



GALBUT & HUNTER
 A PROFESSIONAL CORPORATION
 LAWYERS AND COUNSELORS



0000117327

RECEIVED

ORIGINAL

2003 JUN 23 P 3:54

Jeffrey D. Gardner, Esq.
 jgardner@galbuthunter.com

CORP COMMISSION
 DOCUMENT CONTROL

June 23, 2003

Via Hand-Delivery

Docket Control Center
 Arizona Corporation Commission
 1200 W. Washington
 Phoenix, Arizona 85007-2996
 (602) 542-3477

Arizona Corporation Commission
DOCKETED
 JUN 23 2003

DOCKETED BY 

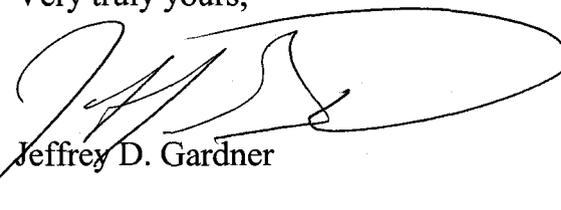
Re: Arizona Securities Division Docket No: S-03539A-03-0000

To Whom It May Concern:

Enclosed herewith please find an original and 13 copies of Respondents Yucatan Resorts, Inc., Yucatan Resorts, S.A., Resort Holdings International, Inc., and Resort Holdings International, S.A.s' Motion to Dismiss the Securities Division's Temporary Cease and Desist Order.

If you have any questions, please do not hesitate to contact the undersigned.

Very truly yours,


 Jeffrey D. Gardner

JDG
 Enclosures
 cc: Joel Held, Esq.
 Paul Roshka, Esq.

ORIGINAL
RECEIVED

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS:

- MARC SPITZER, Chairman**
- JIM IRVIN**
- WILLIAM A. MUNDELL**
- JEFF MATCH-MILLER**
- MIKE GLEASON**

ARIZONA CORPORATION COMMISSION
DOCUMENT CONTROL

In the matter of:

DOCKET NO. S-03539A-03-0000

**YUCATAN RESORTS, INC., d/b/a
YUCATAN RESORTS, S.A.,
3222 Mishawaka Avenue
South Bend, IN 46615;
P. O. Box 2661
South Bend, IN 46680;
Av. Coba #82 Lote 10, 3er. Piso
Cancun, Q. Roo
Mexico C.P. 77500**

**RESPONDENTS RESORT HOLDINGS
INTERNATIONAL, INC., RESORT
HOLDINGS INTERNATIONAL, S.A.,
YUCATAN RESORTS, INC., AND
YUCATAN RESORTS, S.A.S' MOTION
TO DISMISS TEMPORARY ORDER TO
CEASE AND DESIST AND BRIEF IN
SUPPORT THEREOF**

**RESORT HOLDINGS INTERNATIONAL,
INC. d/b/a
RESORT HOLDINGS INTERNATIONAL,
S.A.,
3222 Mishawaka Avenue
South Bend, IN 46615;
P. O. Box 2661
South Bend, IN 46680;
Av. Coba #82 Lote 10, 3er. Piso
Cancun, Q. Roo
Mexico C.P. 77500**

Arizona Corporation Commission
DOCKETED

JUN 23 2003

**WORLD PHANTASY TOURS, INC.
a/k/a MAJESTY TRAVEL
a/k/a VIAJES MAJESTY
Calle Eusebio A. Morales
Edificio Atlantida, P Baja
APDO, 8301 Zona 7 Panama**

DOCKETED BY	
-------------	--

**MICHAEL E. KELLY and LORI KELLY,
husband and wife,
3222 Mishawaka Avenue
South Bend, IN 46615;
P. O. Box 2661
South Bend, IN 46680;**

Respondents.

1 Respondents YUCATAN RESORTS, INC., d/b/a YUCATAN RESORTS, S.A.,
2 and RESORT HOLDINGS INTERNATIONAL, INC. (hereinafter "RHI, Inc."), d/b/a
3 RESORT HOLDINGS INTERNATIONAL, S.A. (hereinafter "RHI, S.A."), (collectively
4 "Respondents") file this, their Motion to Dismiss the Temporary Order to Cease and Desist
5 ("C&D Order") and Brief in Support Thereof, and respectfully show the following:¹
6

7 **I. SUMMARY**

8
9 The Arizona Corporation Commission and the Securities Division have no subject
10 matter jurisdiction over this matter. Arizona state law expressly provides that the Arizona
11 securities laws do not apply to the sale of timeshare interests pursuant to timeshare plans
12 approved by the Arizona Department of Real Estate. The Universal Lease which is the
13 subject of the C&D Order issued on May 20, 2003, to which this motion relates does not
14 constitute a "security" under either federal or Arizona law.
15

16 **II. FACTS**

17
18 The Baccara Resort is a popular exclusive four-star timeshare resort located at Blvd.
19 Kukulcán, Km 11.5, Cancún, Quintana Roo 77500, Mexico. This resort has been
20 approved by the Arizona Department of Real Estate to sell timeshare interests under the
21 Universal Lease in Arizona. As admitted by the Arizona Corporation Commission (the
22

23
24 ¹ All other defenses are reserved, including lack of personal and subject matter jurisdiction,
25 as well as venue and insufficiency of service of process. The answer of these Respondents
26 is hereby incorporated herein by reference. Specifically, Respondents deny that Yucatan
Resorts, Inc. is d/b/a Yucatan Resorts, S.A., and Respondents deny that RHI, Inc., is d/b/a
RHI, S.A.

