statement from being misleading.⁵⁹ While the amount of scienter that plaintiff must show to establish a 10b-5 cause of action is unsettled, it is clearly less than that required for common law fraud.⁶⁰ The requirement of reliance on the misrepresented fact or material omission appears to have been relaxed,⁶¹ and the Supreme Court has held that in considering the causal link between defendant's actions and plaintiff's loss, the fraud need only "touch" the sale of the securities.⁶² Although the Court disposed of *Forman* on the jurisdictional issue, had plaintiffs penetrated this first line of defense it appears that they would have had no difficulty surviving a motion to dismiss for failure to state a claim under 10b-5.

56. 421 U.S. at 857 n.24.

57. *Id.*

58. *Id.*

59. 15 U.S.C. § 78j(b) (1970); 17 C.F.R. § 240.10b-5 (1975).

60. Compare *Lanza v. Drexel*, 479 F.2d 1277 (2d Cir. 1973) with *White v. Abrams*, 495 F.2d 724 (9th Cir. 1974).

61. *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 860 (2d Cir. 1968) (*en banc*), cert. denied, 394 U.S. 976 (1969). Reliance was presumed where the device employed was such as would cause reasonable investors to rely thereon. However, the case involved an enforcement action by the SEC rather than a private suit for damages.

62. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971).

The Court may have also worried that inclusion of the Co-Op interests in the Securities Acts would confer on the SEC jurisdiction that might interfere with other state and federal regulatory schemes. The Co-Op City interests are functionally similar to real property interests, and the regulation of real property in our federal system has traditionally been entrusted to the states. In addition, said the Court, New York's Housing Commissioner reviewed "virtually every step" in the development of Co-Op City.⁶³ Given an existing state regulatory mechanism operating in an area traditionally the domain of the states, the Court may have been reluctant to impose on this project a competing regulatory scheme. While no federal agency presently regulates condominium and cooperative housing such as that involved in *Forman*, the Court noted⁶⁴ that Congress recently ordered the Secretary of Housing and Urban Development to conduct a thorough review of these relatively new property interests.⁶⁵ HUD was named as lead agency and the SEC was given no role in the study. If the exclusive choice of HUD for the investigation represents Congressional intent rather than Congressional oversight, the SEC's limited jurisdiction over resort condominiums and cooperatives⁶⁶ may soon terminate.

Two significant and related trends emerge from the *Forman* decision. First, the majority opinion represents a significant narrowing of the *Howey* test. For an interest to be classified as a security after *Forman*, it must produce capital appreciation upon resale or periodic returns on the investment, in substantial amounts, and purchasers must have a significant, realistic expectation of such profits. The second trend, the result of the narrowing of *Howey*, is the closing of the Securities Acts to consumer interests like those involved in *Forman*. The Court has clearly pronounced that consumers must look elsewhere than to the Securities Acts for protection.

W. WOODS DOSTER

63. 421 U.S. at 841.

64. *Id.* at 859 n.26.

65. Housing and Community Development Act of 1974, 88 Stat. 740.

66. See note 46 *supra*.

