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NO. 27635

IN THE INTERMEDIATE COURT OF APPEALS

OF THE STATE OF HAWAI'I

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CLERK, APPELLATE COURTS
STATE OF HAWAI'I

CONNIE Y. FONG,
Plaintiff/Counterclaim Defendant-Appellee,
v.
SEMIN OH, and MYUNG HUI OH,
Defendants/Counterclaimants/Cross-Claimants-Appellants,

and

CELIA OLAES BATLE, Defendant/Cross-Claim Defendant,

and

CLIFF ENTERPRISES, INC.; DAVID JON TAMURA;
ANNE JU TAMURA; RENATO VITO BATLE;
MICHAEL TAMURA; and DOES 1-100, Defendants

and

SEMIN OH, and MYUNG HUI OH,
Third Party Plaintiffs-Appellants,
v.
KEITH M. KIUCHI, Third-Party Defendant-Appellee

APPEAL FROM THE CIRCUIT COURT OF THE FIRST CIRCUIT
(CIVIL NO. 02-1-2007)

MEMORANDUM OPINION
(By: Burns, C.J., Foley and Fujise, JJ.)

Defendants/Counterclaimants/Cross-Claimants/Third Party Plaintiffs-Appellants Semin Oh (Semin) and Myung Hui Oh (Myung) appeal from the circuit court's[1] November 2, 2005 Final Judgment entered in favor of Plaintiff/Counterclaim Defendant-Appellee Connie Y. Fong (Fong).

[1] Judge Gary W.B. Chang presided.

BACKGROUND

In English, Myung passed both her driver's license test and her citizenship test and she testified at her deposition. Before making the purchase relevant to this case, Semin and Myung had operated the Eagle Bar in Kalihi for one year.

Defendant Cliff Enterprises, Inc., (CEI), an Hawai'i corporation, was the lessee of commercial premises at 152 North Pauahi Street, Honolulu, Hawai'i, owned a liquor license, and operated a liquor store at the leased premises.

In the opening brief, Semin and Myung state, in part:

> In mid-October, 2000, an agreement was entered into by Fong, [Michael] Tamura and [Defendant/Cross-Claim Defendant-Appellee Celia Olaes Batle (Celia)]. Pursuant to that agreement, Michael Tamura assigned 55% of the corporate stock of [CEI] to [Celia]. He also signed a second agreement, agreeing to convey the other 45% of the corporate stock to [Celia] when [Celia] paid off the debt owed to Fong. [CEI], [Celia], Ann Tamura, and Tamura's son, David Tamura, then signed a promissory note agreeing to pay Fong the sum of $280,000 in monthly payments of $8,000. This note was secured by three mortgages on real property owned by Ann Tamura and David Tamura and a mortgage on real property owned by [Celia] and her ex-husband. The note was also secured by a blanket security agreement signed by [CEI] and by a pledge of [Celia's] corporate stock. A separate promissory note in favor of Fong, in the amount of $12,000, was signed by Ann Tamura.
>
> After [Celia] assumed control of the Store, the income generated by the Store increased dramatically. The income for the first 15 days of the month of October, 2000, while under the control of Tamura, was $15,145. The income for the last 16 days of the month of October, 2000, while under the control of [Celia], was $28,332. During the period that Tamura was in control, prior to October, the income averaged $31,207 per month. During the period [Celia] was in control, the income averaged $45,866 per month and there were several months in which income exceeded $50,000. The reason for the increase, of course, was that [Celia] was selling un-taxed cigarettes to retail customers at discount prices.
>
> On April 3, 2001, [Celia] was arrested for having illegal cigarettes for sale in the Store. Fong knew that [Celia] was selling illegal cigarettes from the Store. After [Celia's] arrest, Fong arranged for [Third-Party Defendant-Appellee Keith M. Kiuchi (Kiuchi)], acting on behalf of [Celia], to contact the responsible attorney at the office of the Attorney General to discuss the matter.

> Shortly after her arrest, [Celia] informed Fong that she wanted to "just walk away" from the Store. However, Fong held a mortgage against [Celia's] house which she refused to release. So [Celia] produced a potential purchaser . . . .
>
> At this point, [Semin and Myung] entered the picture. . . . . Fong called [Myong] and informed her that the purchase price would be $228,000. Fong arrived at this price by calculating what she was still owed on the promissory note signed by [Celia] in October, 2000. . . . [Myong] then paid Fong $30,000 in cash, as a deposit, so that Fong would not sell the Store to another purchaser. At the time of the payment, there was no written agreement for the purchase of the Store.
>
> During the discussions between [Myong] and Fong, [Myong] specifically asked about the income of the Store. She was told by Fong that the Store had a monthly income of $50,000. Fong also told her that if she wanted to confirm this income she could talk to the accountant employed by [CEI], a man named Harry Lee. [Myong] knew Lee from prior business dealings. She spoke with Lee and he confirmed . . . the income of the store for the immediately preceding months. Although Fong knew that [Celia] was selling illegal cigarettes from the Store, and had been arrested for making such sales, Fong did not disclose those facts to [Myong].

(Footnotes omitted).

