Delaware Journal of Corporate Law

VOLUME 17 1992 NUMBER 2

THE LIMITED PARTNERSHIP INTEREST: IS IT A SECURITY? CHANGING TIMES

BY CONRAD E.J. EVERHARD*

I. INTRODUCTION

Conventional wisdom remains based on the outdated assumption that all limited partners are passive investors, subject to the mercy of the general partners' management decisions. Consequently, limited partnership interests are almost always treated as securities, granting limited partners the protections of the federal securities laws.[1]

In most states, however, limited partners can now contract for and exercise meaningful control over partnership affairs without sacrificing their limited liability. In certain cases, the powers retained by the limited partners are so pervasive that they are in a position to adequately protect themselves. With respect to these transactions, this article proposes that the additional protections of the federal securities laws are neither appropriate nor necessary.

Goodman v. Epstein[2] is a recent case which illustrates how traditional notions of the role of limited partners may be misapplied to modern transactions in which limited partners possess the power

* Associate at Carro, Spanbock, Kaster & Cuiffo in New York City, practicing primarily in the areas of partnership, corporate, and securities law. I wish to dedicate this article to the memory of my friend Anthony Miller. I want to thank my wife, Judith Sullivan, and my colleagues, Derek A. Wittner, Richard Kolodny, and Jonathan Spanbock, for their assistance in the preparation of this article. In particular, I wish to express my gratitude to Lewis R. Kaster, who introduced me to the practice of partnership law.

1. *See* cases cited *infra* note 33 and accompanying text.
2. 582 F.2d 388 (7th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979).

to protect their investments. In autumn of 1971, Lee A. Freeman, an experienced real estate investor, approached L.W. Douglas, Jr., a real estate developer with whom he had extensive dealings, about taking a sizable equity position in a residential project which Mr. Douglas was undertaking with other developers.[3] With Mr. Douglas' approval, Mr. Freeman immediately assumed a pivotal role in getting the project off the ground. Among other things, Mr. Freeman contributed start-up capital, lined up other investors to provide the balance of the equity financing, and was the "moving force" in obtaining third-party loans for the project.[4]

The partners informally carried on this "amorphous business venture" for over six months.[5] Meanwhile, they obtained approval to rezone the property for residential use and took other "beginning steps" towards developing the project.[6] Finally, in June of 1972, they formalized their relationship in a written limited partnership agreement, which listed Mr. Freeman as one of the limited partners and Mr. Douglas as one of the general partners.[7] Once again, Mr. Freeman was a key player in the discussions, personally negotiating many of the agreement's terms.[8]

At this point, the partners encountered serious problems. First, they endured costly delays in site plan preparations and then botched an attempt to sell the property.[9] Finally, they were unable to obtain necessary government approvals for the project.[10] Although the full extent of Mr. Freeman's involvement in these affairs is unclear, it was undisputed that he became so disenchanted with Mr. Douglas that he single-handedly forced him out of the partnership as a general partner.[11]

After the project's demise, Mr. Freeman and his co-investors sued Mr. Douglas and the other promoters, alleging that they were fraudulently induced into investing in the partnership in violation of the federal securities laws.[12] At trial, Judge Julius J. Hoffman of the United States District Court for the Northern District of Illinois,

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3. *Id.* at 391.
4. *Id.* Indeed, there was some evidence that Mr. Freeman "alone would decide who the [investors] were to be." *Id.* at 391 n.7.
5. *Id.* at 391.
6. *Id.* at 392.
7. *Id.* at 391.
8. *Id.*
9. *Id.* at 392-93.
10. *Id.* at 393.
11. *Id.* at 393 n.12.
12. *Id.* at 390.

Eastern Division, allowed the jury to decide whether Mr. Freeman's interest in the limited partnership constituted a security. The jury returned a general verdict against Mr. Freeman and the other investors.[13]

On appeal, the Court of Appeals for the Seventh Circuit reversed the jury verdict.[14] The court disagreed with the trial judge's decision to let the jury determine whether Mr. Freeman's partnership interest was a security.[15] Instead, the court found that the interest was a security as a matter of law.[16] The court determined that the critical factor in this finding was that Mr. Freeman formally retained only a limited partnership interest in the newly-formed partnership when the partnership agreement was finally executed.[17]

The court held that limited partnership interests always constitute securities because limited partners are "prohibited, by law, from taking part in the management of the corporation."[18] The court applied this principle despite the fact that the limited partner in question carried the venture through its inception and personally removed a general partner from the partnership. The court sought to dismiss these overt acts of control on the basis that they did not amount to control over "essential management decisions."[19] In the end, however, the court was reluctant to disturb the "weighty authority" for treating limited partnership interests as securities.[20]

II. PARTNERSHIP INTERESTS UNDER THE FEDERAL SECURITIES LAWS

Neither general nor limited partnership interests are specifically mentioned in the definition of a "security" under the federal securities laws.[21] Thus, in order to constitute securities, these interests

