10-1974

United Housing Foundation v. Forman

Lewis F. Powell Jr.

2nd DRAFT

SUPREME COURT OF THE UNITED STATES

UNITED HOUSING FOUNDATION, INC., ET AL. *v.*
MILTON FORMAN ET AL.; and
STATE OF NEW YORK AND THE NEW YORK
STATE HOUSING FINANCE AGENCY
v. MILTON FORMAN ET AL.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Nos. 74-157 and 74-647. Decided January —, 1974

MR. JUSTICE POWELL, dissenting.

These cases involve a question of national importance as to the application of the Federal Securities Laws of 1933 and 1934, 15 U. S. C. § 77a *et seq.*; 78a *et seq.*

Respondents are tenants of Co-op City, a housing cooperative in New York City which was built as part of a state sponsored program to develop decent living quarters for low and low-middle-income people. N. Y. Private Housing Finance Law §§ 10-37. The State subsidizes the building of such cooperatives, places income limitations on those eligible for tenancy, and provides preferences for veterans, the aged, and the handicapped. Petitioner, the United Housing Foundation, is a nonprofit corporation, comprised of labor unions and civic organizations dedicated to the development of decent low-cost housing, which was chosen as the promoter for Co-op City. To purchase an apartment a buyer must pay $450 per room (each room being considered as one "share"). All tenants receive one vote in cooperative matters. If a tenant wants to sell his apartment he must offer his shares back to the cooperative which, to date, has accepted all such offers. In any event, the tenant may sell his shares only at the initial purchasing price.

Respondents sued in Federal District Court on behalf of all tenants, alleging that the "Information Bulletin" circulated by petitioners to encourage sales in Co-op City violated the securities laws. They requested $30 million in damages claiming that the Information Bulletin misstated the monthly maintenance charges which proved to be significantly greater than had been estimated. The District Court held that it was without jurisdiction to entertain these claims since the securities laws did not apply to the purchase of membership in a housing cooperative such as Co-op City. The Court of Appeals for the Second Circuit reversed, finding that petitioners' denomination of the sale of membership in Co-op City as "stock" was conclusive for purposes of the securities laws. The Court also thought that the substance of the purchase agreement brought it within the intended scope of the securities laws.[1]

The effect of this holding is far reaching. By its terms the decision applies to hundreds of thousands of government subsidized or supported cooperatives.[2] Its rationale also plainly covers private cooperatives[3] and condominiums. Thus, the decision requires application of the extensive regulatory provisions of the securities laws to a whole new area of economic activity, and opens the federal courts to hear grievances that heretofore had been cognizable, if at all, in state courts.[4] For these reasons alone, I think the decision merits review.

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[1] The Court further held that the State of New York and its Housing Agency were not immune from liability under the Eleventh Amendment.

[2] Petitioners assert, without contradiction, that there are "approximately 100,000 such cooperatives in New York State alone . . ." Petn. in No. 74–157, at 13.

[3] This much has already been acknowledged by the Second Circuit in a subsequent decision, *1050 Tenants Corp.* v. *Jakobson*, 503 F. 2d 1375 (1974).

[4] Indeed, respondents in this case have included 10 claims under state law along with their Securities Acts claims, urging the federal court to hear them under the doctrine of pendent jurisdiction.

I am further persuaded to this view because the Second Circuit's opinion reflects a novel, and in my view, an erroneous interpretation of the governing law. Relying on this Court's decisions in *SEC* v. *C. M. Joiner Leasing Co.*, 320 U. S. 344, 351 (1943), and *Tcherpnin* v. *Knight*, 389 U. S. 332, 339 (1967), the court held that a literal interpretation of the Securities Acts requires their application to this case since petitioners have labeled the sale of apartments as a purchase of "stock." But the Acts themselves explicitly reject such a wooden approach by indicating that the literal designation controls "unless the context otherwise requires." 15 U. S. C. § 77b; § 78c (a). And the Court's opinions in *Joiner* and *Tcherpnin* make clear that the application of these statutes turns on the economic reality of the transaction and not the label appended thereto:

> "in searching for the meaning and scope of the word 'security' in the Act[s], *form should be disregarded for substance and emphasis should be on economic reality.*" *Tcherpnin, supra*, at 336 (emphasis supplied).[*]

The Second Circuit, however, went beyond the literal designation and, applying *SEC* v. *J. W. Howey Co., Inc.*, 328 U. S. 293, 298 (1946), concluded that the economic reality of the sale of membership in Co-op City was such as to make the transaction an "investment contract" within the reach of the securities laws. *Howey* defines an "investment contract" as

> "a contract, transaction or scheme whereby a person *invests* his money in a common enterprise and

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[*] Likewise, in *Joiner* the Court stated that to define a "security" a court must look not only to "what character the instrument is given in commerce by the terms of the offer" but also to "the plan of distribution, and the economic inducements held out to the prospect." 320 U. S., at 352, 353. See also 1 Loss, Securities Regulation 493 (2d ed. 1961) ("substance governs rather than form: . . . just as some things which look like real estate are securities, some things which look like securities are real estate.").

> is lead to *expect profits solely from the efforts of the promoter or a third party, . . .*" *Id.*, at 298 (emphasis supplied).

The Court of Appeals found that in this case there was an expectation of profit from the income that might result from operation of commercial facilities at Co-op City. Such facilities are maintained for the convenience of the cooperative tenants and any profits derived therefrom are applied to the overall operating expenses of the cooperative. Thus, it was thought that these profits may broadly be considered "income" to the tenants since potentially they may reduce the monthly maintenance charge.[9] This is a strained, even fanciful view of "profits," without support in economic fact or theory and contrary to the assumptions underlying the Securities Acts.

In this case members of Co-op City have not bought stock or real estate for investment purposes but rather have purchased living quarters generously subsidized by the State of New York. Certainly there was no profit motive, as no rational person would purchase an apartment in this nonprofit housing co-op as an investment for profit. Moreover, a tenant takes no risk with respect to his purchase since, if dissatisfied, he may withdraw from the cooperative and retrieve his initial investment in full. Nor can it even be suggested that the promoters of the cooperative, including the State of New York, sold shares in Co-op City as a means of raising venture capital for a profitmaking operation. Indeed, the promoter is a *nonprofit* corporation. Nothing in the instant transaction partakes of the kind of investment traditionally found to be within the scope and purpose of the securities laws.

This view is supported by the Securities and Exchange Commission, the agency charged with administering the

[9] It would follow, presumably, that this reduction in operating expenses—if in fact it occurs and can be computed—would be taxable income to these beneficiaries of nonprofit, low-cost housing.

securities laws. In a release pertaining to the sales of conventional residential developments generally, the Commission ruled that such sales were not within the Acts unless:

> "The offeror is offering an opportunity through which the purchaser may earn a return on his investments through the managerial efforts of the promoters or a third party . . ." Securities Act Release No. 33–5347 (1–4–73).

The release further states that "where commercial facilities are a part of a residential project," the Acts do not apply when:

> "(a) the income from such facilities is used only to offset common area expenses and (b) the operation of such facilities is incidental to the project as a whole . . . ."

These are precisely the conditions that exist at Co-op City.

In view of the significance of the issues decided, and the doubtfulness of the result reached below, I would grant the writs of certiorari.

Denied 10/25 Relisted for

(A far reaching case extending Securities Acts to non-profit low rent housing projects)

A major Securities Act case extending the Acts of '33 & '34 to the leasing and purchasing of living projects) greater in coops & condominiums.

Petr., a non-profit corp. organized by civic & labor groups to provide low cost housing, sold nominal "shares" to tenants @ $425 per room to be rented. Owner of shares was entitled to live in the coop rent free, to one vote (regardless of number of shares held), to no dividends, & coop was obligated to repurchase shares if tenant moved out.

Discuss
Comment on back
RC

Preliminary Memo

Conf. of Oct. 25, 1974
List 1, Sheet 4

No. 74-157

Tenants did have to pay pro-rata share of operating expenses (interest, maintenance, etc).

Resps sued for $ 32 million, claiming that a brochure describing the project understated the operating expense & failed to make full disclosure.

UNITED HOUSING FOUNDATION — Cert. to CA 2 (Oakes, Hays, Christensen) — Timely

V.

FORMAN — Federal/Civil

Summary: Resps, residents in a cooperative housing development subsidized and regulated by the State of New York in order to provide low cost housing, brought suit against petr United Housing Foundation [USF], a non-profit corporation organized by civic groups and labor unions to provide low cost cooperative housing, and its subsidiaries in USDC alleging that resps' shares in the co-op constituted

The case has not been heard on the merits as CA 2's decision was interlocutory - but issue is ripe & should be heard by the Court now.

securities as defined in §3(a) of the Securities Exchange Act of 1934 [15 U.S.C. §78c(a)] and its counterpart in the Securities Act of 1933 [15 U.S.C. §77b(1)], that the sale of such shares to them by petr and its subsidiaries violated §17 of the 1933 Act and §10(b) of the 1934 because of failures to disclose. They also alleged 10 state law claims under pendent jurisdiction. The USDC dismissed the complaint on the grounds that the resp residents' shares were not securities within the 1933 and 1934 Acts. The Second Circuit reversed holding that the shares did constitute securities as defined in the Acts and remanded the case for a trial on the merits. Petrs now seek cert to review the CA judgment arguing that the co-op shares were not §3(a)(10) securities.

Facts: Resps are residents of Co-op City, the largest co-operative housing project in the United States, which was organized by petr in 1951 in order to provide inexpensive housing for low and middle income families. The project was financed and regulated by the New York State Housing Authority pursuant to New York's Mitchell-Lama Act providing for state aid to mutual companies formed for the purpose of managing co-ops on a non-profit basis, whose shares are wholly owned by the actual tenants of the co-op and transferable only back to the mutual company upon leaving the project. There are income limitations on those who may live in the project and preferences to certain disadvantaged groups.

If a tenant is accepted for occupancy in one of the co-op areas, he purchases $425 worth of mutual company shares for each room in the apartment that he will occupy. However, each tenant gets only one vote in the company no matter how many shares he holds. The shares cannot be owned apart from actual occupancy in the co-op nor may they be pledged, encumbered or transferred in any way save by repurchase by the mutual company for the same amount paid when the tenant leaves the project either voluntarily or for breach of his lease. The shares pay no dividends and confer no value except for the right to occupancy under the terms of a standardized lease, the right to an equal voice in the non-profit mutual company's management of the project, and the right to redemption upon departure at the purchase price.

The carrying charges or monthly rentals under the lease vary depending on expenses incurred by the mutual company in its management of the project (e.g. the carrying charges on the construction mortgage and maintenance/repair costs) and income realized by the company from such activities as parking fees and renting certain areas for shops. The tenants can deduct interest paid by the company on the mortgage under certain IRC provisions designed to extend this benefit of home ownership to co-op residents.

The gravamen of the resps' complaint in this case is that an information bulletin given to them at the time that they signed share subscription agreements for shares in the under-construction co-op failed to adequately disclose that increases in construction

costs of the co-op and increases in interest rates could result in an increase in estimated monthly carrying charges or rental and that as, a result of such factors, rentals did in fact increase from $23/month to $39/month per room. Resps, filing in behalf of all similarly situated tenants, therefore claim in excess of $30 million in damages from various eleemosynary institutions.

Section 3(a)(10) of the 1934 Act provides that:

> "When used in this subchapter, unless the context otherwise requires -- . . . . (10) The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting trust certificate, certificate of deposit for a security, or in general, any instrument commonly known as a security. . . ."

Contention: The sole question presented by this petition is whether the bundle of rights encompassed by the co-op shares constituted a "security" within the meaning of the above cited section.[1/] Petr argues that this is the first decision in the history of these acts extending them to the purchase and sale of residences, citing the widespread criticism of the decision by the securities bar and others [Pet. at 13] and states that it extends the acts to the sale of several million condominium and cooperative

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1/The definition of "security" under the 1933 Act [15 U.S.C. §77(b)(1)] is almost identical and has been construed as being interchangeable with the above section. Tcherepnin v. Knight, 389 U.S. 332, 335-336.

units each year, many of which are publically financed and regulated. It adds the intricate and expensive web of federal securities regulation, designed in the 1930's for regulation of major money markets, to already extensive state regulation of this area which is peculiarly unsuited to application of existent federal securities laws. It frustrates state regulation of the area, allows forum shopping in violation of Erie, creates uncertainty as to whether registration of such sales is required and, for example, eliminates the practice of arbitration of disputes arising in connection with sales of such units since violations of the federal security laws are not subject to mandatory arbitration provisions. Wilko v. Swan, 346 U.S. 427.

Although the co-op shares sold were denominated "stock" and §3(a)(10) includes in its definition of a security "stock", the literal reading given the statute by the CA was error. The statute specifically states ". . .unless the context otherwise requires. . ." and here economic reality does require a different reading. Tcherepnin v. Knight, supra. The legislative history of the Acts shows that they were not intended to apply to the sale of residences especially where such sales were regulated and financed by the states themselves. The literalist approach has been rejected by two CA decisions. Lino v. City Investing Co., 487 F.2d 689 (3rd Cir. 1973); McClure v. First National Bank of Lubbock, 497 F.2d 490 (5th Cir. 1974).

This means, I think, the "context" of the stat., not the econ. context.

The CA's application of the Howey test [SEC v. W. J. Howey, 328 U.S. 293, 298-299] to find the shares an investment contract and hence within §3(a)(10) was error. Howey requires that the investor be led to expect profits from the efforts of a third party as does SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 352. This element of the test has been restated many times. In the immediate case, there is no profit in any conventional sense since the shares are redeemed at a fixed price and the CA decision which found "profit" in reduced rentals and federal tax benefits was simply error.

The decision of the CA is in direct conflict with the position of the SEC as expressed in Securities Act Release No. 33-5347 [pet. at D5] which exempts cooperatives such as that in issue from registration requirements on the grounds that they are not a security.

The USDC opinion repeated many of the above arguments of petr and was grounded on a finding that Howey was not met since from an examination of all relevant circumstances the USDC concluded that the resp residents did not invest with an expectation of profit.

The CA opinion was bottomed on a two-fold analysis. First, instruments denominated as one of the categories enumerated in the statute are a security. Stock is an enumerated category and these shares were called stock. "Instruments may be included within any of these definitions, as a matter of law, if on their face they answer to the name or description. . . ." SEC v.

C. M. Joiner Leasing Corp., supra at 351. Tcherepnin v. Knight, supra at 339. Second, the shares constituted an investment contract under Howey since there was an expectation of profit by the investor -- such profit being in the form of reduced rentals and tax benefits.

Resps generally repeats the CA reasoning and argues that "profit" as used in the Howey test requires only the expectation of economic benefit and not a direct return in the form of a capital gain on sale or dividends or other conventional payment as petr implies. He argues that the SEC's exemption of cooperative unit sales from registration in SEC Rule 235 shows that the SEC regards such units as securities since it wouldn't otherwise be necessary to exempt them.

Discussion: Inasmuch as the decision below stands on the literalist view of §3(a)(10) that because the shares were denominated "stock", they were within the statute, it isn't particularly novel and reflects the widespread interpretation of C. M. Joiner's dicta. As evidenced by the cited CA opinions, the literalist view is under some attack in this area paralleling the subjective move under Section 16(b) because of the irrational results it produces. It is difficult to justify the notion that because the tenant's rights were labeled "stock" rather than a membership they were subject to an entire body of regulatory legislation designed for the protection of major money markets and not residence sales. It would be possible

to distinguish Joiner on the grounds suggested by petr.

The alternate grounds for the CA's holding (that Howey was satisfied by the expectation of "profit" in the form of tax savings and lower rent) would simply make any form of investment a "security" subject to federal regulation and certainly would reach all condominium and cooperative sales in the United States. If the federal security laws are other than a regulation of all not expressly exempt commercial transactions, then the holding that "profit" as used in Howey means expectation of economic benefit is wrong.

This petition seeks review of an interlocutory CA judgement so that petitioner carries a laboring oar in convincing the Court that the questions presented are fundamental to resolution of the case and of extrinsic importance.[2/] A somewhat similar petition presenting the question of §3(a)(10)'s reach was presented in Equity Securities Corp. v. El Khadem, No. 74-46; was on the discuss list for the October 7 conference; and has not yet been disposed of. This case would not be an appropriate hold for Equity (if that petition is granted) given the alternate holdings here and the somewhat different facts presented.

2/R. Stern & E. Gressman, Supreme Court Practice §4.19 at 180-81 (4th ed. 1969).

Cert should be granted in the instant case only if the Court is willing to modify the literalist view of §3(a)(10) expressed in Joiner.

There is a response.

10/15/74 O'Neill Ops in Pet.

I think the decision below was probably wrong. Howie did take an extremely broad, "literalistic" view of what constitutes a security, but it said that the Acts were meant to apply to all instruments, or whatever, sold by persons who seek to use the money of others to gain profits. In other words, it seems to look to the profit-making motive of the seller, not to whether the buyer expects to gain an "economic benefit."

Since there appears to be a conflict (see p. 5, supra), I would probably join 3 in granting. The judgment below was not "final," since it reversed dismissal and remanded. But that's not a jurisdictional bar.

No. 74-46 — Equity Securities v. El Khadem — has been relisted, at your request, for the conf. this week (Oct. 18). That case raises a different, and closer question than the one here, concerning the def. of a security — whether a loan for the purchase of securities, is itself a

We denied as to who I was tempted

security, when the lender receives a promissory note, plus the purchased securities and other value as collateral, and uses these to secure credit for itself in its profit-making activities.

RC.

Court CA - 2 | Voted on ....., 19... | DISCUSS

Argued ....., 19... | Assigned ....., 19... | No. 74-157

Submitted ....., 19... | Announced ....., 19...

UNITED HOUSING FOUNDATION, INC., ET AL., Petitioners

vs.

MILTON FORMAN, ET AL.

8/22/74 Cert. filed.

Denied
(But relisted for L.F.P.)

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING	
		G	D	N	POST	DIS	AFF	REV	AFF	G	D			
Rehnquist, J.			✓											
Powell, J.		✓												
Blackmun, J.		✓												
Marshall, J.			✓											
White, J.			✓											
Stewart, J.			✓											
Brennan, J.			✓											
Douglas, J.			✓											
Burger, Ch. J.					Jour. 3									

Argued ....., 19... *Assigned* ....., 19... No. 74-157

Submitted ....., 19... *Announced* ....., 19...

DISCUSS

UNITED HOUSING FOUNDATION, INC.

vs.

FORMAN

RELIST
(By LFP)

Relist
for
LFP

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING	
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Court ..... *Voted on* ....., 19...

Argued ....., 19... *Assigned* ....., 19... No. 74-157

Submitted ....., 19... *Announced* ....., 19...

DISCUSS

UNITED HOUSING FOUNDATION, INC.

vs.

FORMAN

RELIST

See Recent development - letter indicating a second case from same judgment is on way up.

Relisted 12/13

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING	
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Douglas, J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Burger, Ch. J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....

Court ..... *Voted on* ....., 19...

Argued ....., 19... *Assigned* ....., 19... No. 74-157

Submitted ....., 19... *Announced* ....., 19...

UNITED HOUSING FOUNDATION, INC.

DISC

vs.

FORMAN

RELIST

Relisted
12/13
L 7P

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING	
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Burger, Ch. J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....

Court ..... *Voted on*....., 19...

Argued ....., 19... *Assigned* ....., 19... No. 74-157

Submitted ....., 19... *Announced* ....., 19...

UNITED HOUSING FOUNDATION, INC.

vs.

FORMAN RELIST

Motion to Defer is granted — but will Relisted

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING	
		G	D	N	POST	DIS	AFF	REV	AFF	G	D			
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Rehnquist, J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Powell, J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Blackmun, J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Marshall, J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
White, J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Stewart, J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Brennan, J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
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Burger, Ch. J.	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

January 16, 1975

Re: Nos. 74-157 and 74-747 - United Housing Foundation, et al. v. Forman, et al.

Dear Lewis:

Your opinion dissenting from denial of certiorari in these cases has persuaded me to change my vote and I will vote to grant certiorari. I will not, however, break my sacred tradition of not dissenting from denial.

Sincerely,

WHR

Mr. Justice Powell

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

January 16, 1974

Re: No. 74-157 - United Housing Foundation, Inc.
v. Forman
No. 74-647 - New York v. Forman

Dear Lewis:

Please join me in your dissent from the anticipated denial of certiorari in these cases.

Sincerely,

Harry

Mr. Justice Powell

cc: The Conference

Court ..... *Voted on* ....., *19*...

Argued ....., *19*... *Assigned* ....., *19*... No. 74-157

Submitted ....., *19*... *Announced* ....., *19*...

UNITED HOUSING FOUNDATION, INC.

vs.

FORMAN RELIST

Grant
Consolidate
with 74-647

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING	
		G	D	N	POST	DIS	AFF	REV	AFF	G	D			
Rehnquist, J.		✓												
Powell, J.		✓												
Blackmun, J.		✓												
Marshall, J.			✓											
White, J.		✓												
Stewart, J.		✓												
Brennan, J.			✓											
Douglas, J.		✓												
Burger, Ch. J.		✓												

MEMORANDUM

TO: Mr. Justice Powell

FROM: Joel Klein DATE: April 14, 1975

No. 74-157, New York, et al. v. Forman

In view of your position, as expressed in the proposed dissent from denial that we prepared, I feel quite assured that we will not have to address the immunity issue raised by the state petitioners in this case. If, for some reason, however, you are required to express your views on that issue I would find that there is no immunity here, either for the State of New York or its Housing Agency. I will briefly outline my views.

1. With respect to the State itself, the New York statutes, referring to the present housing laws, provides:

> "With regard to duties and liabilities arising out of this article the state, the commissioner or the supervisory agency may be sued in the same manner as a private person."

This is, I would assume, an explicit waiver of immunity applicable to the State. New York's argument, that this provision does not waive immunity in federal court, is hollow. Nothing in the statute suggests this distinction.* Indeed, if

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* In other statutes, the New York legislature has made clear that it intended only a limited waiver of immunity.

a private person can be sued in federal court, as CA 2 erroneously held, then the State can be so sued.

2. This explicit waiver provision does not apply to petitioner, the State Housing Finance Agency since it is not a "supervising agency" as required by the statute. Nevertheless, as petitioner virtually concedes, this Agency is wholly distinct from the state. By statute, the state is exempted from liability for the debts of the Agency. In this situation the Agency is not protected by the Eleventh Amendment.

3. Since the first two points would resolve the immunity issue in this case, I would certainly avoid the alternative ground relied on by CA 2 below, since I think it raises difficult and confusing issues. The alternative ground is that states which sell securities after the passage of the 1933 and 1934 Acts are liable to suit on the theory that they have implicitly consented to Congressional abrogation of immunity since the Securities Acts apply against the States. In essence this question boils down to whether Edelman v. Jordan, 415 U.S. 651 cuts back on Parden v. Terminal R. of Ala., 377 U.S. 184. It would seem that Edelman probably does erode somewhat the holding in Parden but I would hardly decide that issue here; rather I would wait for a case in which I thought the Securities Act did apply to the stocks at issue, and then decide whether those Acts intended to abrogate state immunity.

JK

74-157 UNITED HOUSING v. FORMAN
74-647 NEW YORK v. FORMAN

Argued 4/22/75

Rifkind

"Three pedestals" support Petrs' position.

1. Their transaction related to homes
— not investments.

2. Not a commercial transaction
— no profits

3. A State Welfare plan under which benefits were conferred upon low income citizens. Congress, in enacting Securities Acts, has no intention to cover this.

Rejkuid

Massive benefits were made available to tenants by State Law:

1. Interest savings by tax exempt mtg debt.
2. Abatement of real estate taxes
3. Elimination of promoters, builders profits.
4. Mtg. payments spread over 40 yrs.

Only these benefits enabled sale of apts at $450 per room.

92.6% of cost (of $400 million plan) was provided by State directly or indirectly.

Concept of commercialism & of profit wholly ~~exclusive~~ excluded from this transaction.

United Housing Corp - the sponsor - could make no profit (see its charter). The

Rifkind (cont)

All that appellees were offered was opportunity to buy a home.

Only Q is whether this case belongs in Fed Ct under Securities Law or in State Ct under state fraud & other laws.

Congress did not intend to regulate the purchase of homes

Cohen (for N.Y.)

Argued state immunity — which is [redacted] case we do not reach if Sec. Act is not applicable.

Nizer (for Resp)

Relies chiefly on Tcherepnin
(but there was potential of
dividends)

Jonson (SEC) - a flop.

