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Securities

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SECURITIES OVERVIEW

I. INTRODUCTION

In three of the four Tenth Circuit cases decided under the federal securities laws during the period of this survey, the very existence of a security was the issue litigated.[1] Where novel schemes have been outside the literal language of the Securities Acts,[2] it has been necessary to compare the specific facts of each scheme with the definition of an "investment contract"[3] that has coalesced from Supreme Court decisions in *SEC v. C.M. Joiner Leasing Corp.*,[4] *SEC v. W.J. Howey Co.*,[5] and *United Housing Foundation, Inc. v. Forman.*[6] There is no conflict as such in this line of authority; yet a subtle shifting of emphasis in language from one case to another has produced different results in close cases.[7]

Courts have discovered investment contracts related to such underlying assets as whiskey warehouse receipts,[8] beaver,[9] silver

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[1] *See* Woodward v. Terracor, 574 F.2d 1023 (10th Cir. 1978); Crowley v. Montgomery Ward & Co., 570 F.2d 877 (10th Cir. 1978); McGovern Plaza Joint Venture v. First of Denver Mortgage Investors, 562 F.2d 645 (10th Cir. 1977).

The fourth case, Hassig v. Pearson, 565 F.2d 644 (10th Cir. 1977), was brought under the anti-fraud section of the Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1976). It was litigated on the merits, but its significance is limited; the Tenth Circuit merely affirmed the finding of the trial court that the facts did not support the allegation of fraud.

[2] Section 2 of the Securities Act of 1933, 15 U.S.C. § 77(b) (1976) provides:

> When used in this title, unless the context otherwise requires—(1) 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 "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.

Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(10)(1976), sets forth a similar definition. The Supreme Court has noted that the two definitions are "virtually identical." Tcherepin v. Knight, 389 U.S. 332, 342 (1967).

[3] *See* text accompanying notes 19, 28, and 33 *infra*.

[4] 320 U.S. 344 (1943).

[5] 328 U.S. 293 (1946).

[6] 421 U.S. 837 (1975).

[7] *See* text accompanying notes 19-35 *infra*.

[8] Glen-Arden Commodities, Inc. v. Constantino, 493 F.2d 1027 (2d Cir. 1974).

[9] Continental Marketing Corp. v. SEC, 387 F.2d 466 (10th Cir. 1967).

foxes,[10] and gold coins.[11] Indeed, state securities officials have recently challenged promoters of worm breeding schemes.[12] The Tenth Circuit has considered and rejected a residential subdivision lot,[13] a loan commitment,[14] and a franchise[15] as investment contracts. These latter transactions may not be as exotic as the former, but they are undeniably significant to the practitioner.

II. REAL ESTATE: *Woodward v. Terracor, Inc.*[16]

That a transaction which purports to be a real estate transaction may be a security is not debatable.[17] In *Woodward*, however, the Tenth Circuit was asked to find that the sale of a lot in a residential subdivision constituted an investment contract.

A. *Facts of the Case*

Terracor, a developer, promoted Stansbury Park as a planned residential community with an impressive array of amenities.[18] The plantiffs, who had purchased lots in the development, charged that it was "dying on the vine," although there was a factual dispute as to the actual status of the project.[19] Some of the plantiffs apparently intended to build on the lots for their own use, while others purchased solely for speculative purposes. The alleged misrepresentations of the developer formed no part of the written agreement between the parties.

B. *The Tenth Circuit Opinion*

The Supreme Court in *SEC v. W.J. Howey Co.* identified an

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[10] SEC v. Payne, 35 F. Supp. 873 (S.D.N.Y. 1940).

[11] SEC v. Brigadoon Scotch Dist., Ltd., 388 F. Supp. 1288 (S.D.N.Y. 1975).

[12] Machalaba, *Many States Worry About Using Worms to Lure Investors*, Wall St. J., June 5, 1978, at 1, col. 4.

