



Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City
Office of the General Counsel

21 December 2011

SEC-OGC Opinion No. 11-49
Sale of Securities; Investment Contract

MR. FABIO MORETTI
MR. ROLDAN M. ANTONIO
Thunderbird Pilipinas
Hotels & Resorts, Inc. (TPHRI)
24/F Salcedo Towers
169 H.V. Dela Costa St.,
Salcedo Village, Makati City

Gentlemen:

This refers to your letters dated 03 August 2011 and 21 September 2011 requesting for confirmation on whether the intended revised business plan for Thunderbird Pilipinas Hotels & Resorts, Inc.'s (TPHRI) condotel project is not considered as "sale of securities" under the provisions of the Securities Regulation Code (SRC).¹

As disclosed in your letters, TPHRI is the assignee to all the rights and obligations of Thunderbird Resorts, Inc. (TRI) in the Lease Agreement dated 02 August 2005 entered into with the Bases Conversion and Development Authority (BCDA) and the Poro Point Management Corporation (PPMC) for the development, operation and management of 65.5 hectare parcel of land located in Poro Point Freeport Zone, Poro Point, San Fernando City, La Union. A portion of the leased property has been designated and utilized for the development of a residential estate project wherein TPHRI will assign its leasehold rights over subdivided and individual lots to interested assignees who shall construct a residential estate over the lot. The assignees shall possess and enjoy the assigned lot until 2054.

Your letter dated 21 September 2011 clarified that TPHRI is now contemplating on expanding the real estate component of the lease through the construction and development of a condominium-hotel project ("condotel project"). Under the condotel project, TPHRI will build condotel units and assign both its leasehold rights over the lot and the units to interested assignees for valuable consideration. The lease over the lot and the units will be until 2054. Said condotel units will be enrolled by their assignees in

¹ Republic Act No. 8799.

the pool of units to be rented out as hotel rooms. The condotel project will be managed by TPHRI or its authorized condotel operator under the following terms and conditions:

(a) the costs and expenses for maintenance of the condotel units shall be for the condotel operator's account;

(b) in consideration of the management services rendered by the condotel operator, it shall receive from the assignee a fixed monthly management fee inclusive of sales and marketing commissions; and

(c) the assignee shall be allowed an aggregate of thirty (30) days use per year of the condotel unit.

You aver that the aforementioned business plan should not be considered as sale of securities under the SRC, citing SEC Opinion No. 11-05 wherein we purportedly opined that "the assignment of leasehold rights for a valuable consideration over subdivided lots to interested assignees is not considered as sale of securities under both SRC Section 3.1 (b) and RSA Sec. 2(a) which requires registration with the Commission." Please take note, however, that the aforementioned opinion is rendered in SEC Opinion No. 10-03 and not SEC Opinion No. 11-05. In fact, this Office opined in SEC Opinion No. 11-05 that "the assignment by TPHRI of leasehold rights over condotel units to individual assignees in exchange for a 6% return on capital invested therein plus the return of the original investment upon the expiration of the period of the lease is considered a 'sale of securities' under the SRC that requires registration with the Commission."

It is apparent from the beginning that the present query involves a distinct set of facts that warrants a different opinion.

To reiterate, Section 3.1 of the SRC defines "securities" as to include investment contracts, certificates of interest or participation in a profit sharing agreement, viz –

"Section 3. Definition of Terms. – 3.1. "Securities" are shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character. It includes:

(a) Shares of stock, bonds, debentures, notes, evidences of indebtedness, asset-backed securities;

(b) Investment contracts, certificates of interest or participation in a profit sharing agreement, certificates of deposit for a future subscription;

(c) Fractional undivided interests in oil, gas, or other mineral rights;

(d) Derivatives like option and warrants;

(e) Certificates of assignments, certificates of participation, trust certificates, voting trust certificates or similar instruments;



(f) Proprietary or nonproprietary membership certificates in corporations; and

(g) Other instruments as may in the future be determined by the Commission."
(Emphasis supplied)

An investment contract is defined in Rule 3 of the Amended Implementing Rules and Regulations of the SRC as a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits primarily from the efforts of others, viz –

"SRC Rule 3 – Definition of Terms Used in the Rules and Regulations

xxx xxx xxx

G. An investment contract means a contract, transaction or scheme (collectively "contract") whereby a person invests his money in a common enterprise and is led to expect profits primarily from the efforts of others.

1. An investment contract is presumed to exist whenever a person seeks to use the money or property of others on the promise of profits.

2. A common enterprise is deemed created when two (2) or more investors "pool" their resources, creating a common enterprise, even if the promoter receives nothing more than a broker's commission." (Emphasis supplied)

To be a security subject to regulation by the SEC, the Supreme Court, in *Power Homes Unlimited Corporation v. Securities and Exchange Commission*,² held that an investment contract in our jurisdiction must be proved to be (1) an investment of money, (2) in a common enterprise, (3) with expectation of profits, (4) primarily from efforts of others, viz –

An investment contract is defined in the Amended Implementing Rules and Regulations of R.A. No. 8799 as a "contract, transaction or scheme (collectively 'contract') whereby a person invests his money in a common enterprise and is led to expect profits **primarily** from the efforts of others."

