The Hard Rock Hotel San Diego — a condo hotel — did NOT offer “securities” according to new appellate court decision in Salameh v. Tarsadia Hotel. Lower district court dismissal upheld.

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Hotel Lawyers on “hotel condo” units as securities (or NOT).

An important decision on when a condo hotel does NOT involve the sale of a “security”

by

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One of the most significant challenges for developers of a condo hotel project is whether the sale of the condo units constitutes the sale of a “security.” If it does, the principals and sellers of the project will have much greater compliance issues, costs and liabilities, which could make the project unworkable.

We have been advising clients on these issues in connection with more than 100 hotel mixed-use transactions since 2000. The deals usually have a significant residential component (condo hotels, hotel condos, single family homes or home sites, etc.) retail, entertainment and other uses added to a core hotel component. The Ninth Circuit opinion in Salameh v. Tarsadia Hotel (CA-9, No. 11-55479) discussed today provides a significant new level of comfort for all involved in such matters.

In an important decision yesterday (August 13, 2013) written by Judge Ronald M. Gould, a 3-judge panel of the Court of Appeals for the Ninth Circuit upheld the lower federal district court’s dismissal of plaintiff’s lawsuit arising out of their purchase of hotel condominium units at the Hard Rock Hotel San Diego, a “condo-hotel.”

The case was filed as a class action by Tamer Salameh and other named plaintiffs against some of the most respected people in Southern California’s hospitality industry, including Tarsadia Hotel, Tushar Patel, B.U. Patel, Gregory Casserly and other defendants. Notably, Playground Destination Properties, one of the first developers and most esteemed marketing companies for condo hotels, was also named in the action.

Essential to the plaintiffs’ claims was their characterization of their purchase as involving “securities” under the federal securities laws. They said that defendants offered condominium units together with a rental-management program, and doing so, constituted the sale of a “security.” The lower court dismissed the case after giving plaintiffs an opportunity to amend, finding that the amended complaint still did not state facts sufficient to find the existence of a “security.” The lower court also dismissed related common law fraud claims. For background on this issue and its importance, see “Condo Hotel Lawyer: Why does the SEC care about condo hotels?”

If you don’t know what a condo hotel is, or how it fits into hotel mixed-used, we have an entire section of HotelLawyer.com and HotelLawBlog devoted to condo hotels and to mixed-use. Just use the search bar at the top for any subject or click
condo hotels or mixed use!

Why is this case important?

1. The Ninth Circuit is one of the most prestigious and highly regarded federal appellate courts in the country, perhaps second only to the Second Circuit in New York in matters involving the securities laws. Well-reasoned, and properly decided in our view, this case is likely to clarify and establish a safe harbor for condo hotels avoiding the dreaded characterization of a sale of securities. It is also likely to deter a lot of frivolous litigation in the future.

2. The Ninth Circuit was also the court (in the *Hocking v Dubois* case) that held — under the facts of that case — that a certain offering of condominium hotel units in Hawaii was a sale of “securities.” The *Hocking* case gave rise to concerns about what the Ninth Circuit might do on a better-structured condo hotel like Tarsadia’s. In fact the *Hocking* case should not have surprised anyone as it has been clear for decades that the pooling of revenues from condos and sharing of profits amongst various owners does create a “security.” No good condo hotel structure involves pooling of revenues.

3. Under the applicable legal standard, the appellate court made a *de novo* review of the case — a complete review of everything. It was not bound by any aspects of the lower court’s decision. This gives the decision greater weight since it re-examined the facts of the case and applicable legal theories.

4. Although condo hotel development slowed abruptly with the Great Recession, it remains a viable and valuable structure in the right circumstances, particularly for luxury hotels. In addition, rental management programs for condominium units in a hotel mixed-use development remain popular among developers and condominium unit buyers wishing to reduce their cost of ownership when they are not using their condo. This case reaffirms the advice we have given clients over the years about putting together a safe condo hotel or condo rental program. This case helps ensure a bright future for well-structured condo hotel projects.