1 "Commission") in the C&D Order, the Universal Lease allows a lessee to lease a specific
2 vacation unit (the "Vacation Unit") for a specific week during the year. The Universal
3 Lease has a typical lease term of twenty-five years. The Vacation Unit rental fee, which
4 must be pre-paid at the time of the execution of the Universal Lease, depends upon the
5 particular type of room(s) that is leased and on the week of the year that it is leased. Also,
6 as admitted by the Commission in the C&D Order, the person to whom the Universal
7 Lease is sold (the "Leaseholder") has the right to: (1) personally use the Vacation Unit
8 during the leased week(s); (2) personally lease the Vacation Unit to a third party; or (3)
9 hire a third-party management company to lease the Vacation Unit for the Leaseholder.²
10

11
12 Importantly, the Leaseholder is not required to lease his or her Vacation Unit to
13 another party nor can a Leaseholder appoint any of the Respondents as the lease
14 management company. Neither RHI, Inc., RHI, S.A., Yucatan, Inc. nor Yucatan S.A.³ will
15 act as the leasing agent for the Vacation Unit. If asked, Resort S.A. or Yucatan S.A. will
16 refer the Leaseholder to a third party leasing agent, of which there are several in Cancun,
17 including Century 21, World Phantasy Tours, and others. The Leaseholder is not required
18 to use World Phantasy Tours or any other leasing agent, whether or not recommended by
19 RHI, S.A. or Yucatan S.A. Neither RHI, S.A. nor Yucatan S.A. has any ownership or
20 financial interest in any leasing agent, including World Phantasy Tours.
21
22

23
24 ² The Universal Lease Agreement and the Universal Lease Program are referenced
25 throughout the C&D Order. True and correct copies of the Universal Lease and the
26 materials related thereto will be filed under separate cover.

³ Neither RHI, Inc., nor Yucatan, Inc., offer, sell or act as distributors for the Universal
Lease.

1 Neither Respondents, nor anyone affiliated with Respondents acts or may act as a
2 leasing agent for purposes of subleasing any of the Vacation Units. The Leaseholder may
3 sublease his or her Vacation Unit and/or assign his or her lease only with the prior written
4 consent of RHI, S.A. or Yucatan S.A., as the case may be, which consent shall not be
5 unreasonably withheld. The Leaseholder has a right to extend the term of the Universal
6 Lease for an additional twenty years on sixty days' written notice for the aggregate amount
7 of pre-paid rent of one dollar. Yucatan S.A. ceased marketing the Universal Lease in early
8 2002, at which time RHI, S.A. became the marketing company for the Universal Lease.
9

10
11 Yucatan S.A. and now RHI, S.A. maintains the vacation resort and manages the
12 day-to-day operations of the vacation club at the resort. The Leaseholders pay an annual
13 operations and maintenance fee to RHI, S.A. The fee includes the Leaseholder's share of:
14 (1) costs associated with operating and maintaining the common areas and the Vacation
15 Unit; (2) property taxes; and (3) insurance. The fee may be increased, provided however,
16 that the increase cannot be more than the percentage increase in the Consumer Price Index
17 for the previous year, plus 3%.
18

19
20 Yucatan S.A. had, and RHI, S.A. has the option to exercise a right (but not the
21 obligation) to purchase the balance of the Leaseholder's leasehold interest at a pre-
22 determined price based upon the number of years remaining on the Universal Lease. In
23 addition, Yucatan, S.A. and now RHI, S.A. has a right of first refusal to purchase the
24 Leaseholder's leasehold interest should the Leaseholder determine to sell his or her
25 leasehold interest.
26

1 The rental income from the Vacation Units is not pooled. Leaseholders do not
2 receive a pro-rata share of income from the Vacation Units. If a Leaseholder elects to
3 sublease his Vacation Unit, then that Leaseholder is entitled solely to the rental income
4 generated from subleasing his Vacation Unit, less any money owed to a third party leasing
5 agent, if one is used.
6

7 The Leaseholder is required to complete and sign an Acknowledgement that the
8 Leaseholder fully understands the terms of the lease agreement and that "Yucatan Resorts
9 [now RHI, S.A.] is in no way promoting the purchase of this vacation unit for investment
10 purposes and there is no investment guarantee from Yucatan Resorts [now RHI, S.A.]."
11

12 The promotional and marketing efforts of Yucatan S.A. and/or RHI, S.A. or other
13 distributors do not emphasize the economic benefits to be derived from the efforts of a
14 third party leasing agent. In this regard, these Respondents at no time promised or
15 guaranteed anyone that they would receive any return, much less "a 9% or 11% return."
16 Indeed, neither Yucatan S.A. nor RHI, S.A. or any other person or entity affiliated with
17 such respondents provides or pays a return of any type to Leaseholders, much less a
18 guaranteed rate of return.
19
20

21 As is typical with any timeshare plan, a Leaseholder pays for a timeshare unit for
22 personal use during a specified period time. If the Leaseholder is unable or chooses not to
23 use the unit for the time allotted, the Leaseholder has the option of renting the unit to a
24 third party. The arrangement offered by Respondents is typical throughout the timeshare
25
26

1 industry. This arrangement does not constitute an investment contract, as the timeshare
2 units are offered and purchased for personal use and consumption by the Leaseholder.

3 One of the services offered by World Phantasy Tours, which is not affiliated with
4 RHI, Inc., RHI, S.A., Yucatan, Inc., or Yucatan S.A. is acting as rental or leasing agent for
5 the Leaseholder, should the Leaseholder so choose. The Leaseholder is under no
6 obligation to choose any third party management company or rental agent. World
7 Phantasy Tours and the Leaseholder make their own arrangements regarding leasing of the
8 Vacation Unit.
9
10

11 **III. TIMESHARE SALES ARE NOT SUBJECT TO ARIZONA**
12 **SECURITIES LAWS**

13 Arizona's securities registration statutes do not apply to the sale of timeshares.

14 A.R.S. §32-2197.22(A) states:

15
16 A. Sections 44-1841 and 44-1842 do not apply to a timeshare plan that has
17 been issued a timeshare public report pursuant to this article or exempted
18 by special order of the commissioner.