In the answering brief, Fong states, in part:

> Prior to signing the Stock Purchase Agreement, [Semin and Myung] met with Harry Lee, CPA, whom [Semin and Myung] had employed in the past, to discuss the sales figures for the previous three months, *i.e.*, February, March, and April of 2001. [Semin and Myung] learned the sales were about $50,000.00 per month, confirmed by the general excise tax records for those months.

(Footnotes omitted).

Pursuant to the Stock Purchase Agreement entered on May 25, 2001, Celia agreed to sell, and Semin and Myung agreed to buy, all of the stock of CEI for $228,000 "plus the wholesale cost of the inventory[.]" The Stock Purchase Agreement states in part:

> 3. **Promissory Note.**
>
> [Semin and Myung] acknowledge[] that [Celia] is individually obligated under a promissory note from [Celia] to [Fong] in the principal amount of $280,000.00. [CEI] is also obligated under that promissory note. Said promissory note was executed by [Celia] and by [CEI] in favor of [Fong] based upon the agreement

of [Fong] to allow [CEI] to assume those obligations owed to her under that promissory note by and between [Fong] and Waterlily Investment, Inc. Waterlily Investment, Inc. was the previous owner of that liquor store known as "Angie's Liquor II", which is the primary asset owned by [CEI]. At the Date of Closing the promissory note shall be modified to read as follows:

A. The principal amount due under the modified promissory note shall be ONE HUNDRED AND FORTY EIGHT THOUSAND DOLLARS ($148,000.00).

B. The debtor under the promissory note shall be [CEI] and the promissory note shall be guaranteed by [Semin and Myung].

. . . .

E. The parties acknowledge that there is presently in existence a Security Agreement and UCC-1 Financing Statement executed by [CEI] in favor of [Fong] to secure the obligations under the original promissory note. These obligations shall not be released and shall remain in full force and effect. Additionally [Semin and Myung] shall execute on the Date of Closing a security agreement and UCC-1 Financing Statement, pledging all of the stock in the Corporation as collateral. [Semin and Myung] shall additionally execute, on the Date of Closing, a Special Power of Attorney in favor of [Fong] that will allow [Fong] to exercise control over both the stock held by [Semin and Myung] and control over [CEI] in the event that [Semin and Myung] and/or [CEI] defaults under any of their obligations under the modified promissory note. [Semin and Myung] shall, if required by [Fong], provide additional personal guarantees to secure the obligations from [Semin and Myung] and [CEI] to [Fong]. Both [Myung and Semin] shall personally guarantee the obligations of [CEI] under the aforesaid modified promissory note.

. . . .

5. Closing Date.

The Closing Date of this Stock Purchase Agreement shall be Tuesday, May 29, 2001. [Semin and Myung] shall take possession of the liquor store owned by [CEI] as of Tuesday, May 29, 2001. Escrow for the closing shall be the law firm of Kiuchi & Nakamoto. Closing shall not be delayed for any reason. The parties acknowledge that the law firm of Kiuchi & Nakamoto represents [Fong] and has previously represented [Celia] and [Celia's] corporation. In this transaction however the law firm of Kiuchi & Nakamoto represents only [Fong] and its only other duty will be to act as escrow and to draft documents. [Celia] and [Myung and Semin] both acknowledge that they have the right to obtain separate counsel to represent them and that the law firm of Kiuchi & Nakamoto does not represent them in this transaction.

6. Representations of [Celia] to [Myung and Semin].

[Celia] makes the following representations as to the stock being transferred to [Myung and Semin]:

> A. Seller represents that she is the true and lawful owner of all of the shares of stock in [CEI] and that [s]he has the full right and authority to sell and deliver the same in accordance with this Agreement and that the delivery of said shares to [Myung and Semin] pursuant to this Agreement will transfer valid legal title thereto in said shares of stock, free and clear of all liens, except for the obligations to [Fong]. [Celia] further represents that this constitutes ALL of the issued shares of stock in [CEI] and that the Seller is presently the sole shareholder in [CEI].
>
> . . . .
>
> D. [Celia] further covenants with [Myung and Semin] that [s]he has not incurred any liabilities on behalf of the corporation, and that should any said liabilities appear and/or become due after the execution of this Agreement that [Celia] shall be solely responsible for such debts. In conjunction with such covenant, [Celia] shall indemnify and hold harmless [Myong and Semin] from any liability that [s]he incurred on behalf of [CEI] during the time that she was a shareholder and officer in [CEI] other than those liabilities or debts listed in any schedule attached to this Agreement.

The Stock Purchase Agreement did not have any schedule of liabilities or debts attached to it.