[13] Woodward v. Terracor, 574 F.2d 1023 (10th Cir. 1978).

[14] McGovern Plaza Joint Venture v. First of Denver Mortgage Investors, 562 F.2d 645 (10th Cir. 1978).

[15] Crowley v. Montgomery Ward & Co., 570 F.2d 877 (10th Cir. 1978).

[16] 574 F.2d 1023 (10th Cir. 1978).

[17] *See, e.g.*, SEC v. W.J. Howey Co., 328 U.S. 293 (1946) (fee simple interests in tracts containing citrus groves); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943) (assignments of oil leases); Andrews v. Blue, 489 F.2d 367 (10th Cir. 1973) (real estate joint venture); Gilbert v. Nixon, 429 F.2d 348 (10th Cir. 1970) (fractional interests in oil and gas leases). *See also*, Clurman, *Condominiums as Securities: A Current Look*, 19 N.Y.L.F. 457 (1974).

[18] 574 F.2d at 1025. The amenities were to include shopping, transporation, recreation, health, and cultural facilities.

[19] *Id.*

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 . . . ."[20] Judge Breitenstein applied the facts to this test and failed to find any evidence of a common enterprise binding the plaintiffs to Terracor.[21] In particular, the only contractual agreement between the parties was a standard real estate contract; there was no collateral management contract.[22]

The court cited ample support for its approach in the opinions of several federal district courts.[23] However, Judge Breitenstein was forced to distinguish the Tenth Circuit's own contrary precedent established by *McCown v. Heidler*.[24] In *McCown* the defendants had "contractually promised" to complete certain projects which would have enhanced the value of the plaintiffs' lots,[25] whereas Terracor's contractual obligation was apparently limited to delivery of title.[26]

C. *Analysis*

The decision of the court might have been correct either as a syllogistic application of *Howey* or as a response to the Supreme Court's current restrictive posture toward the securities laws.[27]

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[20] 328 U.S. 293, 298-99.

[21] 574 F.2d at 1025.

[22] *Id.* In *Howey*, a collateral management contract enabled the investors to rely solely upon the efforts of the promoter to pick the citrus crop, market it, and distribute the profits. The investors lacked the knowledge, skill, and equipment to do the job themselves. 328 U.S. at 296.

[23] Davis v. Rio Rancho Estates, Inc., 401 F. Supp. 1045 (S.D.N.Y. 1975); Happy Investment Group v. Lakewood Properties, Inc., 396 F. Supp. 175 (N.D. Cal. 1975); Contract Buyers League v. F & F Investment, 300 F. Supp. 210 (N.D. Ill. 1969). *Contra*, Fogel v. Sellamerica, Ltd., 445 F. Supp 1269 (S.D.N.Y. 1978); Jenne v. Amrep Corp. [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,343 (D. N.J. Feb. 14, 1978).

[24] 527 F.2d 204 (10th Cir. 1975).

[25] *Id.* at 209. It is not clear from the opinion whether the promises were limited to material contained in the traditional real estate documents, or whether promises made in conversations and brochures were included.

[26] 574 F.2d at 1025, 1027.

[27] *Cf.* Santa Fe Indus., Inc. v. Green, 97 S.Ct. 1292 (1977) (§ 10(b) will not be available to minority shareholders in a short form merger absent a misrepresentation); Piper v. Chris Craft Indus. Inc., 97 S.Ct. 926 (1977) (defeated tender offeror has no cause of action against successful competitor); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (plaintiff must prove "scienter" in suits brought under § 10(b)); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (plaintiff must have been a "purchaser" or "seller" to pursue a § 10(b) remedy). *See generally*, Lowenfels, *Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings*, 65 GEO. L.J. 891

However, the facile distinction between *McCown* and *Woodward*—whether or not the representations were part of the written agreement between the parties—is not entirely satisfactory. One could infer that Professor Loss would not support the distinction, although the Tenth Circuit confidently quoted from his treatise:

> [N]o "investment contract" is involved when a person invests in real estate, with the hope perhaps of earning a profit as the result of a general increase in values concurrent with the development of the neighborhood, as long as he does not do so as part of an enterprise whereby it is *expressly or impliedly* understood that property will be developed or operated by others.[28]

It is reasonable to conclude that it would be necessary to go beyond the written agreement of the parties to examine their express or implied understandings.