19 A.R.S. §32-2197(28) defines "timeshare plan":

20 28. "Timeshare plan" means any arrangement, plan or similar device,
21 other than an exchange program, whether by membership agreement,
22 sale, lease, deed, license or right-to-use agreement or by any other means,
23 in which a purchaser, in exchange for consideration, receives ownership
24 rights in or the right to use accommodations for a period of time less than
25 a full year during any given year, but not necessarily for consecutive
26 years. A timeshare plan may be a single site timeshare plan or a multi-site
timeshare plan.

1 (emphasis supplied). The Universal Lease is such a timeshare plan, and it has been
2 approved by the Arizona Department of Real Estate.

3 On July 3, 2000, Resort Holdings International obtained approval to sell timeshare
4 units in Arizona and was issued a timeshare public report under the name of its resort,
5 “Baccara Resort Hotel,” Registration No. DM01-027605. In that public report,
6 Respondents are identified and listed on the cover page as: “RESORT HOLDINGS
7 INTERNATIONAL, Dba YUCATAN INVESTMENTS S.A. de CIV.”⁴

8 Pursuant to A.R.S. §32-2197.22(A), Arizona’s securities registration statutes do not
9 apply to Respondents because they are selling timeshare interests pursuant to an approved
10 timeshare plan. Thus, they are not required to comply with Arizona’s securities registration
11 statutes relative to the sale of timeshare interests within the State, and cannot be charged
12 with failing to register under A.R.S. §44-1841 or §44-1842.

13 Moreover, Respondents cannot be charged under A.R.S. §44-1991, which applies
14 only “in connection with a transaction or transactions within or from [Arizona] involving
15 an offer to sell or buy securities” A.R.S. §44-1991(A). Arizona does not apply the
16 securities registration statutes to the sale of timeshare interests under an approved
17 timeshare plan and should also not apply to §44-1991 because the sale of timeshare
18 interests are not “securities.”

19
20
21
22
23
24
25
26

⁴ See Time-Share Public Report, attached hereto as Exhibit “1”.

1
2
3 **IV. THE UNIVERSAL LEASES ARE NOT SECURITIES WITHIN**
4 **THE MEANING OF FEDERAL AND ARIZONA SECURITIES LAWS**

5 **A. The Definition of a "Security."**

6 Even if not specifically excluded from the definition of "security" pursuant to
7 A.R.S. §32-2197, Universal Leases do not constitute "securities" as that term is defined in
8 the securities laws. The determination that the Universal Leases do not constitute a
9 security begins with a review of the relevant statutory language. Arizona courts have
10 consistently held that a "security," as defined in the Arizona Securities Act, is substantially
11 similar to the definition of "securities" in both the Securities Act of 1933 and the Securities
12 Exchange Act of 1934. See Nutek Information Systems, Inc. v. Arizona Corporation
13 Commission, 194 Ariz. 104, 977 P.2d 826 (Ct. App. 1998). The Arizona Securities Act
14 defines a security as follows:
15

16
17 "Security" means any note, stock, treasury stock, bond, commodity
18 investment contract, commodity option, debenture, evidence of
19 indebtedness, certificate of interest or participation in any profit-sharing
20 agreement, collateral-trust certificate, preorganization certificate or
21 subscription, transferable share, investment contract, viatical or life
22 settlement investment contract, voting-trust certificate, certificate of
23 deposit for a security, fractional undivided interest in oil, gas or other
24 mineral rights, real property investment contract or, in general, any interest
25 or instrument commonly known as a "security", or any certificate of
26 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.

1 See A.R.S. § 44-1801(26). If an investment falls within these enumerated classes, it will
2 be deemed a security.

3 Neither real estate leases, vacation leases, nor anything similar to the Universal
4 Lease is enumerated as a “security” under the federal or Arizona securities acts. Thus, one
5 claiming the existence of a security would have to allege that another element of the
6 definition of a “security” encompasses the Universal Leases. The Arizona Securities Act,
7 following the federal statutes, includes the term “investment contract” in the definition of
8 “security.” The term has been used by the courts as a means to bring within the coverage
9 of the federal securities laws those instruments of a “more variable character.” Landreth
10 Timber Co. v. Landreth, 471 U.S. 681, 686, 105 S.Ct. 2297, 2301(1985). However, the
11 Universal Lease in this case is in no way an “investment contract” as defined by the courts.
12
13

14
15 **B. Leasehold Interests Purchased for Personal Use or for Purposes of**
16 **Appreciation in Value are Not Securities.**

17 In distinguishing the facts of its case, the Arizona Court of Appeals in Rose v.
18 Dobras, 128 Ariz. 209, 624 P.2d 887 (Ct. App. 1981), suggested that if a buyer purchased
19 a leasehold interest for: (1) the purpose of taking advantage of increases in its land value
20 (citing Happy Investment Group v. Lakeworld Properties, Inc., 396 F.Supp. 175 (N.D.Cal.
21 1975); or (2) consumption, it might not constitute a “security.” Rose, 128 Ariz. at 212
22 (citing Timmreck v. Munn, 433 F.Supp. 396 (N.D.Cal. 1975), which discussed United
23 Housing Foundation, Inc. v. Forman, 421 U.S. 837, 95 S.Ct. 2051 (1975)).
24
25
26

1 In United Housing, tenants purchased leasehold interests in a low-income
2 cooperative housing project, then later filed suit alleging a violation of federal securities
3 laws. The Court held that despite the specific inclusion of "stock" in the definitions of
4 "security" under the federal securities laws, shares of stock which entitled purchasers to
5 lease an apartment in a state subsidized and supervised nonprofit housing cooperative were
6 not "securities" within the purview of Securities Act of 1933, and Securities Exchange Act
7 of 1934. Id. at 859.
8