Semin and Myung further state, "On May 30, 2001, in a closing at Kiuchi's office, [Semin and Myung] signed the promissory note and paid Fong $50,000. Immediately after the closing, Fong, and [Semin and Myung] did an inventory of the merchandise." Also on May 30, 2001, Semin, Myung, and Fong signed the following document, which states in relevant part:

> DISCLOSURE RE: STOCK PURCHASE AGREEMENT
>
> . . . .
>
> WHEREAS, [Fong] desires to make certain disclosures to [Semin and Myung] at the same time that they purchase all of the stock in [CEI]; and
>
> WHEREAS, [Fong], upon making these disclosures, desires to be indemnified from any claims or liabiliity that may arise from the purchase by [Semin and Myung] of the stock of [CEI]:
>
> **NOW, THEREFORE**, the parties hereby covenant and agree as follows:

> 1. **Condition of Assets of [CEI].** [Fong] hereby makes no representations or warranties regarding the condition of the assets of [CEI]. [Semin and Myung] acknowledge that in buying all of the stock [of CEI] that they are acquiring that corporation in an "AS IS" condition and the assets of [CEI] in an "AS IS" condition. . . .
>
> 2. **Disclosure re: Pending Liquor License Violation.** [Fong] hereby discloses that [CEI] has recently received a citation from the Honolulu Liquor Commission for selling liquor to a minor. . . .
>
> 3. **No Liability for Stock Purchase**. [Semin and Myung] hereby acknowledge that [Fong] has made no representations or warranties to them regarding the success or failure of that business operated by [CEI] which is a liquor store located on 152 N. Pauahi St., Honolulu, HI.

Fong told Semin and Myung that the store's landlord required one month's rent as a security deposit. On June 14, 2001, Semin and Myung gave Fong a check in the amount of one month's rent payable to cash as rent security deposit. In addition:

> Once the cost for the inventory was set, Kiuchi, at Fong's request, prepared an agreement titled "Agreement Re: Inventory" (hereinafter, "Inventory Agreement") which was signed by [Semin, Myung, and Celia]. . . . The Inventory Agreement was subsequently amended to reduce the purchase price to $30,000, of which, $20,000 was payable immediately and the balance was payable at a later date. Pursuant to the Inventory Agreement, [Semin and Myung] paid Fong $20,000 on June 25, 2001.

(Footnotes omitted). The opening brief further states:

> On January 31, 2002, [Celia] was formally charged with a violation of §245-37(a)(2) [Hawai'i Revised Statutes (H.R.S.)], which is a Class C felony, for having illegal cigarettes for sale in the Store in April, 2001. In the same Complaint, [CEI] was also charged with a violation of §245-37(a)(2) H.R.S. In a plea agreement worked out in February, 2002, [Celia] pled "no contest" to the felony charge and paid a fine of $10,000 in return for the State agreeing to drop the charge against the corporation.
>
> In approximately June, 2002, [Semin and Myung] learned, for the first time, that no income tax return had been filed and no income tax paid by [CEI] for the fiscal year ending April 30, 2001. The total of taxes and penalties due as of June, 2002, was approximately $30,000. The liquor license of [CEI] expired June 30, 2002. The Honolulu Liquor Commission would not issue a new license unless [CEI] filed the delinquent federal and state income tax returns and paid the delinquent taxes and penalties.

> In June, 2002, [Myung] told Fong that [she and Semin] could not afford to pay the delinquent taxes and demanded that either she or [Celia] pay those taxes. Fong refused. The taxes were not paid, so a tax clearance could not be obtained, and the liquor license was lost.
>
> . . . .
>
> After [Semin and Myung] lost their liquor license, counsel for [Semin and Myung] wrote to Fong, on August 2, 2002, and notified Fong that [Semin and Myung] were exercising their right, pursuant to section 485-20 H.R.S. to void the stock purchase transaction. [Semin and Myung] offered to convey the stock of [CEI] to Fong and/or [Celia] in return for refund of all amounts paid by [Semin and Myung], together with interest at the statutory rate and reasonable attorneys' fees. This offer was refused. In September, 2002, [CEI] abandoned the lease for the store premises and ceased doing business.

(Footnotes omitted).

When CEI defaulted on its debt to Fong, Fong sued CEI, Myung, Semin, David Tamura, Anne Tamura, Michael Tamura, Celia and Renato Vito Batle (Renato). Fong's complaint alleges that Semin and Myung are "obligors" of approximately $120,000, and David Tamura, Anne Tamura, Michael Tamura, Celia and Renato are "guarantors". It further states that CEI owed Fong $120,000 secured by the assets of CEI and Celia's residence.

Semin and Myung counterclaimed against Fong.

Semin and Myung cross-claimed against Celia.

Semin and Myung filed a Third-Party Complaint against Kiuchi.

On December 17, 2003, the court entered a stipulated judgment in favor of Fong and against David Jon Tamura and Anne Ju Tamura in the amount of $112,000 "together with pre-judgment interest of ten percent (10%) from April 16, 2001 through October 7, 2003[.]"

On November 15, 2004, Fong filed a motion for summary judgment (MFSJ). Although not clearly stated, it appears that Fong's MFSJ was against to Semin and Myung. On November 18, 2004, Kiuchi filed a MFSJ against Semin and Myung.

On January 3, 2005, in light of Celia's discharge in bankruptcy, the court dismissed all claims by Fong, Semin, and Myung against Celia, without prejudice.

On January 7, 2005, the court entered an order granting Fong's MFSJ against Semin and Myung. On January 12, 2005, Fong, Semin, and Myung stipulated that the amount due on the Promissory Note "including interest, but not including costs, expenses and attorneys' fees, is $136,400.00" On January 18, 2005, the court entered an order granting Kiuchi's MFSJ against Semin and Myung.