Perhaps the court had extended itself too far in *McCown* by relying on the more general language of *Joiner*.[29] In that early case the test for an investment contract was formulated as:

> 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]

Joiner made no distinction between written and oral representations. One could easily imagine an overzealous developer's oral representations holding out inducements such that an investment contract might exist in the sale of a residential lot. In the recent case of *Jenne v. Amrep Corp.*,[31] which cited *McCown* with approval, the Federal District Court for the District of New Jersey detailed the economic inducements offered and examined all rep-

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(1977); Ruppert, *The Supreme Court's Trimming of the Section 10(b) Tree: The Cultivation of a New Securities Law Perspective*, 3 J. CORP L. 112 (1977).

[28] 574 F.2d at 1026 (quoting 1 LOSS, SECURITIES REGULATION 491-92 (2d ed. 1961)) (emphasis added).

[29] 320 U.S. 344 (1943).

In *McCown*, the Tenth Circuit said: "In characterizing the purchase of . . . lots, the standard set out in *SEC v. C.M. Joiner Leasing Corp.*, must be applied . . . ." 527 F.2d at 208. The court described the enthusiatic marketing techniques of the promoters in great detail. For example, the court observed that the brochures "covered such topics as 'the secret in speculating in raw land,' capital gain and real estate and fortunes, large and small are being made in land." *Id.* at 210.

[30] 320 U.S. 344, 352-53 (1943).

[31] [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,343 (D.N.J. Feb. 14, 1978).

resentations of the promoter, both written and oral. The defendants had urged that the court consider only the purchase agreement, a short form document. This the court refused to do because to do so would have been inconsistent with *Joiner*.[32]

Another consideration in determining whether investment contracts are securities is the subjective motivation of the purchaser. Other than to note that various plaintiffs in *Woodward* had different motivations for purchasing the lots in Stansbury Park,[33] Judge Breitenstein wisely declined to decide the case on the basis of the purchasers' subjective motivations. There was language in the Supreme Court's *Forman* decision which might have led him to do so. In support of its holding that the "expectation of profit" element of *Howey* had not been met, the Court noted that "[i]n the present case there can be no doubt that investors were attracted solely by the prospect of acquiring a place to live, and not by financial returns on their investments."[34] Common sense would have supported an assertion that most of the *Woodward* plaintiffs were "acquiring a place to live." In another recent case involving a real estate development, *Fogel v. Sellamerica, Ltd.*,[35] the Federal District Court for the Southern District of New York focused upon the subjective motivation of the purchasers: Did they or did they not purchase the lots for investment purposes?[36] Under this rationale some buyers would have purchased a security while others would have merely purchased a lot. Courts inclined to follow this deceptively simple approach may find themselves mired in speculation over the dominant motivation of purchasers.

Finally, *McCown*,[37] *Jenne*,[38] and *Fogel*[39] appeared to involve land for vacation or retirement homes, whereas *Woodward* appeared to involve a typical residential development.[40] Circum-

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[32] *Id.* at 93,166.

[33] 574 F.2d 1023, 1025.

[34] 421 U.S. 837, 853 (1975).

[35] 445 F. Supp. 1269 (S.D.N.Y. 1978)

[36] *Id.* at 1277-78. The court found support for this analysis in *McCown*. *Id.* at 1278.

[37] 527 F.2d at 210 (lots for "individuals to construct a home and retire, all in a scenic and recreation area").