Rifkind (Reply)

Every ctt. was rescindable.

Dividends - "no coop pays
dividends". If costs turned
out to be less, there would be
a rebate - not a dividend.

SEC has changed its position
- May have given no-action
letters (see SEC brief)

April 22, 1975

No. 74-157 N.Y. v. Foreman

Characteristics of Common Stock

1. Transferability - must offer back to co-op.

2. Voting Rights - here each Tenant had one vote regardless of number of shares (one share for each room).

3. Opportunity to Profit - Tenant may not profit, as must sell only at initial purchasing price. Charter so provides as required by N.Y. Law. (See A-86

4. A stock corporation by definition is different from a nonstock-nonprofit corporation. How could a member of a nonprofit corporation profit, if corporation is not allowed to make any profits. (Joel - What about farm, milk and rurual electric co-ops).

5. Dividends - none.

(Reduction in operating expenses is not a profit. No tax is paid on this. If fuel costs went down, and operating costs decreased, would there be a profit?)

L.F.P., Jr.

ss

April 22, 1975

No. 74-157 New York v. Foreman

As described by the District Court, the central facts in this case include:

The project, Coop City, was authorized by New York's Mitchell-Lamar Act designed to provide housing for low-income families. Pursuant to the Act, the defendant New York State Housing Finance Agency (the Agency) provides subsidized mortgaged financing; another defendant, New York State Division of Housing and Community Renewal (the State Division) is responsible under New York law for the construction and operation of the project. United Housing Foundation (UHF) initiated and sponsored Coop City. It is a nonprofit, charitable corporation (see charter) comprised of housing cooperatives, civic groups and labor unions.

River Bay Corporation (River Bay) is the cooperative housing corporation in which these plaintiffs purchased shares, and which owns and operates Coop City. River Bay was organized under the Mitchell-Lamar Act. By virtue of that Act and the charter of the corporation, it shares of "stock" have the following unique characteristics:

1. The shares are tied to rooms in apartments at the rate of $450 per room - 18 shares at $25 per share entitled the purchaser to one room.

2. May not be pledged or otherwise encumbered.

3. May not be inherited except by a surviving spouse (who would have the right to occupancy).

4. The stock purchase transaction is rescindable by either party.

5. The shares may not be owned separate and apart from actual occpancy in Coop City.

6. If the tenant leaves Coop City, he is required to divest himself of the stock: Offering it first to the corporation for repurchase at the exact.*

7. Voting rights are limited to one vote per apartment, regardless of the number of the shares.

8. No dividends.

9. No opportunity to make a profit. The charter, pursuant to New York law, provides expressly that shares may be sold only at the initial purchase price.

*In the unlikely event that the corporation does not repurchase the shares, the owner may sell them elsewhere but only at the original purchase price, plus a fraction of the mortgage amortization which he paid during his tenure at Coop City. The coop has a reserve fund (totaling some $900,000 at Dec. 31, 1972) for repurchase purposes - a reserve not needed because several thousand families are on the waiting list for apartments, and the turnover is slight.

April 22, 1975

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5. Dividends - none.

(Reduction in operating expenses is not a profit. No tax is paid on this. If fuel costs went down, and operating costs decreased, would there be a profit?)

L.F.P., Jr.

ss

The Chief Justice Paused. Reverse
Label of "stock" not controlling.

Douglas, J. Rever 6-2

Not present.

Brennan, J. Affirm (both cases)
Congress intended to cover every thing

Stewart, J. Reverse (tentative)
Close case because of statutory language
Not inventor

Affirm

Close case.

Had chance to make a "loss".

Reverse (both)

Only the use of word "stock" ~~supports~~ supports Resp. Economic reality.

Blackmun, J.

Reverse (both)

Powell, J. Reverse (both)

Rehnquist, J. Reverse

Don't reach Immunity Issue if we Reverse

MEMORANDUM

TO: Mr. Joel Klein DATE: May 26, 1975

FROM: Lewis F. Powell, Jr.

74-157
No. ~~74-75~~ United Housing

I deliver back to you herewith the draft of May 9, which I have reviewed carefully.

It is totally convincing (at least to me), and well organized and drafted. I have, as usual, made a number of editing changes to reflect my own taste and style.

In addition, I have suggested revisions of certain portions by dictating riders which are attached.

All of my changes are subject, of course, to further discussion. After you have reviewed them, I suggest we talk about any points or changes which you think should be discussed.

Then, let's get a chambers copy printed promptly.

L.F.P., Jr.

ss

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

June 2, 1975

Re: No. 74-157 - United Housing Foundation v. Forman
No. 74-647 - New York v. Forman

Dear Lewis:

Please join me.

Sincerely,

Harry

Mr. Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

June 2, 1975

RE: Nos. 74-157 & 74-647 - United Housing Foundation & State of N.Y. and N.Y. State Housing, etc. v. Milton Forman, et al.

Dear Lewis:

In due course I shall circulate a dissent in the above.

Sincerely,

Bill

Mr. Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

June 2, 1975

Re: Nos. 74-157 and 74-647 - United Housing v. Forman

Dear Lewis:

Please join me.

Sincerely,

WHR

Mr. Justice Powell

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE POTTER STEWART

June 2, 1975

Re: Nos. 74-157, United Housing Fd., Inc.
and 74-647, New York v. Forman

Dear Lewis,

I am glad to join your opinion for the Court in these cases.

Sincerely yours,

P.S.

Mr. Justice Powell

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

June 2, 1975

No. 74-157 -- United Housing Foundation, Inc. v.
Milton Forman
74-647 -- State of New York and the New York State
Housing Finance Agency v. Milton Forman

Dear Lewis:

Please join me.

Sincerely,

T.M.

Mr. Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

June 3, 1975

Re: Nos. 74-157 & 74-647 - United Housing Foundation, Inc. v. Forman

Dear Lewis:

I shall await Bill Brennan's dissent.

Sincerely,

Mr. Justice Powell

Copies to Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

June 6, 1975

Re: 74-157 - United Housing Foundation v. Forman
74-647 - State of New York v. Forman

Dear Lewis:

I join you.

Regards,

WEB

Mr. Justice Powell

Copies to the Conference

P.S. (LFP only)
This is an excellent job and I particularly welcome the addition of note 15.

WEB

CHAMBERS OF
JUSTICE BYRON R. WHITE

June 10, 1975

Re: Nos. 74-157 & 74-647 - United Housing Foundation, Inc. v. Forman

Dear Bill:

Please add my name to your dissenting opinion in these cases.

Sincerely,

Byron

Mr. Justice Brennan

Copies to Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM O. DOUGLAS

June 11, 1975

Re: United Housing Foundation v. Forman, No. 74-157
State of New York v. Forman, No. 74-647

Dear Bill:

Please join me in your dissenting opinion.

Sincerely,

WILLIAM O. DOUGLAS

Mr. Justice Brennan

cc: The Conference

June 11, 1975

No. 74-157 United Housing v. Forman
No. 74-647 New York v. Forman

Dear Mr. Putzel:

The line-up in the above case is as follows:

Powell, J., delivered the opinion of the Court, in which Burger, C.J., Stewart, Marshall, Blackmun and Rehnquist, JJ., joined. Brennan, J., filed a dissenting opinion, in which Douglas and White, JJ., joined.

Sincerely,

Mr. Henry Putzel, jr.

lfp/ss

cc: Mr. Cornio

This case, here on certiorari to the Court of Appeals for the Second Circuit, involves a large cooperative housing project in New York known as Co-Op City. This nonprofit project was financed and constructed under a New York Law designed to provide low-cost cooperative housing for low income tenants. The project was heavily subsidized by long-term, low-interest mortgage loans and tax exemptions.

Co-Op City solicited prospective tenants by an Information Bulletin which described the project, and included estimates of construction costs and monthly rental charges. To acquire an apartment, the prospective tenant had to buy prescribed shares of stock in the project.

Construction costs greatly exceeded estimates, resulting in substantial increases in the rental charges. The plaintiffs in this suit are tenants who claim that the Information Bulletin contained false and misleading statements. The defendants are the various parties that sponsored, constructed and now operate the project.

Suit was brought in the federal court on the theory that sale of the shares was subject to the anti-fraud provisions of the federal Securities Acts. The sole issue in this case is whether these shares constitute securities within the meaning of the federal Acts.

The shares at issue cannot be transferred to a non-tenant; they cannot be bequeathed except to a surviving spouse; they cannot be encumbered; and voting rights are limited to one vote per apartment. More important, there can be no capital appreciation on the shares, and they carry no dividend rights.

Plaintiffs, nevertheless, contend that profits may be derived indirectly in terms of low-cost housing, possible reduction in rental charges from the operation of shops and services within the co-op, and from certain tax benefits.

The Court of Appeals agreed with the plaintiffs, and held that these shares are securities within the meaning of the federal Acts.

We take a different view. The plaintiffs were not investing in stock with the view to making a profit thereon; they were acquiring the right to occupy housing on exceptionally favorable terms. These shares possessed none of the characteristics of instruments commonly known as securities. Accordingly, we concluded that they are not within the purview of the federal Securities Acts, and we reverse the judgment of the Court of Appeals.

Mr. Justice Brennan has filed a dissenting opinion, in which Mr. Justice Douglas and Mr. Justice White have joined.

2 copies to Mr Putzel 6/2/75

THE C. J.	W. O. D.	W. J. B.	P. S.	B. R. W.	T. M.	H. A. B.	L. F. P.	W. H. R.
							4/28/75	
Join L F P 6/6/75	Join WJB 6-11-75	Will Dissent 6-2-75 Dissent 6-9-75 10th draft 6-10-75 2nd draft w WOD + BRW 6-13-75	Join LFP 6-2-75	Will await Dissent 6-3-75 Join WJB 6-10-75	Join LFP 6-2-75	Join LFP 6-2-75	1st draft 5/30/75 2nd draft 6/5/75 3rd draft 6/11/75	Join LFP 6-2-75
					74-157 United Housing v. Forman 74-647 New York v. Forman			

Co-Op Shares Held Not to Be Securities

By Margaret Gentry
Associated Press

The Supreme Court yesterday refused to extend the protection of the federal securities laws to hundreds of thousands of owners of cooperative apartments.

In a 6-to-3 decision, the court ruled that stock purchased in cooperative housing projects does not qualify as a security subject to federal regulation.

The decision reversed a U.S. circuit court ruling in a case involving the 50,000 tenants of Co-Op City in The Bronx, N.Y., the largest housing cooperative in the nation.

The appellate court in New York had ruled that federal regulations apply, partly because tenants purchased what was called stock.

Writing for the Supreme Court majority, Justice Lewis F. Powell said that calling something stock does not make it so.

The ownership shares purchased by the tenants offered no prospect of profit and have none of the other features common to securities laws, Powell said.

The Co-Op City residents filed the class action suit to challenge increases in their monthly maintenance costs.

They argued that the project sponsors, United Housing Foundation, and its operating arm, Riverbay, were bound by a 1965 information bulletin which said the average monthly cost would be about $82 for a four-room apartment.

By July 1974, the average monthly rate had exceeded $156 for the same space.

The Co-Op City residents argued that the 1965 prediction amounted to a solicitation to buy stock and that the project operators were bound by it by federal securities law.

If that position had prevailed, it could have set off similar suits to force rental reductions in many other cooperative housing projects across the country.

"Common sense suggests that people who intended to acquire only a residential apartment in a state-subsidized cooperative for their personal use are not likely to believe that, in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock," Powell wrote.

Despite the name, he continued, shares in Co-Op City lack "the most common feature of stock," the right to receive dividends from the company's profits.

"In short, the inducement to purchase was solely to acquire subidized low-cost living space; it was not to invest for profit," he concluded.

Powell said the court paid little attention to urgings from the Securities and Exchange Commission supporting the application of federal securities laws to cooperative housing.

The SEC has taken the opposite position with effect to condominiums and "this unexplained contradiction" diminished its influence with the court in this case, Powell said.

Joining him in the majority were Chief Justice Warren E. Burger and Justices Potter Stewart, Thurgood Marshall, Harry A. Blackmun and William H. Rehnquist.

Justices William J. Brennan, William O. Douglas and Byron R. White dissented.

Co-Op City Tenants Lose High Court Plea on Costs

Special to The New York Times

WASHINGTON, June 16—The Supreme Court ruled today that stock purchased by prospective tenants in cooperative housing projects to qualify for apartments was not subject to Federal regulation that might have held monthly carrying charges down to originally advertised figures.

Dividing 6 to 3, the justices held that 50,000 tenants of Co-Op City in the Bronx, the largest cooperative in the country, were not entitled to Federal court trial of their request for a ban on many of their carrying-charge increases above the 1965 level. They had also sought more than $30-million in damages.

Had the high court decided otherwise, hundreds of thousands of other tenants across the country, in cooperatives and perhaps in condominiums, might have been able to hold the developers of these projects to their original estimates of monthly carrying charges, independent of subsequent construction-cost inflation.

In concluding that shares in a cooperative are not stock subject to Federal regulations, the majority rejected the views of the Securities and Exchange Commission and the United Court of Appeals for the Second Circuit.

The Supreme Court majority left open the possibility that Co-Op City tenants might be able to pursue their claims of

Continued on Page 22, Column 7

TENANTS OF CO-OP LOSE COSTS SUIT

Continued From Page 1, Col. 8

fraud in the state courts.

Associate Justice William J. Brennan Jr. maintained for the minority that stock bought by cooperative tenants represented "securities" subject to Federal oversight because it was called "stock" and involved an "investment contract" from which the tenants might profit in various ways.

Joining in the dissent were Associate Justices William O. Douglas and Byron R. White.

To get an apartment in the state-aided, nonprofit Co-Op City project, which opened in 1968, a tenant had to buy 18 shares of $25 stock for each room, or $1,800 worth for a four-room apartment. In a circular in 1965, the operating corporation said the average monthly carrying charge would then be $23 a room.

The stock requirement remained steady, but the monthly carrying charge, with inflation driving up construction costs by $125-million, rose to more than $40 a room by 1974, and the tenants filed suit in Federal District Court.

They contended that their "stock" was no different from the securities traded on exchanges across the country and that they had been misled, in violation of S.E.C. regulations, as to their prospective monthly charges. They also contended that operators of the project had withheld several important financial facts from the beginning.

The suit did not challenge those increases in carrying charges resulting from rising maintenance and operating costs. It challenges only those increases that resulted from the sharply rising construction costs while the 35-building, 300-acre project went up between 1965 and 1972. The original cost estimate was about $280-million; the final cost was more than $420-million.

Currently, the Co-op City residents are being asked to pay 25 per cent increase in carrying charges, stemming from rising operating and maintenance costs, state officials say. This request has led to a withholding of carrying charges and a state take-over of the management of the project.

Prominent Counsel

The Federal suit pitted two prominent lawyers against each other—Louis Nizer for the suing cooperators, and former Federal Judge Simon H. Rifkind for the project's sponsor, the United Housing Foundation, and its builder, Community Services, Inc.

Federal District Court dismissed the lawsuit on the ground that cooperative shares were not stock. But the Court of Appeals reversed, holding that the tenants had been involved in an investment contract when they bought the shares, with "an expectation of profits" in terms of low housing costs, tax deductions on the interest and realty-tax part of their carrying charges, and possible rent reductions resulting from income from commercial franchises at Co-Op City.

Majority View

Associate Justice Lewis F. Powell Jr. wrote for the majority today that "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 investment."

Franchise income, from store and office rental and parking garages was "far too speculative and insubstantial" to make Co-Op City shares an attractive investment such as common stock, the majority declared.

Such cooperative stock, Justice Powell noted, does not give purchasers the right to dividends based on profit, is not negotiable, cannot be pledged against a debt and cannot appreciate in value under the terms of the purchase contract.

"What distinguishes a security transaction and what is absent here," the majority said, "is an investment where one parts with his money in the hope of receiving profits from the efforts of others and not where he purchases a commodity for personal consumption or living quarters for personal use."

Justice Powell said the majority gave "no special weight" to the Securities and Exchange Commission's contention, announced in the case only this year, that cooperative stock was a federally regulatable security, since the agency had taken the opposite position in a policy statement in 1973.

[illegible] GREEN CAMP. KIDS.

June 16, 1975

74- 157

Case Held for No. 74-647, New York v. Forman

MEMORANDUM TO THE CONFERENCE:

No. 74-1190 MacKethan v. Virginia

I will vote to deny this petition. The basic issue is whether a state can be held liable under the federal Securities Acts for activities that it undertakes while regulating a savings and loan institution. USDC and CA4 found the action barred by the Eleventh Amendment. Although a vaguely similar issue was presented in the state's petition in Forman, our disposition there made it unnecessary to consider the immunity question.

L.F.P., Jr.

ss

July 9, 1975

No. 74-157, United Housing v. Forman

MEMORANDUM TO MR. PUTZEL

Although the change from "purchasers" etc. to "tenants' may clarify things, on balance I think the present arrangement is preferable.

Joel Klein

LFP/gg 7-10-75

This is fine with me JK

(4)

Respondents are referred to herein variously as "purchasers", "owners", or "tenants". Respondents do not hold legal title to their respective apartments, but they are purchasers and owners of the shares of Riverbay which entitle them to occupy the apartments. By virtue of their right of occupancy, Respondents are usually described as tenants.

Justice Powell - perhaps put this fn after 1st sentence in first full ¶ on page 3, or after word "Respondents" in second line of first full ¶ on page 5. This will require renumbering footnotes, which can readily be done. If placed in fn. 4 it will be a bit stilted but nevertheless O K.

Remember all footnotes after 4 see also in subsequent

4. Respondents are referred to herein variously as "purchasers", "owners", or "tenants". Respondents do not hold legal title to their respective apartments, but they are purchasers and owners of the shares of Riverbay which entitle them to occupy the apartments. By virtue of their right of occupancy, Respondents are usually described as tenants.

July 14, 1975

Memorandum to Mr. Putzel:

Please insert this footnote at page 3, first paragraph, line 2, and renumber the following footnotes, including the infra and supra cites.

Joel Klein

CHAMBERS DRAFT

SUPREME COURT OF THE UNITED STATES

Nos. 74–157 AND 74–647

United Housing Foundation, Inc., et al., Petitioners, 74–157 *v.* Milton Forman et al.	On Writs of Certiorari to the United States Court of Appeals for the Second Circuit.
State of New York and the New York State Housing Finance Agency, Petitioners, 74–647 *v.* Milton Forman et al.	

[June —, 1975]

MR. JUSTICE POWELL delivered the opinion of the Court.

The issue in this case is whether shares of stock entitling a purchaser to lease an apartment in Co-Op City, a state subsidized and supervised nonprofit housing cooperative, are "securities" within the purview of the Securities Act of 1933 and the Securities Exchange Act of 1934.

I

Co-Op City is a massive housing cooperative in New York City. Built between 1965 and 1971, it presently houses approximately 50,000 people on a 200-acre site containing 35 high rise buildings and 236 town houses. The project was organized, financed, and constructed under the New York State Private Housing Finance Law,

commonly known as the Mitchell-Lama Act, enacted to ameliorate a perceived crisis in the availability of decent low income urban housing. In order to encourage private developers to build low cost cooperative housing, New York provides these developers with large long-term, low-interest mortgage loans and substantial tax exemptions. Receipt of such benefits is conditioned on a willingness to have the State review virtually every step in the development of the cooperative. See N. Y. Private Housing Finance Law §§ 11–40, as amended (McKinney Supp. 1974–1975). The developer also must operate the facility strictly "on a nonprofit basis," *id.*, at § 11–a (2a), and he may lease apartments only to people below a certain income level and who have been approved by the State.[1]

The United Housing Foundation (UHF), a nonprofit membership corporation established for the purpose of "aiding and encouraging" the creation of "adequate, safe and sanitary housing accommodations for wage earners and other persons of low and moderate income," [2] Appendix, at 95a, was responsible for initiating and sponsoring the development of Co-Op City. Acting under the Mitchell-Lama Act, UHF organized the Riverbay Corporation (Riverbay) to own and operate the land and buildings comprising Co-Op City. Riverbay, a nonprofit cooperative housing corporation, issued the stock which is the subject of this litigation.[3] UHF also con-

[1] Eligibility is limited to families whose monthly income does not exceed six times the monthly rental charge (or, for families of four or more, seven times the rental charge). N. Y. Private Housing Finance Law § 31 (2)(a) (McKinney Supp. 1974–1975). Preference in admission must be given to veterans, handicapped people and the elderly. *Id.*, at § 31 (7)–(9).

[2] UHF is comprised of labor unions, housing cooperatives and civic groups. It has sponsored the building of several major housing cooperatives in New York City.

tracted with Community Services, Inc. (CSI), its wholly owned subsidiary, to become the general contractor and sales agent for the project.[3] As required by the Mitchell-Lama Act, these decisions were approved by the State Housing Commissioner.

To acquire an apartment in Co-Op City a prospective purchaser, assuming he meets the eligibility requirements and is approved by the State, is required to buy 18 shares of stock in Riverbay for each room desired. The cost per share is $25, making the total cost $450 per room, or $1,800 for a four-room apartment. The sole purpose of acquiring these shares is to enable the purchaser to occupy an apartment in Co-Op City; in effect, their purchase is a recoverable deposit on an apartment. The shares are explicitly tied to the apartment: they cannot be transferred to a nontenant; nor can they be pledged or encumbered; and they descend, along with the apartment, only to a surviving spouse. No voting rights attach to the shares as such; ~~as voting~~ in affairs of the cooperative appertains to the apartment, each tenant being entitled to one vote irrespective of the number of shares he owns.

Any tenant who wants to terminate his occupancy or is forced to move out,[4] must offer his stock to Riverbay at its initial selling price of $25 per share. In the extremely unlikely event that Riverbay declines to repurchase the stock,[5] the tenant cannot sell it for more than

---

[3] CSI is a business corporation that has acted as the contractor on several UHF-sponsored housing cooperatives.

[4] A tenant can be forced to move out if he violates the provisions of his "occupancy agreement," which is essentially a lease for the apartment, or if his income grows to exceed the eligibility standards.

[5] To date every family that has moved out of Co-Op City has received back its initial payment in full. Indeed, at the time this suit was filed there were 7,000 families on the waiting list for apartments in this cooperative. In addition, a special fund of nearly

the initial purchase price plus a fraction of the mortgage that he has paid off, and then only to a prospective tenant satisfying the statutory income eligibility requirements. See N. Y. Private Housing Finance Law § 31–a (McKinney Supp. 1974–1975).

In May 1965, subsequent to the completion of the initial planning, Riverbay circulated an Information Bulletin seeking to attract tenants for what would someday be apartments in Co-Op City. After describing the nature and advantages of cooperative housing generally and Co-Op City in particular, the Bulletin informed prospective tenants that the total estimated cost of the project, based largely on an anticipated construction contract with CSI, was $283,695,550. Only a fraction of this sum, $32,795,550, was to come from the purchase of shares by tenants. The remaining $250,900,000 was to be financed by a 40-year low-interest mortgage loan from the New York Private Housing Finance Agency. After the project was built, the servicing of the mortgage and current operating expenses would be defrayed from monthly rental charges paid by the tenants. While these rental charges were to vary, depending on the size, nature, and location of an apartment, the 1965 Bulletin estimated that the "average" monthly cost would be $23.02 per room, or $92.08 for a four-room apartment.

Several times during the construction of Co-Op City, Riverbay, with the approval of the State Housing Commissioner, revised its contract with CSI by allowing for increased construction costs. In addition, Riverbay also incurred other expenses that had not been reflected in the 1965 Bulletin. To meet these increased expenditures, Riverbay, with the Commissioner's approval, repeatedly

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$1 million had been established by small monthy contributions from all tenants to insure that those who wanted to sell their apartments would be able to do so.

secured increased mortgage loans from the State Housing Agency. Ultimately the construction loan was $125 million more than the figure estimated in the 1965 Bulletin. As a result, while the initial purchasing price remained at $450 per room, the average monthly carrying charges were increased periodically, reaching a figure of $39.68 per room as of July 1974.[6]

These increases in the rental charges precipitated the present lawsuit. Respondents, 57 residents of Co-Op City, sued in federal court on behalf of all 15,372 apartment owners, and derivatively on behalf of Riverbay, seeking upwards of $30 million in monetary damages, forced rental reductions and other "appropriate" relief. Named as defendants (petitioners herein) were UHF, CSI, Riverbay, several individual directors of these organizations, the State of New York, and the State Private Housing Finance Agency. The heart of respondents' claim was that the 1965 Co-Op City Information Bulletin falsely represented that CSI would bear all subsequent cost increases due to unanticipated factors such as inflation. Respondents further alleged that they were misled in their purchases of shares since the Information Bulletin failed to disclose several critical facts.[7] On these

[6] As the rental charges increased, the income eligibility requirements for residents of Co-Op City expanded accordingly. See n. 1, *supra*.