On January 20, 2005, Semin and Myung filed a motion for reconsideration (MFR) of both summary judgment orders. In the MFR, Semin and Myung argued:

> It is the position of [Semin and Myung] that both [Fong] and [Kiuchi] may be held liable to [Semin and Myung] for failing to disclose, prior to [Semin and Myung's] purchase of the stock of [CEI] that the seller of the stock, [Celia], was illegally selling untaxed cigarettes from the store premises leased by [CEI]. In [Semin and Myung's] view, the fact that a significant portion of the income from the store was due to illegal sales is a "material fact" within the purview of relevant Hawaii appellate court decisions.
>
> Although Fong was not nominally the seller of the stock, [Semin and Myung] contend that she may be held liable as an agent of the seller under the provisions of the Uniform Securities Act, as well as common law theories of fraud and negligent misrepresentation. Kiuchi's duty to disclose arose from his undertaking to act as "escrow" in the sale of the stock.

This MFR was denied on March 21, 2005.

On February 15, 2005, the court entered an order granting Fong's request for attorney fees in the amount of $34,000. Presumptively, this order is against Semin and Myung.

On August 12, 2005, the court entered a default judgment in favor of Fong and against CEI for the following amounts:

$148,000.00	principal
59,200.00	interest (5-30-01 to 4-1-05)
41,440.00	attorney fees
248,640.00	subtotal
-150,000.00	payment
$ 98,640.00	Judgment

On October 4, 2005, Fong voluntarily dismissed all claims against Michael Tamura and Renato Batle. On November 2, 2005, the court entered a Final Judgment in favor of Fong and against CEI for $98,640; in favor of Fong and against David Jon Tamura and Anne Ju Tamura (correct legal name is Ann Ju Ji) in the amount of $112,000 plus pre-judgment interest of 10% from April 16, 2001 through October 7, 2003; in favor of Fong and against Semin and Myung in the amount of $22,679; and in favor of Kiuchi and against Semin and Myung.

On November 30, 2005, Semin and Myung filed a notice of appeal. This panel of judges was assigned on July 21, 2006.

DISCUSSION

I.

In the memorandum in support of Fong's MFSJ, Fong states that she "acted only as a lender in this transaction who

acquiesced to the transfer of the obligation." The record supports a finding/conclusion that Fong acted for herself and as an agent of Celia.

II.

Semin and Myong contend that Fong "committed clear fraud when she collected one month's rent from [Semin and Myung], on the representation that the money was a 'security deposit' which she would pay to the landlord on their behalf, and then kept the money for herself." Fong does not deny these facts. In the answering brief, she responds that, "[a]s any tenant would be, [Semin and Myung] were required to pay a security deposit. . . . [Semin and Myung] were not damaged in any way, they paid and received credit for the security deposit!" "[T]he landlord credited [Celia's] security deposit to [Semin and Myung's] account, while the security deposit paid by [Semin and Myung] went to Fong, as with the rest of the purchase price, to satisfy [Celia's] obligation under the Promissory Note."

We agree with Semin and Myung. CEI had paid a security deposit. Semin and Myung purchased the stock of CEI. Semin and Myung were not obligated to pay another security deposit. In essence, Fong caused Semin and Myung to make a payment to Fong before it was due. If Fong had not lied to them, Semin and Myung would not have had to make the payment when they made it. They were damaged to the extent that Fong fraudulently induced them to make that payment to her before it was due.

III.

Semin and Myung contend that "Fong's failure to disclose to [them] the illegal cigarette sales by [Celia] constituted an omission to state a material fact necessary in order to make other statements made by Fong not misleading, within the meaning of §485-25 H.R.S."[2] Fong responds that "[t]he law is well-established that H.R.S. § 485-25 applies only to the sale of securities, and that stock in an owner-operated enterprise such as [CEI] is not a security."

As noted by Semin and Myung in their opening brief, the question is "whether the anti-fraud provisions of §485-25 H.R.S. apply when a party sells all, as opposed to only a portion, of the stock of a corporation." Based on the following Hawai'i precedent, the answer is no.

B. The Risk Capital Approach to Defining an Investment Contract.

The salient feature of securities sales is the public solicitation of venture capital to be used in a business enterprise. Silver Hills Country Club v. Sobieski, 55 Cal.2d 811, 815, 13 Cal.Rptr. 186, 188, 361 P.2d 906, 908 (1961); Goodwin, Franchising in the Economy: The Franchise Agreement as a Security Under Securities Acts, Including 10b-5 Considerations, 24 Business Lawyer 1311, 1320-21 (1969). This subjection of the investor's money to the risks of an enterprise over which he exercises no managerial control is the basic economic reality of a security

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[2] Hawaii Revised Statutes (HRS) § 485-25 (Supp. 2005) states in part:

Fraudulent and other prohibited practices. (a) It is unlawful for any person, in connection with the offer, sale, or purchase (whether in a transaction described in section 485-6 or otherwise) of any security (whether or not of a class described in section 485-4), in the State, directly or indirectly:

(1) To employ any device, scheme, or artifice to defraud;
(2) To make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading;
(3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person[.]

transaction. Coffey, The Economic Realities of a "Security": Is There a More Meaningful Formula?, 18 W.Res.L.Rev. 367, 412 (1967); see Silver Hills Country Club v. Sobieski, supra; see Securities & Exchange Commission v. Latta, 250 F.Supp. 170, 173 (N.D.Cal.1965), aff'd per curiam, 356 F.2d 103 (9th Cir. 1965), cert. denied, 384 U.S. 940, 86 S.Ct. 1459, 16 L.Ed.2d 539 (1966). Any formula which purports to guide courts in determining whether a security exists should recognize this essential reality and be broad enough to fulfill the remedial purposes of the Securities Act. Those purposes are (1) to prevent fraud, and (2) to protect the public against the imposition of unsubstantial schemes by regulating the transactions by which promoters go to the public for risk capital. HRS § 485-10(e). Therefore, we hold that for the purposes of the Hawaii Uniform Securities Act (Modified) an investment contract is created whenever:

. . . .

(4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.

The above test provides, we believe, the necessary broad coverage to protect the public from the novel as well as the conventional forms of financing enterprises. . . .

. . . .

C. The Lack of Managerial Control Over the Enterprise.

Finally, as previously stated, it is irrelevant to the remedial purposes of the Securities Act that an investor participates in a minor way in the operations of the enterprise. Courts should focus on the quality of the participation. In order to negate the finding of a security the offeree should have practical and actual control over the managerial decisions of the enterprise. For it is this control which gives the offeree the opportunity to safeguard his own investment, thus obviating the need for state intervention. Coffey, The Economic Realities of a "Security": Is There a More Meaningful Formula?, supra at 396-398.

State v. Hawaii Market Center, Inc., 52 Haw. 642, 648-52, 485 P.2d 105, 109-11 (1971) (footnote omitted).[3]

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[3] In fn. 1 of State v. Hawaii Market Center, Inc., 52 Haw. 642, 643, 485 P.2d 105, 106 (1971), HRS § 485-1(12) at that time stated:

"Security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting trust certificate, certificate of deposit for a security, certificate of interest in an oil, gas, or mining title or lease, or, in general, any interest or instrument commonly known was a "security," or any certificate of interest or participation in, temporary or interim certificate for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed number of dollars either in a lump sum or periodically for life or some other specified period.

The fact that the United States Supreme Court subsequently decided essentially the same question opposite to the Hawai'i Supreme Court's decision does not authorize this court to contradict the Hawai'i Supreme Court's precedent. The view of the United States Supreme Court is:

> As we also recognized in Forman, the fact that instruments bear the label "stock" is not of itself sufficient to invoke the coverage of the Acts. Rather, we concluded that we must also determine whether those instruments possess "some of the significant characteristics typically associated with" stock, [United Hous. Found., Inc. v. Forman, 421 U.S. 837,] 851, 95 S.Ct. [2051,] 2060[(1975)], recognizing that when an instrument is both called "stock" and bears stock's usual characteristics, "a purchaser justifiably [may] assume that the federal securities laws apply," id., at 850, 95 S.Ct., at 2059. We identified those characteristics usually associated with common stock as (i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability; (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value.[4] Id., at 851, 95 S.Ct., at 2060.
>
> Under the facts of Forman, we concluded that the instruments at issue there were not "securities" within the meaning of the Acts. That case involved the sale of shares of stock entitling the purchaser to lease an apartment in a housing cooperative. The stock bore none of the characteristics listed above that are usually associated with traditional stock. Moreover, we concluded that under the circumstances, there was no likelihood that the purchasers had been misled by use of the word "stock" into thinking that the federal securities laws governed their purchases. The purchasers had intended to acquire low-cost subsidized living space for their personal use; no one was likely Ibid.

Currently, as a result of section 8 of Act 281 (1984), HRS § 485-1(13) (1993) states:

> "Security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, variable annuity contract, voting trust certificate, certificate of deposit for a security, certificate of interest in an oil, gas, or mining title or lease, option on commodity futures contracts 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, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "Security" does not include any insurance or endowment policy or fixed annuity contract.

[4] Although we did not so specify in Forman, we wish to make clear here that these characteristics are those usually associated with common stock, the kind of stock often at issue in cases involving the sale of a business. Various types of preferred stock may have different characteristics and still be covered by the Acts.

In contrast, it is undisputed that the stock involved here possesses all of the characteristics we identified in Forman as traditionally associated with common stock. Indeed, the District Court so found. App. to Pet. for Cert. 13a. Moreover, unlike in Forman, the context of the transaction involved here-the sale of stock in a corporation-is typical of the kind of context to which the Acts normally apply. It is thus much more likely here than in Forman that an investor would believe he was covered by the federal securities laws. Under the circumstances of this case, the plain meaning of the statutory definition mandates that the stock be treated as "securities" subject to the coverage of the Acts.