[38] [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,343 at 93,164 (semi-arid land in New Mexico), at 93,167 (other litigation pending across the country).

[39] 445 F. Supp. at 1272 (plaintiffs who were New York residents purchased lots in the Pocono mountains of Pennsylvania).

[40] 574 F.2d at 1024 (a planned residential community). *See also*, Note, *Recreational Land Subdivisions As Investment Contract Securities*, 13 HOUS. L. REV. 153 (1975).

stances surrounding the marketing of vacation homes would more easily support the finding of an investment contract. As a policy matter there may be valid reasons to keep the typical sale of residential real estate beyond the purview of the securities acts.[41] As a practical matter, developers should avoid certain representations until this area of the law becomes settled.[42]

III. THE LOAN COMMITMENT: *McGovern Plaza Joint Venture v First of Denver Mortgage Investors*[43]

Just as the securities laws have stopped somewhat short of absorbing all real property transactions, they have not reached all commercial transactions. The concept of a "commercial-investment dichotomy" has been offered as an aid to analyzing whether commercial loan transactions are securities.[44]

A. *Facts of the Case*

In furtherance of its plan to build a hotel, the plaintiffs obtained a construction loan commitment from defendant First of Denver, and a permanent loan commitment from defendant B.F. Saul Advisory Co.[45] Plaintiffs alleged that there had been a misrepresentation of material facts. In any event, the loan commitments were not carried out and the hotel was not built; the plaintiffs sought an anti-fraud remedy under the securities acts.[46]

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[41] *See generally,* Berman & Stone, *Federal Securities Law and the Sale of Condominiums, Homes and Homesites,* 30 BUS. LAW. 411 (1975).

[42] *Id.* at 430-31.

The authors counsel developers to avoid representations concerning the increasing value of property and income or tax benefits of ownership. Mandatory collateral services should be avoided. The purchase of multiple units by single purchasers should be discouraged because it suggests specualtion. Futhermore, the authors advocate that developers keep a careful watch on salesmen, that they require purchasers to sign a statement acknowledging that they are buying for current or future residential use, and that they tape the closing transaction to "provide a permanent record of the parties' state of mind."

[43] 562 F.2d 645 (10th Cir. 1977).

[44] *See* Comment, *An Overview of Promissory Notes Under The Federal Securities Laws,* 6 FORDHAM URB. L. J. 529 (1978); Comment, *Commercial Notes and Definition of "Security" Under Securities Exchange Act of 1934: A Note is a Note is a Note?,* 52 NEB. L. REV. 478 (1973) [hereinafter cited as *Commercial Notes*].

[45] 562 F.2d at 646.

[46] *Id.* The applicable anti-fraud sections are § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q (1976) and § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1976).

B. *The Tenth Circuit Opinion*

Judge McWilliams noted that "[t]he plaintiffs were in no sense relying on the efforts of either First of Denver or Saul to gain their profits."[47] Thus the reliance element of the *Howey* test was not met. An inquiry into the motiviation of the plaintiffs (presumably they wanted to build a hotel), or into the manner of the lenders' promotions (the facts gave no indication of anything other than private negotiations) would not have supported a finding of reliance in *McGovern*.

In addition, Judge McWilliams reasonably concluded that the loan commitment was a commercial rather than an investment transaction.[48] He relied upon *Zabriskie v. Lewis*,[49] a Tenth Circuit case adopting a test of whether the transaction was of a type in which stock was usually given.[50] Under the facts of *Zabriskie*, which involved a note given in consideration of funds to promote a corporation, the answer was "yes."[51] In *McGovern* the transaction was of a type in which stock is usually not given.

C. *Analysis*

Many courts have employed the concept of a commercial-investment dichotomy to analyze notes in order to escape the literal language of the statutory definitions of a security.[52] The Tenth Circuit's *Zabriskie* opinion summarized the rationale of the test:

> This test is based upon the purpose of the Act to protect investors, the "unless the context otherwise requires" language, and the practical considerations of subjecting commercial notes to the registration provisions of the Securities Act as well as fear of the resulting litigation flooding the federal courts if commercial notes were included.[53]

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[47] 562 F.2d at 647.