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13. *Id.* at 395.
14. *Id.* at 416.
15. *Id.* at 406.
16. *Id.*
17. *Id.* The limited partnership agreement itself was apparently of the garden-variety type, formally vesting all management authority with Mr. Douglas and the other general partners. *Id.* at 392. Evidently, however, this did not prevent Mr. Freeman from continuing to influence partnership affairs, as demonstrated by his removal of Mr. Douglas as a general partner. *Id.* at 393 n.12.
18. *Id.* at 408. In fact, the limited partnership laws contain no such prohibition. *See infra* text accompanying notes 61-87.
19. *Goodman*, 582 F.2d at 408.
20. *Id.* at 408-09. Apparently, Mr. Freeman and the other investors never formally raised this issue on appeal. Because the jury verdict was being reversed on other grounds as well, however, the court instructed the trial judge to treat the limited partnership interests accordingly. *Id.*
21. The Securities Act of 1933 § 2(1) provides as follows:

must fall within one of the more general categories enumerated in the definition of a security. Almost universally, courts and commentators have applied investment contract analysis when dealing with partnership interests to determine whether such interests are securities within the meaning of the federal securities acts.[22]

In the seminal case *SEC v. W.J. Howey Co.*,[23] the United States Supreme Court established a four-prong test for determining whether particular instruments are investment contracts. The Court held that "[t]he test is whether the scheme involves [1] an investment of money,

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> When used in this subchapter, unless the context otherwise requires—
> (1) the term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest . . . or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, 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, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

The Securities Act of 1933 § 2(1), 15 U.S.C. § 77(b)(1) (1988).

The definition of "security" under The Securities Exchange Act of 1934 § 3(a), 15 U.S.C. § 78(c)(a) (1988), is practically identical, and both definitions will be treated interchangeably for the purposes of this article.

22. The other two definitional categories which might possibly apply to partnership interests are "certificate of interest or participation in any profit-sharing agreement" (PSA) and "instrument commonly known as a 'security'." 15 U.S.C. § 77(b)(1) (1988). With respect to the latter category, the Supreme Court has suggested that it be treated the same as the investment contract category. Landreth Timber Co. v. Landreth, 471 U.S. 681, 691 n.5 (1985). The same appears to hold true with respect to the PSA category. While at one time there existed a distinction between a PSA and an investment contract, "the tendency today is to lump the general phrases together, as if they were interchangeable." Joseph C. Long, *Partnership, Limited Partnership, and Joint Venture Interests as Securities*, 37 MO. L. REV. 581, 597 n.65 (1972). *See also* Marine Bank v. Weaver, 455 U.S. 551, 560 (1982) (applying the same analysis in determining whether a privately negotiated profit sharing agreement was either an investment contract or a PSA); Goodwin v. Elkins, 730 F.2d 99, 102 n.4 (3d Cir.), *cert. denied*, 469 U.S. 831 (1984) (plurality opinion) ("We are satisfied that, regardless of whether an interest is characterized as an 'investment contract' or as a 'profit-sharing agreement,' it still must meet the requirements of *Howey*."); Simon v. Fribourg, 650 F. Supp. 319, 322-23 (D. Minn. 1986). Additionally, the Supreme Court held in *Marine Bank* that an agreement to share profits, without more, is not enough to render the agreement a security. *Marine Bank*, 455 U.S. at 560. Thus, the only distinguishing characteristic between a PSA and an investment contract was specifically negated.

23. 328 U.S. 293 (1946).

[2] in a common enterprise, [3] with an expectation of profit, [4] to come solely from the efforts of others."[24]

By far, the most contentious aspect of the *Howey* test is the requirement that all entrepreneurial efforts come "solely" from the promoters. The *Howey* Court thought that investors who participate in an enterprise do not need the protection of the federal securities statutes because, through their involvement in the business, they are well positioned to protect their investments and gain access to information about the business.[25] Courts, however, came to recognize that under a literal approach to *Howey* unscrupulous promoters could easily evade the federal securities statutes by simply requiring that investors contribute some "modicum of effort" to the enterprise.[26] As a result, the modern view is that an interest constitutes an investment contract so long as the "essential managerial efforts which affect the failure or success of the enterprise" are made by others, even if the investor has some nominal role to play in the overall scheme.[27]

Typically, general and limited partnership interests meet the first three criteria of the *Howey* test. They involve investments of

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24. *Id.* at 301.

25. Thus, for example, general partnership interests are almost never found to be securities because general partners usually participate in running the business. *See infra* text accompanying notes 34-65. The same logic holds true with respect to franchising agreements. *See* Mr. Steak, Inc. v. River City Steak, Inc., 460 F.2d 666 (10th Cir. 1972). *Cf.* Fargo Partners v. Dain Corp., 540 F.2d 912, 915 (8th Cir. 1976) (holding that an agreement to sell an apartment complex coupled with an exclusive management agreement was not a security because the investor reserved the right to remove the property manager at any time and therefore retained "ultimate control" over its investment).

26. *See, e.g.*, SEC v. Glenn W. Turner Enter., Inc., 474 F.2d 476, 482 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). This issue came to the forefront in a series of cases involving pyramid schemes in the 1970s. *See* SEC v. Koscot Interplanetary Inc., 497 F.2d 473 (5th Cir. 1974). Typically, under these arrangements, the investor is responsible for performing some nominal role, like soliciting prospects and bringing them to recruitment meetings, despite the fact that practical control of the enterprise remains entirely with the promoters.