9
10 **C. The Universal Leases Are Not Investment Contracts.**

11 The federal and state cases analyzing fractional ownership or leasehold interests in
12 real estate or other property as potential securities focus on whether those fractional
13 interests are "investment contracts" within the meaning of federal and state securities laws.
14 An analysis of the term "investment contract" begins with the test established by the
15 United States Supreme Court case S.E.C. v. W. J. Howey Co., 328 U.S. 293, 66 S.Ct.
16 1100, 90 L.Ed. 1244 (1946). Arizona courts, as well as federal courts, have looked to this
17 test to determine whether a particular interest constitutes an "investment contract" which,
18 in turn, constitutes a security. The Howey test defines an investment contract as a security
19 if a person (1) invests money (2) in a "common enterprise" and (3) is led to expect profits
20 (4) solely from the efforts of the promoter or a third party. Howey, 328 U.S. at 301. The
21 Supreme Court in United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852 95 S.Ct.
22 2051, 2060 (1975), effectively deleted the word "solely" from the third prong of the
23
24
25
26

1 Howey test, which has caused most courts to apply three prongs, with the third being an
2 expectation of profits which are derived from the efforts of others.

3 Additionally, the Ninth Circuit has further clarified this third element by
4 examining “whether the efforts made by those other than the investor are the undeniably
5 significant ones, those essential managerial efforts which affect the failure or success of
6 the enterprise.” S.E.C. v. Glenn W. Turner Enterprises, Inc., 474 F. 2d 476, 482 (9th Cir.
7 1973). Arizona courts have adopted the Turner modification to the Howey test. *See* Rose,
8 128 Ariz. at 212; Daggett v. Jackie Fine Arts, Inc., 152 Ariz. 559, 566, 733 P.2d 1142,
9 1148 (Ct. App. 1986).

12 In Howey, the defendants sold strips of land on which orange groves were planted.
13 Each prospective customer was offered both a land sales contract and a service contract,
14 “after having been told that it [was] not feasible to invest in a grove unless service
15 arrangements are made.” Howey, 328 U.S. at 295. Although the purchasers were free to
16 make arrangements with other service companies, 85% of the acreage sold was serviced by
17 a company which was under direct common control and management with the defendant-
18 seller. Id. The profits from the entire grove were pooled and allocated to the purchasers.
19 Id. at 296. The Supreme Court found that the sales contracts, warranty deed and service
20 contracts were “investment contracts” because the transactions were: (1) an opportunity to
21 contribute money and to share in the profits of the citrus fruit enterprise, which was (2) to
22 be pooled in a common enterprise managed by the respondents or third parties with (3) the
23
24
25
26

1 adequate personnel and equipment to run the orchard that were essential to the investors
2 achieving a return on their investments. Id. at 299-300.

3
4 **1. The First Prong of the Howey Test: Investment of Money.**

5 Although the first prong of the Howey test is rarely contested and is not, standing
6 alone, dispositive in an analysis of whether the Universal Leases are investment contracts,
7 it should be noted that the Ninth Circuit has held that an investor makes an investment of
8 money when he commits his assets to an enterprise that will subject him to a financial loss.
9
10 Hector v. Wiens, 533 F.2d 429, 432 (9th Cir. 1976). The U.S. Supreme Court has held that
11 the investment must be “tangible and definable consideration in return for an interest that
12 had substantially the characteristics of a security.” International Brotherhood of Teamsters,
13 Chauffeurs, Warehousemen and Helpers of America v. Daniel, 439 U.S. 551, 560, 99 S.Ct.
14 790, 797 (1979).

15
16 Leaseholders have not committed their assets to an enterprise that will subject them
17 to financial loss in essentially the same manner as would a security. They have prepaid
18 rent on a vacation timeshare unit for their own personal consumption and use. If they
19 choose to not use their unit in any given year, they have the option of leasing it to a third
20 party by their own efforts, or by the efforts of a third-party leasing agent. The choice of
21 whether to personally use the Vacation Unit or rent to a third party is solely that of the
22 Leaseholder. Leaseholders do not participate in any profits or losses of the Respondent
23 entities or their business enterprise. Therefore, the consideration paid for a timeshare plan
24 by the Leaseholders is not characteristic of an investment in a “security.”
25
26

1 **2. The Second Prong: Horizontal and Vertical Commonality.**

2 The second prong of the Howey test requires that the investment be made in a
3 “common enterprise.” A common enterprise exists where “the fortunes of the investor are
4 interwoven with and dependent upon the efforts and success of those seeking the
5 investment or of third parties.” Vairo v. Clayden, 153 Ariz. 13, 17, 734 P.2d 110, 114 (Ct.
6 App. 1981); *see also* Milnarik v. M-S Commodities, Inc., 457 F.2d 274, 276-77 (7th Cir.
7 1972) (concluding there is not a common enterprise unless the success or failure of other
8 contracts have a direct impact on the profitability of the investor's contract); Wals v. Fox
9 Hills Dev. Corp., 24 F.3d 1016, 1018 (7th Cir. 1994)(stating that the value of each interest
10 is independent in that the right to use different weeks of the year carry different values, and
11 these unique characteristics preclude the finding of a common enterprise).

