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Commonwealth of Kentucky

Court of Appeals

NO. 2006-CA-001934-MR

COMMONWEALTH OF KENTUCKY, EX REL., THE COMMISSIONER OF THE DEPARTMENT OF FINANCIAL INSTITUTIONS OF COMMONWEALTH OF KENTUCKY — APPELLANT

v.

APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE SAM G. MCNAMARA, JUDGE
ACTION NO. 99-CI-00717

GREENLEAF MARKETING CORPORATION; YUCATAN INVESTMENTS CORPORATION; MICHAEL E. KELLY; AND OTHER INTERESTED PARTIES AS NAMED IN THE NOTICE OF APPEAL — APPELLEES

OPINION
AFFIRMING

** ** ** ** **

BEFORE: HOWARD, JUDGE; GUIDUGLI AND KNOPF,[1] SENIOR JUDGES.

[1] Senior Judges Daniel T. Guidugli and William L. Knopf sitting as Special Judges by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

KNOPF, SENIOR JUDGE: The Office of Financial Institutions of the Commonwealth of Kentucky (Commonwealth) appeals an order of the Franklin Circuit Court denying its motion for sanctions against Yucatan Investments Corporation (Yucatan) and Michael Kelly, individually, an officer for the corporation, alleging that Yucatan offered and sold unregistered securities as defined by KRS 292.310(18). For the reasons stated below, we affirm.

The facts are as follows. In 1999, the Commonwealth filed an action against Yucatan and Kelly alleging that Yucatan violated KRS 292.320(1) after it sold unregistered securities in the form of promissory notes. A settlement was reached between the parties in which Yucatan agreed to a permanent injunction stating that it would no longer sell securities in Kentucky, and the Commonwealth dismissed its complaint. Later, in 2006, the Commonwealth filed a motion for sanctions in the Franklin Circuit Court alleging that Yucatan and Kelly had violated the injunction by offering and selling timeshares to Kentucky residents from 2000 until 2004. The Commonwealth alleged that the timeshares, coupled with contemporaneous offers for a management contract, constituted securities in the form of investment contracts. After a bench trial on July 24, 2006, the Franklin Circuit Court entered a judgment in favor of Yucatan, finding that the timeshares were not securities pursuant to KRS 292.310(18) and were not subject to regulation. The Commonwealth filed a motion to alter, amend or vacate the judgment, which was denied by an order on August 28, 2006. This appeal followed.

In the present case, the sole question to be answered is a question of law, and thus, is reviewed *de novo*. *Bob Hook Chevrolet Isuzu, Inc. v. Com. Transp. Cabinet*, 983 S.W.2d 488, 490-91 (Ky. 1998).

The Commonwealth argues that the timeshares sold by Yucatan were turned into investment contracts because Yucatan also offered a third party management contract if the buyer wished to have the timeshare rented. We disagree. Buyers had the option of using the timeshare personally or renting the timeshare out. The buyer could also use the third party property management company that Yucatan suggested or use any rental company of their choice. However, most of the buyers elected to use the management company Yucatan recommended, which is not unusual considering most of the buyers were unsophisticated investors with very little knowledge of property management. Many of these buyers and potential buyers would have no way of realizing a profit on their investment if they did not allow a third party to manage the timeshare. The Commonwealth argues that the offer of the investment contract was a violation of the injunction because investment contracts are a type of security included in KRS 292.310(18).

In determining whether an investment contract exists, Kentucky has adopted the four-prong test in *Securities and Exchange Com'n v. W.J. Howey Co.*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946), which states an investment contract consists of: 1) the presence of an investment; 2) in a common scheme or enterprise; 3) premised on a reasonable expectation of profits; 4) to be derived from the entrepreneurial

or managerial efforts of others. *Scholarship Counselors, Inc. v. Waddle*, 507 S.W.2d 138, 141 (Ky. 1974).

In this case, the trial court held that the ability of the investor to use the timeshare, as opposed to acquiring and holding it as an investment, and the ability to use any management company of the buyer's choice prevented the packaged offers from being an investment contract as defined by *Howey.* We agree. The Court in *Howey* held that an investment contract existed because the companies in violation were offering something more than just simple interests in land coupled with management services. *Howey, supra,* at 300, 1103. The companies were "offering an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by the [investors]." *Id*. This is not the case here. The timeshares offered do not require the buyers to invest their money in a common pool or enterprise which results in a distribution of profits.

The investors in *Howey* were found to "have no desire to occupy the land or to develop it themselves" and it would not be "economically feasible if they did." *Id*. These are also not the facts at issue here. The timeshares could reasonably be used as vacation properties for the benefit of the buyer or could be used as an investment. Even though the *Howey* case deals with orchards, the basis of the holding is applicable to the case at hand. Had the investment in this case created a common venture or enterprise between the individual investors, the packaged offers may have risen to the level of an investment contract. However, holdings from numerous jurisdictions say that common

timeshare agreements are not securities. *See Wals v. Fox Hills Dev. Corp*., 24 F.3d 1016 (7th Cir. 1994); *Deckebach v. La Vida Charters, Inc. of Florida*, 867 F.2d 278 (6th Cir. 1989); and *Lavery v. Kearns*, 792 F.Supp. 847 (D.Me. 1992).

Further, the timeshares sold by Yucatan are very similar to the sale of fractional interests in a thoroughbred breeding syndication as in *Kefalas v. Bonnie Brae Farms, Inc*., in which the court held the interests were not securities under either federal or state law. 630 F.Supp. 6 (E.D.K.y. 1985). The court determined that the breeding interests were not investment contracts subject to regulation. *Id*. No common enterprise was found, even considering that each investor owned a fraction of the same horse, because the court opined that each fractional interest was "unitary in nature and each will be a success or failure without regard to the others." *Id*. at 8 (citation omitted). The court also noted that "the profits of the owners thus depend on their own efforts and good fortune in addition to the efforts of the syndicate manager." *Id*.

In the case at hand, the success of each timeshare will be a direct result of both good fortune and the efforts of the owner and rental company. No common enterprise or venture exists between the buyers and Yucatan. Therefore, the trial court was correct in its holding that no investment contract exists subject to Kentucky securities regulations.

The judgment of the Franklin Circuit Court is affirmed.

ALL CONCUR.

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