[7] Respondents maintained that the following material facts were omitted: (i) the original estimated cost had never been adhered to in any of the previous Mitchell-Lama projects sponsored by UHF and built by CSI; (ii) petitioners knew that the initial estimate would not be followed in the present project; (iii) CSI was a wholly owned subsidiary of UHF; (iv) CSI's net worth was so small that it could not have been legally held to complete the contract within the original estimated costs; (v) the State Housing Commissioner had waived his own rule regarding liquidity requirements in approving CSI as the contractor; and (vi) there was an additional undisclosed $200,000 agreement between CSI and Riverbay.

bases, respondents asserted two claims under the fraud provisions of the Federal Securities Acts of 1933 and 1934, 15 U. S. C. § 77g (a); 15 U. S. C. § 78j (b), and 17 CFR § 240.10b-5. They also presented a claim against the State Financing Agency under the Civil Rights Act, 42 U. S. C. § 1983, and 10 pendent state law claims.

Petitioners, while denying the substance of these allegations,[8] moved to dismiss the complaint on the ground that federal jurisdiction was lacking. They maintained that shares of stock in Riverbay were not "securities" within the definitional sections of the Federal Securities Acts. In addition, the state parties moved to dismiss on sovereign immunity grounds.

The District Court granted the motion to dismiss. 366 F. Supp. 1117 (1973). It held that the denomination of the shares in Riverbay as "stock" did not, by itself, make them securities under the federal acts. The court further ruled, relying primarily on this Court's decisions in *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344 (1943), and *SEC* v. *W. J. Howey Co.*, 328 U. S. 293 (1946), that the purchase in issue was not a security since it was neither induced by an offer of tangible material profits, nor could such profits realistically be expected. In the District Court's words, it was "the fundamental nonprofit nature of this transaction" which presented "the insurmountable barrier to [respondents'] claims in the federal court." *Id.*, at 1128.[9]

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[8] Petitioners asserted that the Information Bulletin warned purchasers of the possibility of rental increases, and denied it omitted material facts. They also argued that prior to occupancy all tenants were informed that rental charges had increased. In any event, petitioners claimed that respondents have suffered no damages since they may move out and retrieve their initial investments in full.

[9] The District Court also dismissed the § 1983 claim finding that the securities laws claims were "the only well-pleaded underlying basis for jurisdiction" under the Civil Rights Act. *Id.*, at 1132. In

The Court of Appeals for the Second Circuit reversed. 500 F. 2d 1246 (1974). It rested its decision on two alternative grounds. First, the court held that since the shares purchased were called "stock" the Securities Acts, which explicitly include "stock" in their definitional sections, literally applied. Second, the Court of Appeals concluded that the transaction was an investment contract, within the meaning of the Acts and as defined by *Howey*, since there was an expectation of profits from three sources: (i) rental reductions resulting from the income produced by the commercial facilities established for the use of tenants at Co-Op City; (ii) tax deductions for the portion of the monthly rental charges allocable to interest payments on the mortgage; and (iii) savings based on the fact that apartments at Co-Op City cost substantially less than comparable nonsubsidized housing. The court further ruled that the immunity claims by the state parties were unavailing.[10] Accordingly, the case was remanded to the District Court for consideration of respondents' claim on the merits.

In view of the importance of the issues presented we granted certiorari. — U. S. — (1975). As we conclude that the disputed transactions are not securities within the contemplation of the federal statutes, we reverse.

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view of these rulings the court did not reach the sovereign immunity claims.

[10] The Circuit Court held that the State Agency was independent and distinct from the State itself and therefore it was a "person" for purposes of § 1983, that both the Agency and the State had waived immunity under § 32 (5) of the Private Housing Finance Act, and that the State had also implicitly waived its immunity by voluntarily participating in the sale of securities, an area subject to plenary federal regulations. See *Parden* v. *Terminal Ry. of Alabama Docks Dept.*, 377 U. S. 184 (1964). In view of our disposition of this case we do not reach these immunity issues.

II

The Securities Act of 1933, 15 U. S. C. § 77b (1), defines a "security" as

> "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 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." [11]

In providing this definition Congress did not attempt to articulate the relevant economic criteria for distinguishing "securities" from "non-securities." Rather it sought to define "the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H. R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933). The task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad of financial transactions in our society come within the coverage of these statutes.

In making this determination in the present case we do not write on a clean slate. Well-settled principles

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[11] The definition of a security in the 1934 Act is virtually identical and, for present purposes, the coverage of the two Acts may be considered equivalent. See *Tcherepnin* v. *Knight*, 389 U. S. 332, 336, 342 (1967); S. Rep. No. 792, 73d Cong., 2d Sess., 14 (1934).

enunciated by this Court establish that the sale of shares which entitle the purchaser to an apartment in Co-Op City is not one of the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits," *Howey, supra,* 328 U. S., at 299, and therefore it does not fall within "the ordinary concept of a security."

A

We reject at the outset any suggestion that the present transaction, evidenced by the sale of shares called "stock," must be considered a security simply because the statutory definition of a security includes the words "any . . . stock." Rather we adhere to the basic principle that has guided all of the Court's decisions in this area:

> "In searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin v. Knight,* 389 U. S., 332, 336 (1967).

See also *Howey, supra,* 328 U. S., at 298.

The primary purpose of the Securities Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market by providing for the regulation of the sale of securities and the operation of securities exchanges. The focus of the Acts are on the capital market of the enterprise system: the raising of capital for profit-making purposes by the sale of securities, the providing of trading exchanges therefor, and the regulation thereof to prevent fraud and to protect the interest of investors. Transactions within the securities market, broadly defined, are economic in character; they necessarily turn on economic reality rather than form.[12]

[12] While the record does not indicate precisely why the term stock was used for the instant transaction, it appears that this form is generally used as a matter of tradition and convenience. See

Thus, in construing these Acts against the background of their purpose, we bear in mind a traditional canon of statutory construction

> "that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers." *Church of the Holy Trinity* v. *United States*, 143 U. S. 457, 459 (1892). See also *United States* v. *American Trucking Assns., Inc.*, 310 U. S. 534, 543 (1940).[13]

Respondents' reliance on *Joiner* as support for a "literal approach" to defining a security is misplaced. The issue in *Joiner* was whether assignments of interests in oil leases, coupled with the promoters' offer to drill an exploratory well, were securities. Looking to the economic inducement provided by the proposed exploratory well, the Court concluded that these leases were securities even though "leases" as such were not included in the list of instruments mentioned in the statutory definitions. In dictum the Court noted that "[i]nstruments *may* be included within [the definition of a security], as [a] a matter of law, if on their face they answer to the name or description." 320 U. S., at 351 (emphasis supplied). And later, again in dictum, the Court stated

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P. Rohan & M. Reskin, Cooperative Housing Law & Practice, § 2.01 (4) (1973).

[13] With the exception of the Second Circuit, every court of appeals to consider the issue recently has rejected the literal approach urged by respondents. See *C. N. S. Enterprises, Inc.* v. *G&G Enterprises, Inc.*, 508 F. 2d 1354 (CA7 1975); *McClure* v. *First National City Bank of Lubbock*, 497 F. 2d 490 (CA5 1974), cert. denied, — U. S. — (1975); *Lino* v. *City Investing Co.*, 487 F. 2d 689 (CA3 1973). See also 1 Loss, Securities Regulation 493 (2d ed. 1961) ("substance governs rather than form: . . . just as some things which look like real estate are securities, some things which look like securities are real estate.").

that a security *"might"* be shown "by proving the document itself, which on its face would be a note, a bond or a share of stock." *Id.*, at 355 (emphasis supplied). By using the conditional words "may" and "might" in these dicta the Court made clear that it was not establishing an inflexible rule barring inquiry into the economic realities underlying a transaction. On the contrary, the Court intended only to make the rather obvious point that, in contrast to the instrument before it which was not included within the explicit statutory terms, most instruments bearing these traditional titles are likely to be covered by the statutes.[14]

In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

In the present case respondents do not contend, nor could they, that they were misled by use of the word "stock" into believing that the federal securities laws governed their purchase. Common sense suggests that people who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are

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[14] Nor can respondents derive any support for a literal approach from *Tcherepnin* v. *Knight*, *supra*, which cited the *Joiner* dictum. Indeed in *Tcherepnin* the Court explicitly stated that "form should be disregarded for substance," *id.*, at 336, and, only after analyzing the economic realities of the transaction at issue did it conclude that an instrument called a "withdrawable capital share" was, in substance, an "investment contract," a share of "stock," a "certificate of interest or participation in a profit sharing agreement," and a "transferable share."

not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock. Even had there been reliance in this case on the nomenclature used, it would have been misplaced because the stock at issue had none of the characteristics "that in our commercial world fall within the ordinary concept of a security." H. R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933). It should have been obvious to respondents that the interest which they purchased, although denominated "stock," lacked what the Court in *Tcherepnin* deemed the most essential feature of stock: the right to receipt of "dividends contingent upon an apportionment of profits." 289 U. S., at 339. Since Riverbay was a nonprofit corporation, there could be no profits and hence no distribution of profits by way of dividends. These shares also lack the other characteristics traditionally associated with stock: they are not negotiable; they cannot be pledged or hypothecated; they confer no voting rights in proportion to the number of shares owned; and they cannot appreciate in value. In short, the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit.

We conclude that the designation of the instruments transferred as "stock" cannot control their legal effect or bring the transaction within the federal securities laws. Viewing economic reality rather than mere form, we hold that the shares purchased by respondents were not stock within the meaning of these laws.

B

The Court of Appeals, as an alternative ground for its decision, concluded that a share in Riverbay was also an "investment contract" as defined by the Securities Acts. Respondents also argue, in the alternative, that in any

event what they agreed to purchase is "commonly known as a 'security' " within the meaning of these laws. In making this determination we again must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an investment contract or a security. In either case, the basic test for distinguishing the instrument from other commercial dealings is

> "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U. S., at 301.

This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, see *Joiner, supra* (sale of oil leases conditioned on promoters' agreement to drill exploratory well); *Howey, supra* (sale of orange groves coupled with service contract to cultivate, harvest and sell the crops), or a participation in earnings, typically called "dividends," resulting from the use of investors' funds, see *SEC* v. *Variable Annuity Life Insurance Co.*, 359 U. S. 65 (1959) (annuity payments fluctuate with value of insurance company's investment portfolio); *Tcherepnin* v. *Knight, supra* (dividends on the investment based on savings and loan association's profits). The investor is "attracted solely by the prospects of a return" on his investment. *Howey, supra*, 328 U. S., at 300. By contrast, when a purchaser is motivated by a desire to use or consume the item pur-

chased—"to occupy the land or to develop it themselves," as the *Howey* Court put it, 328 U. S., at 300—the securities laws do not apply. See *Joiner*, *supra*.[15]

In 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.[16] The Information Bulletin used to interest prospective residents emphasized the fundamental nature and purpose of the undertaking:

> "A cooperative is a nonprofit enterprise controlled democratically by its members—the people who are using its services. . . .
>
> "People find living in a cooperative community enjoyable for more than one reason. Most people join, however, for the simple reason that it is a way to obtain decent housing at a reasonable price. However, there are other advantages. The purpose of a cooperative is to provide home ownership, not just apartments to rent. The community is de-

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[15] In *Joiner*, the Court stated:

"Undisputed facts seem to us, however, to establish the conclusion that defendants were not, as a practical matter, offering naked leasehold rights. Had the offer mailed by defendants omitted the economic inducements of the proposed and promised exploration well, it would have been quite a different proposition." 320 U. S., at 348.

This distinction was critical because the exploratory drillings gave the investments "most of their value and all of their lure." *Id.*, at 349. The land itself was purely an incidental consideration in the transaction.

[16] In some transactions the investor is offered both a commodity for use and an expectation of profits. See SEC Release No. 33-5347 in 38 Fed. Reg. 1735 (Jan. 18, 1973). See generally Rohan, The Securities Law Implications of Condominium Marketing Programs Which Feature a Rental Agency or Rental Pool, 2 Conn. L. Rev. 1 (1969). The application of the federal securities laws to these transactions may raise difficult questions that are not present in this case.

> signed to provide a favorable environment for family and community living. . . .
>
> "The common bond of collective ownership which you share makes living in a cooperative different. It is a community of neighbors. Home ownership, common interests and the community atmosphere make living in a cooperative like living in a small town. As a rule there is very little turnover in a cooperative." Appendix, at 162a–164a.

Nowhere does the Bulletin seek to attract investors by the hope of profits resulting from the efforts of the promoters or third parties. On the contrary, the Bulletin repeatedly emphasizes the *"nonprofit"* nature of the endeavor. It explains that if rental charges exceed expenses the difference will be returned as a rebate, not invested for profit. It also informs purchasers that they will be unable to resell their apartments at a profit since the apartment must first be offered back to Riverbay "at the price paid for it."[17] In short, neither of the kinds of profits traditionally associated with securities were offered to respondents.

The Court of Appeals recognized that there must be an expectation of profits, and conceded that there is "no possible profit on a resale of [this] stock." 500 F. 2d,

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[17] This requirement effectively insures that no apartment will be sold for more than its original cost. Consonant with the purposes of the Mitchell-Lama Act, whenever there are prospective purchasers willing to pay as much as the initial purchase price for an apartment in Co-Op City, Riverbay will purchase back the apartment and resell it at its original cost. See Appendix, at 138a. Indeed if, for some reason, Riverbay does not repurchase these apartments, a tenant is prohibited by law from reselling his apartment for more than the purchase price plus a fraction of the mortgage amortization that he has paid, and then only to an approved tenant. See N. Y. Private Housing Finance Law § 31–a. (McKinney Supp. 1974–1975).

at 1254. The court correctly noted, however, that profit may be derived from the income yielded by an investment as well as from captial appreciation, and then proceeded to find "an expectation of 'income' in at least three ways." *Ibid.* Two of these supposed sources of income or profits may be disposed of summarily. We turn first to reliance by the Court of Appeals on the deductibility for tax purposes of the portion of the monthly rental or "occupancy charge" that is applied to interest on the mortgage. We know of no basis in law or economics for the view that payment of interest, with the consequent deductibility for tax purposes, constitutes income or profits. The tax benefit here relied upon is available to any homeowner who pays interest on his mortgage. See Internal Revenue Code, 26 U. S. C. § 216; *Eckstein* v. *United States*, 452 F. 2d 1036 (Ct. Cl. 1971). This is a function of the tax laws that is wholly unrelated to any concept of profits from an investment.[18]

The Court of Appeals also found support for its notion of profits in the fact that Co-Op City offered space at a cost substantially below the going rental charges for comparable housing. Again, this is a wholly novel theory of "profits" and one we cannot accept. The low rent derives from the substantial financial subsidies provided by the State of New York. This benefit cannot be liquidated into cash; nor does it result from the managerial efforts of others. In a real sense, it no more embodies the attributes of income or profits than do welfare benefits, food stamps or other government subsidies.

The final source of profit relied on by the Court of Appeals was the possibility of net income derived from

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[18] See *Rosenbaum*, The Resort Condominium and the Federal Securities Law—a Case Study in Government Inflexibility, 60 Va. L. Rev. 785, 795–796 (1974); Casenote, 62 Geo. L. Rev. 1515, 1524–1526.

the leasing of Co-Op City of commercial facilities, professional offices and parking spaces, and its operation of community washing machines. The income, if any, from these conveniences, all located within the common areas of the housing project, was to be used to reduce tenant rental cost. Conceptually, one might readily agree that net income from the leasing of commercial and professional facilities is the kind of profit traditionally associated with a security investment.[19] See *Tcherepnin* v. *Knight, supra.* But in the present case this income—if indeed there is any—is far too speculative and insubstantial to bring the entire transaction within the Securities Acts.

Initially we note that the prospect of such income as a means of offsetting rental costs is never mentioned in the Information Bulletin. Thus it is clear that investors were not attracted to Co-Op City by the offer of potential rental reductions resulting from the leasing of these facilities. Moreover, there is nothing in the record to suggest that these facilities do in fact return a profit in the sense that the leasing fees are greater than the actual cost to Co-Op City of the space rented.[20] The short of the matter is that the stores and services in question were established not as a means of returning profits to

[19] The "income" derived from the rental of parking spaces and the operation of washing machines clearly was not profits for respondents since these facilities were provided exclusively for the use of tenants. Thus when the income collected from the use of these facilities exceeds the cost of their operation the tenants simply receive the return of an initial overcharge in the form of a rent rebate.

[20] The Court of Appeals quoted the gross rental income received from these facilities. But such figures by themselves are irrelevant since the record does not indicate the cost to Co-Op City of providing and maintaining the rented space. There can be no profits in the absence of net income.

tenants, but for the purpose of making available essential services for the residents of this enormous complex.[21] Without stores in which to shop, and medical and dental offices in which to receive treatment, this development seeking to house 50,000 people would hardly be a viable community. See generally Miller, Cooperative Apartments: Real Estate or Securities? 45 B. U. L. Rev. 464, 500 (1965). In sum, these commercial facilities are simply incidental to the project. Undoubtedly they make Co-Op City a more attractive housing opportunity, but the possibility of some rental reduction is not an "expectation of profit" in the sense found necessary in *Howey*.[22]

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[21] By statute these commercial facilities could only be "incidental and appurtenant" to the housing project. N. Y. Private Housing Law § 12 (5) (McKinney Supp. 1974–1975).

[22] Respondents urge us to abandon the element of profits in the definition of securities and to adopt the "risk capital" approach articulated by the California Supreme Court in *Silver Hills Country Club* v. *Sobieski*, 55 Cal. 2d 811, 361 P. 2d 906 (1961). Cf. *El Kahodem* v. *Equity Securities Corp.*, 494 F. 2d 1224 (CA9 1974), cert. denied, — U. S. — (1974). See generally Coffey, The Economic Realities of a Security: Is There a More Meaningful Formula?", 18 Case W. Res. L. Rev. 367 (1967); Long, "An Attempt to Return 'Investment Contracts' to the Mainstream of Securities Regulations," 24 Okla. L. Rev. 135 (1971); Hannan & Thomas, The Importance of Economic Reality and Risk in Defining Federal Securities, 25 Hast. L. Rev. 219 (1974). Even if we were inclined to adopt such a "risk capital" approach we would not apply it in the present case. Purchasers of apartments in Co-Op City take no risk in any significant sense. If dissatisfied with their apartments, they may recover their initial investment in full. See n. 6, *supra*.

Respondents assert that if Co-Op City becomes bankrupt they stand to lose their whole investment. But, in view of the fact that the State has financed over 92% of the cost of construction and carefully regulates the development and operation of the project, bankruptcy in the normal sense is an unrealistic possibility. In any event, the risk of insolvency of an ongoing housing cooperative

There is no doubt that purchasers in this housing cooperative sought to obtain a decent home at an attractive price. But that type of economic interest characterizes every form of commercial transaction. What distinguishes a security transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use.[22]

"differ[s] vastly" from the kind of risk of "fluctuating" value associated with securities investments. *SEC.* v. *Variable Annuity Life Insurance Co., supra,* 395 U. S., at 90–91 (BRENNAN, J., concurring). See Hannan & Thomas, *supra,* at 242–249; Long, Introduction to Symposium: Interpreting The Statutory Definition of a Security: Some Pragmatic Considerations, 6 St. Mary's L. J. 96, 126–128 (1974).

[23] The SEC has filed an amicus brief urging us to hold the federal securities laws applicable to this case. Traditionally the views of an agency charged with administering the governing statute would be entitled to considerable weight. See, *e. g., United States National Association of Securities Dealers,* — U. S. — (1975) (slip op., at 22); *Saxbe* v. *Bustos,* 419 U. S. 65 (1974); *Investment Company Institute* v. *Camp,* 401 U. S. 617, 626–627 (1971). But in this case the SEC's position flatly contradicts what would appear to be a rather careful statement of the Commission's views in a recent release. In Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973), applicable to "the sale of condominium units and other units in a real estate development," the SEC stated its view that only those real estate investments that are "offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter," are to be considered securities. *Id.,* at 1736. In particular, the Commission explained that the Securities Acts do not apply when "commercial facilities are a part of a residential project" if

"(a) the income from such facilities is used only to offset common area expenses and (b) the operation of such facilities is incidental to the project as a whole and are not established as a primary income

III

In holding that there is no federal jurisdiction, we do not address the merits of respondents' claim. Nor do we indicate any view as to whether the type of claims here involved should be protected by federal rather than state law.[24] We decide only that the type of transaction

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source for the individual owners of a condominium or cooperative unit."

See also SEC Real Estate Advisory Committee Report 74–91 (1972); Dickey & Thorpe, Federal Security Regulation of Condominimum Offerings, 19 N. Y. L. F. 473 (1974).

Several commentators have noted the inconsistency between the SEC's position in the above release and the decision by the Court of Appeals in this case, which the SEC now supports. See Berman & Stone, Federal Securities Law and the Sale of Condominiums, Homes and Homesite, 30 Bus. Law. 411, 420–425 (1975); Note, Condominium Regulation: Beyond Disclosure, 123 U. Pa. L. Rev. 639, 654–655 (1975). In view of this unexplained contradiction in the Commission's position we accord no special weight to its views. See *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418, 426 (1972); *Blue Chip Stamps* v. *Manor Drug Stores*, —— U. S. —— (1975) (slip op., at 21 n. 8).

[24] Several commentators have suggested that the sale of housing developments such as condominiums and cooperatives is in need of federal regulation and therefore that the securities laws should be stretched to reach these transactions. See, *e. g.*, Note, Federal Securties Regulation of Condominiums: A Purchaser's Perspective, 62 Geo. L. J. 1403 (1974); Note, Cooperative Housing Corporations and the Federal Securities Laws, 71 Colum. L. Rev. 118 (1971). Others have disagreed, claiming that the extensive body of regulation developed over more than four decades under these acts would be in appropriate and also costly to the sellers and buyers of residential housing. See Berman & Stone, *supra*, n. 23; Note, Condominimum Regulation: Beyond Disclosure, *supra*, n. 23. Moreover, extension of the coverage of the securities laws to real estate transactions would involve important questions as to the appropriate balance between state and federal responsibility. In any event, the determination of whether and in what manner federal regulation may be required for housing transactions, where the characteristics of an investment in securities are not present, is better left

before us, in which the purchasers were interested in acquiring housing rather than making an investment for profit, is not within the scope of the federal securities laws.

Since respondents' claims are not cognizable in federal court, their complaint must be dismissed.[25] The judgment below is therefore

Reversed.

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to the Congress which can assess both the costs and benefits of any such regulation. Indeed, only recently, Congress instructed the Secretary of Housing and Urban Development "to conduct a full and complete investigation and study . . . with respect to . . . the problems, difficulties and abuses or potential abuses applicable to condominium and cooperative housing." Pub. L. 93-383, 88 Stat. 740 (Aug. 22, 1974). See also Real Estate Settlement Procedures Act of 1974, Pub. L. No. 93-533; Interstate Land Sales Full Disclosure Act, 15 U. S. C. §§ 1701-1720.

[25] Besides the Securities Acts claims, respondents also included a vague and conclusory allegation under 42 U. S. C. § 1983 against petitioner, the New York State Housing Finance Agency. We agree with the District Court that "the federal securities allegations represent the only well pleaded underlying basis for jurisdiction under [§ 1983]." 366 F. Supp., at 1132. Thus that count must also be dismissed. The remaining counts in the complaint were all predicated on alleged violations of state law, not independently cognizable in federal court.

To: The Chief Justice
Mr. Justice Douglas
Mr. Justice Brennan
Mr. Justice Stewart
Mr. Justice White
Mr. Justice Marshall
Mr. Justice Blackmun
Mr. Justice Rehnquist

From: Powell, J.

Circulated: MAY 3 0 1975

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1st DRAFT

SUPREME COURT OF THE UNITED STATES

Nos. 74–157 AND 74–647

United Housing Foundation, Inc., et al., Petitioners,
74–157 v.
Milton Forman et al.

State of New York and the New York State Housing Finance Agency, Petitioners,
74–647 v.
Milton Forman et al.

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit.

[June —, 1975]

MR. JUSTICE POWELL delivered the opinion of the Court.