27. *Glenn Turner*, 474 F.2d at 482. *See also Koscot Interplanetary Inc.*, 497 F.2d at 480; Rivanna Trawlers Unltd. v. Thompson Trawlers, Inc., 840 F.2d 236 (4th Cir. 1988); Gordon v. Terry, 684 F.2d 736, 741 (11th Cir. 1982), *cert. denied*, 459 U.S. 1203 (1983); *Goodman*, 582 F.2d at 408 n.59; *Fargo Partners*, 540 F.2d at 914-15. *See also* Real Estate Syndications, The Securities Act of 1933, Release No. 33-4877, 32 Fed. Reg. 11,705 (1967) (codified at 17 C.F.R. § 231.4877) ("It would appear that nominal or purely formal participation by investors in the operation of the enterprise would not affect the application of the statutory provisions here discussed."). The United States Supreme Court has acknowledged, but not formally adopted, the *Glenn Turner* standard. United Housing Found., Inc. v. Forman, 421 U.S. 837, 852 n.16 (1975).

money[28] in a common enterprise with an expectation of profit.[29] In most cases, therefore, it is the fourth prong of *Howey*, dealing with the partner's level of control, which ultimately determines whether a particular partnership interest constitutes a security.

III. LIMITED PARTNERSHIP INTERESTS

A limited partnership consists of one or more general partners, who are responsible for conducting the partnership's business and

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28. Occasionally, a partner contributes goods or services, rather than cash, in exchange for his partnership interest. In these cases, an issue arises as to whether a contribution other than cash satisfies the first prong of *Howey*. The Supreme Court specifically left this issue open in International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 560 n.12 (1979). The dilemma, however, is that if a partner contributes substantial services to an enterprise then, even if the first prong of *Howey* is met, he would presumably fail the last prong because he would not be dependent on the efforts of others. *See* Frazier v. Manson, 484 F. Supp. 449 (N.D. Tex. 1980), *aff'd*, 651 F.2d 1078 (5th Cir. 1981). One commentator has suggested that a contribution of goods or services might satisfy *Howey* "as long as it is not designed to enhance the profitability of the investment." Deborah A. Calloway, Note, *General Partnership Interests as Securities Under the Federal Securities Laws: Substance Over Form*, 54 FORDHAM L. REV. 303, 310 n.33 (1985).

29. An issue sometimes arises as to whether an interest in a tax shelter partnership designed primarily to generate tax benefits satisfies the expectation of profit requirement under the *Howey* test. In *United Housing*, the Supreme Court stated that "profits" in this context means either "capital appreciation" or "a participation in earnings." *United Housing*, 421 U.S. at 852. The Court went on to negate the possibility that the tax advantages associated with an ordinary homeowners mortgage could ever be "profits" for these purposes. *Id.* at 855. Some courts have nonetheless hinted that tax benefits alone may under certain circumstances constitute a sufficient expectation of profits. *See* Long v. Shultz Cattle Co., 881 F.2d 129, 132 n.2 (5th Cir. 1989). In most cases, however, courts have circumvented the issue by finding an eventual expectation of profits either from future cash flow or the ultimate resale of the underlying asset. *See, e.g.*, SEC v. Professional Assocs., 731 F.2d 349, 356 (6th Cir. 1984); *Goodman*, 582 F.2d at 407; Stowell v. Ted S. Finkel Inv. Servs. Inc., 489 F. Supp. 1209, 1221 (S.D. Fla. 1980), *aff'd after remand*, 641 F.2d 323 (5th Cir. 1981).

Another factor is that "profits" must be derived from someone's efforts. In other words, if no efforts are required to bring the enterprise to fruition, there cannot be a security. *See United Housing*, 421 U.S. at 855 n.20 (stating that even if tax deductions constituted "profits," the *Howey* test would still not be met because "they do not result from the managerial efforts of others"). Thus, for example, if the sole purpose of a partnership is to acquire a specific plot of undeveloped land and wait for it to appreciate, the interests in the partnership are not securities because no managerial efforts are required for the success of the venture. LOUIS LOSS, SECURITIES REGULATION 491-92 (1961). On the other hand, if effort or skill is necessary to locate, develop and/or manage the property, a court is likely to find the requisite profit expectation. *See Gordon*, 684 F.2d at 740 n.4; McConnell v. Frank Howard Allen & Co., 574 F. Supp. 781, 784-85 (N.D. Cal. 1983).

are personally liable to creditors, and one or more limited partners, whose liability is limited to their investments. Traditionally, the trade-off for protection from liability has been the exclusion of the limited partners from the management of the business.[30] Although the Uniform Limited Partnership Act of 1916 (ULPA), the prevailing statute in most states through the mid-1980s, does not expressly prohibit limited partners from being involved in management, it does provide that a limited partner who "takes part in the control of the business" of the partnership becomes exposed to general liability for the partnership's obligations.[31] As a result of the threat of general liability, limited partners have historically tended to be passive investors who rely solely on the general partners for the success of their investments.

