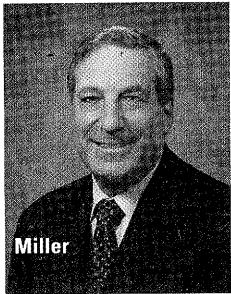


## IS WITHHOLDING INFO THE RIGHT ANSWER?

**A**ttorneys advising developers regarding the sale of condo hotel units rely on SEC guidelines that are not binding precedent, that don't address anti-fraud issues and that depend on withholding material information as well as firing anyone who deviates from structured protocols regarding non-disclosure.



Miller

Sales consultants regularly advise, "Make sure salespeople provide no information about the economic benefits of ownership. Videotape agents and if they make such disclosures, fire them. Always wait until the deposit is non-refundable before letting the buyer know whom to contact regarding any rental program arrangement."

How could intentionally withholding information be the best answer for the developer and the selling agents? Separating the purchase transaction from a subsequent rental program has, to some extent, SEC support, but the likelihood of

succeeding in a litigation is questionable, though as yet untested.

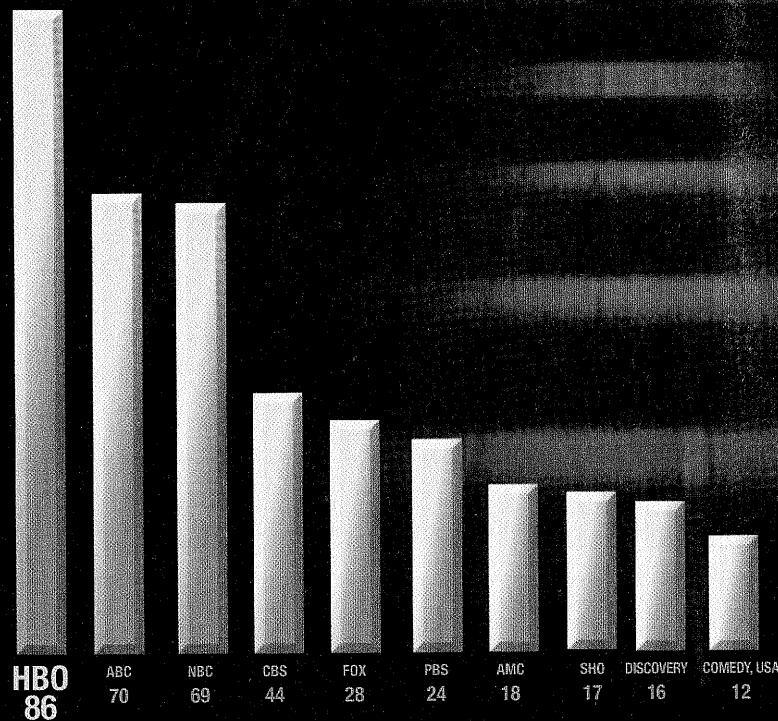
### AN ALTERNATIVE SOLUTION

In the hotel condo context, a sale and leaseback program should avoid having the transaction characterized as an investment contract. At a minimum, a developer should seriously consider requesting a no-action letter from the SEC.

At least one major developer/operator is using leasebacks in proven markets, where they are willing to assume greater risk. Implementing a leaseback strategy in a new market addresses the legal risks, and the business risks can be addressed through pricing and revenue sharing structured to reward the developer for incurring the added business risk.

In 1946, the Supreme Court decided *SEC v. Howey*, in which it defined the meaning of an investment contract as a security under the SEC Act of 1933. The court stated, "In other words, 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..."

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CIRCLE 33 ON READER SERVICE CARD

In 2007, the Howey case remains the fundamental test of whether a transaction involves an investment contract. Courts apply the test in a very broad manner; however, not every transaction constitutes an investment contract. The specific facts and language in the Howey case make us think that a properly structured sale and leaseback of a condo hotel unit would avoid investment contract treatment.