[48] *Id.*

[49] 507 F.2d 546 (10th Cir. 1974)

[50] *Id.* at 551 In adopting the test, the Tenth Circuit cited with approval the student comment, *Commercial Notes*, *supra* note 44.

[51] 507 F.2d at 551-52.

[52] *See, e.g.*, McClure v. First Nat'l Bank, 497 F.2d 490, 494-95 (5th Cir. 1974); Bellah v. First Nat'l Bank of Hereford, 495 F.2d 1109, 1111-14 (5th Cir. 1974); Lino v. City Investing Co., 487 F.2d 689, 694-95 (3d Cir. 1973); Sanders v. John Nuveen & Co., 463 F.2d 1075, 1080 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972).

The definitions of a security in both the 1933 and 1934 Acts include "any note." *See* note 2 *supra*.

[53] 507 F.2d 546, 551.

While at least one commentator has formulated detailed criteria for application of the test,[54] others have observed that the test is more easily stated then applied.[55] Although it may be of little assistance in analyzing close cases, it is hard to fault the use of the commercial-investment dichotomy analysis in *McGovern*. The loan commitments were obtained to assure funds for the hotel construction, a commercial project. Neither party contemplated that they were to stand on their own merits as investments.[56]

The outcome in *McGovern* required the Tenth Circuit to distinguish its own precedent, *United States v. Austin*,[57] which had declared a loan commitment to be a security. Fortunately, there was nothing inconsistent in the two decisions: "[w]hether a particular investment constitutes a security depends upon the facts and circumstances of the case."[58] In *Austin*, the defendants had conceived an ambitious scheme of issuing back-up commitments guaranteeing that others would make loans. Investors were induced to purchase the commitments with the expectation of immediately selling them at a profit.[59] Unfortunately, there is language in *McGovern* which might lead one to believe that the

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[54] *Commercial Notes, supra* note 44 at 510-24. The factors include use of the proceeds, application of the *Howey* test, risk, numbers of notes issued, dollar amount of the transaction, time elements, and characterization of the notes on the relevant financial statements. The Ninth Circuit opinion in Great Western Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976), examined the character of a note using a list of substantially similar factors.

[55] *See, e.g.*, Lipton & Katz, *Notes Are Not Always Securities*, 30 BUS. LAW. 763, 766 (1975); Comment, 30 VAND. L. REV. 110, 117 (1977); Comment, *Bank Loan Participations as Securities; Notes, Investment Contracts, and the Commercial/Investment Dichotomy*, 15 DUQ. L. REV. 261, 276-77 (1976-77); Comment, *Notes as Securities Under the Securities Act of 1933 and the Securities Exchange Act of 1934*, 36 MARYLAND L. REV. 233, 243-44 (1976).

[56] One suggested criterion for analyzing a note is to examine the common expectations of the parties: How would a reasonable businessman characterize the instrument? *See Commercial Notes, supra*, note 44 at 510.

[57] 462 F.2d 724 (10th Cir.), *cert. denied*, 409 U.S. 1048 (1972).

[58] Vincent v. Moench, 473 F.2d 430, 435 (10th Cir. 1973).

[59] 462 F.2d at 727-29. The *Austin* opinion provided scant analysis. Its language seemed applicable to the loan commitment in *McGovern:*

> [T]his letter of commitment was sold for a substantial consideration, and the buyer received what appeared to be an enforceable obligation which contemplated the flow of funds. It indicated a binding and legally enforceable right. Therefore, we can find no fault with the ruling of the trial court insofar as it regarded the letter of commitment as plainly being a security.