12 Commonality can be divided into two concepts: horizontal and vertical
13 commonality. Under the Howey test, horizontal commonality exists when there is a
14 pooling of funds collectively managed by a promoter or third party, and vertical
15 commonality exists when there is a positive correlation between the success of the investor
16 and the success of the promoter, and a pooling of funds is not required. *See* Daggett, 152
17 Ariz. at 565. In Arizona, if either of these commonalities exists, the second prong of the
18 Howey test has been met. *See id.* The Universal Lease in this case does not meet either
19 test.
20
21
22
23
24
25
26

1 **a. Horizontal Commonality.**

2 Horizontal commonality requires a pooling of investor funds collectively managed
3 by a promoter or third party. *See e.g. Vairo*, 153 Ariz. at 17; *Daggett*, 152 Ariz. at 565;
4 *Revak v. SEC Realty Corp.*, 18 F.3d 81 (2nd Cir. 1993)(citing SEC Release No. 33-5347,
5 38 Fed. Reg. 1735, 1736 (Jan 18, 1973) (“An owner of a condominium unit may, after
6 purchasing his unit, enter into a non-pooled rental arrangement with an agent not
7 designated or required to be used as a condition to the purchase, whether or not such agent
8 is affiliated with the offeror, without causing a sale of a security to be involved in the sale
9 of the unit”).
10
11

12 In the case of the Universal Lease: (1) Leaseholders execute separate contracts for
13 the purchase of their leasehold interests; (2) Leaseholders’ decisions, profits or losses are
14 independent of the fortunes of other purchasers; and (3) the purchase of a leasehold interest
15 itself does not hinge on the requirement that the Leaseholder utilize the services of a
16 leasing agent, which arrangement could give rise to an expectation of profits. Thus, there
17 is no horizontal commonality as a matter of fact and law.
18
19

20 There can be no question that the Leaseholder’s interest is unaffected by either the
21 Respondents or any other leaseholder. In any given year, the Leaseholder has the option of
22 occupying the Vacation Unit for personal use, leasing the Vacation Unit to a third party by
23 the Leaseholder’s own efforts or by a third party agent. Neither respondents nor other
24 leaseholders participate in the leasing of a Vacation Unit to a third party.
25
26

1 Moreover, any income received by the Leaseholder in connection with the leasing of
2 his or her Vacation Unit in any given year belongs to the Leaseholder and neither the
3 Respondents nor any other leaseholder shares in such funds. Neither does the Leaseholder
4 share in any funds generated by any other leaseholder who subleases his or her Vacation
5 Unit to a third party.
6

7 The Leaseholder does not share in any profits or losses realized by Respondents, nor
8 does the success of the Respondents or the Universal Lease plan have any direct bearing
9 on the rental or resale value the Leaseholder might expect should the Leaseholder choose
10 to rent their Vacation Unit or sell their timeshare interest. Any increase in value of the
11 Vacation Unit is attributable to the normal and expected appreciation of property values.
12

13 Based upon these facts, horizontal commonality does not exist because the
14 Leaseholder's fortunes are not "tied to one another." The profits and losses from the
15 leased Vacation Units are not pooled and distributed to the Leaseholders on a pro-rata
16 basis. *See Howey*, 328 U.S. at 299-300.
17

18 **b. Vertical Commonality.**
19

20 To prove vertical commonality, there must be evidence that the Respondents'
21 fortunes rise or fall with those of the Leaseholder. *Daggett*, 152 Ariz. at 565. In order to
22 understand how there is no vertical commonality with regard to the Universal Leases, the
23 case of *Lavery v. Kearns*, 792 F.Supp. 847 (D.Me. 1992), is instructive. In that case, the
24 plaintiffs entered into lease and buyback agreements with the defendants. Pursuant to the
25 terms of the agreements, the plaintiffs purchased condominium units and simultaneously
26

1 leased the units back to Atlantic Hospitality (“Atlantic”), an entity under common
2 management and control with the other defendants. The lease agreement provided that the
3 unit would be rented to customers at rates determined by Atlantic. Atlantic was
4 responsible for the leasing and maintenance of the units. Atlantic also agreed to pay
5 plaintiffs a set monthly fee.
6

7 The Lavery Court held that vertical commonality *did not* exist because, “[t]he lease,
8 with its fixed payment term, makes it contractually impossible for plaintiffs to share profits
9 or losses with anyone.” Id. at 853. Thus, while Atlantic could reap profits by leasing units
10 well above the monthly rate owed to plaintiffs, vertical commonality did not exist because
11 the fortunes of the plaintiffs were not intertwined with those of the promoters. Id.
12

13 In the Universal Lease program, the Leaseholders pay a fixed amount of prepaid
14 rent, plus an annual maintenance fee, which is standard in any condominium project,
15 timeshare plan, or development in which common areas benefit leaseholders or owners.
16

17 Whether or not the Leaseholder receives any revenue depends entirely on the
18 efforts of the Leaseholder. Neither the actions of Respondents nor any other purchaser of a
19 Vacation Unit has any impact on the Leaseholder.
20

21 If the Leaseholder decides to use the Vacation Unit as his or her own personal
22 accommodation in any given year, there is no expectation of revenue whatsoever. If the
23 Leaseholder decides to not use the Vacation unit, but to lease it to a third party, the
24 Leaseholder has the option of either leasing it out personally or through a third-party agent.
25
26

1 Thus, the “fortunes” of the Leaseholder are not linked to Respondents. As a result, there is
2 neither horizontal nor vertical commonality with respect to the Universal Lease.

3 **3. The Third Prong: Efforts of Others.**

4 The third element of the Howey test requires that the investor have an expectation
5 of profits. In United Housing Foundation, Inc. v. Forman, the United States Supreme
6 Court stated that the expectation of profits means:
7

8 either capital appreciation resulting from the development of the initial
9 investment . . . or a participation in earnings resulting from the use of
10 investors’ funds. . . In such cases the investor is attracted solely by the
11 prospects of a return on his investment.

12 United Housing, 421 U.S. 837, 852 95 S.Ct. 2051, 2060 (1975)(quoting Howey, 328 U.S.
13 at 300). The Howey test also requires that these profits be derived from the efforts of
14 others.