The Howey court described the investment contract transaction as follows: "They are offering an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents. They are offering this opportunity to persons who reside in distant localities and who lack the equipment and experience requisite to the cultivation, harvesting and marketing of the citrus products. Such persons have no desire to occupy the land or to develop it themselves; they are attracted solely by the prospects of a return on their investment.

"A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments. Their

respective shares in this enterprise are evidenced by land sales contracts and warranty deeds, which serve as a convenient method of determining the investors' allocable shares of the profits. The resulting transfer of rights in land is purely incidental."

#### A USEFUL EXAMPLE

Consider the following scenario: A condo hotel development with 200 units on 10 floors, contains units of various sizes, configurations and views. Smith owns Unit 1001, which has 1,350 square feet, two bedrooms, a balcony and overlooks the ocean. It is leased to the hotel operator for 46 weeks per year, for the next three years, at \$24 per square foot. Jones owns Unit 515, which has 600 square feet and overlooks the street. It is leased to the hotel developer for 48 weeks per year for the next two years at \$14 per square foot.

Are Smith and Jones in a common enterprise? We think not. Each has a different fixed rental payment for a different term, payment of which is predicated solely on the credit-worthiness of the lessee, not the profit of the hotel. Admittedly, the operator could default but that is true in any lease. The landlord has its remedies under the law.

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CIRCLE 34 ON READER SERVICE CARD

LODGINGToday SPEAKING OUT (CONTINUED)

Further, Smith and Jones each intend to occupy the unit for some time each year. For many, if not most, condo hotel unit buyers, the primary objective is to defray some of the costs of owning vacation real estate, and developers should present and market the unit in this way.

Is this arrangement an investment contract? We think the SEC would find that it is not. Further, the transaction can be fully implemented without withholding material information and exposing the developer to potential fraud claims. At a minimum, we think developers are well advised to consider requesting a no-action letter from the SEC.

Mitch Miller is the founder of the *Miller Law Group*, a full-service hospitality law firm. For more information about the firm visit [www.millerlg.com](http://www.millerlg.com), or contact him at (650) 566-2290 or [mmiller@millerlg.com](mailto:mmiller@millerlg.com).

## Upcoming Industry Events

### SEPTEMBER 4

Hotel Sales Strategy Conference, sponsored by HSMAI, Washington (DC) Convention Center. Information: [www.hsm.ai.org](http://www.hsm.ai.org)

### SEPTEMBER 5-6

HSMAI's Affordable Meetings National, Washington (DC) Convention Center. Information: [www.affordablemeetings.com](http://www.affordablemeetings.com)

### SEPTEMBER 8-12

AH&LA Resort Committee Annual Meeting, The Fairmont Southampton Bermuda. Information: [www.conventions@ahla.com](http://www.conventions@ahla.com)

### SEPTEMBER 9

Middle East Leisure Real Estate Symposium, sponsored by NorthCourse Leisure Real Estate Solutions and Group RCI, Grosvenor House Hotel, Dubai, U.A.E. Information: [www.northcourse.com](http://www.northcourse.com)

### SEPTEMBER 9-12

20th Annual AH&LEF Golf Classic, Barton Creek Resort & Spa, Austin, TX. Information: [sadaway@ahla.com](mailto:sadaway@ahla.com)

### SEPTEMBER 17-18

Associated Owners & Developers Annual Conference, Washington, DC. Information: [www.constructionchannel.net](http://www.constructionchannel.net)

### SEPTEMBER 19

Loss Prevention Conference, Phoenix. Information: [www.HospitalityLawyer.com](http://www.HospitalityLawyer.com)

### SEPTEMBER 25-28

13th annual Lodging Conference, Arizona Biltmore, Phoenix. Information: [www.lodginglink.com](http://www.lodginglink.com)

### OCTOBER 1-2

Green + Design Conference and Expo, Hyatt Regency Atlanta. Information: [www.greendesignexpo.com](http://www.greendesignexpo.com)

### OCTOBER 1-4

Vacation Ownership Investment Conference, The Peabody Orlando. Information: [www.vacationownershipinvestment.com](http://www.vacationownershipinvestment.com)