Id. at 736.

result in *Austin* differed (1) because it was a criminal case, and (2) because "[t]he entire procedure was fraudulent an no loans were ever made."[60] The existence of a security should not depend upon the nature of the action, civil or criminal, nor should it depend upon the degree of fraud perceived by the court. Not every fraudulent scheme involves a security.

IV. THE FRANCHISE: *Crowley v. Montgomery Ward & Co.*[61]

In 1975, in an unpublished opinion, the Tenth Circuit reversed the District Court for the District of Utah, which had granted defendant Montgomery Ward's motion to dismiss the action on the grounds that its catalog sales agency agreement with the plaintiff could not be a security.[62]

Were the *Howey* test to be interpreted literally in that profits must have come *solely* from the efforts of others,[63] the Utah court would have been correct. Furthermore, it would be useless to question franchises or any other investment contract, since clever counsel could help their clients design schemes in which a token amount of investor effort would defeat the application of the securities laws.[64]

The Tenth Circuit has now concluded that the catalog sales agreement was not a security;[65] its consideration of the factors which went into this determination merits some discussion.

A. *Facts of the Case*

The opinions in both the instant case and the earlier case were silent concerning the gravamen of plaintiff's injury. One can only infer that the catalog sales agency was less than successful.

Although the plaintiff was required by the agreement to "devote his full time and best efforts to the operation of the Agency,"[66] the factual question of the amount of control actually exercised by Montgomery Ward was critical.

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[60] 562 F.2d 645, 648.

[61] 570 F.2d 877 (10th Cir. 1978).

[62] The case has now been published at 570 F.2d 875 (10th Cir. 1975).

[63] 328 U.S. 293, 298-99 (1946).

[64] One commentator has suggested that the promoters in *Howey* could have avoided the application of the securities laws by requiring each investor to pick one orange. *See* Long, *An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation*, 24 OKLA. L. REV. 135, 145 (1971).

[65] 570 F.2d 877, 878.

[66] 570 F.2d 875, 876.

B. *The Tenth Circuit Opinion*

Judge Breitenstein reaffirmed the Tenth Circuit's alignment with other circuits that have modified that part of the *Howey* test which directed that profits were to come *solely* from the efforts of others.[67] The Tenth Circuit's position was that the franchisee's "control over the factors essential to success of the enterprise" would preclude existence of an investment contract.[68] The operator of the catalog agency had some discretion in pricing, credit, and advertising policies. He was responsible for hiring and firing employees, together with all of the day-to-day operations of the business. Thus the court concluded that in economic reality "the contributions of the franchisees significantly and substantially affect[ed] the profits expected from the enterprise."[69]

C. *Analysis*

Many cases have considered and rejected the contention that a particular franchise agreement was a security.[70] Among them is the Tenth Circuit's decision in *Mr. Steak, Inc. v. River City Steak, Inc.*,[71] which provides more than adequate support for the court's holding that the agreement between Crowley and Montgomery Ward did not constitute an investment contact.

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[67] *See, e.g.*, SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 480 (5th Cir. 1974) ("a literal application of the *Howey* test would frustrate the remedial purposes of the Act"); Lino v. City Investing Co., 487 F.2d 689, 692 (3d Cir. 1973) ("an investment contract can exist where the investor is required to perform some duties, as long as they are nominal or limited . . ."); SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 (9th Cir.), *cert. denied* 414 U.S. 821 (1973) ("[W]e adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones . . . .").

The Supreme Court has yet to put its imprimatur upon this expansion. In United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975), the Court acknowledged the variation and explicitly declined to comment upon it. *Id.* at 852 n.16.

[68] 570 F.2d at 880.

[69] *Id.* at 881.

[70] Bitter v. Hoby's Int'l, Inc., 498 F.2d 183 (9th Cir. 1974); Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973); Nash & Assocs. v. Lum's of Ohio, 484 F.2d 392 (6th Cir. 1973); Chapman v. Rudd Paint & Varnish Co., 409 F.2d 635 (9th Cir. 1969).