Not surprisingly, most courts and commentators have either mistakenly assumed that limited partners are prohibited from acquiring the sorts of control rights which would preclude their interests from being securities or they have simply taken for granted that limited partners would be deterred by the threat of general liability from ever doing so.[32] For this reason, the overwhelming majority of cases in this area have held that limited partnership interests are investment contracts and, therefore, securities.[33]

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30. As one court stated: "A limited partner is a capitalist or investor only, placing his money into a partnership without becoming a general partner or risking anything in the business except the capital originally subscribed." Caley Inv. I v. Lowe Family Assocs., Ltd., 754 P.2d 793, 795 (Colo. Ct. App. 1988).

31. UNIF. LIMITED PARTNERSHIP ACT § 7, 6 U.L.A. 582 (1969). In fact, the ULPA contains precious few rights for limited partners. Generally, these are limited to the right to inspect the partnership's books and records, to demand an accounting, to dissolve the partnership by court decree, and to receive profits and a return of capital contributions. *See generally id.* § 10, 6 U.L.A. 590 (describing the rights of limited partners).

32. *See infra* note 33.

33. *See* Siebel v. Scott, 725 F.2d 995 (5th Cir.), *cert. denied*, 467 U.S. 1242 (1984); Mayer v. Oil Field Sys. Corp., 721 F.2d 59 (2d Cir. 1983), *aff'd*, 803 F.2d 749 (2d Cir. 1986); SEC v. Murphy, 626 F.2d 633 (9th Cir. 1980); Goodman v. Epstein, 582 F.2d 388 (7th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979); Dooner v. NMI, Ltd., 725 F. Supp. 153 (S.D.N.Y. 1989); Hagstrom v. Breutman, 580 F. Supp. 773 (N.D. Ill. 1984); Kroungold v. Triester, 407 F. Supp. 414 (E.D. Pa. 1975); Bayoud v. Ballard, 404 F. Supp. 417 (N.D. Tex. 1975); Hirsch v. DuPont, 396 F. Supp. 1214 (S.D.N.Y. 1975), *aff'd*, 553 F.2d 750 (2d Cir. 1977). *See also* Securities Act of 1933 Release No. 33-4877, 32 Fed. Reg. 11,705 (1967) (codified at 17 C.F.R. § 231.4877) ("Under the Federal Securities Laws, an offering of limited partnership interests . . . generally constitutes an offering of a 'profit sharing agreement' or an 'investment contract' which is a 'security' . . . ."); Long, *supra* note 22, at 611 ("Limited partnership interests are always securities under the [Howey] test."). *But see* cases cited *infra* note 110.

IV. GENERAL PARTNERSHIP INTERESTS

General partnership interests are almost never deemed to be securities because, unlike limited partners, statutes confer upon general partners equal right to control the conduct of the partnership's business.[34] Therefore, general partners have the power to protect themselves and do not need the additional protection of the federal securities laws.

The principal caveat to this rule is that a general partner's management rights may be circumscribed by agreement between the partners.[35] Despite the fact that most general partners insist on some degree of control over the enterprise to offset their exposure to general liability and the lack of liquidity of their investments, there are circumstances in which general partners may be contractually excluded from the decision-making process.[36] Additionally, there may be general partners who are unable to exercise meaningful control over the partnership, even if not divested of the legal power to do so, because of inexperience or otherwise. In either case, it is arguable that the "non-managing" general partners are practically dependent on the efforts of others despite their nominal general partner status.

Two schools of thought have evolved with respect to whether a general partnership interest is a security. On the one hand, there is authority for the proposition that, as a matter of law, general partnership interests are never securities.[37] Predictably, this approach is not widely followed because it allows promoters to circumvent the securities laws by simply labelling their enterprises as general partnerships even though they retain all practical control.

The other view, which prevails today, focuses on the economic reality of the relationship between the general partners. More specifically, does each general partner possess the legal and practical

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34. Section 18 of the Uniform Partnership Act provides that "subject to any agreement between them . . . all partners have equal rights in the management and conduct of the partnership business." UNIF. PARTNERSHIP ACT § 18, 6 U.L.A. 213 (1969).

35. *Id.*

36. The classic examples are large professional partnerships where managerial authority is delegated to a management committee or small group of senior partners.

37. *See Goodwin*, 730 F.2d at 107. *See also Hirsch*, 396 F. Supp. at 1221 (leaving open the possibility that a general partnership interest might constitute a security if the general partner is divested by contract of all management authority).

ability to control the enterprise? This approach was pioneered by the Fifth Circuit in the landmark case of *Williamson v. Tucker*.[38]

Williamson involved three real estate joint ventures consisting of approximately fifteen investors each.[39] In each case, an affiliate of the promoters was retained to manage the properties and run the business.[40] Each manager was prohibited, however, from participating in certain activities without the consent of the joint venturers.[41] These activities included developing the properties, borrowing monies, encumbering joint venture assets, confessing judgments against the joint ventures, and amending the joint venture agreements.[42] In addition, the joint venturers were empowered to remove the managers and take other concerted actions.[43] Unfortunately, they did not avail themselves of their contractual powers and chose instead to rely entirely on the managers' efforts.[44]

When the projects ultimately failed, some of the investors sought to hold the managers accountable under the federal securities laws.[45] The trial court dismissed their action for lack of subject-matter jurisdiction.[46] The Fifth Circuit disagreed with the grounds for dismissal and remanded the case. In so doing, however, it took it upon itself to guide the lower court in determining whether the venture interests were securities.