The issue in this case is whether shares of stock entitling a purchaser to lease an apartment in Co-Op City, a state subsidized and supervised nonprofit housing cooperative, are "securities" within the purview of the Securities Act of 1933 and the Securities Exchange Act of 1934.

I

Co-Op City is a massive housing cooperative in New York City. Built between 1965 and 1971, it presently houses approximately 50,000 people on a 200-acre site containing 35 high rise buildings and 236 town houses. The project was organized, financed, and constructed under the New York State Private Housing Finance Law,

commonly known as the Mitchell-Lama Act, enacted to ameliorate a perceived crisis in the availability of decent low-income urban housing. In order to encourage private developers to build low cost cooperative housing, New York provides them with large long-term, low-interest mortgage loans and substantial tax exemptions. Receipt of such benefits is conditioned on a willingness to have the State review virtually every step in the development of the cooperative. See N. Y. Private Housing Finance Law §§ 11–40 (McKinney Supp. 1974–1975). The developer also must agree to operate the facility "on a nonprofit basis," *id.*, at § 11-a (2a), and he may lease apartments only to people whose incomes fall below a certain level and who have been approved by the State.[1]

The United Housing Foundation (UHF), a nonprofit membership corporation established for the purpose of "aiding and encouraging" the creation of "adequate, safe and sanitary housing accommodations for wage earners and other persons of low and moderate income," [2] Appendix, at 95a, was responsible for initiating and sponsoring the development of Co-Op City. Acting under the Mitchell-Lama Act, UHF organized the Riverbay Corporation (Riverbay) to own and operate the land and buildings constituting Co-Op City. Riverbay, a nonprofit cooperative housing corporation, issued the stock that is the subject of this litigation. UHF also con-

[1] Eligibility is limited to families whose monthly income does not exceed six times the monthly rental charge (or for families of four or more, seven times the rental charge). N. Y. Private Housing Finance Law § 31 (2)(a) (McKinney Supp. 1974–1975). Preference in admission must be given to veterans, the handicapped, and the elderly. *Id.*, at § 31 (7)–(9).

[2] UHF is composed of labor unions, housing cooperatives, and civic groups. It has sponsored the construction of several major housing cooperatives in New York City.

tracted with Community Services, Inc. (CSI), its wholly owned subsidiary, to serve as the general contractor and sales agent for the project.[3] As required by the Mitchell-Lama Act, these decisions were approved by the State Housing Commissioner.

To acquire an apartment in Co-Op City an eligible prospective purchaser must buy 18 shares of stock in Riverbay for each room desired. The cost per share is $25, making the total cost $450 per room, or $1,800 for a four-room apartment. The sole purpose of acquiring these shares is to enable the purchaser to occupy an apartment in Co-Op City; in effect, their purchase is a recoverable deposit on an apartment. The shares are explicitly tied to the apartment: they cannot be transferred to a nontenant; nor can they be pledged or encumbered; and they descend, along with the apartment, only to a surviving spouse. No voting rights attach to the shares as such: participation in the affairs of the cooperative appertains to the apartment, with the residents of each apartment being entitled to one vote irrespective of the number of shares owned.

Any tenant who wants to terminate his occupancy, or who is forced to move out,[4] must offer his stock to Riverbay at its initial selling price of $25 per share. In the extremely unlikely event that Riverbay declines to repurchase the stock,[5] the tenant cannot sell it for more than

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[3] CSI is a business corporation that has acted as the contractor on several UHF-sponsored housing cooperatives.

[4] A tenant can be forced to move out if he violates the provisions of his "occupancy agreement," which is essentially a lease for the apartment, or if his income grows to exceed the eligibility standards.

[5] To date every family that has withdrawn from Co-Op City has received back its initial payment in full. Indeed, at the time this suit was filed there were 7,000 families on the waiting list for apartments in this cooperative. In addition, a special fund of nearly

the initial purchase price plus a fraction of the portion of the mortgage that he has paid off, and then only to a prospective tenant satisfying the statutory income eligibility requirements. See N. Y. Private Housing Finance Law § 31–a (McKinney Supp. 1974–1975).

In May 1965, subsequent to the completion of the initial planning, Riverbay circulated an Information Bulletin seeking to attract tenants for what would someday be apartments in Co-Op City. After describing the nature and advantages of cooperative housing generally and of Co-Op City in particular, the Bulletin informed prospective tenants that the total estimated cost of the project, based largely on an anticipated construction contract with CSI, was $283,695,550. Only a fraction of this sum, $32,795,550, was to come from the purchase of shares by tenants. The remaining $250,900,000 was to be financed by a 40-year low-interest mortgage loan from the New York Private Housing Finance Agency. After construction of the project the mortgage payments and current operating expenses would be met by monthly rental charges paid by the tenants. While these rental charges were to vary, depending on the size, nature, and location of an apartment, the 1965 Bulletin estimated that the "average" monthly cost would be $23.02 per room, or $92.08 for a four-room apartment.

Several times during the construction of Co-Op City, Riverbay, with the approval of the State Housing Commissioner, revised its contract with CSI to allow for increased construction costs. In addition, Riverbay incurred other expenses that had not been reflected in the 1965 Bulletin. To meet these increased expenditures, Riverbay, with the Commissioner's approval, repeatedly

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$1 million had been established by small monthly contributions from all tenants to insure that those wanting to move out would receive full compensation for their shares.

secured increased mortgage loans from the State Housing Agency. Ultimately the construction loan was $125 million more than the figure estimated in the 1965 Bulletin. As a result, while the initial purchasing price remained at $450 per room, the average monthly rental charges increased periodically, reaching a figure of $39.68 per room as of July 1974.[6]

These increases in the rental charges precipitated the present lawsuit. Respondents, 57 residents of Co-Op City, sued in federal court on behalf of all 15,372 apartment owners, and derivatively on behalf of Riverbay, seeking upwards of $30 million in damages, forced rental reductions and other "appropriate" relief. Named as defendants (petitioners herein) were UHF, CSI, Riverbay, several individual directors of these organizations, the State of New York, and the State Private Housing Finance Agency. The heart of respondents' claim was that the 1965 Co-Op City Information Bulletin falsely represented that CSI would bear all subsequent cost increases due to factors such as inflation. Respondents further alleged that they were misled in their purchases of shares since the Information Bulletin failed to disclose several critical facts.[7] On these bases,

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[6] As the rental charges increased, the income eligibility requirements for residents of Co-Op City expanded accordingly. See n. 1, *supra*.

[7] Respondents maintained that the following material facts were omitted: (i) the original estimated cost had never been adhered to in any of the previous Mitchell-Lama projects sponsored by UHF and built by CSI; (ii) petitioners knew that the initial estimate would not be followed in the present project; (iii) CSI was a wholly owned subsidiary of UHF; (iv) CSI's net worth was so small that it could not have been legally held to complete the contract within the original estimated costs; (v) the State Housing Commissioner had waived his own rule regarding liquidity requirements in approving CSI as the contractor; and (vi) there was an additional undisclosed contract between CSI and Riverbay

respondents asserted two claims under the fraud provisions of the federal Securities Acts of 1933 and 1934, 15 U. S. C. § 77q (a); 15 U. S. C. § 78j (b), and 17 CFR § 240.10b–5. They also presented a claim against the State Financing Agency under the Civil Rights Act, 42 U. S. C. § 1983, and 10 pendent state law claims.

Petitioners, while denying the substance of these allegations,[8] moved to dismiss the complaint on the ground that federal jurisdiction was lacking. They maintained that shares of stock in Riverbay were not "securities" within the definitional sections of the federal Securities Acts. In addition, the state parties moved to dismiss on sovereign immunity grounds.

The District Court granted the motion to dismiss. 366 F. Supp. 1117 (1973). It held that the denomination of the shares in Riverbay as "stock" did not, by itself, make them securities under the federal acts. The court further ruled, relying primarily on this Court's decisions in *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344 (1943), and *SEC* v. *W. J. Howey Co.*, 328 U. S. 293 (1946), that the purchase in issue was not a security transaction since it was neither induced by an offer of tangible material profits, nor could such profits realistically be expected. In the District Court's words, it was "the fundamental nonprofit nature of this transaction" which presented "the insurmountable barrier to [respondents'] claims in the federal court." *Id.*, at 1128.[9]

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[8] Petitioners asserted that the Information Bulletin warned purchasers of the possibility of rental increases, and denied that it omitted material facts. They also argued that prior to occupancy all tenants were informed that rental charges had increased. In any event, petitioners claimed that respondents have suffered no damages since they may move out and retrieve their initial investments in full.

[9] The District Court also dismissed the § 1983 claim finding that the securities laws claims were "the only well-pleaded underlying basis for jurisdiction under the Civil Rights Act." *Id.*, at 1132. In

The Court of Appeals for the Second Circuit reversed. 500 F. 2d 1246 (1974). It rested its decision on two alternative grounds. First, the court held that since the shares purchased were called "stock" the Securities Acts, which explicitly include "stock" in their definitional sections, were literally applicable. Second, the Court of Appeals concluded that the transaction was an investment contract within the meaning of the Acts and as defined by *Howey*, since there was an expectation of profits from three sources: (i) rental reductions resulting from the income produced by the commercial facilities established for the use of tenants at Co-Op City; (ii) tax deductions for the portion of the monthly rental charges allocable to interest payments on the mortgage; and (iii) savings based on the fact that apartments at Co-Op City cost substantially less than comparable nonsubsidized housing. The court further ruled that the immunity claims by the State parties were unavailing.[10] Accordingly, the case was remanded to the District Court for consideration of respondents' claim on the merits.

In view of the importance of the issues presented we granted certiorari. 419 U. S. 1120 (1975). As we conclude that the disputed transactions are not purchases of securities within the contemplation of the federal statutes, we reverse.

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view of these rulings the court did not reach the sovereign immunity claims.

[10] The Circuit Court held that the State Agency was independent and distinct from the State itself and therefore was a "person" for purposes of § 1983, that both the Agency and the State had waived immunity under § 32 (5) of the Private Housing Finance Act, and that the State had also implicitly waived its immunity by voluntarily participating in the sale of securities, an area subject to plenary federal regulation. See *Parden v. Terminal Ry. of Alabama Docks Dept.*, 377 U. S. 184 (1964). In view of our disposition of this case we do not reach these issues.

II

The Securities Act of 1933, 15 U. S. C. § 77b (1), defines a "security" as

> "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 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." [11]

In providing this definition Congress did not attempt to articulate the relevant economic criteria for distinguishing "securities" from "non-securities." Rather it sought to define "the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H. R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933). The task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes.

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[11] The definition of a security in the 1934 Act is virtually identical and, for present purposes, the coverage of the two Acts may be considered the same. See *Tcherepnin* v. *Knight*, 389 U. S. 332, 336, 342 (1967); S. Rep. No. 792, 73d Cong., 2d Sess., 14 (1934).

In making this determination in the present case we do not write on a clean slate. Well-settled principles enunciated by this Court establish that the sale of shares which entitle the purchaser to an apartment in Co-Op City is not one of the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits," *Howey, supra,* 328 U. S., at 299, and therefore these shares do not fall within "the ordinary concept of a security."

A

We reject at the outset any suggestion that the present transaction, evidenced by the sale of shares called "stock," [12] must be considered a security transaction simply because the statutory definition of a security includes the words "and . . . stock." Rather we adhere to the basic principle that has guided all of the Court's decisions in this area:

> "In searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin v. Knight,* 389 U. S., 332, 336 (1967). See also *Howey, supra,* 328 U. S., at 298.

The primary purpose of the Securities Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market by providing for the regulation of the sale of securities and the operation of securities exchanges. Plainly the need for this regulation depends on the economic realities underlying certain investment transactions, and not on the names given to these transactions. Thus, in construing these Acts

[12] While the record does not indicate precisely why the term stock was used for the instant transaction, it appears that this form is generally used as a matter of tradition and convenience. See

against the background of their purpose, we are guided by a traditional canon of statutory construction:

> "that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers." *Church of the Holy Trinity* v. *United States*, 143 U. S. 457, 459 (1892). See also *United States* v. *American Trucking Assns., Inc.*, 310 U. S. 534, 543 (1940).[18]

Respondents' reliance on *Joiner* as support for a "literal approach" to defining a security is misplaced. The issue in *Joiner* was whether assignments of interests in oil leases, coupled with the promoters' offer to drill an exploratory well, were securities. Looking to the economic inducement provided by the proposed exploratory well, the Court concluded that these leases were securities even though "leases" as such were not included in the list of instruments mentioned in the statutory definitions. In dictum the Court noted that "[i]nstruments *may* be included within [the definition of a security], as [a] matter of law, if on their face they answer to the name or description." 320 U. S., at 351 (emphasis supplied). And later, again in dictum, the Court stated

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P. Rohan & M. Reskin, Cooperative Housing Law & Practice, § 2.01 (4) (1973).

[18] With the exception of the Second Circuit, every court of appeals recently to consider the issue has rejected the literal approach urged by respondents. See *C. N. S. Enterprises, Inc.* v. *G&G Enterprises, Inc.*, 508 F. 2d 1354 (CA7 1975); *McClure* v. *First National Bank of Lubbock*, 497 F. 2d 490 (CA5 1974), cert. denied, 420 U. S. 930 (1975); *Lino* v. *City Investing Co.*, 487 F. 2d 689 (CA3 1973). See also 1 Loss, Securities Regulation 493 (2d ed. 1961) ("substance governs rather than form: . . . just as some things which look like real estate are securities, some things which look like securities are real estate.").

that a security *"might"* be shown "by proving the document itself, which on its face would be a note, a bond or a share of stock." *Id.*, at 355 (emphasis supplied). By using the conditional words "may" and "might" in these dicta the Court made clear that it was not establishing an inflexible rule barring inquiry into the economic realities underlying a transaction. On the contrary, the Court intended only to make the rather obvious point that, in contrast to the instrument before it which was not included within the explicit statutory terms, most instruments bearing these traditional titles are likely to be covered by the statutes.[14]

In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

In the present case respondents do not contend, nor could they, that they were misled by use of the word "stock" into believing that the federal securities laws governed their purchase. Common sense suggests that people who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are

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[14] Nor can respondents derive any support for a literal approach from *Tcherepnin* v. *Knight*, *supra*, which cited the *Joiner* dictum. Indeed in *Tcherepnin* the Court explicitly stated that "form should be disregarded for substance," *id.*, at 336, and, only after analyzing the economic realities of the transaction at issue did it conclude that an instrument called a "withdrawable capital share" was, in substance, an "investment contract," a share of "stock," a "certificate of interest or participation in a profit sharing agreement," and a "transferable share."

not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock. These shares lack what the Court in *Tcherepnin* deemed the most common feature of stock: the right to receipt of "dividends contingent upon an apportionment of profits." 289 U. S., at 339. Nor do they possess the other characteristics traditionally associated with stock: they are not negotiable; they cannot be pledged or hypothecated; they confer no voting rights in proportion to the number of shares owned; and they cannot appreciate in value. In short, the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit.

B

The Court of Appeals, as an alternative ground for its decision, concluded that a share in Riverbay was also an "investment contract" as defined by the Securities Acts. Respondents further argue that in any event what they agreed to purchase is "commonly known as a 'security' " within the meaning of these laws. In making this determination we again must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an investment contract and an instrument commonly known as a security. In either case, the basic test for distinguishing the instrument from other commercial dealings is

> "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey, supra,* 328 U. S., at 301.

This test, in shorthand form, embodies the essential attri-

butes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, see *Joiner, supra* (sale of oil leases conditioned on promoters' agreement to drill exploratory well), or a participation in earnings resulting from the use of investors' funds, see *Tcherepnin* v. *Knight, supra* (dividends on the investment based on savings and loan association's profits). In such cases the investor is "attracted solely by the prospects of a return" on his investment. *Howey, supra,* 328 U. S., at 300. By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or to develop it themselves," as the *Howey* Court put it, 328 U. S., at 300—the securities laws do not apply.[15] See *Joiner, supra*.[16]

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[15] In some transactions the investor is offered both a commodity or real estate for use and an expectation of profits. See SEC Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973). See generally Rohan, The Securities Law Implications of Condominium Marketing Programs Which Feature a Rental Agency or Rental Pool, 2 Conn. L. Rev. 1 (1969). The application of the federal securities laws to these transactions may raise difficult questions that are not present in this case.

[16] In *Joiner*, the Court stated:

"Undisputed facts seem to us, however, to establish the conclusion that defendants were not, as a practical matter, offering naked leasehold rights. Had the offer mailed by defendants omitted the economic inducements of the proposed and promised exploration well, it would have been quite a different proposition." 320 U. S., at 348.

This distinction was critical because the exploratory drillings gave the investments "most of their value and all of their lure." *Id.*,

In 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. The Information Bulletin distributed to prospective residents emphasized the fundamental nature and purpose of the undertaking:

> "A cooperative is a nonprofit enterprise controlled democratically by its members—the people who are using its services. . . .
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> "People find living in a cooperative community enjoyable for more than one reason. Most people join, however, for the simple reason that it is a way to obtain decent housing at a reasonable price. However, there are other advantages. The purpose of a cooperative is to provide home ownership, not just apartments to rent. The community is designed to provide a favorable environment for family and community living. . . .
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> "The common bond of collective ownership which you share makes living in a cooperative different. It is a community of neighbors. Home ownership, common interests and the community atmosphere make living in a cooperative like living in a small town. As a rule there is very little turnover in a cooperative." Appendix, at 162a–164a.

Nowhere does the Bulletin seek to attract investors by the prospect of profits resulting from the efforts of the promoters or third parties. On the contrary, the Bulletin repeatedly emphasizes the "nonprofit" nature of the endeavor. It explains that if rental charges exceed expenses the difference will be returned as a rebate, not invested for profit. It also informs purchasers that they

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at 349. The land itself was purely an incidental consideration in the transaction.

will be unable to resell their apartments at a profit since the apartment must first be offered back to Riverbay "at the price paid for it." [17] In short, neither of the kinds of profits traditionally associated with securities were offered to respondents.

The Court of Appeals recognized that there must be an expectation of profits for these shares to be securities, and conceded that there is "no possible profit on a resale of [this] stock." 500 F. 2d, at 1254. The court correctly noted, however, that profit may be derived from the income yielded by an investment as well as from capital appreciation, and then proceeded to find "an expectation of 'income' in at least three ways." *Ibid.* Two of these supposed sources of income or profits may be disposed of summarily. We turn first to the Court of Appeals' reliance on the deductibility for tax purposes of the portion of the monthly rental charge applied to interest on the mortgage. Even if these deductions could be considered profits they are not the kind of profits associated with a security transaction since they do not derive from the managerial efforts of others.[18] Rather these deductions are tax benefits available to any

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[17] This requirement effectively insures that no apartment will be sold for more than its original cost. Consonant with the purposes of the Mitchell-Lama Act, whenever there are prospective purchasers willing to pay as much as the initial purchase price for an apartment in Co-Op City, Riverbay will repurchase the apartment and resell it at its original cost. See Appendix, at 138a. If, for some reason, Riverbay does not purchase the apartment the tenant still cannot make a profit on his sale. See pp. 3–4, *supra*.

[18] See Rosenbaum, The Resort Condominium and the Federal Securities Law—a Case Study in Government Inflexibility, 60 Va. L. Rev. 785, 795–796 (1974); Casenote, 62 Georgetown L. Rev. 1515, 1524–1526 (1974).

homeowner who pays interest on his mortgage. See Internal Revenue Code, 26 U. S. C. § 216; *Eckstein* v. *United States*, 452 F. 2d 1036 (Ct. Cl. 1971).

The Court of Appeals also found support for its concept of profits in the fact that Co-Op City offered space at a cost substantially below the going rental charges for comparable housing. This is a wholly novel theory of "profits" and one we cannot accept. The low rent derives from the substantial financial subsidies provided by the State of New York. This benefit cannot be liquidated into cash; nor does it result from the managerial efforts of others. In a real sense, it no more embodies the attributes of income or profits than do welfare benefits, food stamps or other government subsidies.

The final source of profit relied on by the Court of Appeals was the possibility of net income derived from the leasing by Co-Op City of commercial facilities, professional offices and parking spaces, and its operation of community washing machines. The income, if any, from these conveniences, all located within the common areas of the housing project, is to be used to reduce tenant rental costs. Conceptually, one might readily agree that net income from the leasing of commercial and professional facilities is the kind of profit traditionally associated with a security investment.[19] See *Tcherepnin* v. *Knight*, *supra*. But in the present case this income—if indeed there is any—is far too specula-

[19] The "income" derived from the rental of parking spaces and the operation of washing machines clearly was not profit for respondents since these facilities were provided exclusively for the use of tenants. Thus when the income collected from the use of these facilities exceeds the cost of their operation the tenants simply receive the return of an initial overcharge in the form of a rent rebate.

tive and insubstantial to bring the entire transaction within the Securities Acts.

Initially we note that the prospect of such income as a means of offsetting rental costs is never mentioned in the Information Bulletin. Thus it is clear that investors were not attracted to Co-Op City by the offer of these potential rental reductions. Moreover, nothing in the record suggests that the facilities in fact return a profit in the sense that the leasing fees are greater than the actual cost to Co-Op City of the space rented.[20] The short of the matter is that the stores and services in question were established not as a means of returning profits to tenants, but for the purpose of making essential services available for the residents of this enormous complex. Without stores in which to shop, and medical and dental offices in which to receive treatment, this development seeking to house 50,000 people would hardly be a viable community.[21] By statute these facilities could only be "incidental and appurtenant" to the housing project," N. Y. Private Housing Law § 12 (5) (McKinney Supp. 1974–1975). Undoubtedly they make Co-Op City a more attractive housing opportunity, but the possibility of some rental reduction is not an "expectation of profit" in the sense found necessary in *Howey*.[22]

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[20] The Court of Appeals quoted the gross rental income received from these facilities. But such figures by themselves are irrelevant since the record does not indicate the cost to Co-Op City of providing and maintaining the rented space.

[21] See Miller, Cooperative Apartments: Real Estate or Securities?, 45 B. U. L. Rev. 464, 500 (1965).

[22] Respondents urge us to abandon the element of profits in the definition of securities and to adopt the "risk capital" approach articulated by the California Supreme Court in *Silver Hills Country Club* v. *Sobieski*, 55 Cal. 2d 811, 361 P. 2d 906 (1961). Cf. *El Khadem* v *Equity Securities Corp.*, 494 F. 2d 1224 (CA9 1974), cert. denied, 419 U. S. 900 (1974). See generally Coffey, The Eco-

There is no doubt that purchasers in this housing cooperative sought to obtain a decent home at an attractive price. But that type of economic interest characterizes every form of commercial transaction. What distinguishes a security transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use.[28]

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nomic Realities of a Security: Is There a More Meaningful Formula?, 18 Case W. Res. L. Rev. 367 (1967); Long, An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulations, 24 Okla. L. Rev. 135 (1971); Hannan & Thomas, The Importance of Economic Reality and Risk in Defining Federal Securities, 25 Hast. L. Rev. 219 (1974). Even if we were inclined to adopt such a "risk capital" approach we would not apply it in the present case. Purchasers of apartments in Co-Op City take no risk in any significant sense. If dissatisfied with their apartments, they may recover their initial investment in full. See n. 6, *supra*.

Respondents assert that if Co-Op City becomes bankrupt they stand to lose their whole investment. But, in view of the fact that the State has financed over 92% of the cost of construction and carefully regulates the development and operation of the project, bankruptcy in the normal sense is an unrealistic possibility. In any event, the risk of insolvency of an ongoing housing cooperative "differ[s] vastly" from the kind of risk of "fluctuating" value associated with securities investments. *SEC.* v. *Variable Annuity Life Insurance Co.*, 395 U. S. 65, 90–91 (1959) (BRENNAN, J., concurring). See Hannan & Thomas, *supra*, at 242–249; Long, Introduction to Symposium: Interpreting The Statutory Definition of a Security: Some Pragmatic Considerations, 6 St. Mary's L. J. 96, 126–128 (1974).