Reading the securities laws to apply to the sale of stock at issue here comports with Congress' remedial purpose in enacting the legislation to protect investors by "compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" SEC v. W.J. Howey Co., 328 U.S., at 299, 66 S.Ct., at 1103 (quoting H.R.Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)). Although we recognize that Congress did not intend to provide a comprehensive federal remedy for all fraud, Marine Bank v. Weaver, supra, 455 U.S., at 556, 102 S.Ct., at 1223, we think it would improperly narrow Congress' broad definition of "security" to hold that the traditional stock at issue here falls outside the Acts' coverage.

III

Under other circumstances, we might consider the statutory analysis outlined above to be a sufficient answer compelling judgment for petitioner.[5] Respondents urge, however, that language in our previous opinions, including Forman, requires that we look beyond the label "stock" and the characteristics of the instruments involved to determine whether application of the Acts is mandated by the economic substance of the transaction. Moreover, the Court of Appeals rejected the view that the plain meaning of the definition would be sufficient to hold this stock covered, because it saw "no principled way," 731 F.2d, at 1353, to justify treating notes, bonds, and other of the definitional categories differently. We address these concerns in turn.

A

It is fair to say that our cases have not been entirely clear on the proper method of analysis for determining when an instrument is a "security." This Court has decided a number of cases in which it looked to the economic substance of the transaction, rather than just to its form, to determine whether the Acts applied. In SEC v. C.M. Joiner Leasing Corp., for example, the Court considered whether the 1933 Act applied to the sale of leasehold interests in land near a proposed oil well drilling. In holding that the leasehold interests were "securities," the Court noted that "the reach of the Act does not

[5] Professor Loss suggests that the statutory analysis is sufficient. L. Loss, Fundamentals of Securities Regulation 212 (1983). See infra, at 2306.

stop with the obvious and commonplace." 320 U.S., at 351, 64 S.Ct., at 123. Rather, it ruled that unusual devices such as the leaseholds would also be covered "if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a 'security.'" Ibid, 64 S.Ct., at 124.

SEC v. W.J. Howey Co., supra, further elucidated the Joiner Court's suggestion that an unusual instrument could be considered a "security" if the circumstances of the transaction so dictated. At issue in that case was an offering of units of a citrus grove development coupled with a contract for cultivating and marketing the fruit and remitting the proceeds to the investors. The Court held that the offering constituted an "investment contract" within the meaning of the 1933 Act because, looking at the economic realities, the transaction "involve[d] an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U.S., at 301, 66 S.Ct., at 1104.

This so-called "Howey test" formed the basis for the second part of our decision in Forman, on which respondents primarily rely. As discussed above, see Part II, *supra,* the first part of our decision in Forman concluded that the instruments at issue, while they bore the traditional label "stock," were not "securities" because they possessed none of the usual characteristics of stock. We then went on to address the argument that the instruments were "investment contracts." Applying the Howey test, we concluded that the instruments likewise were not "securities" by virtue of being "investment contracts" because the economic realities of the transaction showed that the purchasers had parted with their money not for the purpose of reaping profits from the efforts of others, but for the purpose of purchasing a commodity for personal consumption. 421 U.S., at 858, 95 S.Ct., at 2063.

Respondents contend that Forman and the cases on which it was based[6] require us to reject the view that the shares of stock at issue here may be considered "securities" because of their name and characteristics. Instead, they argue that our cases require us in every instance to look to the economic substance of the transaction to determine whether the Howey test has been met. According to respondents, it is clear that petitioner sought not to earn profits from the efforts of others, but to buy a company that it could manage and control. Petitioner was not a passive investor of the kind Congress intended the Acts to protect, but an active entrepreneur, who sought to "use or consume" the business purchased just as the purchasers in Forman sought to use the

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[6] Respondents also rely on Tcherepnin v. Knight, 389 U.S. 332, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967), and Marine Bank v. Weaver, 455 U.S. 551, 102 S.Ct. 1220, 71 L.Ed.2d 409 (1982), as support for their argument that we have mandated in every case a determination of whether the economic realities of a transaction call for the application of the Acts. It is sufficient to note here that these cases, like the other cases on which respondents rely, involved unusual instruments that did not fit squarely within one of the enumerated specific kinds of securities listed in the definition. Tcherepnin involved withdrawable capital shares in a state savings and loan association, and Weaver involved a certificate of deposit and a privately negotiated profit sharing agreement. See Marine Bank v. Weaver, supra, at 557, n. 5, 102 S.Ct., at 1224, n. 5, for an explanation of why the certificate of deposit involved there did not fit within the definition's category "certificate of deposit, for a security."

apartments they acquired after purchasing shares of stock. Thus, respondents urge that the Acts do not apply.

We disagree with respondents' interpretation of our cases. First, it is important to understand the contexts within which these cases were decided. All of the cases on which respondents rely involved unusual instruments not easily characterized as "securities." See n. [6], supra. Thus, if the Acts were to apply in those cases at all, it would have to have been because the economic reality underlying the transactions indicated that the instruments were actually of a type that falls within the usual concept of a security. In the case at bar, in contrast, the instrument involved is traditional stock, plainly within the statutory definition. There is no need here, as there was in the prior cases, to look beyond the characteristics of the instrument to determine whether the Acts apply.