The Fifth Circuit noted that, as a rule, general partners and joint venturers have a "difficult burden to overcome" in order to demonstrate that their interests are securities.[47] This burden, the court stressed, is not met simply because the investors choose to rely

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38. 645 F.2d 404, 423 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981). *See also* Koch v. Hankins, 928 F.2d 1471 (9th Cir. 1991); Bailey v. J.W.K. Properties, Inc., 904 F.2d 918 (4th Cir. 1990); Odom v. Slavik, 703 F.2d 212 (6th Cir. 1983); Gordon v. Terry, 684 F.2d 736 (11th Cir. 1982), *cert. denied*, 459 U.S. 1203 (1983); Casablanca Prod., Inc. v. Pace Int'l Research, 697 F. Supp. 1563 (D. Or. 1988); Power Petroleums, Inc. v. P & G Mining Co., 682 F. Supp. 492 (D. Colo. 1988); Cohen v. Goodfriend, 642 F. Supp. 95 (E.D.N.Y. 1986); McConnell v. Frank Howard Allen & Co., 574 F. Supp. 781 (N.D. Cal. 1983).

39. *Williamson*, 645 F.2d at 408.

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.* at 408-09.

44. *Id.* at 409.

45. *Id.*

46. *Id.*

47. *Id.* at 424.

on others or delegate their statutory powers.[48] Instead, a general partner or venturer must demonstrate that, despite his statutory rights of control, "he was so dependent on the promoter or third party that he was in fact unable to exercise meaningful [control] powers."[49]

The court then adopted what essentially amounts to a two-prong test for determining whether a general partner or venturer is incapable of exerting meaningful control powers. The first step is to determine whether the investor has in fact been contractually divested of his legal right to control the partnership.[50] If he has not, the second step is to determine whether the formal control powers retained by the investor are realistically exercisable.[51] The court focused on two sets of circumstances. Specifically, the court considered whether

> [1] the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or [2] the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.[52]

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48. *Id.* at 423-24. The court stated:

> An investor who retains control over his investment has not purchased an interest in a common venture "premised on the reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others," even if he has contracted with [another] for the management of [his investment]. So long as the investor retains ultimate control, he has the power over the investment and the access to information about it which is necessary to protect against any unwilling dependence on the manager. *It is not enough, therefore, that partners in fact rely on others* for the management of their investment; a partnership can be an investment contract only when the partners are so dependent on a particular manager that they cannot replace him or otherwise exercise ultimate control.

Id. (citations omitted) (emphasis added).

49. *Williamson*, 645 F.2d at 424.

50. *See id.*

51. *Id.*

52. *Id.* The court noted that other factors might also be relevant depending on the circumstances. *Id.* at 424 n.15. For a more detailed examination of these factors, see *infra* text accompanying notes 149-82. Some courts purporting to apply *Williamson* have limited their inquiry to the legal powers retained by the investor and have refused to look at outside circumstances to see whether those powers were realistically exercisable. *See* Banghart v. Hollywood Gen. Partnership, 902 F.2d 805, 808 (10th Cir. 1990); Matek v. Murat, 862 F.2d 720, 730-31 (9th Cir. 1988). One court dispensed only with the inquiry into the knowledge and business expertise of

Applying this reasoning, the court opined that the joint venture interests in question did not appear to be securities.[53] The court found that the contractual rights of consent and supervision retained by the non-managing joint venturers gave them "ultimate control" over the enterprise.[54] While the actual day-to-day management responsibility may have been delegated to others, the investors nonetheless enjoyed, by virtue of these powers, sufficient influence over partnership affairs that would allow them access to information about the business and to reduce their dependency on the managers.[55]

Moreover, none of the factors which might call into question the investors' ability to exercise their control powers appeared to be present. The investors were all sophisticated businessmen and had been involved in other joint ventures.[56] Furthermore, the promoters possessed no special expertise which made them "uniquely capable" of running the venture.[57]

Although *Williamson* concerned joint venture interests, the reasoning of the case has been applied, albeit in a slightly altered form,[58] to other investment instruments which empower investors with potential rights of control.[59] *Williamson* is particularly relevant to the

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each partner. *Rivanna*, 840 F.2d at 241 n.7. The Ninth Circuit, however, recently rejected the stream-lined version of *Williamson* espoused by *Matek* and confirmed that it would consider all of the factors set forth in *Williamson*. *Koch*, 928 F.2d at 1478. Likewise, the Fourth Circuit has limited its reasoning in *Rivanna* to the general partnership context so that courts in the Fourth Circuit may now consider the sophistication of investors in other investment settings. *Bailey*, 904 F.2d at 923. Only the Tenth Circuit continues to limit its focus to the legal powers of control retained by the investor. *See* Maritan v. Birmingham Properties, 875 F.2d 1451, 1456 (10th Cir. 1989).

53. *Williamson*, 645 F.2d at 424.

54. *Id.* There exists substantial authority for the position that indirect control powers, like veto or consent rights, may constitute legal control of an enterprise for purposes of the *Howey* test, even though day-to-day management responsibility is entrusted to others. *See* cases cited *infra* note 145.

55. *Williamson*, 645 F.2d at 422.