[28] The SEC has filed an amicus brief urging us to hold the federal securities laws applicable to this case. Traditionally the views of an agency charged with administering the governing statute would be entitled to considerable weight. See, *e. g.*, *United States National Association of Securities Dealers*, — U. S. — (1975) (slip op., at 22); *Saxbe* v. *Bustos*, 419 U. S. 65, 74 (1974); *Investment Company Institute* v. *Camp*, 401 U. S. 617, 626–627 (1971). But in this case the SEC's position flatly contradicts what appears to be a rather

III

In holding that there is no federal jurisdiction, we do not address the merits of respondents' allegations of fraud. Nor do we indicate any view as to whether the type of claims here involved should be protected by federal regulations.[24] We decide only that the type of

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careful statement of the Commission's views in a recent release. In Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973), applicable to "the sale of condominium units and other units in a real estate development," the SEC stated its view that only those real estate investments that are "offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter," are to be considered securities. *Id.*, at 1736. In particular, the Commission explained that the Securities Acts do not apply when "commercial facilities are a part of a residential project" if

"(a) the income from such facilities is used only to offset common area expenses and (b) the operation of such facilities is incidental to the project as a whole and are not established as a primary income source for the individual owners of a condominium or cooperative unit." *Ibid.*

See also SEC Real Estate Advisory Committee Report 74-91 (1972); Dickey & Thorpe, Federal Security Regulation of Condominium Offerings, 19 N. Y. L. F. 473 (1974).

Several commentators have noted the inconsistency between the SEC's position in the above release and the decision by the Court of Appeals in this case, which the SEC now supports. See Berman & Stone, Federal Securities Law and the Sale of Condominiums, Homes and Homesites, 30 Bus. Law. 411, 420-425 (1975); Note, Condominium Regulation: Beyond Disclosure, 123 U. Pa. L. Rev. 639, 654-655 (1975). In view of this unexplained contradiction in the Commission's position we accord no special weight to its views. See *Reliance Electric Co.* v *Emerson Electric Co.*, 404 U. S. 418, 426 (1972); *Blue Chip Stamps* v. *Manor Drug Stores*, — U. S. — (1975) (slip op., at 21 n. 8).

[24] It has been suggested that the sale of housing developments such as condominiums and cooperatives is in need of federal regulation and therefore the securities laws should be construed or

transaction before us, in which the purchasers were interested in acquiring housing rather than making an investment for profit, is not within the scope of the federal securities laws.

Since respondents' claims are not cognizable in federal court, the District Court properly dismissed their complaint.[25] The judgment below is therefore

Reversed.

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amended to reach these transactions. See, *e. g.*, Note, Federal Securities Regulations of Condominiums: A Purchaser's Perspective, 62 Georgetown L. J. 1403 (1974); Note, Cooperative Housing Corporations and the Federal Securities Laws, 71 Colum. L. Rev. 118 (1971). Others have disagreed, claiming that the extensive body of regulation developed over more than four decades under these Acts would be inappropriate and unduly costly to the sellers and buyers of residential housing. See Berman & Stone, *supra*, n. 23; Note, Condominimum Regulation: Beyond Disclosure, *supra*, n. 23. Moreover, extension of the securities laws to real estate transactions would involve important questions as to the appropriate balance between state and federal responsibility. The determination of whether and in what manner federal regulation may be required for housing transactions, where the characteristics of an investment in securities are not present, is better left to the Congress, which can assess both the costs and benefits of any such regulation. Indeed, only recently, Congress instructed the Secretary of Housing and Urban Development "to conduct a full and complete investigation and study . . . with respect to . . . the problems, difficulties and abuses or potential abuses applicable to condominium and cooperative housing." Pub. L. 93-383, 88 Stat. 740 (Aug. 22, 1974). See also Real Estate Settlement Procedures Act of 1974, Pub. L. No. 93-533; Interstate Land Sales Full Disclosure Act, 15 U. S. C. §§ 1701-1720.

[25] Besides the Securities Acts claims, respondents also included a vague and conclusory allegation under 42 U. S. C. § 1983 against petitioner, the New York State Housing Finance Agency. We agree with the District Court that "the federal securities allegations represent the only well pleaded underlying basis for jurisdiction under [§ 1983]." 366 F. Supp., at 1132. Thus that count must also be dismissed. The remaining counts in the complaint were all predicated on alleged violations of state law, not independently cognizable in federal court.

4, 9-10, 12, 13, 16, 17, 21

To: The Chief Justice
Mr. Justice Douglas
Mr. Justice Brennan
Mr. Justice Stewart
Mr. Justice White
Mr. Justice Marshall
Mr. Justice Blackmun
Mr. Justice Rehnquist

From: Powell, J.

Circulated: _____

Recirculated: JUN 4 1975

2nd DRAFT

SUPREME COURT OF THE UNITED STATES

Nos. 74-157 AND 74-647

United Housing Foundation, Inc., et al., Petitioners,
74-157 v.
Milton Forman et al.

State of New York and the New York State Housing Finance Agency, Petitioners,
74-647 v.
Milton Forman et al.

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit.

[June —, 1975]

MR. JUSTICE POWELL delivered the opinion of the Court.

The issue in this case is whether shares of stock entitling a purchaser to lease an apartment in Co-Op City, a state subsidized and supervised nonprofit housing cooperative, are "securities" within the purview of the Securities Act of 1933 and the Securities Exchange Act of 1934.

I

Co-Op City is a massive housing cooperative in New York City. Built between 1965 and 1971, it presently houses approximately 50,000 people on a 200-acre site containing 35 high rise buildings and 236 town houses. The project was organized, financed, and constructed under the New York State Private Housing Finance Law,

commonly known as the Mitchell-Lama Act, enacted to ameliorate a perceived crisis in the availability of decent low-income urban housing. In order to encourage private developers to build low cost cooperative housing, New York provides them with large long-term, low-interest mortgage loans and substantial tax exemptions. Receipt of such benefits is conditioned on a willingness to have the State review virtually every step in the development of the cooperative. See N. Y. Private Housing Finance Law §§ 11–37, as amended, (McKinney Supp. 1974–1975). The developer also must agree to operate the facility "on a nonprofit basis," *id.*, at § 11–a (2a), and he may lease apartments only to people whose incomes fall below a certain level and who have been approved by the State.[1]

The United Housing Foundation (UHF), a nonprofit membership corporation established for the purpose of "aiding and encouraging" the creation of "adequate, safe and sanitary housing accommodations for wage earners and other persons of low and moderate income," [2] Appendix, at 95a, was responsible for initiating and sponsoring the development of Co-Op City. Acting under the Mitchell-Lama Act, UHF organized the Riverbay Corporation (Riverbay) to own and operate the land and buildings constituting Co-Op City. Riverbay, a nonprofit cooperative housing corporation, issued the stock that is the subject of this litigation. UHF also con-

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[1] Eligibility is limited to families whose monthly income does not exceed *six* times the monthly rental charge (or for families of four or more, seven times the rental charge). N. Y. Private Housing Finance Law § 31 (2)(a) (McKinney Supp. 1974–1975). Preference in admission must be given to veterans, the handicapped, and the elderly. *Id.*, at § 31 (7)–(9).

[2] UHF is composed of labor unions, housing cooperatives, and civic groups. It has sponsored the construction of several major housing cooperatives in New York City.

tracted with Community Services, Inc. (CSI), its wholly owned subsidiary, to serve as the general contractor and sales agent for the project.[3] As required by the Mitchell-Lama Act, these decisions were approved by the State Housing Commissioner.

To acquire an apartment in Co-Op City an eligible prospective purchaser must buy 18 shares of stock in Riverbay for each room desired. The cost per share is $25, making the total cost $450 per room, or $1,800 for a four-room apartment. The sole purpose of acquiring these shares is to enable the purchaser to occupy an apartment in Co-Op City; in effect, their purchase is a recoverable deposit on an apartment. The shares are explicitly tied to the apartment: they cannot be transferred to a nontenant; nor can they be pledged or encumbered; and they descend, along with the apartment, only to a surviving spouse. No voting rights attach to the shares as such: participation in the affairs of the cooperative appertains to the apartment, with the residents of each apartment being entitled to one vote irrespective of the number of shares owned.

Any tenant who wants to terminate his occupancy, or who is forced to move out,[4] must offer his stock to Riverbay at its initial selling price of $25 per share. In the extremely unlikely event that Riverbay declines to repurchase the stock,[5] the tenant cannot sell it for more than

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[3] CSI is a business corporation that has acted as the contractor on several UHF-sponsored housing cooperatives.

[4] A tenant can be forced to move out if he violates the provisions of his "occupancy agreement," which is essentially a lease for the apartment, or if his income grows to exceed the eligibility standards.

[5] To date every family that has withdrawn from Co-Op City has received back its initial payment in full. Indeed, at the time this suit was filed there were 7,000 families on the waiting list for apartments in this cooperative. In addition, a special fund of nearly

the initial purchase price plus a fraction of the portion of the mortgage that he has paid off, and then only to a prospective tenant satisfying the statutory income eligibility requirements. See N. Y. Private Housing Finance Law § 31-a (McKinney Supp. 1974–1975).

In May 1965, subsequent to the completion of the initial planning, Riverbay circulated an Information Bulletin seeking to attract tenants for what would someday be apartments in Co-Op City. After describing the nature and advantages of cooperative housing generally and of Co-Op City in particular, the Bulletin informed prospective tenants that the total estimated cost of the project, based largely on an anticipated construction contract with CSI, was $283,695,550. Only a fraction of this sum, $32,795,550, was to be raised by the sale of shares to tenants. The remaining $250,900,000 was to be financed by a 40-year low-interest mortgage loan from the New York Private Housing Finance Agency. After construction of the project the mortgage payments and current operating expenses would be met by monthly rental charges paid by the tenants. While these rental charges were to vary, depending on the size, nature, and location of an apartment, the 1965 Bulletin estimated that the "average" monthly cost would be $23.02 per room, or $92.08 for a four-room apartment.

Several times during the construction of Co-Op City, Riverbay, with the approval of the State Housing Commissioner, revised its contract with CSI to allow for increased construction costs. In addition, Riverbay incurred other expenses that had not been reflected in the 1965 Bulletin. To meet these increased expenditures, Riverbay, with the Commissioner's approval, repeatedly

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$1 million had been established by small monthy contributions from all tenants to insure that those wanting to move out would receive full compensation for their shares.

secured increased mortgage loans from the State Housing Agency. Ultimately the construction loan was $125 million more than the figure estimated in the 1965 Bulletin. As a result, while the initial purchasing price remained at $450 per room, the average monthly rental charges increased periodically, reaching a figure of $39.68 per room as of July 1974.[6]

These increases in the rental charges precipitated the present lawsuit. Respondents, 57 residents of Co-Op City, sued in federal court on behalf of all 15,372 apartment owners, and derivatively on behalf of Riverbay, seeking upwards of $30 million in damages, forced rental reductions and other "appropriate" relief. Named as defendants (petitioners herein) were UHF, CSI, Riverbay, several individual directors of these organizations, the State of New York, and the State Private Housing Finance Agency. The heart of respondents' claim was that the 1965 Co-Op City Information Bulletin falsely represented that CSI would bear all subsequent cost increases due to factors such as inflation. Respondents further alleged that they were misled in their purchases of shares since the Information Bulletin failed to disclose several critical facts.[7] On these bases,

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[6] As the rental charges increased, the income eligibility requirements for residents of Co-Op City expanded accordingly. See n. 1, *supra*.

[7] Respondents maintained that the following material facts were omitted: (i) the original estimated cost had never been adhered to in any of the previous Mitchell-Lama projects sponsored by UHF and built by CSI; (ii) petitioners knew that the initial estimate would not be followed in the present project; (iii) CSI was a wholly owned subsidiary of UHF; (iv) CSI's net worth was so small that it could not have been legally held to complete the contract within the original estimated costs; (v) the State Housing Commissioner had waived his own rule regarding liquidity requirements in approving CSI as the contractor; and (vi) there was an additional undisclosed contract between CSI and Riverbay.

respondents asserted two claims under the fraud provisions of the federal Securities Acts of 1933 and 1934, 15 U. S. C. § 77q (a); 15 U. S. C. § 78j (b), and 17 CFR § 240.10b–5. They also presented a claim against the State Financing Agency under the Civil Rights Act, 42 U. S. C. § 1983, and 10 pendent state law claims.

Petitioners, while denying the substance of these allegations,[8] moved to dismiss the complaint on the ground that federal jurisdiction was lacking. They maintained that shares of stock in Riverbay were not "securities" within the definitional sections of the federal Securities Acts. In addition, the state parties moved to dismiss on sovereign immunity grounds.

The District Court granted the motion to dismiss. 366 F. Supp. 1117 (1973). It held that the denomination of the shares in Riverbay as "stock" did not, by itself, make them securities under the federal acts. The court further ruled, relying primarily on this Court's decisions in *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344 (1943), and *SEC* v. *W. J. Howey Co.*, 328 U. S. 293 (1946), that the purchase in issue was not a security transaction since it was neither induced by an offer of tangible material profits, nor could such profits realistically be expected. In the District Court's words, it was "the fundamental nonprofit nature of this transaction" which presented "the insurmountable barrier to [respondents'] claims in th[e] federal court." *Id.*, at 1128.[9]

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[8] Petitioners asserted that the Information Bulletin warned purchasers of the possibility of rental increases, and denied that it omitted material facts. They also argued that prior to occupancy all tenants were informed that rental charges had increased. In any event, petitioners claimed that respondents have suffered no damages since they may move out and retrieve their initial investments in full.

[9] The District Court also dismissed the § 1983 claim finding that the "federal securities allegations represent the only well-pleaded underlying basis for jurisdiction under the Civil Rights Act." *Id.*,

The Court of Appeals for the Second Circuit reversed. 500 F. 2d 1246 (1974). It rested its decision on two alternative grounds. First, the court held that since the shares purchased were called "stock" the Securities Acts, which explicitly include "stock" in their definitional sections, were literally applicable. Second, the Court of Appeals concluded that the transaction was an investment contract within the meaning of the Acts and as defined by *Howey*, since there was an expectation of profits from three sources: (i) rental reductions resulting from the income produced by the commercial facilities established for the use of tenants at Co-Op City; (ii) tax deductions for the portion of the monthly rental charges allocable to interest payments on the mortgage; and (iii) savings based on the fact that apartments at Co-Op City cost substantially less than comparable nonsubsidized housing. The court further ruled that the immunity claims by the State parties were unavailing.[10] Accordingly, the case was remanded to the District Court for consideration of respondents' claims on the merits.

In view of the importance of the issues presented we granted certiorari. 419 U. S. 1120 (1975). As we conclude that the disputed transactions are not purchases of securities within the contemplation of the federal statutes, we reverse.

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at 1132. In view of these rulings the court did not reach the sovereign immunity claims.

[10] The Circuit Court held that the State Agency was independent and distinct from the State itself and therefore was a "person" for purposes of § 1983, that both the Agency and the State had waived immunity under § 32 (5) of the Private Housing Finance Law, and that the State had also implicitly waived its immunity by voluntarily participating in the sale of securities, an area subject to plenary federal regulation. See *Parden* v. *Terminal Ry. of Alabama Docks Dept.*, 377 U. S. 184 (1964). In view of our disposition of this case we do not reach these issues.

II

The Securities Act of 1933, 15 U. S. C. § 77b (1), defines a "security" as

> "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." [11]

In providing this definition Congress did not attempt to articulate the relevant economic criteria for distinguishing "securities" from "non-securities." Rather it sought to define "the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H. R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933). The task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes.

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[11] The definition of a security in the 1934 Act is virtually identical and, for present purposes, the coverage of the two Acts may be considered the same. See *Tcherepnin* v. *Knight*, 389 U. S. 332, 336, 342 (1967); S. Rep. No. 792, 73d Cong., 2d Sess., 14 (1934).

In making this determination in the present case we do not write on a clean slate. Well-settled principles enunciated by this Court establish that the shares purchased by respondents do not represent any of the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits," *Howey, supra,* 328 U. S., at 299, and therefore do not fall within "the ordinary concept of a security."

A

We reject at the outset any suggestion that the present transaction, evidenced by the sale of shares called "stock," [12] must be considered a security transaction simply because the statutory definition of a security includes the words "any . . . stock." Rather we adhere to the basic principle that has guided all of the Court's decisions in this area:

> "[I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin* v. *Knight,* 389 U. S. 332, 336 (1967). See also *Howey, supra,* 328 U. S., at 298.

The primary purpose of the Securities Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the

[12] While the record does not indicate precisely why the term stock was used for the instant transaction, it appears that this form is generally used as a matter of tradition and convenience. See P. Rohan & M. Reskin, Cooperative Housing Law & Practice, § 2.01 (4) (1973).

interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto. Thus, in construing these Acts against the background of their purpose, we are guided by a traditional canon of statutory construction:

> "that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers." *Church of the Holy Trinity* v. *United States*, 143 U. S. 457, 459 (1892). See also *United States* v. *American Trucking Assns., Inc.*, 310 U. S. 534, 543 (1940).[12]

Respondents' reliance on *Joiner* as support for a "literal approach" to defining a security is misplaced. The issue in *Joiner* was whether assignments of interests in oil leases, coupled with the promoters' offer to drill an exploratory well, were securities. Looking to the economic inducement provided by the proposed exploratory well, the Court concluded that these leases were securities even though "leases" as such were not included in the list of instruments mentioned in the statutory definition. In dictum the Court noted that "[i]nstruments *may* be included within [the definition of a security], as [a] matter of law, if on their face they answer to the

[12] With the exception of the Second Circuit, every court of appeals recently to consider the issue has rejected the literal approach urged by respondents. See *C. N. S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F. 2d 1354 (CA7 1975); *McClure* v. *First National Bank of Lubbock*, 497 F. 2d 490 (CA5 1974), cert. denied, 420 U. S. 930 (1975); *Lino* v. *City Investing Co.*, 487 F. 2d 689 (CA3 1973). See also 1 L. Loss, Securities Regulation 493 (2d ed. 1961) ("substance governs rather than form: . . . just as some things which look like real estate are securities, some things which look like securities are real estate.").

name or description." 320 U. S., at 351 (emphasis supplied). And later, again in dictum, the Court stated that a security *"might"* be shown "by proving the document itself, which on its face would be a note, a bond or a share of stock." *Id.*, at 355 (emphasis supplied). By using the conditional words "may" and "might" in these dicta the Court made clear that it was not establishing an inflexible rule barring inquiry into the economic realities underlying a transaction. On the contrary, the Court intended only to make the rather obvious point that, in contrast to the instrument before it which was not included within the explicit statutory terms, most instruments bearing these traditional titles are likely to be covered by the statutes.[14]

In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

In the present case respondents do not contend, nor could they, that they were misled by use of the word "stock" into believing that the federal securities laws governed their purchase. Common sense suggests that peo-

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[14] Nor can respondents derive any support for a literal approach from *Tcherepnin* v. *Knight*, *supra*, which quoted the *Joiner* dictum. Indeed in *Tcherepnin* the Court explicitly stated that "form should be disregarded for substance," *id.*, at 336, and only after analyzing the economic realities of the transaction at issue did it conclude that an instrument called a "withdrawable capital share" was, in substance, an "investment contract," a share of "stock," a "certificate of interest or participation in a profit sharing agreement," and a "transferable share."

ple who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock. These shares have none of the characteristics "that in our commercial world fall within the ordinary concept of a security." H. R. Rep. No. 85, *supra*, at 11. Despite their name, they lack what the Court in *Tcherepnin* deemed the most common feature of stock: the right to receive "dividends contingent upon an apportionment of profits." 289 U. S., at 339. Nor do they possess the other characteristics traditionally associated with stock: they are not negotiable; they cannot be pledged or hypothecated; they confer no voting rights in proportion to the number of shares owned; and they cannot appreciate in value. In short, the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit.

B

The Court of Appeals, as an alternative ground for its decision, concluded that a share in Riverbay was also an "investment contract" as defined by the Securities Acts. Respondents further argue that in any event what they agreed to purchase is "commonly known as a 'security'" within the meaning of these laws. In considering these claims, we again must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an "investment contract" and an "instrument commonly known as a security." In either case, the basic test for distinguishing the transaction from other commercial dealings is

"whether the scheme involves an investment of

> money in a common enterprise with profits to come solely from the efforts of others." *Howey, supra,* 328 U. S., at 301.[15]

This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, as in *Joiner, supra* (sale of oil leases conditioned on promoters' agreement to drill exploratory well), or a participation in earnings resulting from the use of investors' funds, as in *Tcherepnin* v. *Knight, supra* (dividends on the investment based on savings and loan association's profits). In such cases the investor is "attracted solely by the prospects of a return" on his investment. *Howey, supra,* 328 U. S., at 300. By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or to develop it themselves," as the *Howey* Court put it, 328 U. S., at 300—the securities laws do not apply.[16] See *Joiner, supra.*[17]

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[15] This test speaks in terms of "profits to come *solely* from the efforts of others." (Emphasis supplied.) Although the issue is not presented in this case, we note that the Court of Appeals for the Ninth Circuit has held that "the word 'solely' should not be read as a strict or literal limitation of the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities." *SEC* v. *Glenn Turner Enterprises, Inc.,* 474 F. 2d 476, 482 (1973), cert. denied, 414 U. S. 821 (1973).

[16] In some transactions the investor is offered both a commodity or real estate for use and an expectation of profits. See SEC Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973). See generally

[*Footnote 17 is on p. 14*]

In 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. The Information Bulletin distributed to prospective residents emphasized the fundamental nature and purpose of the undertaking:

> "A cooperative is a nonprofit enterprise owned and controlled democratically by its members—the people who are using its services. . . .
>
> "People find living in a cooperative community enjoyable for more than one reason. Most people join, however, for the simple reason that it is a way to obtain decent housing at a reasonable price. However, there are other advantages. The purpose of a cooperative is to provide home ownership, not just apartments to rent. The community is designed to provide a favorable environment for family and community living. . . .
>
> "The common bond of collective ownership which you share makes living in a cooperative different. It is a community of neighbors. Home ownership,

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Rohan, The Securities Law Implications of Condominium Marketing Programs Which Feature a Rental Agency or Rental Pool, 2 Conn. L. Rev. 1 (1969). The application of the federal securities laws to these transactions may raise difficult questions that are not present in this case.

[17] In *Joiner*, the Court stated:

"Undisputed facts seem to us, however, to establish the conclusion that defendants were not, as a practical matter, offering naked leasehold rights. Had the offer mailed by defendants omitted the economic inducements of the proposed and promised exploration well, it would have been quite a different proposition." 320 U. S., at 348.

This distinction was critical because the exploratory drillings gave the investments "most of their value and all of their lure." *Id.*, at 349. The land itself was purely an incidental consideration in the transaction.

> common interests and the community atmosphere make living in a cooperative like living in a small town. As a rule there is very little turnover in a cooperative." Appendix, at 162a–166a.

Nowhere does the Bulletin seek to attract investors by the prospect of profits resulting from the efforts of the promoters or third parties. On the contrary, the Bulletin repeatedly emphasizes the "nonprofit" nature of the endeavor. It explains that if rental charges exceed expenses the difference will be returned as a rebate, not invested for profit. It also informs purchasers that they will be unable to resell their apartments at a profit since the apartment must first be offered back to Riverbay "at the price . . . paid for it."[18] *Id.*, at 162a. In short, neither of the kinds of profits traditionally associated with securities were offered to respondents.

The Court of Appeals recognized that there must be an expectation of profits for these shares to be securities, and conceded that there is "no possible profit on a resale of [this] stock." 500 F. 2d, at 1254. The court correctly noted, however, that profit may be derived from the income yielded by an investment as well as from capital appreciation, and then proceeded to find "an expectation of 'income' in at least three ways." *Ibid.* Two of these supposed sources of income or profits may be disposed of summarily. We turn first to the Court of Appeals' reliance on the deductibility for tax purposes of the portion of the monthly rental charge applied to

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[18] This requirement effectively insures that no apartment will be sold for more than its original cost. Consonant with the purposes of the Mitchell-Lama Act, whenever there are prospective buyers willing to pay as much as the initial purchase price for an apartment in Co-Op City, Riverbay will repurchase the apartment and resell it at its original cost. See Appendix, at 138a. If, for some reason, Riverbay does not purchase the apartment the tenant still cannot make a profit on his sale. See pp. 3–4, *supra*.

interest on the mortgage. We know of no basis in law for the view that the payment of interest, with its consequent deductibility for tax purposes, constitutes income or profits.[19] These tax benefits are nothing more than that which is available to any homeowner who pays interest on his mortgage. See Internal Revenue Code, 26 U. S. C. § 216; *Eckstein* v. *United States*, 452 F. 2d 1036 (Ct. Cl. 1971).

The Court of Appeals also found support for its concept of profits in the fact that Co-Op City offered space at a cost substantially below the going rental charges for comparable housing. Again, this is an inappropriate theory of "profits" that we cannot accept. The low rent derives from the substantial financial subsidies provided by the State of New York. This benefit cannot be liquidated into cash; nor does it result from the managerial efforts of others. In a real sense, it no more embodies the attributes of income or profits than do welfare benefits, food stamps or other government subsidies.