Contrary to respondents' implication, the Court has never foreclosed the possibility that stock could be found to be a "security" simply because it is what it purports to be. In SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 64 S.Ct. 120, 88 L.Ed. 88 (1943), the Court noted "[W]e do nothing to the words of the Act; we merely accept them· · · · In some cases, [proving that the documents were securities] might be done by proving the document itself, which on its face would be a note, a bond, or a share of stock." Id., at 355, 64 S.Ct., at 125. Nor does Forman require a different result. Respondents are correct that in Forman we eschewed a "literal" approach that would invoke the Acts' coverage simply because the instrument carried the label "stock." Forman does not, however, eliminate the Court's ability to hold that an instrument is covered when its characteristics bear out the label. See supra, at 2302-2303.

Second, we would note that the Howey economic reality test was designed to determine whether a particular instrument is an "investment contract," not whether it fits within any of the examples listed in the statutory definition of "security." Our cases are consistent with this view.[7] Teamsters v. Daniel, 439 U.S., at 558, 99 S.Ct., at 795 (appropriate to turn to the Howey test to "determine whether a particular financial relationship constitutes an investment contract"); United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 95 S.Ct. 2051, 44 L.Ed.2d 621

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[7] In support of their contention that the Court has mandated use of the Howey test whenever it determines whether an instrument is a "security," respondents quote our statement in Teamsters v. Daniel, 439 U.S. 551, 558, n. 11, 99 S.Ct. 790, 795, n. 11, 58 L.Ed.2d 808 (1979), that the Howey test "'embodies the essential attributes that run through all of the Court's decisions defining a security'" (quoting Forman, 421 U.S., at 852, 95 S.Ct., at 2060). We do not read this bit of dicta as broadly as respondents do. We made the statement in Forman in reference to the purchasers' argument that if the instruments at issue were not "stock" and were not "investment contracts," at least they were "instrument [s] commonly known as a 'security'" within the statutory definition. We stated, as part of our analysis of whether the instruments were "investment contracts," that we perceived "no distinction, for present purposes, between an 'investment contract' and an 'instrument commonly known as a "security."'" Ibid. (emphasis added). This was not to say that the Howey test applied to any case in which an instrument was alleged to be a security, but only that once the label "stock" did not hold true, we perceived no reason to analyze the case differently whether we viewed the instruments as "investment contracts" or as falling within another similarly general category of the definition-an "instrument commonly known as a 'security.'" Under either of these general categories, the Howey test would apply.

> (1975); see supra, at 2304. Moreover, applying the Howey test to traditional stock and all other types of instruments listed in the statutory definition would make the Acts' enumeration of many types of instruments superfluous. Golden v. Garafalo, 678 F.2d 1139, 1144 (CA2 1982). See Tcherepnin v. Knight, 389 U.S. 332, 343, 88 S.Ct. 548, 556, 19 L.Ed.2d 564 (1967).
>
> Finally, we cannot agree with respondents that the Acts were intended to cover only "passive investors" and not privately negotiated transactions involving the transfer of control to "entrepreneurs." The 1934 Act contains several provisions specifically governing tender offers, disclosure of transactions by corporate officers and principal stockholders, and the recovery of short-swing profits gained by such persons. See, e.g., 1934 Act, §§ 14, 16, 15 U.S.C. §§ 78n, 78p. Eliminating from the definition of "security" instruments involved in transactions where control passed to the purchaser would contravene the purposes of these provisions. Accord, Daily v. Morgan, 701 F.2d 496, 503 (CA5 1983). Furthermore, although § 4(2) of the 1933 Act, 15 U.S.C. § 77d(2), exempts transactions not involving any public offering from the Act's registration provisions, there is no comparable exemption from the antifraud provisions. Thus, the structure and language of the Acts refute respondents' position.[8]

Landreth Timber Co. v. Landreth, 471 U.S. 681, 686-692, 105 S.Ct. 2297, 2305-2305 (1985) (footnotes in original; renumbered).

IV.

For what months did Harry Lee, CPA, say that the gross sales of the store were about $50,000 per month? Fong says the months were February, March, and April of 2001. If so, how much of those gross sales, if any, included illegal cigarette sales? Celia testified that she stopped the illegal cigarette sales in December 2000. Moreover, Celia was arrested for this illegal activity on April 3, 2001.

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[8] In criticizing the sale of business doctrine, Professor Loss agrees. He considers that the doctrine "comes dangerously close to the heresy of saying that the fraud provisions do not apply to private transactions; for nobody, apparently, has had the temerity to argue that the sale of a publicly owned business for stock of the acquiring corporation that is distributed to the shareholders of the selling corporation as a liquidating dividend does not involve a security." L. Loss, Fundamentals of Securities Regulation 212 (1983) (emphasis in original) (footnote omitted).