56. *Id.* at 424-25.

57. *Id.* at 425.

58. Outside of the general partnership context, of course, the first question must be whether the investor has in fact acquired the legal right to control the enterprise because, unlike general partners, investors in other investment vehicles do not start-off with statutory control rights. Only then is it appropriate to consider whether the legal powers are realistically exercisable.

59. *See, e.g.*, Bailey v. J.W.K. Properties, Inc., 904 F.2d 918 (4th Cir. 1990) (cattle breeding program); Hocking v. Dubois, 885 F.2d 1449 (9th Cir. 1989), *cert. denied*, 494 U.S. 1078 (1990) (contract to sell condominium coupled with optional rental pool arrangement); Long v. Shultz Cattle Co., 881 F.2d 129 (5th Cir. 1989)

treatment of limited partnership interests under the federal securities laws. As a result of recent statutory changes, limited partners in many jurisdictions can now enjoy the same rights and powers traditionally reserved for general partners and joint venturers. In fact, it is possible to structure limited partnerships in some states so that the limited partners retain the same contractual powers of control possessed by the non-managing venturers in *Williamson*.[60]

V. THE EVOLVING CONCEPT OF CONTROL

The conventional wisdom states that limited partnership interests necessarily constitute securities because limited partners are prohibited from enjoying meaningful rights of control. This thinking is flawed in a number of important respects.

First, the vast majority of securities cases dealing with limited partnership interests involve limited partnerships formed under the ULPA.[61] Yet, as of the date of this article, only Alaska and Vermont are still governed by the ULPA.[62] The other states, except for Louisiana, have adopted revised versions of the ULPA which allow limited partners greater flexibility to engage in management activities without incurring general liability.[63]

(cattle feeding program); Deutsch Energy Co. v. Mazur, 813 F.2d 1567 (9th Cir. 1987) (mineral and extraction rights); Gordon v. Terry, 684 F.2d 736 (11th Cir. 1982) (real estate syndication trusts and limited partnership); Perry v. Gammon, 583 F. Supp. 1230 (N.D. Ga. 1984) (contract to sell apartment complex coupled with exclusive management agreement); Westlake v. Abrams, 565 F. Supp. 1330 (N.D. Ga. 1983) (commodities futures options).

60. The Revised Uniform Limited Partnership Act with 1985 Amendments (1985 RULPA) contains a specific statutory provision exculpating limited partners from liability for the exercise of contractual rights of approval over any partnership matter, so long as such rights are expressly granted in writing in the limited partnership agreement. REVISED UNIF. LIMITED PARTNERSHIP ACT (1976) WITH THE 1985 AMENDMENTS § 303(b)(6)(ix), 6 U.L.A. 326 (West Supp. 1991). Because the veto and other consent rights retained by the non-managing venturers in *Williamson* were set forth in their respective partnership contracts, these rights would fall squarely within the 1985 RULPA "safe harbor" if they were in the hands of a limited partner in a 1985 RULPA jurisdiction. For a more detailed examination of 1985 RULPA, see *infra* text accompanying notes 94-109.

61. *See, e.g.*, Siebel v. Scott, 725 F.2d 995 (5th Cir.), *cert. denied*, 467 U.S. 1242 (1984); Mayer v. Oil Field Sys. Corp., 721 F.2d 59 (2d Cir. 1983), *aff'd*, 803 F.2d 749 (2d Cir. 1986).

62. The last major holdout, the State of New York, recently enacted the Revised Uniform Limited Partnership Act of the State of New York, which became effective on July 1, 1991.

63. As of the date of this article, the following states have enacted revised

Second, limited partnership statutes, including the ULPA, do not affirmatively prohibit limited partners from exercising control. Instead, they provide that limited partners who take part in certain types of control activity do so at the risk of losing their limited liability. There is nothing in the statutes, however, which prevents a limited partner who is willing to assume this risk from partaking in whatever conduct he pleases. Indeed, it is entirely conceivable that some limited partners might be willing to accept a certain degree of exposure to liability in exchange for greater say over the fate of their investments.

Finally, the most fundamental problem with this thinking is the assumption that the possession by a limited partner of sufficient control power to preclude his interest from being a security under the federal securities laws would also necessarily expose him to general liability under the limited partnership laws. To the contrary, each statute is concerned with a very different concept of control. For securities law purposes, control means the power to protect oneself from dependence on others and to gain access to information about the business.[64] On the other hand, the type of control that the limited partnership statutes attempt to discourage is increasingly being limited to those activities that might conceivably mislead creditors into believing that the limited partners are in fact general partners.[65] These divergent concepts of control are not mutually exclusive. It is possible, in other words, for a limited partner to enjoy bona fide rights of control over his investment without deceiving creditors about his limited partner status.