15 In discussing the “efforts of others” element, the courts have held “where the
16 investor maintains legal control over his investment (or the ability to regain control), in
17 order to claim the investment is a security he must show practical dependence, an inability
18 to exercise meaningful powers of control or to find others to manage his investment.”
19 Hocking v. Dubois, 885 F.2d 1449, 1459 (9th Cir. 1989). Importantly, in order to satisfy
20 the “efforts of others” standard, proof must be presented that “the reliance on the manager
21 which forms the basis of the [investor’s] expectations was an understanding in the original
22 transaction, and not some subsequent decision to delegate . . . duties.” Williamson v.
23 Tucker, 645 F.2d 404, 424 n.14 (5th Cir. 1981).
24
25
26

1 The Fifth Circuit decision in Williamson is the leading case on the “efforts of other”
2 standard. Under that test, the “efforts of others” prong will be met where:

3 (1) an agreement exists among the parties which leaves investors with so little
4 power that the arrangement in fact distributes power like a limited partnership; or
5

6 (2) the investors are so inexperienced and unknowledgeable in business affairs that
7 they are incapable of intelligently exercising their partnership powers; or

8 (3) the investors are so dependent on some unique entrepreneurial or managerial
9 ability such that the investors cannot replace the manager or otherwise exercise meaningful
10 partnership powers.
11

12 Williamson, 645 F.2d at 424; Nutec, 194 Ariz. at 109.

13 Under the terms of the Universal Lease, the Leaseholder has the sole power to
14 determine whether to use, not use, or sub-lease the Vacation Unit. Further the Leaseholder
15 retains the power to sub-lease the Vacation Unit on his own or hire a third-party leasing
16 agent of his choice to sub-lease the Unit. Thus, the Universal Lease does not satisfy the
17 third prong of the Howey test, thereby defeating a finding of an “investment contract.”
18

19 In order to establish the “efforts of others” prong in this case, there must be proof
20 that the Universal Lease, combined with a management agreement for a third party to rent
21 or lease the Leaseholder’s timeshare unit, were essentially part of the same transaction and
22 that the Leaseholder relied on the efforts of the management company to lease out the unit
23 at a profit to the Leaseholder. In this case, any agreement the Leaseholder decides to enter
24 into with a leasing agent/management company is not part of the Universal Lease
25
26

1 transaction, and is entered into at the option of the Leaseholder. In determining whether
2 to utilize the services of a leasing agent to rent out his or her vacation unit, the Leaseholder
3 is in no way depending upon the leasing agent to perform “essential managerial efforts
4 which affect the failure or success of the enterprise.” Glenn W. Turner Enterprises, Inc.,
5 474 F. 2d at 482.

7 Even if, *arguendo*, the Universal Lease and a third party service/management
8 agreement were deemed to be essentially part of the same transaction (which they are not),
9 the 11th Circuit decision in SEC v. ETS Payphones, et al., 300 F.3d 1281, 1284 (11th Cir.
10 2002) is instructive.⁵ In that case, investors purchased pay phones directly from an ETS
11 affiliate and then leased them back to ETS in exchange for “a fixed monthly fee.” Id. at
12 1282. In its decision holding that the lease arrangements did not constitute a “security,”
13 the court stated:
14
15

16 Moreover, the fixed lease payments paid to owners of the telephones
17 cannot be considered participation in earnings; owners were not looking
18 for any profit in the sense that they would receive earnings from the
19 company. The owners certainly had no intention to share in the
20 concomitant risk that their participation in the company’s earnings
21 would occasionally require them to share company losses. Of course,
22 the funds generated by the pay phones helped ETS meet its obligations.
23 But this does not justify characterization as participation in earnings.
24 Because the investors received a fixed monthly sum, the actual earnings
25 of the telephone, or ETS, were irrelevant. ETS alone shouldered the
26 risk of its placement of the telephones and ETS alone depended upon
the earnings of its business. Thus, only ETS could reap profits as that
term is understood under the federal securities laws.

25 Id. at 1284-85.

26 ⁵ The United States Supreme Court has granted *certiorari* on issues raised in that case.

1 The Court determined that “because [the investors’] returns were contractually
2 guaranteed, those returns were not derived from the efforts of [respondents]; rather, they
3 were derived as the benefit of the investors’ bargain under the contract.” The Court found
4 that the “efforts of others” requirement had not been met, and that the telephone lease
5 agreements were not “securities” under federal securities laws. In our case, there is no
6 guarantee of a return whatsoever, and that is spelled out in the agreements.
7

8 Absent proof on any one of the three prongs of the Howey test, the existence of an
9 “investment contract” cannot be established. In this case, none of the three elements – (1)
10 an “investment,” (2) in a “common enterprise,” (3) with the expectation of profits from the
11 “efforts of others,” have been met. Thus, the selling of timeshare vacation units under the
12 Universal Lease are not “investment contracts.”
13

14
15 **D. The SEC’s position.**

16 The SEC’s position on these issues is also instructive and supports Resort Holdings’
17 and Yucatan’s position. On November 8, 2002, the SEC issued an important no-action
18 letter. The no-action letter related to Intrawest Corporation (“Intrawest”), which was
19 proposing to offer for sale condominium units, utilizing a sales and promotional program
20 which would enable Intrawest, as the developer and promoter, to disclose the existence of
21 a rental management program in addition to other services it would offer.
22

23 Intrawest informed the SEC that over 80% of its condominium purchasers placed
24 their condominium into some form of rental management structure after the purchase and
25 that, historically, their condominium purchasers had recognized the value of being able to
26