The final source of profit relied on by the Court of Appeals was the possibility of net income derived from the leasing by Co-Op City of commercial facilities, professional offices and parking spaces, and its operation of community washing machines. The income, if any, from these conveniences, all located within the common areas of the housing project, is to be used to reduce tenant rental costs. Conceptually, one might readily agree that net income from the leasing of commercial and professional facilities is the kind of profit tra-

[19] Even if these tax deductions were considered profits, they would not be the type associated with a security investment since they do not result from the managerial efforts of others. See Rosenbaum, The Resort Condominium and the Federal Securities Law—A Case Study in Government Inflexibility, 60 Va. L. Rev. 785, 795–796 (1974); Casenote, 62 Georgetown L. Rev. 1515, 1524–1526 (1974).

ditionally associated with a security investment.[20] See *Tcherepnin* v. *Knight, supra.* But in the present case this income—if indeed there is any—is far too speculative and insubstantial to bring the entire transaction within the Securities Acts.

Initially we note that the prospect of such income as a means of offsetting rental costs is never mentioned in the Information Bulletin. Thus it is clear that investors were not attracted to Co-Op City by the offer of these potential rental reductions. See *Joiner, supra,* 320 U. S., at 353. Moreover, nothing in the record suggests that the facilities in fact return a profit in the sense that the leasing fees are greater than the actual cost to Co-Op City of the space rented.[21] The short of the matter is that the stores and services in question were established not as a means of returning profits to tenants, but for the purpose of making essential services available for the residents of this enormous complex.[22] By statute these facilities can only be "incidental and appurtenant" to the

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[20] The "income" derived from the rental of parking spaces and the operation of washing machines clearly was not profit for respondents since these facilities were provided exclusively for the use of tenants. Thus when the income collected from the use of these facilities exceeds the cost of their operation the tenants simply receive the return of the initial overcharge in the form of a rent rebate. Indeed, it could be argued that the "income" from the commercial and professional facilities is also, in effect, a rebate on the cost of goods and services purchased at these facilities since it appears likely that they are patronized almost exclusively by Co-Op City residents. See Casenote, 53 Tex. L. Rev. 623, 630–631 n. 38 (1975).

[21] The Court of Appeals quoted the gross rental income received from these facilities. But such figures by themselves are irrelevant since the record does not indicate the cost to Co-Op City of providing and maintaining the rented space.

[22] See Miller, Cooperative Apartments: Real Estate or Securities?, 45 B. U. L. Rev. 464, 500 (1965).

housing project, N. Y. Private Housing Law § 12 (5) (McKinney Supp. 1974–1975). Undoubtedly they make Co-Op City a more attractive housing opportunity, but the possibility of some rental reduction is not an "expectation of profit" in the sense found necessary in *Howey*.[23]

There is no doubt that purchasers in this housing cooperative sought to obtain a decent home at an attractive price. But that type of economic interest characizes every form of commercial dealing. What distinguishes a security transaction—and what is absent

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[23] Respondents urge us to abandon the element of profits in the definition of securities and to adopt the "risk capital" approach articulated by the California Supreme Court in *Silver Hills Country Club* v. *Sobieski*, 55 Cal. 2d 811, 361 P. 2d 906 (1961). Cf. *El Khadem* v. *Equity Securities Corp.*, 494 F. 2d 1224 (CA9 1974), cert. denied, 419 U. S. 900 (1974). See generally Coffey, The Economic Realities of a "Security": Is There a More Meaningful Formula?, 18 Case W. Res. L. Rev. 367 (1967); Long, An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation, 24 Okla. L. Rev. 135 (1971); Hannan & Thomas, The Importance of Economic Reality and Risk in Defining Federal Securities, 25 Hast. L. Rev. 219 (1973). Even if we were inclined to adopt such a "risk capital" approach we would not apply it in the present case. Purchasers of apartments in Co-Op City take no risk in any significant sense. If dissatisfied with their apartments, they may recover their initial investment in full. See n. 5, *supra*.

Respondents assert that if Co-Op City becomes bankrupt they stand to lose their whole investment. But, in view of the fact that the State has financed over 92% of the cost of construction and carefully regulates the development and operation of the project, bankruptcy in the normal sense is an unrealistic possibility. In any event, the risk of insolvency of an ongoing housing cooperative "differ[s] vastly" from the kind of risk of "fluctuating" value associated with securities investments. *SEC.* v. *Variable Annuity Life Insurance Co.*, 359 U. S. 65, 90–91 (1959) (BRENNAN, J., concurring). See Hannan & Thomas, *supra*, at 242–249; Long, Introduction to Symposium: Interpreting The Statutory Definition of a Security: Some Pragmatic Considerations, 6 St. Mary's L. J. 96, 126–128 (1974).

here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use.[24]

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[24] The SEC has filed an amicus brief urging us to hold the federal securities laws applicable to this case. Traditionally the views of an agency charged with administering the governing statute would be entitled to considerable weight. See, *e. g., United States National Association of Securities Dealers*, — U. S. — (1975) (slip op., at 22); *Saxbe* v. *Bustos*, 419 U. S. 65, 74 (1974); *Investment Company Institute* v. *Camp*, 401 U. S. 617, 626–627 (1971). But in this case the SEC's position flatly contradicts what appears to be a rather careful statement of the Commission's views in a recent release. In Release No. 33–5347, 38 Fed. Reg. 1735 (Jan. 18, 1973), applicable to "the sale of condominium units and other units in a real estate development," the SEC stated its view that only those real estate investments that are "offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter," are to be considered securities. *Id.*, at 1736. In particular, the Commission explained that the Securities Acts do not apply when "commercial facilities are a part of the common elements of a residential project" if

"(a) the income from such facilities is used only to offset common area expenses and (b) the operation of such facilities is incidental to the project as a whole and are not established as a primary income source for the individual owners of a condominium or cooperative unit." *Ibid.*

See also SEC Real Estate Advisory Committee Report 74–91 (1972); Dickey & Thorpe, Federal Security Regulation of Condominium Offerings, 19 N. Y. L. F. 473 (1974).

Several commentators have noted the inconsistency between the SEC's position in the above release and the decision by the Court of Appeals in this case, which the SEC now supports. See Berman & Stone, Federal Securities Law and the Sale of Condominiums, Homes and Homesites, 30 Bus. Law. 411, 420–425 (1975); Note, Condominium Regulation: Beyond Disclosure, 123 U. Pa. L. Rev. 639, 654–655 (1975); Casenote, *supra*, n. 20, at 628. In view of this unexplained contradictions in the Commission's position we accord no special weight to its views. See *Reliance Electric Co.* v. *Emerson*

III

In holding that there is no federal jurisdiction, we do not address the merits of respondents' allegations of fraud. Nor do we indicate any view as to whether the type of claims here involved should be protected by federal regulations.[25] We decide only that the type of transaction before us, in which the purchasers were interested in acquiring housing rather than making an investment for profit, is not within the scope of the federal securities laws.

Electric Co., 404 U. S. 418, 426 (1972); *Blue Chip Stamps* v. *Manor Drug Stores*, — U. S. — (1975) (slip op., at 21 n. 8).

[25] It has been suggested that the sale of housing developments such as condominiums and cooperatives is in need of federal regulation and therefore the securities laws should be construed or amended to reach these transactions. See, *e. g.*, Note, Federal Securities Regulations of Condominiums: A Purchaser's Perspective, 62 Georgetown L. J. 1403 (1974); Note, Cooperative Housing Corporations and the Federal Securities Laws, 71 Colum. L. Rev. 118 (1971). Others have disagreed, claiming that the extensive body of regulation developed over more than four decades under these Acts would be inappropriate and unduly costly to the sellers and buyers of residential housing. See Berman & Stone, *supra*, n. 24; Casenote, *supra*, n. 20. Moreover, extension of the securities laws to real estate transactions would involve important questions as to the appropriate balance between state and federal responsibility. The determination of whether and in what manner federal regulation may be required for housing transactions, where the characteristics of an investment ~~assess both the costs and benefits of any such regulation. Indeed,~~ in securities are not present, is better left to the Congress, which can assess both the costs and benefits of any such regulation. Indeed only recently, Congress instructed the Secretary of Housing and Urban Development "to conduct a full and complete investigation and study . . . with respect to . . . the problems, difficulties and abuses or potential abuses applicable to condominium and cooperative housing." Pub. L. 93-383, 88 Stat. 740 (Aug. 22, 1974). See also Real Estate Settlement Procedures Act, Pub. L. No. 93-533 (Dec. 22, 1974); Interstate Land Sales Full Disclosure Act, U. S. C. §§ 1701-1720.

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Since respondents' claims are not cognizable in federal court, the District Court properly dismissed their complaint.[20] The judgment below is therefore

Reversed.

MR. JUSTICE DOUGLAS took no part in the consideration or decision of this case.

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[20] Besides the Securities Acts claims, respondents also included a vague and conclusory allegation under 42 U. S. C. § 1983 against petitioner, the New York State Housing Finance Agency. We agree with the District Court that this count must also be dismissed. See n. 9, *supra*. The remaining counts in the complaint were all predicated on alleged violations of state law, not independently cognizable in federal court.

12

3rd DRAFT

SUPREME COURT OF THE UNITED STATES

Nos. 74-157 AND 74-647

United Housing Foundation, Inc., et al., Petitioners, 74-157 *v.* Milton Forman et al.	On Writs of Certiorari to the United States Court of Appeals for the Second Circuit.
State of New York and the New York State Housing Finance Agency, Petitioners, 74-647 *v.* Milton Forman et al.	

[June —, 1975]

MR. JUSTICE POWELL delivered the opinion of the Court.

The issue in this case is whether shares of stock entitling a purchaser to lease an apartment in Co-Op City, a state subsidized and supervised nonprofit housing cooperative, are "securities" within the purview of the Securities Act of 1933 and the Securities Exchange Act of 1934.

I

Co-Op City is a massive housing cooperative in New York City. Built between 1965 and 1971, it presently houses approximately 50,000 people on a 200-acre site containing 35 high rise buildings and 236 town houses. The project was organized, financed, and constructed under the New York State Private Housing Finance Law,

commonly known as the Mitchell-Lama Act, enacted to ameliorate a perceived crisis in the availability of decent low-income urban housing. In order to encourage private developers to build low-cost cooperative housing, New York provides them with large long-term, low-interest mortgage loans and substantial tax exemptions. Receipt of such benefits is conditioned on a willingness to have the State review virtually every step in the development of the cooperative. See N. Y. Private Housing Finance Law §§ 11–37, as amended, (McKinney Supp. 1974–1975). The developer also must agree to operate the facility "on a nonprofit basis," *id.*, at § 11–a (2a), and he may lease apartments only to people whose incomes fall below a certain level and who have been approved by the State.[1]

The United Housing Foundation (UHF), a nonprofit membership corporation established for the purpose of "aiding and encouraging" the creation of "adequate, safe and sanitary housing accommodations for wage earners and other persons of low and moderate income," [2] Appendix, at 95a, was responsible for initiating and sponsoring the development of Co-Op City. Acting under the Mitchell-Lama Act, UHF organized the Riverbay Corporation (Riverbay) to own and operate the land and buildings constituting Co-Op City. Riverbay, a nonprofit cooperative housing corporation, issued the stock that is the subject of this litigation. UHF also con-

[1] Eligibility is limited to families whose monthly income does not exceed six times the monthly rental charge (or for families of four or more, seven times the rental charge). N. Y. Private Housing Finance Law § 31 (2) (a) (McKinney Supp. 1974–1975). Preference in admission must be given to veterans, the handicapped, and the elderly. *Id.*, at § 31 (7)–(9).

[2] UHF is composed of labor unions, housing cooperatives, and civic groups. It has sponsored the construction of several major housing cooperatives in New York City.

tracted with Community Services, Inc. (CSI), its wholly owned subsidiary, to serve as the general contractor and sales agent for the project.[2] As required by the Mitchell-Lama Act, these decisions were approved by the State Housing Commissioner.

To acquire an apartment in Co-Op City an eligible prospective purchaser must buy 18 shares of stock in Riverbay for each room desired. The cost per share is $25, making the total cost $450 per room, or $1,800 for a four-room apartment. The sole purpose of acquiring these shares is to enable the purchaser to occupy an apartment in Co-Op City; in effect, their purchase is a recoverable deposit on an apartment. The shares are explicitly tied to the apartment: they cannot be transferred to a nontenant; nor can they be pledged or encumbered; and they descend, along with the apartment, only to a surviving spouse. No voting rights attach to the shares as such: participation in the affairs of the cooperative appertains to the apartment, with the residents of each apartment being entitled to one vote irrespective of the number of shares owned.

Any tenant who wants to terminate his occupancy, or who is forced to move out,[4] must offer his stock to Riverbay at its initial selling price of $25 per share. In the extremely unlikely event that Riverbay declines to repurchase the stock,[5] the tenant cannot sell it for more than

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[2] CSI is a business corporation that has acted as the contractor on several UHF-sponsored housing cooperatives.

[4] A tenant can be forced to move out if he violates the provisions of his "occupancy agreement," which is essentially a lease for the apartment, or if his income grows to exceed the eligibility standards.

[5] To date every family that has withdrawn from Co-Op City has received back its initial payment in full. Indeed, at the time this suit was filed there were 7,000 families on the waiting list for apartments in this cooperative. In addition, a special fund of nearly

the initial purchase price plus a fraction of the portion of the mortgage that he has paid off, and then only to a prospective tenant satisfying the statutory income eligibility requirements. See N. Y. Private Housing Finance Law § 31-a (McKinney Supp. 1974–1975).

In May 1965, subsequent to the completion of the initial planning, Riverbay circulated an Information Bulletin seeking to attract tenants for what would someday be apartments in Co-Op City. After describing the nature and advantages of cooperative housing generally and of Co-Op City in particular, the Bulletin informed prospective tenants that the total estimated cost of the project, based largely on an anticipated construction contract with CSI, was $283,695,550. Only a fraction of this sum, $32,795,550, was to be raised by the sale of shares to tenants. The remaining $250,900,000 was to be financed by a 40-year low-interest mortgage loan from the New York Private Housing Finance Agency. After construction of the project the mortgage payments and current operating expenses would be met by monthly rental charges paid by the tenants. While these rental charges were to vary, depending on the size, nature, and location of an apartment, the 1965 Bulletin estimated that the "average" monthly cost would be $23.02 per room, or $92.08 for a four-room apartment.

Several times during the construction of Co-Op City, Riverbay, with the approval of the State Housing Commissioner, revised its contract with CSI to allow for increased construction costs. In addition, Riverbay incurred other expenses that had not been reflected in the 1965 Bulletin. To meet these increased expenditures, Riverbay, with the Commissioner's approval, repeatedly

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$1 million had been established by small monthly contributions from all tenants to insure that those wanting to move out would receive full compensation for their shares.

secured increased mortgage loans from the State Housing Agency. Ultimately the construction loan was $125 million more than the figure estimated in the 1965 Bulletin. As a result, while the initial purchasing price remained at $450 per room, the average monthly rental charges increased periodically, reaching a figure of $39.68 per room as of July 1974.[6]

These increases in the rental charges precipitated the present lawsuit. Respondents, 57 residents of Co-Op City, sued in federal court on behalf of all 15,372 apartment owners, and derivatively on behalf of Riverbay, seeking upwards of $30 million in damages, forced rental reductions, and other "appropriate" relief. Named as defendants (petitioners herein) were UHF, CSI, Riverbay, several individual directors of these organizations, the State of New York, and the State Private Housing Finance Agency. The heart of respondents' claim was that the 1965 Co-Op City Information Bulletin falsely represented that CSI would bear all subsequent cost increases due to factors such as inflation. Respondents further alleged that they were misled in their purchases of shares since the Information Bulletin failed to disclose several critical facts.[7] On these bases,

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[6] As the rental charges increased, the income eligibility requirements for residents of Co-Op City expanded accordingly. See n. 1, *supra*.

[7] Respondents maintained that the following material facts were omitted: (i) the original estimated cost had never been adhered to in any of the previous Mitchell-Lama projects sponsored by UHF and built by CSI; (ii) petitioners knew that the initial estimate would not be followed in the present project; (iii) CSI was a wholly owned subsidiary of UHF; (iv) CSI's net worth was so small that it could not have been legally held to complete the contract within the original estimated costs; (v) the State Housing Commissioner had waived his own rule regarding liquidity requirements in approving CSI as the contractor; and (vi) there was an additional undisclosed contract between CSI and Riverbay.

respondents asserted two claims under the fraud provisions of the federal Securities Acts of 1933 and 1934, 15 U. S. C. § 77q (a); 15 U. S. C. § 78j (b), and 17 CFR § 240.10b–5. They also presented a claim against the State Financing Agency under the Civil Rights Act, 42 U. S. C. § 1983, and 10 pendent state law claims.

Petitioners, while denying the substance of these allegations,[8] moved to dismiss the complaint on the ground that federal jurisdiction was lacking. They maintained that shares of stock in Riverbay were not "securities" within the definitional sections of the federal Securities Acts. In addition, the state parties moved to dismiss on sovereign immunity grounds.

The District Court granted the motion to dismiss. 366 F. Supp. 1117 (1973). It held that the denomination of the shares in Riverbay as "stock" did not, by itself, make them securities under the federal Acts. The court further ruled, relying primarily on this Court's decisions in *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344 (1943), and *SEC* v. *W. J. Howey Co.*, 328 U. S. 293 (1946), that the purchase in issue was not a security transaction since it was neither induced by an offer of tangible material profits, nor could such profits realistically be expected. In the District Court's words, it was "the fundamental nonprofit nature of this transaction" which presented "the insurmountable barrier to [respondents'] claims in th[e] federal court." *Id.*, at 1128.[9]

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[8] Petitioners asserted that the Information Bulletin warned purchasers of the possibility of rental increases, and denied that it omitted material facts. They also argued that prior to occupancy all tenants were informed that rental charges had increased. In any event, petitioners claimed that respondents have suffered no damages since they may move out and retrieve their initial investments in full.

[9] The District Court also dismissed the § 1983 claim finding that the "federal securities allegations represent the only well-pleaded underlying basis for jurisdiction under the Civil Rights Act." *Id.*,

The Court of Appeals for the Second Circuit reversed. 500 F. 2d 1246 (1974). It rested its decision on two alternative grounds. First, the court held that since the shares purchased were called "stock" the Securities Acts, which explicitly include "stock" in their definitional sections, were literally applicable. Second, the Court of Appeals concluded that the transaction was an investment contract within the meaning of the Acts and as defined by *Howey*, since there was an expectation of profits from three sources: (i) rental reductions resulting from the income produced by the commercial facilities established for the use of tenants at Co-Op City; (ii) tax deductions for the portion of the monthly rental charges allocable to interest payments on the mortgage; and (iii) savings based on the fact that apartments at Co-Op City cost substantially less than comparable nonsubsidized housing. The court further ruled that the immunity claims by the State parties were unavailing.[10] Accordingly, the case was remanded to the District Court for consideration of respondents' claims on the merits.

In view of the importance of the issues presented we granted certiorari. 419 U. S. 1120 (1975). As we conclude that the disputed transactions are not purchases of securities within the contemplation of the federal statutes, we reverse.

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at 1132. In view of these rulings the court did not reach the sovereign immunity claims.

[10] The Circuit Court held that the State Agency was independent and distinct from the State itself and therefore was a "person" for purposes of § 1983, that both the Agency and the State had waived immunity under § 32 (5) of the Private Housing Finance Law, and that the State had also implicitly waived its immunity by voluntarily participating in the sale of securities, an area subject to plenary federal regulation. See *Parden* v. *Terminal Ry. of Alabama Docks Dept.*, 377 U. S. 184 (1964). In view of our disposition of this case we do not reach these issues.

II

The Securities Act of 1933, 15 U. S. C. § 77b (1), defines a "security" as

> "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." [11]

In providing this definition Congress did not attempt to articulate the relevant economic criteria for distinguishing "securities" from "non-securities." Rather it sought to define "the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H. R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933). The task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes.

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[11] The definition of a security in the 1934 Act is virtually identical and, for present purposes, the coverage of the two Acts may be considered the same. See *Tcherepnin* v. *Knight*, 389 U. S. 332, 336, 342 (1967); S. Rep. No. 792, 73d Cong., 2d Sess., 14 (1934).

In making this determination in the present case we do not write on a clean slate. Well-settled principles enunciated by this Court establish that the shares purchased by respondents do not represent any of the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits," *Howey, supra*, 328 U. S., at 299, and therefore do not fall within "the ordinary concept of a security."

A

We reject at the outset any suggestion that the present transaction, evidenced by the sale of shares called "stock," [12] must be considered a security transaction simply because the statutory definition of a security includes the words "any . . . stock." Rather we adhere to the basic principle that has guided all of the Court's decisions in this area:

> "[I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin* v. *Knight*, 389 U. S. 332, 336 (1967). See also *Howey, supra*, 328 U. S., at 298.

The primary purpose of the Securities Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the

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[12] While the record does not indicate precisely why the term stock was used for the instant transaction, it appears that this form is generally used as a matter of tradition and convenience. See P. Rohan & M. Reskin, Cooperative Housing Law & Practice § 2.01 (4) (1973).

interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto. Thus, in construing these Acts against the background of their purpose, we are guided by a traditional canon of statutory construction:

> "that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers." *Church of the Holy Trinity* v. *United States*, 143 U. S. 457, 459 (1892). See also *United States* v. *American Trucking Assns., Inc.*, 310 U. S. 534, 543 (1940).[18]

Respondents' reliance on *Joiner* as support for a "literal approach" to defining a security is misplaced. The issue in *Joiner* was whether assignments of interests in oil leases, coupled with the promoters' offer to drill an exploratory well, were securities. Looking to the economic inducement provided by the proposed exploratory well, the Court concluded that these leases were securities even though "leases" as such were not included in the list of instruments mentioned in the statutory definition. In dictum the Court noted that "[i]nstruments *may* be included within [the definition of a security], as [a] matter of law, if on their face they answer to the

[18] With the exception of the Second Circuit, every court of appeals recently to consider the issue has rejected the literal approach urged by respondents. See *C. N. S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F. 2d 1354 (CA7 1975); *McClure* v. *First National Bank of Lubbock*, 497 F. 2d 490 (CA5 1974), cert. denied, 420 U. S. 930 (1975); *Lino* v. *City Investing Co.*, 487 F. 2d 689 (CA3 1973). See also 1 L. Loss, Securities Regulation 493 (2d ed. 1961) ("substance governs rather than form . . . just as some things which look like real estate are securities, some things which look like securities are real estate.").

name or description." 320 U. S., at 351 (emphasis supplied). And later, again in dictum, the Court stated that a security *"might"* be shown "by proving the document itself, which on its face would be a note, a bond or a share of stock." *Id.*, at 355 (emphasis supplied). By using the conditional words "may" and "might" in these dicta the Court made clear that it was not establishing an inflexible rule barring inquiry into the economic realities underlying a transaction. On the contrary, the Court intended only to make the rather obvious point that, in contrast to the instrument before it which was not included within the explicit statutory terms, most instruments bearing these traditional titles are likely to be covered by the statutes.[14]

In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

In the present case respondents do not contend, nor could they, that they were misled by use of the word "stock" into believing that the federal securities laws governed their purchase. Common sense suggests that peo-

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[14] Nor can respondents derive any support for a literal approach from *Tcherepnin* v. *Knight*, *supra*, which quoted the *Joiner* dictum. Indeed in *Tcherepnin* the Court explicitly stated that "form should be disregarded for substance," *id.*, at 336, and only after analyzing the economic realities of the transaction at issue did it conclude that an instrument called a "withdrawable capital share" was, in substance, an "investment contract," a share of "stock," a "certificate of interest or participation in a profit sharing agreement," and a "transferable share."

ple who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock. These shares have none of the characteristics "that in our commercial world fall within the ordinary concept of a security." H. R. Rep. No. 85, *supra*, at 11. Despite their name, they lack what the Court in *Tcherepnin* deemed the most common feature of stock: the right to receive "dividends contingent upon an apportionment of profits." 289 U. S., at 339. Nor do they possess the other characteristics traditionally associated with stock: they are not negotiable; they cannot be pledged or hypothecated; they confer no voting rights in proportion to the number of shares owned; and they cannot appreciate in value. In short, the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit.