A. *Definition of Control Under the ULPA*

Although the discussion is now largely academic, even under the ULPA, the possession or exercise of meaningful partnership powers by a limited partner does not necessarily result in the im-

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limited partnership statutes: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

64. *Williamson*, 645 F.2d at 422. *See also* SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

65. *See infra* notes 66-87 and accompanying text.

position of general liability. Specifically, many courts interpreting the ULPA have determined that the restriction against limited partners taking part in the control of the business does not apply to all management activity.[66] Limited partners in ULPA jurisdictions have, for instance, attended partnership meetings,[67] advised general partners,[68] visited the partnership's business,[69] consented to extraordinary decisions,[70] and become actively involved in management during periods of financial difficulties[71] without losing their special status. In fact, some courts have even sanctioned far more pervasive involvement by the limited partners in partnership activities.[72] In the words of one court,

> the law does not confine the role of a limited partner to that of a passive investor, as in a conventional syndication. To the contrary, as is expressly recognized in the new Act, and as was implicit in the [ULPA], *a limited partner may be actively involved in the day to day operation of the partnership's*

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66. *See* cases cited *infra* notes 67-71.

67. Trans-Am Builders, Inc. v. Woods Mill, Ltd., 210 S.E.2d 866 (Ga. App. 1974).

68. *Id.*

69. *Id.*

70. First Wis. Nat'l Bank v. Towboat Partners, Ltd., 630 F. Supp. 171 (E.D. Mo. 1986), *aff'd*, Towboat Partners, Ltd. v. Donelan, 802 F.2d 1069 (8th Cir. 1986) (limited partners had veto right over draw requests under partnership loan guaranteed by them).

71. Weil v. Diversified Properties, 319 F. Supp. 778 (D.D.C. 1970); Trans-Am Builders v. Woods Mill, Ltd., 210 S.E.2d 866 (Ga. App. 1974).

72. Mount Vernon Sav. & Loan Ass'n v. Partridge Assocs., 679 F. Supp. 522 (D. Md. 1987). Some courts appear to focus on whether the limited partner was involved in the financial decision making process. Consider, for example, Alzado v. Blinder, Robinson & Co., 752 P.2d 544 (Colo. 1988). In this case, a limited partnership was formed under a ULPA statute for the purpose of promoting a boxing match between Lyle Alzado and Muhammed Ali. *Id.* at 547. The limited partner, a business entity, became actively involved in promoting the match and allowed its facilities to be used for partnership purposes. *Id.* at 552. The match was a financial disaster. Afterwards, Mr. Alzado sought to hold the limited partner personally liable for amounts owed to him by the partnership based on the theory that it had participated in the control of the business. *Id.* at 547. With respect to this claim, the jury returned a verdict in Mr. Alzado's favor. *Id.* at 548. On appeal, the Supreme Court of Colorado affirmed the court of appeals' reversal of the jury verdict. *Id.* The court found that, although the limited partner engaged in promotional activities on behalf of the partnership, it made "no investment, accounting or other financial decisions for the partnership." *Id.* at 552. Thus, the record failed to establish that the limited partner participated in control within the meaning of the ULPA. *Id. See also In re* Stefanoff, 106 B.R. 251 (Bankr. N.D. Okla. 1984) (participation by limited partner in financing decisions rendered him generally liable).

> *affairs*, provided that he does not have ultimate decision making responsibility.[73]

Without question, the most progressive approach adopted in terms of giving limited partners flexibility to engage in control activities under the ULPA is the "creditor reliance test." This test is based on the proposition that the sole purpose of the control restriction is to protect creditors from being deceived as to whether the limited partners stand behind the obligations of the limited partnership.[74] Under this reasoning, only limited partner conduct that could reasonably induce a creditor to believe that the limited partner is a general partner and, therefore, liable for partnership debts will result in the imposition of general liability.[75] Support for this position is found in the Official Comment to section 1 of the ULPA:

> No public policy requires a person who contributes to the capital of a business, acquires an interest in the profits, *and some degree of control over the conduct of the business*, to become bound for the obligations of the business; *provided creditors have no reason to believe at the time their credits were extended that such person was so bound.*[76]

The leading case in support of the "creditor reliance test" is *Frigidaire Sales Corp. v. Union Properties, Inc.*,[77] which involved a limited partnership formed under the ULPA. The sole general partner of the partnership was a corporation that was wholly-owned by two of the limited partners.[78] Additionally, these limited partners were officers and directors of the corporate general partner and, in such capacities, exercised the day-to-day management of the limited partnership.[79] The case arose when the limited partnership defaulted on several of its commercial obligations. The creditors sought to hold the limited partners personally liable based on the fact that, through

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73. *Mount Vernon*, 679 F. Supp. at 528 (emphasis added).

74. Alan L. Feld, *The "Control" Test for Limited Partnerships*, 82 HARV. L. REV. 1471, 1479 (1969).

75. *See generally id.* (describing possible ways to determine whether a limited partner has exercised "control" over the partnership).

76. UNIF. LIMITED PARTNERSHIP ACT § 1, 6 U.L.A. 564 Official Comment (1969) (emphasis added).

77. 544 P.2d 781 (Wash. App. 1975), *aff'd*, 562 P.2d 244 (Wash. 1977).

78. *Id.* at 782.