1 utilize a single rental management company in any given project. Furthermore, Intrawest
2 asserted that of the 80% of purchasers who placed their condominium into a rental
3 management structure, over 90% chose Intrawest for rental management. Therefore,
4 Intrawest wanted to be sure that it could offer the services of its rental management
5 program to prospective purchasers.
6

7 Intrawest stated it would not make any representations or inducements to purchase
8 based on the rentability or income-producing capability of the unit, and stated that it would
9 inform purchasers that they were free to utilize the services of any rental management
10 company, regardless of whether the company was affiliated with Intrawest, or to rent their
11 units themselves.
12

13 Based on Intrawest's assurances that it would not offer condominium units to
14 prospective purchasers with an emphasis on the economic benefits that might be derived
15 from the managerial efforts of the developer, and that any rental agreement transaction
16 would be kept separate from the condominium purchase transaction, the SEC took the
17 position that it "[would] not recommend enforcement action to the Commission if
18 Intrawest, in reliance upon your opinion as counsel that registration is not required, offers
19 and sells condominium units . . . without compliance with the registration requirements of
20 the Securities Act of 1933."
21
22

23 In this case, any transaction involving a Leaseholder's agreement to utilize the
24 services of a leasing agent is completely separate from the transaction in which the
25 purchaser first enters into the Universal Lease agreement. Furthermore, the Leaseholder
26

1 is required to complete and sign an Acknowledgement that the Leaseholder fully
2 understands the terms of the lease agreement and that "Yucatan Resorts [now RHI, S.A.] is
3 in no way promoting the purchase of this vacation unit for investment purposes and there
4 is no investment guarantee from Yucatan Resorts [now RHI, S.A.]" Therefore, consistent
5 with Arizona's real estate and securities laws, federal case law, and the position of SEC,
6 Respondents have not violated Arizona's securities laws.
7

8
9 **V. CONCLUSION**

10 Based upon the foregoing, Respondents respectfully submit that the Arizona
11 securities laws do not apply to the Universal Leases, as the Universal Leases are not
12 "securities" under applicable laws.

13 WHEREFORE, the Temporary Cease and Desist order must be vacated.

14 Respectfully submitted on this 23rd day of June, 2003.

15
16 GALBUT & HUNTER
17 A Professional Corporation

18
19 By Martin R. Galbut

20 Martin R. Galbut
21 Jeana R. Webster
22 Jeffrey D. Gardner
23 Camelback Esplanade, Suite 1020
24 2425 East Camelback Road
25 Phoenix, Arizona 85016
26 Attorneys for Respondents
Yucatan Resorts, Inc., Yucatan
Resorts S.A. RHI, Inc., and RHI, S.A.

1 ORIGINAL and thirteen copies of the foregoing
2 hand-delivered this 23rd day of June, 2003 to:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington Street
6 Phoenix, Arizona 85007

7 COPY of the foregoing hand-delivered
8 this 23rd day of June, 2003 to:

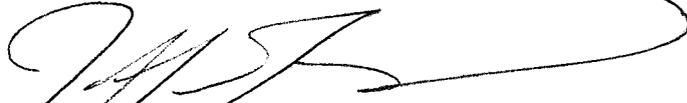
9 Hearing Officer
10 Hearing Division
11 Arizona Corporation Commission
12 1200 West Washington Street
13 Phoenix, Arizona 85007

14 Jaime Palfai, Esq.
15 W. Mark Sendrow, Esq.
16 Securities Division
17 Arizona Corporation Commission
18 1300 West Washington Street, 3rd Floor
19 Phoenix, Arizona 85007

20 COPY of the foregoing sent *via* U.S. Mail
21 this 23rd day of June, 2003 to:

22 Joel Held, Esq.
23 Elizabeth Yingling, Esq.
24 Baker & McKenzie
25 2300 Trammell Crow Center
26 2001 Ross Avenue – Ste.2300
Dallas, Texas 75201
Attorneys for Respondent
Yucatan Resorts, Inc., Yucatan Resorts, S.A.,
RHI, Inc., and RHI, S.A.

1 Paul J. Roshka, Jr., Esq.
Dax Watson, Esq.
2 One Arizona Center
3 400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004
4 Attorneys for Respondents
Michael and Lori Kelly

5 

6
7 Jeffrey D. Gardner

8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

EXHIBIT 1

STATE OF ARIZONA
DEPARTMENT OF REAL ESTATE

TIME-SHARE PUBLIC REPORT

FOR

BACCARA RESORT HOTEL

Registration No. DM01-027605

DEVELOPER

RESORT HOLDINGS INTERNATIONAL
DbA YUCATAN INVESTMENTS S.A. de CIV.
2533 North Carson Street
Carson City, Nevada 89706

July 3, 2001
Effective Date

PROPERTY REPORT DISCLAIMER

This report is NOT A RECOMMENDATION NOR AN ENDORSEMENT by the State of Arizona of this land but is provided for informational purposes ONLY. The report reflects information provided by the subdivider and obtained by the Department in its review process in accordance with the provisions of Title 32, Chapter 20, Article 9, of the Arizona Revised Statutes, as amended. **NOTE** that not all of the information in this report has been verified by the Department; certain information has been accepted by the Department as true and accurate based on attestation of the subdivider and/or the subdivider's agents. The purchaser should verify all facts before signing any documents. The Department has not passed upon the quality or quantity of any improvement or structure and does not assume responsibility in either event.

Phoenix Office:
2910 N. 44th Street
First Floor
Phoenix, Arizona 85018
(602) 468-1414 ext. 400

Tucson Office:
400 W. Congress
Suite 523
Tucson, Arizona 85701
(520) 628-6940

THE ARIZONA DEPARTMENT OF REAL ESTATE

REQUIRES THAT:

1. You BE GIVEN this public report;
2. YOU SIGN A RECEIPT indicating that you received this report;

RECOMMENDS:

1. You DO NOT SIGN ANY AGREEMENT before you have read this report;
2. You see an ACCURATE REPRESENTATION of the unit you are interested in BEFORE SIGNING any document for lease or purchase.