Assuming a material amount of those gross sales included illegal cigarette sales, Semin and Myung contend that "Fong's failure to disclose to [Semin and Myung] the illegal cigarette sales by [Celia]" "breached a duty of care which she owed to [Semin and Myung][.]" They cite the following precedent:

> Information Negligently Supplied for the Guidance of Others
>
> (1) One who, in the course of his [or her] business, profession or employment, or in any other transaction in which he [or she] has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he [or she] fails to exercise reasonable care or competence in obtaining or communicating the information.
>
> (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
>
> (a) by the person or one of a limited group of persons for whose benefit and guidance he [or she] intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) through reliance upon it in a transaction that he [or she] intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.
>
> (3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transaction in which it is intended to protect them.
>
> [Chun v. Park, 51 Haw. 462, 464-65, 462 P.2d 905, 906-07 (1969).] See also Shaffer v. Earl Thacker Co., 6 Haw.App. 188, 716 P.2d 163 (1986) (applying Restatement position).
>
> The duty imposed by section 552 is therefore to exercise reasonable care or competence in obtaining or communicating information for the guidance of others in their business transactions.

State by Bronster v. U.S. Steel Corp., 82 Hawai'i 32, 41, 919 P.2d 294, 303 (1996). In other words, Semin and Myong assert the tort of negligent misrepresentation.

> Negligent misrepresentation requires that: (1) false information be supplied as a result of the failure to exercise reasonable care or competence in communicating the information; (2) the person for whose benefit the information is supplied suffered the loss; and (3) the recipient relies upon the misrepresentation. See Kohala Agriculture[v. Deloitte & Touche], 86 Hawai'i [301,] 323, 949 P.2d [141,] 163; Restatement (Second) of Torts § 552.

Blair v. Ing, 95 Hawai'i 247, 269, 21 P.3d 452, 474 (2001).

Although the tort of negligent misrepresentation applies to one who "supplies false information for the guidance of others in their business transactions," Semin and Myung contend that "[b]y failing to inform [Semin and Myung] about [Celia's] illegal cigarette sales from the Store, Fong breached this duty." They do not recognize that failing to supply information does not breach a duty not to supply false information.

V.

Semin and Myung contend that "Kiuchi breached a duty of care which he owed to the [Semin and Myung] as 'escrow' for the stock purchase transaction by failing to inform [Semin and Myung] of the illegal cigarette sales made by [Celia][.]" Semin and Myung state that the question is "whether an attorney who purports to act as escrow in connection with a sale of stock owes a duty of disclosure to purchasers who are not his clients." They cite a case reciting the duties real estate agents, Han v. Yang, 84 Haw. 162, 172, 931 P.2d 604 (1997), and title companies Kraft v. Bartholomew, 1 Haw. App. 459, 620 P.2d 755 (1980), owe to their clients. They further argue that "when an attorney

undertakes to act as escrow, he must bring to that position, not only the duty of care that would be exercised by a laymen, but also the duty of care that is owed by someone with special knowledge." They complain that

> Kiuchi, by reason of his training and experience, full well understood that the transaction was being structured to leave [Semin and Myung] holding the bag. Yet he took no steps to protect [Semin and Myung]. He could, for instance, have insisted that if he was to act as escrow, a share of the sale proceeds must remain in escrow until all tax obligations were settled. He did not. Kiuchi could also have insisted that the illegal cigarette sales, and the implication of those sales on the gross revenue of the corporation, be explained to [Semin and Myung]. But he did not.

This court's precedent is:

> The general rule is that an escrow depository occupies a fiduciary relationship with the parties to the escrow agreement or instructions and must comply strictly with the provisions of such agreement or instructions. See 30A C.J.S. Escrows § 8 (1965); Woodworth v. Redwood Empire Savings & Loan Ass'n, 22 Cal.App.3d 347, 99 Cal.Rptr. 373 (1971); Union Title Company v. Burr, 102 Ariz. 421, 432 P.2d 433 (1967).

DeMello v. Home Escrow, Inc., 4 Haw. App. 41, 47, 659 P.2d 759, 763 (1983). We conclude that there is no evidence of an agreement or instructions imposing on Kiuchi a duty to take the steps to protect Semin and Myung that Semin and Myung contend was his duty to take.

CONCLUSION

Accordingly, with respect to the circuit court's November 2, 2005 Final Judgment entered in favor of Plaintiff/Counterclaim Defendant-Appellee Connie Y. Fong, (a) we vacate regarding the claim by Defendants/Counterclaimants/Cross-Claimants-Appellants Semin Oh and Myung Hui Oh that Fong "committed clear fraud when she

collected one month's rent from [Semin and Myung], on the representation that the money was a 'security deposit' which she would pay to the landlord on their behalf, and then kept the money for herself"; and (b) in all other respects, we affirm.

DATED: Honolulu, Hawai'i, October 27, 2006.

On the briefs:

Thomas T. Watts
(Kemper & Watts)
for Defendants/Cross
Claimants/
Third Party Plaintiffs-
Appellants.

David J. Gierlach
for Plaintiff/Counterclaim
Defendant-Appellee

Keith K. Hiraoka and
Rhonda L. Ching
(Roeca Louie & Hiraoka)
for Third Party Defendant-
Appellee

James A. Burns
Chief Judge

Daniel R. Foley
Associate Judge

Associate Judge