Cases which have held to the contrary have involved pyramid schemes, in which the promoter stresses the amount of money the participant can make by recruiting others to participate: SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974); SEC v. Glenn W. Turner Enterprises, Inc. 474 F.2d 476 (9th Cir.), *cert. denied* 414 U.S. 821 (1973).

For a balanced discussion of most of these cases, see Freedman, *An Analysis of the Franchise Agreement Under Federal Securities Laws*, 27 SYRACUSE L. REV. 919 (1976).

[71] 460 F.2d 666 (10th Cir. 1972) *aff'g* 324 F. Supp. 640 (D. Colo. 1970).

In *Mr. Steak*, the franchisee essentially abdicated all managerial responsibility for running the franchised restaurant. He *could have* selected the manager, but the franchisor was responsible for training the manager, who then held his job at the franchisor's sufferance.[72] Other than this option to select a manager (which was not exercised), the scope of the franchisee's authority was severely circumscribed.[73] Nevertheless, the Tenth Circuit held that the mere *possibility* of control constituted sufficient participation in the enterprise to controvert the implication of an investment contract.[74] However, the fact that the court had so thoroughly examined the relationship between the parties demonstrates its unwillingness to apply the *Howey* test in mechanical fashion.[75]

When the facts of *Mr. Steak* are compared to the facts of *Crowley* one must wonder why the court found it necessary to remand the latter case for further factual determination. While the franchisee in *Mr. Steak* merely *could have* selected a manager, the *Crowley* plaintiff's agreement with Montgomery Ward *required* that he "devote his full time and best efforts to the operation of the Agency."[76] It is puzzling that when *Crowley* was first before the Tenth Circuit in 1975, the court did not cite its opinion in *Mr. Steak* for the quantity or quality of managerial control necessary to preclude the existence of an investment contract.[77]

Abuses in the burgeoning franchise method of doing business have led some commentators to suggest that franchisees need the protection of the Securities Acts.[78] However, the SEC, in agreement with most courts, has taken the position that "true fran-

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[72] 324 F. Supp. at 643.

[73] In particular, the financial control exercised by the franchisor was comprehensive. *Id.*.

[74] 460 F.2d at 670.

[75] The detailed analysis was contained in the district court opinion of Judge Arraj at 324 F. Supp. 640, which the Tenth Circuit gratefully adopted. *See* 460 F.2d at 669.

[76] 570 F.2d 875, 876.

[77] *Mr. Steak* was cited for the proposition that courts should give consideration to the facts in determining the existence of an investment contract. 570 F.2d at 880.

It was apparent that the Tenth Circuit disapproved of the lack of analysis in the trial court's order of dismissal. *Id.*

[78] *See, e.g.*, Comment, *Compelling Full Disclosure in Franchise Agreements*, 5 CUM.-SAM. L. REV. 501 (1975); Comment, *What is a Security?* Howey, Turner Enterprises, *And Franchise Agreements*, 22 KAN. L. REV. 55 (1973).

chising" is distinguishable from pyramid marketing schemes and that the former is normally not an investment contract.[79] Therefore, the decision in *Crowley* would seem to have ample support even under an interpretation of the investment contract in which profits are not required to come solely from the efforts of the promoter or a third party.

V. CONCLUSION

It cannot be assumed that future cases bearing some resemblance to the cases discussed herein will be decided in the same way. This caveat, rather than expressing criticism of the Tenth Circuit's analytical approach, merely recognizes that the determination of a security is a "shifting, highly fact-oriented determination."[80] However, given the Supreme Court's recent pronouncements on the securities laws,[81] it seems unlikely that the Tenth Circuit will adopt an expansive definition of a security.

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[79] SEC Securities Act Release, No. 5211 (Nov. 30, 1971), *reprinted in* [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,446.

[80] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 755 (1975).

[81] *See* note 27 *supra*.