ARIZONA LAW STATES:

1. A PERSON SHALL NOT SELL OR LEASE OR OFFER FOR SALE OR LEASE IN THIS STATE TWELVE OR MORE TIME-SHARE INTERVALS WITHOUT FIRST OBTAINING A PUBLIC REPORT FROM THE COMMISSIONER. ANY SALE OR LEASE OF TWELVE OR MORE TIME-SHARE INTERVALS PRIOR TO ISSUANCE OF THE PUBLIC REPORT IS VOIDABLE BY THE PURCHASER. AN ACTION BY THE PURCHASER TO VOID SUCH TRANSACTION MUST BE BROUGHT WITHIN FIVE YEARS OF THE DATE OF THE EXECUTION OF THE PURCHASE AGREEMENT BY THE PURCHASER. IN ANY SUCH ACTION, THE PREVAILING PARTY IS ENTITLED TO REASONABLE ATTORNEY FEES AS DETERMINED BY THE COURT.
2. ANY CONTRACT OR AGREEMENT TO PURCHASE OR LEASE A TIME-SHARE INTERVAL MAY BE RESCINDED BY THE PURCHASER WITHOUT CAUSE OF ANY KIND BY SENDING OR DELIVERING WRITTEN NOTICE OF RESCISSION BY MIDNIGHT OF THE SEVENTH CALENDAR DAY FOLLOWING THE DAY ON WHICH THE PURCHASER OR PROSPECTIVE PURCHASER EXECUTED THE CONTRACT OR AGREEMENT.

GENERAL

This report includes: 16 units divided into 800 time-share intervals.

The Project Map for this development: is recorded in Public Deed records No. 160, L 16-6, records of Benito Jaurez County, State of Quintana Roo, Mexico. The entire development includes 23 units.

The Project: as shown in the Declaration of a wish to establish a tourism time share regime as Baccara Resort Hotel under number 60, pages 606-613 of book CCXCVII-A section 1 of the Public Probate and Commerce Records Office.

TIME-SHARE USE

Sales: will be evidenced by a lease for 25 years, renewable for 20 years. The offering is for fixed unit and fixed time for fifty, (50) one week intervals per unit.

Lock-outs: no.

Maintenance period: 2 weeks per year.

PROJECT LOCATION

The Project: is located at Blvd. Kukulcan Km. 11.5, Hotel Zone, Cancun, Quintana Roo, Mexico CP. 77500.

Existing and proposed land uses adjacent to project: Beach at seaside, rentals on either side and shopping center across street.

AIRPORTS

Airport: Cancun International Airport 18 Km. (approx. 12 miles).

NARRATIVE OF OFFERING

This development is a six story hotel building directly on the beach. There are 23 living quarters of which 16 are currently committed to time-share.

Units #12 and 19 are 3 bedrooms of 900 square foot each

Units #7, 8, 14 and 15 are 2 bedrooms of 650 square foot each.

Units #6, 9, 10, 11, 13, 16, 17 and 18

Unit #2 Junior Presidential Suite of 1,100 square feet

Unit #1 Presidential Suite of 1,500 square feet.

There is a swimming pool, a formal restaurant and a casual restaurant, sun bathing decks, a swim-up bar, a beach bar, a cocktail lounge and a TV viewing room with a billiard table and game table.

Each room is furnished with cable TV, refrigerator, microwave, range top, king size bed, dresser, chest of drawers, dinning table with 4 chairs, sofa, easy chair, coffee table, Juccuzi and a private terrace.

UTILITIES

Electricity, gas, water and sewage are provided to each unit, cost is paid by lessor.

ACCESS STREETS AND ROADS

Access to the Development: Asphalt paved public street maintained by the city.

COMMON AREA FACILITIES

Within the Development: Swimming pool, beach bar, swim-up bar and a TV viewing room with billiard and game table.

Maintenance of Development Facilities: Developer provides maintenance.

LOCAL SERVICE AND FACILITIES

Shopping Facilities: Flamingo Plaza mall is directly across Kukulcan Blvd.

Public Transportation: Public bus stop in front of development.

Medical Facilities: Ameri-Med Medical Center 5 Km north

Fire Protection: City of Cancun

Ambulance Service: Via 911

Police Service: City of Cancun

LEASE

LEASE: will be evidenced by seller delivering a lease agreement to purchaser and the purchasers earnest money being deposited into escrow account at Wells Fargo Bank in Phoenix Arizona during 7 day rescission period, then to developer.

TITLE AND ENCUMBRANCES

Title: to the property is vested with Resort Holdings International, dba Yucatan Investments, S.A de C.V..

Developers Interest: is evidenced by Fee.

Condition of Title and Encumbrances: as noted in public deed 160 as registered under number 60 pages 606-613 of book CCXCVII.

MANAGEMENT AND EXCHANGE NETWORK

The Project: will be managed by Yucatan Resorts S.A. de Civ.

Exchange Programs: none

BUDGETS AND ASSESSMENTS

Operating Costs: see exhibit A

Payment of Operating Costs and Assessments: The developer underwrites operating costs not covered by the annual assessment of each interval which is \$380.00 to \$650.00. Increases in annual assessment are provided for in lease agreement.

Financial Arrangements: Developer reports that the budget is sufficient to guarantee the payment of assessments on unsold interests on dedicated units.

Other Assessments: none

TAXES

Real Property Taxes: Developer reports that the taxes for the time-share dwelling units will be paid by the developer.

Other Tax Assessment: none

INTERVAL OWNERS ASSOCIATIONS

Name of Association: there is no association.

whl