Republic of the Philippines
Securities and Exchange Commission
SEC Bldg., EDSA, Greenhills, Mandaluyong City

26 January 2011

SEC Opinion No. 11-05
Assignment of Rights Over
Condotel Units

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Sir:

This refers to your letter dated 23 December 2010 requesting our opinion on whether or not the assignment of leasehold rights over condominium-hotel project units ("condotel units") for valuable consideration is considered a "sale of securities" under the Securities Regulation Code (SRC)[1]. You also asked for our opinion on whether or not there is a statutorily mandated procedure to be followed that would ensure a six percent (6%) annual return on investment as well as the return of the whole investment at the end of the lease term.

Please note that Securities and Exchange Commission ("SEC") Opinion No. 10-03 dated 27 January 2010 referred to in your letter was premised on the following facts:

1. Thunderbird Resorts, Inc. ("TRI") entered into a Lease Agreement dated 15 August 2006 with the Bases Conversion Development Authority ("BCDA") and the Poro Point Management Corporation ("PPMC") for the development, operation and management of a 65.5-hectare parcel of land located within the Poro Point Freeport Zone in the province of La Union ("Leased Property").

[1] Republic Act No. 8799 (2000).

2. Subsequently, TRI assigned all its rights and obligations under the Lease Agreement to Thunderbird Pilipinas Hotel and Resorts, Inc. ("TPHRI").

3. A portion of the Leased Property was designated for the development of a residential estate project consisting of subdivided lots on which resort-style residences shall be built.

4. TPHRI shall assign its leasehold rights over the subdivided lots to individual assignees for valuable consideration. Under this arrangement, the individual assignees shall have the right to use, occupy and develop the lot/s assigned to them for a specified period.

Based on the above facts, we opined that the assignment of leasehold rights is not considered a "sale of securities" under Section 3.1 of the SRC. The opinion pertinently provides:

> "From the foregoing definition, this Office is of the opinion that the assignment of leasehold rights in this particular transaction does not fall within the definition of securities. The quoted phrase "shares, participation or interest in a corporation or in a commercial enterprise or profit-making venture" refers to, and is suggestive of equity securities. Applying the foregoing in this case, leasehold rights on subdivided portions of the property are not considered as securities as such are not shares, participation or interest in a corporation and even investments in an enterprise. By the assignment of leasehold rights for a valuable consideration, Thunderbird does not acquire shares, participation or interest in BCDA. In turn, the individual assignees only acquire the rights of the assignor to possess and enjoy the subdivided lots for a limited period with the option to construct resort-style residences within three (3) years on such property. In other words, Thunderbird is merely assigning the rights, and not shares or interest in a corporation to develop the property.
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> As correctly pointed out in your letter-query, the assignment of leasehold rights by assignor TRI to assignee Thunderbird may not be deemed as an **investment contract**. In the landmark case of *SEC vs. W.J. Howey Co.,* the Court established the tripartite test to determine whether a particular financial instrument constitutes an investment contract, namely: (1) the investment of money, (2) in a common enterprise, and (3) with an expectation of profits to be derived solely from the efforts of the promoter or a third party. After a careful scrutiny of the nature of the transaction, we opine that there is no investment of money. The consideration paid by Thunderbird pursuant to the Deed of Assignment of Leasehold Rights is not an investment of money to a common enterprise. It is a consideration for the transfer of rights acquired by TRI from BCDA to possess, enjoy and develop the property for a period of forty four (44) years, after which the same

property including its improvements shall be reverted back to BCDA. Further, the transaction is not for the purpose of generating profits from the efforts of others. It is worthy of note that the assignment of leasehold rights to Thunderbird grants them the authority to develop the assigned subdivided portion by building resort-style residences at its own expense, with the privilege of possessing and enjoying the said property including the improvements and the profits thereof for a limited period. Meanwhile, during the existence of the leasehold agreement, the BCDA shall not be entitled to the proceeds of the income from the leased property, but shall regain possession of the said property including the improvements after the expiration of such agreement."

The instant request, however, involves a different set of facts that warrants a different opinion.

In your letter, you stated that TPHRI plans to expand the real estate component of the lease through the development of a condotel project. Under the project, TPHRI will build condotel units, which shall then be assigned to interested assignees for valuable consideration. You likewise stated that under this proposed scheme, the assignees shall be assured of a six percent (6%) annual return on the contract price regardless of whether or not the assigned condotel units yield any revenue, plus the return of the principal contract price upon the expiration of the lease between TPHRI and BCDA/PPMC.