B

The Court of Appeals, as an alternative ground for its decision, concluded that a share in Riverbay was also an "investment contract" as defined by the Securities Acts. Respondents further argue that in any event what they agreed to purchase is "commonly known as a 'security' " within the meaning of these laws. In considering these claims we again must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an "investment contract" and an "instrument commonly known as a security." In either case, the basic test for distinguishing the transaction from other commercial dealings is

"whether the scheme involves an investment of

money in a common enterprise with profits to come solely from the efforts of others." *Howey, supra*, 328 U. S., at 301.[15]

This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, as in *Joiner, supra* (sale of oil leases conditioned on promoters' agreement to drill exploratory well), or a participation in earnings resulting from the use of investors' funds, as in *Tcherepnin v. Knight, supra* (dividends on the investment based on savings and loan association's profits). In such cases the investor is "attracted solely by the prospects of a return" on his investment. *Howey, supra*, 328 U. S., at 300. By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or to develop it themselves," as the *Howey* Court put it, 328 U. S., at 300—the securities laws do not apply.[16] See also *Joiner, supra*.[17]

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[15] This test speaks in terms of "profits to come *solely* from the efforts of others." (Emphasis supplied.) Although the issue is not presented in this case, we note that the Court of Appeals for the Ninth Circuit has held that "the word 'solely' should not be read as a strict or literal limitation of the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities." *SEC* v. *Glenn Turner Enterprises, Inc.*, 474 F. 2d 476, 482 (1973), cert. denied, 414 U. S. 821 (1973). We express no view, however, as to the holding of this case.

[16] In some transactions the investor is offered both a commodity or real estate for use and an expectation of profits. See SEC Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973). See generally

[*Footnote 17 is on p. 14*]

In 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. The Information Bulletin distributed to prospective residents emphasized the fundamental nature and purpose of the undertaking:

> "A cooperative is a nonprofit enterprise owned and controlled democratically by its members—the people who are using its services. . . .
>
> "People find living in a cooperative community enjoyable for more than one reason. Most people join, however, for the simple reason that it is a way to obtain decent housing at a reasonable price. However, there are other advantages. The purpose of a cooperative is to provide home ownership, not just apartments to rent. The community is designed to provide a favorable environment for family and community living. . . .
>
> "The common bond of collective ownership which you share makes living in a cooperative different. It is a community of neighbors. Home ownership,

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Rohan, The Securities Law Implications of Condominium Marketing Programs Which Feature a Rental Agency or Rental Pool, 2 Conn. L. Rev. 1 (1969). The application of the federal securities laws to these transactions may raise difficult questions that are not present in this case.

[17] In *Joiner*, the Court stated:

"Undisputed facts seem to us, however, to establish the conclusion that defendants were not, as a practical matter, offering naked leasehold rights. Had the offer mailed by defendants omitted the economic inducements of the proposed and promised exploration well, it would have been quite a different proposition." 320 U. S., at 348.

This distinction was critical because the exploratory drillings gave the investments "most of their value and all of their lure." *Id.*, at 349. The land itself was purely an incidental consideration in the transaction.

> common interests and the community atmosphere make living in a cooperative like living in a small town. As a rule there is very little turnover in a cooperative." Appendix, at 162a–166a.

Nowhere does the Bulletin seek to attract investors by the prospect of profits resulting from the efforts of the promoters or third parties. On the contrary, the Bulletin repeatedly emphasizes the "nonprofit" nature of the endeavor. It explains that if rental charges exceed expenses the difference will be returned as a rebate, not invested for profit. It also informs purchasers that they will be unable to resell their apartments at a profit since the apartment must first be offered back to Riverbay "at the price . . . paid for it." [16] *Id.*, at 162a. In short, neither of the kinds of profits traditionally associated with securities were offered to respondents.

The Court of Appeals recognized that there must be an expectation of profits for these shares to be securities, and conceded that there is "no possible profit on a resale of [this] stock." 500 F. 2d, at 1254. The court correctly noted, however, that profit may be derived from the income yielded by an investment as well as from capital appreciation, and then proceeded to find "an expectation of 'income' in at least three ways." *Ibid.* Two of these supposed sources of income or profits may be disposed of summarily. We turn first to the Court of Appeals' reliance on the deductibility for tax purposes of the portion of the monthly rental charge applied to

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[16] This requirement effectively insures that no apartment will be sold for more than its original cost. Consonant with the purposes of the Mitchell-Lama Act, whenever there are prospective buyers willing to pay as much as the initial purchase price for an apartment in Co-Op City, Riverbay will repurchase the apartment and resell it at its original cost. See Appendix, at 138a. If, for some reason, Riverbay does not purchase the apartment the tenant still cannot make a profit on his sale. See pp. 3–4, *supra*.

interest on the mortgage. We know of no basis in law for the view that the payment of interest, with its consequent deductibility for tax purposes, constitutes income or profits.[19] These tax benefits are nothing more than that which is available to any homeowner who pays interest on his mortgage. See Internal Revenue Code, 26 U. S. C. § 216; *Eckstein* v. *United States*, 452 F. 2d 1036 (Ct. Cl. 1971).

The Court of Appeals also found support for its concept of profits in the fact that Co-Op City offered space at a cost substantially below the going rental charges for comparable housing. Again, this is an inappropriate theory of "profits" that we cannot accept. The low rent derives from the substantial financial subsidies provided by the State of New York. This benefit cannot be liquidated into cash; nor does it result from the managerial efforts of others. In a real sense, it no more embodies the attributes of income or profits than do welfare benefits, food stamps or other government subsidies.

The final source of profit relied on by the Court of Appeals was the possibility of net income derived from the leasing by Co-Op City of commercial facilities, professional offices and parking spaces, and its operation of community washing machines. The income, if any, from these conveniences, all located within the common areas of the housing project, is to be used to reduce tenant rental costs. Conceptually, one might readily agree that net income from the leasing of commercial and professional facilities is the kind of profit tra-

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[19] Even if these tax deductions were considered profits, they would not be the type associated with a security investment since they do not result from the managerial efforts of others. See Rosenbaum, The Resort Condominium and the Federal Securities Law—A Case Study in Governmental Inflexibility, 60 Va. L. Rev. 785, 795–796 (1974); Casenote, 62 Georgetown L. Rev. 1515, 1524–1526 (1974).

ditionally associated with a security investment.[20] See *Tcherepnin* v. *Knight*, *supra*. But in the present case this income—if indeed there is any—is far too speculative and insubstantial to bring the entire transaction within the Securities Acts.

Initially we note that the prospect of such income as a means of offsetting rental costs is never mentioned in the Information Bulletin. Thus it is clear that investors were not attracted to Co-Op City by the offer of these potential rental reductions. See *Joiner*, *supra*, 320 U. S., at 353. Moreover, nothing in the record suggests that the facilities in fact return a profit in the sense that the leasing fees are greater than the actual cost to Co-Op City of the space rented.[21] The short of the matter is that the stores and services in question were established not as a means of returning profits to tenants, but for the purpose of making essential services available for the residents of this enormous complex.[22] By statute these facilities can only be "incidental and appurtenant" to the

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[20] The "income" derived from the rental of parking spaces and the operation of washing machines clearly was not profit for respondents since these facilities were provided exclusively for the use of tenants. Thus when the income collected from the use of these facilities exceeds the cost of their operation the tenants simply receive the return of the initial overcharge in the form of a rent rebate. Indeed, it could be argued that the "income" from the commercial and professional facilities is also, in effect, a rebate on the cost of goods and services purchased at these facilities since it appears likely that they are patronized almost exclusively by Co-Op City residents. See Casenote, 53 Tex. L. Rev. 623, 630–631 n. 38 (1975).

[21] The Court of Appeals quoted the gross rental income received from these facilities. But such figures by themselves are irrelevant since the record does not indicate the cost to Co-Op City of providing and maintaining the rented space.

[22] See generally Miller, Cooperative Apartments: Real Estate or Securities? 45 B. U. L. Rev. 464, 500 (1965).

housing project. N. Y. Private Housing Law § 12 (5) (McKinney Supp. 1974–1975). Undoubtedly they make Co-Op City a more attractive housing opportunity, but the possibility of some rental reduction is not an "expectation of profit" in the sense found necessary in *Howey*.[23]

There is no doubt that purchasers in this housing cooperative sought to obtain a decent home at an attractive price. But that type of economic interest characizes every form of commercial dealing. What distinguishes a security transaction—and what is absent

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[23] Respondents urge us to abandon the element of profits in the definition of securities and to adopt the "risk capital" approach articulated by the California Supreme Court in *Silver Hills Country Club* v. *Sobieski*, 55 Cal. 2d 811, 361 P. 2d 906 (1961). Cf. *El Khadem* v. *Equity Securities Corp.*, 494 F. 2d 1224 (CA9 1974), cert. denied, 419 U. S. 900 (1974). See generally Coffey, The Economic Realities of a "Security": Is There a More Meaningful Formula?, 18 Case W. Res. L. Rev. 367 (1967); Long, An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation, 24 Okla. L. Rev. 135 (1971); Hannan & Thomas, The Importance of Economic Reality and Risk in Defining Federal Securities, 25 Hast. L. Rev. 219 (1973). Even if we were inclined to adopt such a "risk capital" approach we would not apply it in the present case. Purchasers of apartments in Co-Op City take no risk in any significant sense. If dissatisfied with their apartments, they may recover their initial investment in full. See n. 5, *supra*.

Respondents assert that if Co-Op City becomes bankrupt they stand to lose their whole investment. But, in view of the fact that the State has financed over 92% of the cost of construction and carefully regulates the development and operation of the project, bankruptcy in the normal sense is an unrealistic possibility. In any event, the risk of insolvency of an ongoing housing cooperative "differ[s] vastly" from the kind of risk of "fluctuating" value associated with securities investments. *SEC.* v. *Variable Annuity Life Insurance Co.*, 359 U. S. 65, 90–91 (1959) (BRENNAN, J., concurring). See Hannan & Thomas, *supra*, at 242–249; Long, Introduction to Symposium: Interpreting The Statutory Definition of a Security: Some Pragmatic Considerations, 8 St. Mary's L. J. 96, 126–128 (1974).

here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use.[24]

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[24] The SEC has filed an amicus brief urging us to hold the federal securities laws applicable to this case. Traditionally the views of an agency charged with administering the governing statute would be entitled to considerable weight. See, *e. g.*, *United States National Association of Securities Dealers*, — U. S. — (1975) (slip op., at 22); *Saxbe* v. *Bustos*, 419 U. S. 65, 74 (1974); *Investment Company Institute* v. *Camp*, 401 U. S. 617, 626–627 (1971). But in this case the SEC's position flatly contradicts what appears to be a rather careful statement of the Commission's views in a recent release. In Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973), applicable to "the sale of condominium units and other units in a real estate development," the SEC stated its view that only those real estate investments that are "offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter," are to be considered securities. *Id.*, at 1736. In particular, the Commission explained that the Securities Acts do not apply when "commercial facilities are a part of the common elements of a residential project" if

"(a) the income from such facilities is used only to offset common area expenses and (b) the operation of such facilities is incidental to the project as a whole and are not established as a primary income source for the individual owners of a condominium or cooperative unit." *Ibid.*

See also SEC Real Estate Advisory Committee Report 74–91 (1972); Dickey & Thorpe, Federal Security Regulation of Condominium Offerings, 19 N. Y. L. F. 473 (1974).

Several commentators have noted the inconsistency between the SEC's position in the above release and the decision by the Court of Appeals in this case, which the SEC now supports. See Berman & Stone, Federal Securities Law and the Sale of Condominiums, Homes and Homesites, 30 Bus. Law. 411, 420–425 (1975); Note, Condominium Regulation: Beyond Disclosure, 123 U. Pa. L. Rev. 639, 654–655 (1975); Casenote, *supra*, n. 20, at 628. In view of this unexplained contradiction in the Commission's position we accord no special weight to its views. See *Reliance Electric Co.* v. *Emerson*

III

In holding that there is no federal jurisdiction, we do not address the merits of respondents' allegations of fraud. Nor do we indicate any view as to whether the type of claims here involved should be protected by federal regulation.[25] We decide only that the type of transaction before us, in which the purchasers were interested in acquiring housing rather than making an investment for profit, is not within the scope of the federal securities laws.

Electric Co., 404 U. S. 418, 423 (1972); *Blue Chip Stamps* v. *Manor Drug Stores*, — U. S. — (1975) (slip op., at 22–23, n. 10).

[25] It has been suggested that the sale of housing developments such as condominiums and cooperatives is in need of federal regulation and therefore the securities laws should be construed or amended to reach these transactions. See, *e. g.*, Note, Federal Securities Regulations of Condominiums: A Purchaser's Perspective, 62 Georgetown L. J. 1403 (1974); Note, Cooperative Housing Corporations and the Federal Securities Laws, 71 Colum. L. Rev. 118 (1971). Others have disagreed, claiming that the extensive body of regulation developed over more than four decades under these Acts would be inappropriate and unduly costly to the sellers and buyers of residential housing. See Berman & Stone, *supra*, n. 24; Casenote, *supra*, n. 20. Moreover, extension of the securities laws to real estate transactions would involve important questions as to the appropriate balance between state and federal responsibility. The determination of whether and in what manner federal regulation may be required for housing transactions, where the characteristics of an investment in securities are not present, is better left to the Congress, which can assess both the costs and benefits of any such regulation. Indeed only recently Congress instructed the Secretary of Housing and Urban Development "to conduct a full and complete investigation and study . . . with respect to . . . the problems, difficulties and abuses or potential abuses applicable to condominium and cooperative housing." Pub. L. 93–383, 88 Stat. 740 (Aug. 22, 1974). See also Real Estate Settlement Procedures Act, Pub. L. No. 93–533 (Dec. 22, 1974); Interstate Land Sales Full Disclosure Act, 15 U. S. C. §§ 1701–1720.

Since respondents' claims are not cognizable in federal court, the District Court properly dismissed their complaint.[26] The judgment below is therefore

Reversed.

MR. JUSTICE DOUGLAS took no part in the consideration or decision of this case.

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[26] Besides the Securities Acts claims, respondents also included a vague and conclusory allegation under 42 U. S. C. § 1983 against petitioner, the New York State Housing Finance Agency. We agree with the District Court that this count must also be dismissed. See n. 9, *supra*. The remaining counts in the complaint were all predicated on alleged violations of state law, not independently cognizable in federal court.

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

UNITED HOUSING FOUNDATION, INC., ET AL. *v.* FORMAN ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 74–157. Argued April 22, 1975—Decided June 16, 1975*

Respondents are 57 residents of Co-op City, a massive cooperative housing project in New York City, organized, financed, and constructed under the New York Private Housing Finance Law (Mitchell-Lama Act). They brought this action on behalf of all the apartment owners and derivatively on behalf of the housing corporation, alleging, *inter alia*, violations of the antifraud provisions of the Securities Act of 1933 and of the Securities Exchange Act of 1934 (hereafter collectively Securities Acts), in connection with the sale to respondents of shares of the common stock of the cooperative housing corporation. Citing substantial increases in the tenants' monthly rental charges as a result of higher construction costs, respondents' claim centered on a Co-op City Information Bulletin issued in the project's initial stages, which allegedly misrepresented that the developers would absorb future cost increases due to such factors as inflation. Under the Mitchell-Lama Act, which was designed to encourage private developers to build low-cost cooperative housing, the State provides large, long-term low-interest mortgage loans and substantial tax exemptions, conditioned on step-by-step state supervision of the cooperative's development. Developers must agree to operate the facilities "on a nonprofit basis" and may lease apartments to only state-approved lessees whose incomes are below a certain level. The corporate petitioners in this case built, promoted, and presently control Co-op City: United Housing Foundation (UHF), a nonprofit membership corporation, in-

*Together with No. 74–647, *New York et al.* v. *Forman et al.*, also on certiorari to the same court.

Syllabus

tiated and sponsored the project; Riverbay, a nonprofit cooperative housing corporation, was organized by UHF to own and operate the land and buildings and issue the stock that is the subject of the instant action; and Community Securities, Inc. (CSI), UHF's wholly owned subsidiary, was the project's general contractor and sales agent. To acquire a Co-op City apartment a prospective purchaser must buy 18 shares of Riverbay stock for each room desired at $25 per share. The shares cannot be transferred to a nontenant, pledged, encumbered, or bequeathed (except to a surviving spouse), and do not convey voting rights based on the number owned (the residents of each apartment having one vote). On termination of occupancy a tenant must offer his stock to Riverbay at $25 per share, and in the unlikely event that Riverbay does not repurchase, the tenant cannot sell his shares for more than their original price, plus a fraction of the mortgage amortization that he has paid during his tenancy, and then only to a prospective tenant satisfying the statutory income eligibility requirements. Under the Co-op City lease arrangement the resident is committed to make monthly rental payments in accordance with the size, nature, and location of the apartment. The Securities Acts define a "security" as "any . . . stock, . . . investment contract, . . . or, in general, any instrument commonly known as a 'security.'" Petitioners moved to dismiss the complaint for lack of federal jurisdiction, maintaining that the Riverbay stock did not constitute securities as thus defined. The District Court granted the motion to dismiss. The Court of Appeals reversed, holding that (1) since the shares purchased were called "stock" the definitional sections of the Securities Acts were literally applicable and (2) the transaction was an investment contract under the Securities Acts, there being a profit expectation from rental reductions resulting from (i) the income produced by commercial facilities established for the use of Co-op City tenants; (ii) tax deductions for the portion of monthly rental charges allocable to interest payments on the mortgage; and (iii) savings based on the fact that Co-op City apartments cost substantially less than comparable nonsubsidized housing. *Held:* The shares of stock involved in this litigation do not constitute "securities" within the purview of the Securities Acts, and since respondents' claims are not cognizable in federal court, the District Court properly dismissed their complaint. Pp. 8–18.

Syllabus

(a) When viewed as they must be in terms of their substance (the economic realities of the transaction) rather than their form, the instruments involved here were not shares of stock in the ordinary sense of conferring the right to receive "dividends contingent upon an apportionment of profits," *Tcherepnin* v. *Knight*, 389 U. S. 332, 339, with the traditional characteristics of being negotiable, subject to pledge or hypothecation, conferring voting rights proportional to the number of shares owned, and possibility of appreciating in value. On the contrary, these instruments were purchased not for making a profit, but for acquiring subsidized low-cost housing. Pp. 8–12.

(b) A share in Riverbay does not constitute an "investment contract" as defined by the Securities Acts, a term which, like the term "any instrument commonly known as a security," involves investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. Here neither of the kinds of profits traditionally associated with securities were offered to respondents; instead, as indicated in the Information Bulletin, which stressed the "non-profit" nature of the project, the focus was upon the acquisition of a place to live. Pp. 12–15.

(c) Deductibility for tax purposes of the portion of rental charges applied to interest on the mortgage (benefits generally available to home mortgagors) are not "profits," and, in any event, do not derive from the efforts of third parties. Pp. 15–16.

(d) Low rent attributable to state financial subsidies no more embodies income or profit attributes than other types of government subsidies. P. 16.

(e) Such income as might derive from Co-op City's leasing of commercial facilities within the housing project to be used to reduce tenant rentals (the prospect of which was never mentioned in the Information Bulletin) is too speculative and insubstantial to bring the entire transaction within the Securities Acts. These facilities were established, not for profit purposes, but to make essential services available to residents of the huge complex. Pp. 16–18.

500 F. 2d 1246, reversed.

POWELL, J., delivered the opinion of the Court, in which BURGER, C. J., and STEWART, MARSHALL, BLACKMUN, and REHNQUIST, JJ., joined. BRENNAN, J., filed a dissenting opinion, in which DOUGLAS and WHITE, JJ., joined.

SUPREME COURT OF THE UNITED STATES

Nos. 74–157 AND 74–647

United Housing Foundation, Inc., et al., Petitioners,
74–157 *v.*
Milton Forman et al.

State of New York and the New York State Housing Finance Agency, Petitioners,
74–647 *v.*
Milton Forman et al.

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit.

[June 16, 1975]

MR. JUSTICE POWELL delivered the opinion of the Court.

The issue in this case is whether shares of stock entitling a purchaser to lease an apartment in Co-Op City, a state subsidized and supervised nonprofit housing cooperative, are "securities" within the purview of the Securities Act of 1933 and the Securities Exchange Act of 1934.

I

Co-Op City is a massive housing cooperative in New York City. Built between 1965 and 1971, it presently houses approximately 50,000 people on a 200-acre site containing 35 high rise buildings and 236 town houses. The project was organized, financed, and constructed under the New York State Private Housing Finance Law,

commonly known as the Mitchell-Lama Act, enacted to ameliorate a perceived crisis in the availability of decent low-income urban housing. In order to encourage private developers to build low-cost cooperative housing, New York provides them with large long-term, low-interest mortgage loans and substantial tax exemptions. Receipt of such benefits is conditioned on a willingness to have the State review virtually every step in the development of the cooperative. See N. Y. Private Housing Finance Law §§ 11–37, as amended, (McKinney Supp. 1974–1975). The developer also must agree to operate the facility "on a nonprofit basis," *id.*, at § 11–a (2a), and he may lease apartments only to people whose incomes fall below a certain level and who have been approved by the State.[1]

The United Housing Foundation (UHF), a nonprofit membership corporation established for the purpose of "aiding and encouraging" the creation of "adequate, safe and sanitary housing accommodations for wage earners and other persons of low and moderate income," [2] Appendix, at 95a, was responsible for initiating and sponsoring the development of Co-Op City. Acting under the Mitchell-Lama Act, UHF organized the Riverbay Corporation (Riverbay) to own and operate the land and buildings constituting Co-Op City. Riverbay, a nonprofit cooperative housing corporation, issued the stock that is the subject of this litigation. UHF also con-

[1] Eligibility is limited to families whose monthly income does not exceed six times the monthly rental charge (or for families of four or more, seven times the rental charge). N. Y. Private Housing Finance Law § 31 (2)(a) (McKinney Supp. 1974–1975). Preference in admission must be given to veterans, the handicapped, and the elderly. *Id.*, at § 31 (7)–(9).

[2] UHF is composed of labor unions, housing cooperatives, and civic groups. It has sponsored the construction of several major housing cooperatives in New York City.

tracted with Community Services, Inc. (CSI), its wholly owned subsidiary, to serve as the general contractor and sales agent for the project.[3] As required by the Mitchell-Lama Act, these decisions were approved by the State Housing Commissioner.

To acquire an apartment in Co-Op City an eligible prospective purchaser must buy 18 shares of stock in Riverbay for each room desired. The cost per share is $25, making the total cost $450 per room, or $1,800 for a four-room apartment. The sole purpose of acquiring these shares is to enable the purchaser to occupy an apartment in Co-Op City; in effect, their purchase is a recoverable deposit on an apartment. The shares are explicitly tied to the apartment: they cannot be transferred to a nontenant; nor can they be pledged or encumbered; and they descend, along with the apartment, only to a surviving spouse. No voting rights attach to the shares as such: participation in the affairs of the cooperative appertains to the apartment, with the residents of each apartment being entitled to one vote irrespective of the number of shares owned.

Any tenant who wants to terminate his occupancy, or who is forced to move out,[4] must offer his stock to Riverbay at its initial selling price of $25 per share. In the extremely unlikely event that Riverbay declines to repurchase the stock,[5] the tenant cannot sell it for more than

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[3] CSI is a business corporation that has acted as the contractor on several UHF-sponsored housing cooperatives.

[4] A tenant can be forced to move out if he violates the provisions of his "occupancy agreement," which is essentially a lease for the apartment, or if his income grows to exceed the eligibility standards.

[5] To date every family that has withdrawn from Co-Op City has received back its initial payment in full. Indeed, at the time this suit was filed there were 7,000 families on the waiting list for apartments in this cooperative. In addition, a special fund of nearly

the initial purchase price plus a fraction of the portion of the mortgage that he has paid off, and then only to a prospective tenant satisfying the statutory income eligibility requirements. See N. Y. Private Housing Finance Law § 31–a (McKinney Supp. 1974–1975).

In May 1965, subsequent to the completion of the initial planning, Riverbay circulated an Information Bulletin seeking to attract tenants for what would someday be apartments in Co-Op City. After describing the nature and advantages of cooperative housing generally and of Co-Op City in particular, the Bulletin informed prospective tenants that the total estimated cost of the project, based largely on an anticipated construction contract with CSI, was $283,695,550. Only a fraction of this sum, $32,795,550, was to be raised by the sale of shares to tenants. The remaining $250,900,000 was to be financed by a 40-year low-interest mortgage loan from the New York Private Housing Finance Agency. After construction of the project the mortgage payments and current operating expenses would be met by monthly rental charges paid by the tenants. While these rental charges were to vary, depending on the size, nature, and location of an apartment, the 1965 Bulletin estimated that the "average" monthly cost would be $23.02 per room, or $92.08 for a four-room apartment.