5. The facts of the case provide an important set of guidelines for marketing condo hotel properties. The Court emphasized that entering into the rental agreement was substantially delayed after the decision to purchase the condominium unit, ranging from 8 to 15 months. We have consistently advised our clients that one of the most important factors in offering a rental program is to separate the sale of the condominium unit from the offering of the rental program so that it is clear that the purchase of the condominium unit was not influenced by the availability of the rental program.

6. As importantly, the Court noted, and dismissed, local zoning restrictions that made the rental of the condo units imperative, most significantly, a restriction that prohibited an owner from occupying the unit for more than 28 days a year. The Court also stated that the fact that owners did not have unfettered access to their units (they were required to check in with the property in order to obtain a key) did not impact their analysis.

7. The decision in *Salameh v. Tarsadia Hotel* was reached despite an SEC amicus brief urging that the court find that a sale of securities was involved. Great deference is usually given to the SEC’s view on such matters in this type of case, but the court apparently felt the SEC was way out of bounds, legally speaking.

For more background and details

For more background on the case, see our original 2011 article, “Hotel Lawyer with good news! A new federal court decision upholds condo hotel structure. No “securities” involved as structured. Disgruntled condo hotel unit purchaser lawsuit dismissed.” This article includes a lot of details about the deal structure and selling program used to sell 420 condo
hotel units between 2006 and 2008. It also describes the arguments and defenses put forth by the parties.

For a copy of the Ninth Circuit opinion by Judge Gould, click Salameh v. Tarsadia Hotel.

Other condo hotel resources

You can access the full library of Condo Hotel materials on Hotel Law Blog by going to the home page, selecting the tab at the top that says “HOTEL LAW TOPICS”, and then clicking on “Condo Hotels” in the drop down menu . . . or by clicking here.

Below is a partial listing of articles by JMBM’s Condo Hotel Lawyers:

- Condo Hotel Lawyer: What is a Condo Hotel?
- The “new breed” of condo hotels — Key to financing new hotel development? Selling condo hotels as “securities” under new SEC Rule 506(c) . . .
- Using condo hotels for financing new hotel development: Traditional condo hotel structures as “non-securities”
- Condo Hotel fundamentals — 5 Keys to Success!
- Condo Hotels’ enduring legacy: hotel-enhanced mixed-use
- Hospitality Lawyer: The 5 biggest misconceptions about Condo Hotels
- Condo Hotel Lawyer: Why does the SEC care about condo hotels?
- Condo Hotel Lawyer: Standards must be “built in”
- Condo Hotel Lawyer: Not so fast! Locking down the condo hotel structure
- Condo Hotel Lawyer — What is fanning the condo hotel wild fire in Latin America, the Caribbean, Europe, China, India and the Middle East?
- Condo Hotel Lawyer — Las Vegas Report: What drives successful sellouts today?
- Condo Hotel Lawyer — What in the world is going on with condo hotels now?
- Hospitality Lawyer — Trump’s luxury residential mixed-use project in Hawaii sells out in 8 hours. New sales record claimed.

This is Jim Butler, author of www.HotelLawBlog.com and hotel lawyer, signing off. We’ve done more than $87 billion of hotel transactions and have developed innovative solutions to unlock value from hotels. Who’s your hotel lawyer?

Our Perspective. We represent hotel owners, developers and investors. We have helped our clients find business and legal solutions for more than $87 billion of hotel transactions, involving more than 3,900 properties all over the world, including more than 100 condo hotels and hotel condos. For more information, please contact Jim Butler at jbutler@jmbm.com or +1 (310) 201-3526.

Jim Butler is a founding partner of JMBM, and Chairman of its Global Hospitality Group® and Chinese Investment Group™. Jim is one of the top hospitality attorneys in the world. GOOGLE “hotel lawyer” and you will see why. Jim and his team are more than “just” great hotel lawyers. They are also hospitality consultants and business advisors. They are deal makers. They can help find the right operator or capital provider. They know who to call and how to reach them.