We again call your attention to the definition of "securities" under Section 3.1 of the SRC, to wit:

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

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

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

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

(d) Derivatives like option and warrants;

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

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

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

The above-quoted provision is derived from Section 2(a) of the Revised Securities Act[2], which defined "securities" as a non-exhaustive list that includes "investment contracts... and similar contracts and investments where there is no tangible return on investments plus profits but an appreciation of capital as well as enjoyment of particular privileges and services."

Moreover, the Implementing Rules and Regulations of the SRC ("IRR") define "investment contracts" as follows:

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

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

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

At this point, worth mentioning is the case of *In the Matter of Octopus Network, Inc.*[3], which discussed the nature of investment contracts as defined under the Revised Securities Act. Again, the tripartite test established in *SEC v. W.J. Howey Co.*[4] was used to determine whether an instrument or agreement constitutes an investment contract. The discussion therein pertinently provides:

"Parenthetically, considering that the RSA has been patterned after the American Uniform Sale of Securities and the Federal Securities Act of 1933, the Commission in order to fully address and resolve the issues involved has found persuasive the comments of the American authorities in the field of securities including the interpretation of aforesaid laws by the U.S. courts.

Admittedly, the definition of securities is extraordinarily broad. Included within the scope of "security" are such standard documents as

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[2] (1982).
[3] SEC-PED Case No. 98-2220, May 22, 1998.
[4] 328 U.S. 293 (1946).

stocks and bonds. Also included are instruments of a more variable character designated by such descriptive terms as "investment contract" and "in general any interest or instrument commonly known as "security". In particular, the term "*investment contract*" has been viewed by the courts as a *"catch all" phrase designed to encompass novel devices which serve the same purpose as a "security"* (Cary & Eisenberg Corp. 6th Ed. Concise UCB-22 p. 948)

In SEC vs. W.J. Howey Co., 328 U.S. 293 (1946), the U.S. Supreme Court established a definition of an investment contract as follows:

> "**An investment contract** for purposes of the Securities Act means **a contract, transaction or scheme** whereby **a person invests his money** in **a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party** . . ."

This definition was modified in SEC vs. Glenn Turner Enterprises, Inc. 474 F. 2d 476, 414 U.S. 821, 94. **In the modified test, 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** (69 Am Jur 2d p. 108).

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The phrase "*investment contract*" as enumerated under Sec. 2 of the RSA is taken from the Federal Securities Act. Said phrase or term as appearing in the Federal and Hawaii Securities Act is designed to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits. (infra)

It is clear that the term "*investment contract*" as interpreted in the Howey case was not limited to the existence of a mere agreement by and between the promoter and the investor. **It was given such a broad meaning as to include schemes for as long as it involves the use of the money of others on the promise of profits**. Moreover, a writing is not essential for an investment contract. (1 Loss, Securities Regulation 2d Ed 489.)" (emphasis ours)

Applying the foregoing to the instant case, it is clear that the agreement between TPHRI and the individual assignees whereby the money paid by the latter to the former shall earn a 6% annual return is an investment contract as defined by Section 3.1(b) of the SRC. With respect to the first element, the agreement involves an *investment of money*, which in this case, is the contract price to be paid by the individual assignees to TPHRI. As for the second element, the *common enterprise or profit-making venture* is the lease of the condotel units, which is expected to yield revenue. Finally, the third element of *expectation of profits from the efforts of the promoter or a third party* is clearly present, particularly the 6% return on capital to

the individual assignees regardless of revenue generated on the lease of the condotel units, and the lessees of which shall be procured by TPHRI.

On the basis of the foregoing, the assignment by TPHRI of leasehold rights over condotel units to individual assignees in exchange for a 6% return on capital invested therein plus the return of the original investment upon the expiration of the period of the lease is considered a "sale of securities" under the SRC that requires registration with the Commission.

Anent your second query, please be informed that there is no law or procedure in the Philippines that would guarantee a six percent return, or any other rate of return, to any type of investment.

The foregoing opinion rendered is based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission.[5]

VERNETTE G. UMALI-PACO
General Counsel

1/26/2011

[5] SEC Memorandum Circular No. 15, series of 2003.