Several times during the construction of Co-Op City, Riverbay, with the approval of the State Housing Commissioner, revised its contract with CSI to allow for increased construction costs. In addition, Riverbay incurred other expenses that had not been reflected in the 1965 Bulletin. To meet these increased expenditures, Riverbay, with the Commissioner's approval, repeatedly

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$1 million had been established by small monthy contributions from all tenants to insure that those wanting to move out would receive full compensation for their shares.

secured increased mortgage loans from the State Housing Agency. Ultimately the construction loan was $125 million more than the figure estimated in the 1965 Bulletin. As a result, while the initial purchasing price remained at $450 per room, the average monthly rental charges increased periodically, reaching a figure of $39.68 per room as of July 1974.[6]

These increases in the rental charges precipitated the present lawsuit. Respondents, 57 residents of Co-Op City, sued in federal court on behalf of all 15,372 apartment owners, and derivatively on behalf of Riverbay, seeking upwards of $30 million in damages, forced rental reductions, and other "appropriate" relief. Named as defendants (petitioners herein) were UHF, CSI, Riverbay, several individual directors of these organizations, the State of New York, and the State Private Housing Finance Agency. The heart of respondents' claim was that the 1965 Co-Op City Information Bulletin falsely represented that CSI would bear all subsequent cost increases due to factors such as inflation. Respondents further alleged that they were misled in their purchases of shares since the Information Bulletin failed to disclose several critical facts.[7] On these bases,

[6] As the rental charges increased, the income eligibility requirements for residents of Co-Op City expanded accordingly. See n. 1, *supra*.

[7] Respondents maintained that the following material facts were omitted: (i) the original estimated cost had never been adhered to in any of the previous Mitchell-Lama projects sponsored by UHF and built by CSI; (ii) petitioners knew that the initial estimate would not be followed in the present project; (iii) CSI was a wholly owned subsidiary of UHF; (iv) CSI's net worth was so small that it could not have been legally held to complete the contract within the original estimated costs; (v) the State Housing Commissioner had waived his own rule regarding liquidity requirements in approving CSI as the contractor; and (vi) there was an additional undisclosed contract between CSI and Riverbay.

respondents asserted two claims under the fraud provisions of the federal Securities Acts of 1933 and 1934, 15 U. S. C. § 77q (a); 15 U. S. C. § 78j (b), and 17 CFR § 240.10b–5. They also presented a claim against the State Financing Agency under the Civil Rights Act, 42 U. S. C. § 1983, and 10 pendent state law claims.

Petitioners, while denying the substance of these allegations,[8] moved to dismiss the complaint on the ground that federal jurisdiction was lacking. They maintained that shares of stock in Riverbay were not "securities" within the definitional sections of the federal Securities Acts. In addition, the state parties moved to dismiss on sovereign immunity grounds.

The District Court granted the motion to dismiss. 366 F. Supp. 1117 (1973). It held that the denomination of the shares in Riverbay as "stock" did not, by itself, make them securities under the federal Acts. The court further ruled, relying primarily on this Court's decisions in *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344 (1943), and *SEC* v. *W. J. Howey Co.*, 328 U. S. 293 (1946), that the purchase in issue was not a security transaction since it was neither induced by an offer of tangible material profits, nor could such profits realistically be expected. In the District Court's words, it was "the fundamental nonprofit nature of this transaction" which presented "the insurmountable barrier to [respondents'] claims in th[e] federal court." *Id.*, at 1128.[9]

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[8] Petitioners asserted that the Information Bulletin warned purchasers of the possibility of rental increases, and denied that it omitted material facts. They also argued that prior to occupancy all tenants were informed that rental charges had increased. In any event, petitioners claimed that respondents have suffered no damages since they may move out and retrieve their initial investments in full.

[9] The District Court also dismissed the § 1983 claim finding that the "federal securities allegations represent the only well-pleaded underlying basis for jurisdiction under the Civil Rights Act." *Id.*,

The Court of Appeals for the Second Circuit reversed. 500 F. 2d 1246 (1974). It rested its decision on two alternative grounds. First, the court held that since the shares purchased were called "stock" the Securities Acts, which explicitly include "stock" in their definitional sections, were literally applicable. Second, the Court of Appeals concluded that the transaction was an investment contract within the meaning of the Acts and as defined by *Howey*, since there was an expectation of profits from three sources: (i) rental reductions resulting from the income produced by the commercial facilities established for the use of tenants at Co-Op City; (ii) tax deductions for the portion of the monthly rental charges allocable to interest payments on the mortgage; and (iii) savings based on the fact that apartments at Co-Op City cost substantially less than comparable nonsubsidized housing. The court further ruled that the immunity claims by the State parties were unavailing.[10] Accordingly, the case was remanded to the District Court for consideration of respondents' claims on the merits.

In view of the importance of the issues presented we granted certiorari. 419 U. S. 1120 (1975). As we conclude that the disputed transactions are not purchases of securities within the contemplation of the federal statutes, we reverse.

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at 1132. In view of these rulings the court did not reach the sovereign immunity claims.

[10] The Circuit Court held that the State Agency was independent and distinct from the State itself and therefore was a "person" for purposes of § 1983, that both the Agency and the State had waived immunity under § 32 (5) of the Private Housing Finance Law, and that the State had also implicitly waived its immunity by voluntarily participating in the sale of securities, an area subject to plenary federal regulation. See *Parden* v. *Terminal Ry. of Alabama Docks Dept.*, 377 U. S. 184 (1964). In view of our disposition of this case we do not reach these issues.

II

The Securities Act of 1933, 15 U. S. C. § 77b (1), defines a "security" as

> "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." [11]

In providing this definition Congress did not attempt to articulate the relevant economic criteria for distinguishing "securities" from "non-securities." Rather it sought to define "the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H. R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933). The task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes.

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[11] The definition of a security in the 1934 Act is virtually identical and, for present purposes, the coverage of the two Acts may be considered the same. See *Tcherepnin* v. *Knight*, 389 U. S. 332, 336, 342 (1967); S. Rep. No. 792, 73d Cong., 2d Sess., 14 (1934).

In making this determination in the present case we do not write on a clean slate. Well-settled principles enunciated by this Court establish that the shares purchased by respondents do not represent any of the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits," *Howey, supra,* 328 U. S., at 299, and therefore do not fall within "the ordinary concept of a security."

A

We reject at the outset any suggestion that the present transaction, evidenced by the sale of shares called "stock," [13] must be considered a security transaction simply because the statutory definition of a security includes the words "any . . . stock." Rather we adhere to the basic principle that has guided all of the Court's decisions in this area:

> "[I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin* v. *Knight,* 389 U. S. 332, 336 (1967). See also *Howey, supra,* 328 U. S., at 298.

The primary purpose of the Securities Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the

[13] While the record does not indicate precisely why the term stock was used for the instant transaction, it appears that this form is generally used as a matter of tradition and convenience. See P. Rohan & M. Reskin, Cooperative Housing Law & Practice § 2.01 (4) (1973).

interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto. Thus, in construing these Acts against the background of their purpose, we are guided by a traditional canon of statutory construction:

> "that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers." *Church of the Holy Trinity* v. *United States*, 143 U. S. 457, 459 (1892). See also *United States* v. *American Trucking Assns., Inc.*, 310 U. S. 534, 543 (1940).[13]

Respondents' reliance on *Joiner* as support for a "literal approach" to defining a security is misplaced. The issue in *Joiner* was whether assignments of interests in oil leases, coupled with the promoters' offer to drill an exploratory well, were securities. Looking to the economic inducement provided by the proposed exploratory well, the Court concluded that these leases were securities even though "leases" as such were not included in the list of instruments mentioned in the statutory definition. In dictum the Court noted that "[i]nstruments *may* be included within [the definition of a security], as [a] matter of law, if on their face they answer to the

[13] With the exception of the Second Circuit, every court of appeals recently to consider the issue has rejected the literal approach urged by respondents. See *C. N. S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F. 2d 1354 (CA7 1975); *McClure* v. *First National Bank of Lubbock*, 497 F. 2d 490 (CA5 1974), cert. denied, 420 U. S. 930 (1975); *Lino* v. *City Investing Co.*, 487 F. 2d 689 (CA3 1973). See also 1 L. Loss, Securities Regulation 493 (2d ed. 1961) ("substance governs rather than form: . . . just as some things which look like real estate are securities, some things which look like securities are real estate.").

name or description." 320 U. S., at 351 (emphasis supplied). And later, again in dictum, the Court stated that a security "*might*" be shown "by proving the document itself, which on its face would be a note, a bond or a share of stock." *Id.*, at 355 (emphasis supplied). By using the conditional words "may" and "might" in these dicta the Court made clear that it was not establishing an inflexible rule barring inquiry into the economic realities underlying a transaction. On the contrary, the Court intended only to make the rather obvious point that, in contrast to the instrument before it which was not included within the explicit statutory terms, most instruments bearing these traditional titles are likely to be covered by the statutes.[14]

In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

In the present case respondents do not contend, nor could they, that they were misled by use of the word "stock" into believing that the federal securities laws governed their purchase. Common sense suggests that peo-

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[14] Nor can respondents derive any support for a literal approach from *Tcherepnin* v. *Knight*, *supra*, which quoted the *Joiner* dictum. Indeed in *Tcherepnin* the Court explicitly stated that "form should be disregarded for substance," *id.*, at 336, and only after analyzing the economic realities of the transaction at issue did it conclude that an instrument called a "withdrawable capital share" was, in substance, an "investment contract," a share of "stock," a "certificate of interest or participation in a profit sharing agreement," and a "transferable share."

ple who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock. These shares have none of the characteristics "that in our commercial world fall within the ordinary concept of a security." H. R. Rep. No. 85, *supra*, at 11. Despite their name, they lack what the Court in *Tcherepnin* deemed the most common feature of stock: the right to receive "dividends contingent upon an apportionment of profits." 389 U. S., at 339. Nor do they possess the other characteristics traditionally associated with stock: they are not negotiable; they cannot be pledged or hypothecated; they confer no voting rights in proportion to the number of shares owned; and they cannot appreciate in value. In short, the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit.

B

The Court of Appeals, as an alternative ground for its decision, concluded that a share in Riverbay was also an "investment contract" as defined by the Securities Acts. Respondents further argue that in any event what they agreed to purchase is "commonly known as a 'security' " within the meaning of these laws. In considering these claims we again must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an "investment contract" and an "instrument commonly known as a security." In either case, the basic test for distinguishing the transaction from other commercial dealings is

"whether the scheme involves an investment of

> money in a common enterprise with profits to come solely from the efforts of others." *Howey, supra,* 328 U. S., at 301.[15]

This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, as in *Joiner, supra* (sale of oil leases conditioned on promoters' agreement to drill exploratory well), or a participation in earnings resulting from the use of investors' funds, as in *Tcherepnin* v. *Knight, supra* (dividends on the investment based on savings and loan association's profits). In such cases the investor is "attracted solely by the prospects of a return" on his investment. *Howey, supra,* 328 U. S., at 300. By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or to develop it themselves," as the *Howey* Court put it, 328 U. S., at 300—the securities laws do not apply.[16] See also *Joiner, supra.*[17]

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[15] This test speaks in terms of "profits to come *solely* from the efforts of others." (Emphasis supplied.) Although the issue is not presented in this case, we note that the Court of Appeals for the Ninth Circuit has held that "the word 'solely' should not be read as a strict or literal limitation of the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities." *SEC* v. *Glenn Turner Enterprises, Inc.,* 474 F. 2d 476, 482 (1973), cert. denied, 414 U. S. 821 (1973). We express no view, however, as to the holding of this case.

[16] In some transactions the investor is offered both a commodity or real estate for use and an expectation of profits. See SEC Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973). See generally

[*Footnote 17 is on p. 14*]

In 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. The Information Bulletin distributed to prospective residents emphasized the fundamental nature and purpose of the undertaking:

> "A cooperative is a nonprofit enterprise owned and controlled democratically by its members—the people who are using its services. . . .
>
> "People find living in a cooperative community enjoyable for more than one reason. Most people join, however, for the simple reason that it is a way to obtain decent housing at a reasonable price. However, there are other advantages. The purpose of a cooperative is to provide home ownership, not just apartments to rent. The community is designed to provide a favorable environment for family and community living. . . .
>
> "The common bond of collective ownership which you share makes living in a cooperative different. It is a community of neighbors. Home ownership,

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Rohan, The Securities Law Implications of Condominium Marketing Programs Which Feature a Rental Agency or Rental Pool, 2 Conn. L. Rev. 1 (1969). The application of the federal securities laws to these transactions may raise difficult questions that are not present in this case.

[17] In *Joiner*, the Court stated:

"Undisputed facts seem to us, however, to establish the conclusion that defendants were not, as a practical matter, offering naked leasehold rights. Had the offer mailed by defendants omitted the economic inducements of the proposed and promised exploration well, it would have been quite a different proposition." 320 U. S., at 348.

This distinction was critical because the exploratory drillings gave the investments "most of their value and all of their lure." *Id.*, at 349. The land itself was purely an incidental consideration in the transaction.

> common interests and the community atmosphere make living in a cooperative like living in a small town. As a rule there is very little turnover in a cooperative." Appendix, at 162a–166a.

Nowhere does the Bulletin seek to attract investors by the prospect of profits resulting from the efforts of the promoters or third parties. On the contrary, the Bulletin repeatedly emphasizes the "nonprofit" nature of the endeavor. It explains that if rental charges exceed expenses the difference will be returned as a rebate, not invested for profit. It also informs purchasers that they will be unable to resell their apartments at a profit since the apartment must first be offered back to Riverbay "at the price . . . paid for it." [18] *Id.*, at 162a. In short, neither of the kinds of profits traditionally associated with securities were offered to respondents.

The Court of Appeals recognized that there must be an expectation of profits for these shares to be securities, and conceded that there is "no possible profit on a resale of [this] stock." 500 F. 2d, at 1254. The court correctly noted, however, that profit may be derived from the income yielded by an investment as well as from capital appreciation, and then proceeded to find "an expectation of 'income' in at least three ways." *Ibid.* Two of these supposed sources of income or profits may be disposed of summarily. We turn first to the Court of Appeals' reliance on the deductibility for tax purposes of the portion of the monthly rental charge applied to

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[18] This requirement effectively insures that no apartment will be sold for more than its original cost. Consonant with the purposes of the Mitchell-Lama Act, whenever there are prospective buyers willing to pay as much as the initial purchase price for an apartment in Co-Op City, Riverbay will repurchase the apartment and resell it at its original cost. See Appendix, at 138a. If, for some reason, Riverbay does not purchase the apartment the tenant still cannot make a profit on his sale. See pp, 3–4, *supra*.

interest on the mortgage. We know of no basis in law for the view that the payment of interest, with its consequent deductibility for tax purposes, constitutes income or profits.[19] These tax benefits are nothing more than that which is available to any homeowner who pays interest on his mortgage. See Internal Revenue Code, 26 U. S. C. § 216; *Eckstein* v. *United States*, 452 F. 2d 1036 (Ct. Cl. 1971).

The Court of Appeals also found support for its concept of profits in the fact that Co-Op City offered space at a cost substantially below the going rental charges for comparable housing. Again, this is an inappropriate theory of "profits" that we cannot accept. The low rent derives from the substantial financial subsidies provided by the State of New York. This benefit cannot be liquidated into cash; nor does it result from the managerial efforts of others. In a real sense, it no more embodies the attributes of income or profits than do welfare benefits, food stamps or other government subsidies.

The final source of profit relied on by the Court of Appeals was the possibility of net income derived from the leasing by Co-Op City of commercial facilities, professional offices and parking spaces, and its operation of community washing machines. The income, if any, from these conveniences, all located within the common areas of the housing project, is to be used to reduce tenant rental costs. Conceptually, one might readily agree that net income from the leasing of commercial and professional facilities is the kind of profit tra-

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[19] Even if these tax deductions were considered profits, they would not be the type associated with a security investment since they do not result from the managerial efforts of others. See Rosenbaum, The Resort Condominium and the Federal Securities Law—A Case Study in Governmental Inflexibility, 60 Va. L. Rev. 785, 795–796 (1974); Casenote, 62 Georgetown L. Rev. 1515, 1524–1526 (1974).

ditionally associated with a security investment.[20] See *Tcherepnin* v. *Knight, supra.* But in the present case this income—if indeed there is any—is far too speculative and insubstantial to bring the entire transaction within the Securities Acts.

Initially we note that the prospect of such income as a means of offsetting rental costs is never mentioned in the Information Bulletin. Thus it is clear that investors were not attracted to Co-Op City by the offer of these potential rental reductions. See *Joiner, supra,* 320 U. S., at 353. Moreover, nothing in the record suggests that the facilities in fact return a profit in the sense that the leasing fees are greater than the actual cost to Co-Op City of the space rented.[21] The short of the matter is that the stores and services in question were established not as a means of returning profits to tenants, but for the purpose of making essential services available for the residents of this enormous complex.[22] By statute these facilities can only be "incidental and appurtenant" to the

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[20] The "income" derived from the rental of parking spaces and the operation of washing machines clearly was not profit for respondents since these facilities were provided exclusively for the use of tenants. Thus when the income collected from the use of these facilities exceeds the cost of their operation the tenants simply receive the return of the initial overcharge in the form of a rent rebate. Indeed, it could be argued that the "income" from the commercial and professional facilities is also, in effect, a rebate on the cost of goods and services purchased at these facilities since it appears likely that they are patronized almost exclusively by Co-Op City residents. See Casenote, 53 Tex. L. Rev. 623, 630–631 n. 38 (1975).

[21] The Court of Appeals quoted the gross rental income received from these facilities. But such figures by themselves are irrelevant since the record does not indicate the cost to Co-Op City of providing and maintaining the rented space.

[22] See generally Miller, Cooperative Apartments: Real Estate or Securities? 45 B. U. L. Rev. 464, 500 (1965).

housing project. N. Y. Private Housing Law § 12 (5) (McKinney Supp. 1974–1975). Undoubtedly they make Co-Op City a more attractive housing opportunity, but the possibility of some rental reduction is not an "expectation of profit" in the sense found necessary in *Howey*.[23]

There is no doubt that purchasers in this housing cooperative sought to obtain a decent home at an attractive price. But that type of economic interest characizes every form of commercial dealing. What distinguishes a security transaction—and what is absent

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[23] Respondents urge us to abandon the element of profits in the definition of securities and to adopt the "risk capital" approach articulated by the California Supreme Court in *Silver Hills Country Club* v. *Sobieski*, 55 Cal. 2d 811, 361 P. 2d 906 (1961). Cf. *El Khadem* v. *Equity Securities Corp.*, 494 F. 2d 1224 (CA9 1974), cert. denied, 419 U. S. 900 (1974). See generally Coffey, The Economic Realities of a "Security": Is There a More Meaningful Formula?, 18 Case W. Res. L. Rev. 367 (1967); Long, An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation, 24 Okla. L. Rev. 135 (1971); Hannan & Thomas, The Importance of Economic Reality and Risk in Defining Federal Securities, 25 Hast. L. Rev. 219 (1973). Even if we were inclined to adopt such a "risk capital" approach we would not apply it in the present case. Purchasers of apartments in Co-Op City take no risk in any significant sense. If dissatisfied with their apartments, they may recover their initial investment in full. See n. 5, *supra*.

Respondents assert that if Co-Op City becomes bankrupt they stand to lose their whole investment. But, in view of the fact that the State has financed over 92% of the cost of construction and carefully regulates the development and operation of the project, bankruptcy in the normal sense is an unrealistic possibility. In any event, the risk of insolvency of an ongoing housing cooperative "differ[s] vastly" from the kind of risk of "fluctuating" value associated with securities investments. *SEC.* v. *Variable Annuity Life Insurance Co.*, 359 U. S. 65, 90–91 (1959) (BRENNAN, J., concurring). See Hannan & Thomas, *supra*, at 242–249; Long, Introduction to Symposium: Interpreting The Statutory Definition of a Security: Some Pragmatic Considerations, 6 St. Mary's L. J. 96, 126–128 (1974).

here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use.[24]

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[24] The SEC has filed an amicus brief urging us to hold the federal securities laws applicable to this case. Traditionally the views of an agency charged with administering the governing statute would be entitled to considerable weight. See, *e. g.*, *Saxbe* v. *Bustos*, 419 U. S. 65, 74 (1974); *Investment Company Institute* v. *Camp*, 401 U. S. 617, 626–627 (1971). But in this case the SEC's position flatly contradicts what appears to be a rather careful statement of the Commission's views in a recent release. In Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973), applicable to "the sale of condominium units and other units in a real estate development," the SEC stated its view that only those real estate investments that are "offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter," are to be considered securities. *Id.*, at 1736. In particular, the Commission explained that the Securities Acts do not apply when "commercial facilities are a part of the common elements of a residential project" if

"(a) the income from such facilities is used only to offset common area expenses and (b) the operation of such facilities is incidental to the project as a whole and are not established as a primary income source for the individual owners of a condominium or cooperative unit." *Ibid.*

See also SEC Real Estate Advisory Committee Report 74-91 (1972); Dickey & Thorpe, Federal Security Regulation of Condominium Offerings, 19 N. Y. L. F. 473 (1974).

Several commentators have noted the inconsistency between the SEC's position in the above release and the decision by the Court of Appeals in this case, which the SEC now supports. See Berman & Stone, Federal Securities Law and the Sale of Condominiums, Homes and Homesites, 30 Bus. Law. 411, 420–425 (1975); Note, Condominium Regulation: Beyond Disclosure, 123 U. Pa. L. Rev. 639, 654–655 (1975); Casenote, *supra*, n. 20, at 628. In view of this unexplained contradiction in the Commission's position we accord no special weight to its views. See *Reliance Electric Co.* v. *Emerson*

III

In holding that there is no federal jurisdiction, we do not address the merits of respondents' allegations of fraud. Nor do we indicate any view as to whether the type of claims here involved should be protected by federal regulation.[25] We decide only that the type of transaction before us, in which the purchasers were interested in acquiring housing rather than making an investment for profit, is not within the scope of the federal securities laws.

Electric Co., 404 U. S. 418, 426 (1972); *Blue Chip Stamps* v. *Manor Drug Stores*, — U. S. — (1975) (slip op., at 22–23, n. 10).

[25] It has been suggested that the sale of housing developments such as condominiums and cooperatives is in need of federal regulation and therefore the securities laws should be construed or amended to reach these transactions. See, *e. g.*, Note, Federal Securities Regulations of Condominiums: A Purchaser's Perspective, 62 Georgetown L. J. 1403 (1974); Note, Cooperative Housing Corporations and the Federal Securities Laws, 71 Colum. L. Rev. 118 (1971). Others have disagreed, claiming that the extensive body of regulation developed over more than four decades under these Acts would be inappropriate and unduly costly to the sellers and buyers of residential housing. See Berman & Stone, *supra*, n. 24; Casenote, *supra*, n. 20. Moreover, extension of the securities laws to real estate transactions would involve important questions as to the appropriate balance between state and federal responsibility. The determination of whether and in what manner federal regulation may be required for housing transactions, where the characteristics of an investment in securities are not present, is better left to the Congress, which can assess both the costs and benefits of any such regulation. Indeed only recently Congress instructed the Secretary of Housing and Urban Development "to conduct a full and complete investigation and study . . . with respect to . . . the problems, difficulties and abuses or potential abuses applicable to condominium and cooperative housing." Pub. L. 93-383, 88 Stat. 740 (Aug. 22, 1974). See also Real Estate Settlement Procedures Act, Pub. L. No. 93-533 (Dec. 22, 1974); Interstate Land Sales Full Disclosure Act, 15 U. S. C. §§ 1701–1720.

Since respondents' claims are not cognizable in federal court, the District Court properly dismissed their complaint.[26] The judgment below is therefore

Reversed.

[26] Besides the Securities Acts claims, respondents also included a vague and conclusory allegation under 42 U. S. C. § 1983 against petitioner, the New York State Housing Finance Agency. We agree with the District Court that this count must also be dismissed. See n. 9, *supra*. The remaining counts in the complaint were all predicated on alleged violations of state law, not independently cognizable in federal court.