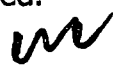
It behooves us to trace the history of the concept of an investment contract under R.A. No. 8799. Our definition of an investment contract traces its roots from the 1946 United States (US) case of *SEC v. W.J. Howey Co.*, 328 U.S. 293, 66 S. Ct. 1100, 163 A.L.R. 1043, 90 L. Ed. 1244 (1946). In this case, the US Supreme Court was confronted with the issue of whether the **Howey** transaction constituted an "investment contract" under the Securities Act's definition of "security." The US Supreme Court, recognizing that the term "investment contract" was not defined by the Act or illumined by any legislative report, held that "Congress was using a term whose meaning had been crystallized" under the state's "blue sky" laws in existence prior to the adoption of the Securities Act. Thus, it ruled that the use of the catch-all term "investment contract"

² G.R. No. 164182, 26 February 2008.

indicated a congressional intent to cover a wide range of investment transactions. It established a test to determine whether a transaction falls within the scope of an "investment contract." Known as the **Howey Test**, it requires a transaction, contract, or scheme whereby a person (1) makes an investment of money, (2) in a common enterprise, (3) with the expectation of profits, (4) to be derived **solely** from the efforts of others. Although the proponents must establish all four elements, the US Supreme Court stressed that the Howey Test "embodies 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 the money of others on the promise of profits." Needless to state, any investment contract covered by the **Howey Test** must be registered under the Securities Act, regardless of whether its issuer was engaged in fraudulent practices.

After Howey came the 1973 US case of *SEC v. Glenn W. Turner Enterprises, Inc. et al.* 474 F. 2d 476, 414 U.S. 821, 94. In this case, the 9th Circuit of the US Court of Appeals ruled that the element that profits must come "solely" from the efforts of others should not be given a strict interpretation. It held that a literal reading of the requirement "solely" would lead to unrealistic results. It reasoned out that its flexible reading is in accord with the statutory policy of affording broad protection to the public. Our R.A. No. 8799 appears to follow this flexible concept for it defines an investment contract as a contract, transaction or scheme (collectively "contract") whereby a person invests his money in a common enterprise and **is led to expect profits not solely but primarily from the efforts of others.** Thus, **to be a security subject to regulation by the SEC, an investment contract in our jurisdiction must be proved to be: (1) an investment of money, (2) in a common enterprise, (3) with expectation of profits, (4) primarily from efforts of others.** (Emphasis supplied)

Interestingly, an agreement or arrangement in which a buyer purchases income-producing property and authorizes the seller, or another person who may or may not be controlled by the seller, to manage the property and to remit the net profits to the buyer is considered an investment contract under the US Securities Act.³ It is unimportant that the purchase or lease agreement may be literally separate from the service or management contract, since both agreements will be considered as part of an overall scheme to pool funds of a number of individuals in a common venture managed by persons other than investors or "buyers," and thus constitute investment contracts.⁴ Similarly, the fact that the party with whom the buyer enters into the management contract is legally distinct from the seller does not alter the character of the investment contract.⁵ Furthermore, the conclusion that such an arrangement is an investment contract is not avoided by the fact that the buyer is not required to enter into the service contract, or even that some such buyers choose not to do so, with the result that as to those buyers, no investment contract has been consummated.⁶



³ 69 Am Jur 2d, Securities Regulation – Federal, §28, citing SEC v. Howey, 328 U.S. 293, 66 S. Ct. 1100, 163 A.L.R. 1043, 90 L. Ed. 1244 (1946).

⁴ Id.

⁵ Id.

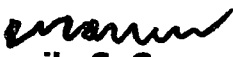
⁶ Id.

Based on your representations, TPHRI's revised business plan involve an arrangement or a scheme whereby TPHRI will assign leasehold rights over the lot and the condotel unit/s for a valuable consideration and the assignee/s will enroll said unit/s under a management contract with TPHRI or its authorized condotel operator to undertake the leasing of the same, wherein profits will necessarily be realized and remitted to the assignee/s, on top of the guaranteed aggregate of thirty-day use per year of the condotel unit. In effect, TPHRI is offering more than leasehold rights in the lot and the condotel units but also the opportunity to contribute money and to share in the profits of leasing said condotel units managed and currently owned by TPHRI.

Stated otherwise, TPHRI's revised business plan involves (1) an investment of money, which in this case is the valuable consideration for the assignment of the condotel unit/s and the corresponding portion of the lot; (2) a common enterprise or profit-making venture, which is the lease to the public of the condotel units and its common areas to be managed by TPHRI or its authorized operator; (3) with expectation of profit, which is the revenue to be generated on the lease of the condotel units; and (4) primarily from the efforts of others, which is apparent in the services to be offered by TPHRI or its authorized operator pursuant to the management contract.

Prescinding from these premises and assuming that the proposed assignment of leasehold rights is allowed under the lease agreement between TRI, BCDA and PPMC, the Commission opines that TPHRI's revised business plan, i.e., the assignment of leasehold rights over the lot and the condotel unit/s with the concomitant enrollment of said units under a management contract with TPHRI or an authorized condotel operator and an expectation of profit from the lease of the units to the public, is an investment contract, which is a security subject to regulation by and registration with the SEC.

The foregoing opinion is rendered based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission whether of similar or dissimilar circumstances.⁷ If, upon investigation, it is disclosed that the facts relied upon are different, this opinion shall be rendered void.


Camilo S. Correa
General Counsel

⁷ SEC Memorandum Circular No. 15, series of 2003.