79. *Id.*

their interests in the corporation, they effectively controlled the partnership.[80]

Although the limited partners did in fact direct the partnership's business, the state appellate court refused to blindly apply the control statute without "inquiry as to the purpose [the statute] seeks to achieve."[81] This purpose, the court found, was to "protect third parties from dealing with the partnership under the mistaken assumption that the limited partner is a general partner with general liability."[82] By the same reasoning, however, where there is no likelihood that creditors will be deceived, no policy is served by holding the limited partners personally accountable for the partnership's obligations.[83]

In the end, the court concluded that, absent fraud or other wrongdoing, creditors who knowingly do business with a corporation can never "justifiably rely on the solvency of the individuals who own the corporation."[84] Instead, when dealing with a corporation, third parties must rely on the solvency of the corporate entity. Therefore, despite the limited partners' control of the corporate general partner, the creditor in question could not have been misled about the role of the limited partners and was not entitled to recover against them.[85]

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80. *Id.* at 783.

81. *Id.* at 785.

82. *Id.*

83. *See supra* note 76 and accompanying text.

84. *Id.*

85. *Id.* Another issue that the court considered was whether using a corporation as the sole general partner of a limited partnership frustrates the statutory requirement of at least one partner with general liability. Ultimately, the court concluded that the concern about inadequate capitalization was not peculiar to corporate general partners and was adequately addressed by general corporation law principles. *Id.* at 784. In affirming the lower court's decision, the Washington State Supreme Court stressed that the corporate general partner in question was not merely an "alter-ego" for the limited partners but served other business purposes. *Frigidaire Sales Corp.*, 562 P.2d at 246-47. The corporate law issues raised in these decisions have been largely mooted by the enactment in most states of specific "safe-harbor" legislation which expressly permits limited partners to serve as shareholders, officers, or directors of corporate general partners without becoming subject to liability. *See infra* notes 103-07 and accompanying text.

With respect to the partnership control issue, the Washington State Supreme Court agreed with the lower court's conclusion that the creditor could not have reasonably relied on the credit of the limited partners. *Frigidaire Sales Corp.*, 562 P.2d at 247. If the creditor had any questions about the solvency of the corporate general partner, the court reasoned, it could have required that the limited partners personally guarantee the partnership's performance. *Id.*

For other cases endorsing a "creditor reliance" approach under the ULPA,

To be sure, the "creditor reliance test" was not universally accepted in all ULPA jurisdictions.[86] Indeed, some courts interpreting the ULPA subscribed to older, less progressive views as to what powers limited partners could safely enjoy.[87] The uncertainty resulting from this divergence of opinion was the primary reason for the enactment of revised limited partnership statutes in many states.

B. *Changes in Statutory Law*

1. Revised Uniform Limited Partnership Act

The first attempt to revamp the control provision was made in the Revised Uniform Limited Partnership Act of 1976 (RULPA). Basically, RULPA retains the old ULPA control test but adds the following qualification: "[I]f the limited partner's participation in the control of the business *is not substantially the same* as the exercise of the powers of a general partner, he [or she] is liable only to persons who transact business with the limited partnership with *actual knowledge* of his participation in control . . . ."[88]

In the final analysis, however, RULPA does not afford limited partners a great deal more latitude to engage in meaningful control

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see Western Camps, Inc. v. Riverway Ranch Enters., 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (1977); Outlet Co. v. Wade, 377 So. 2d 722 (Fla. Dist. Ct. App. 1979).

86. In a case with facts similar to *Frigidaire Sales*, the Texas Supreme Court allowed a creditor to reach the assets of limited partners who wholly-owned and controlled the limited partnership's corporate general partner. Delaney v. Fidelity Lease Ltd., 526 S.W.2d 543 (Tex. 1975). "The [ULPA] makes no mention of any requirement of reliance on the part of the party attempting to hold the limited partner personally liable." *Id.* at 545. Likewise, the New York Court of Appeals rejected a reliance requirement in New York's version of the ULPA. Gonzalez v. Chalpin, 565 N.E.2d 1253 (N.Y. 1990). Both of these holdings have been statutorily mooted by the subsequent enactment of revised limited partnership statutes in Texas and New York. N.Y. PARTNERSHIP LAW § 121-303(b)(1) (McKinney 1990); TEX. CORPS. & ASS'NS CODE ANN. § 3.03(b)(1) (Vernon 1987). *See also* Continental Waste Sys., Inc. v. Zoso Partners, 727 F. Supp. 1143, 1148 (N.D. Ill. 1989) ("[I]t seems likely that Illinois courts would side with those courts that have chosen not to import a reliance requirement into [the ULPA]."); Mursor Builders, Inc. v. Crown Mountain Apt. Assocs., 467 F. Supp. 1316, 1333-34 (D.C.V.I. 1978) (stating that limited partners are generally liable for debts of the partnership, regardless of third-party reliance).

87. There does not appear to be any relevant authority as to what constitutes taking part "in the control of the business" in either of the two remaining ULPA jurisdictions.

88. REVISED UNIF. LIMITED PARTNERSHIP ACT § 303(a), 6 U.L.A. 325 (West Supp. 1991) (1976 version) (emphasis added).

activities. In the first place, liability under RULPA is premised on "knowledge" rather than "reliance." In other words, so long as a third party has "actual knowledge" of purported acts of control by the limited partners, he can presumably recover against the limited partners even if those acts could not possibly have misled him into believing that the limited partners were in fact general partners with general liability.

Second, the protection from liability provided by the knowledge requirement under RULPA does not extend to all limited partner conduct. Specifically, the language of the provision implies that limited partners who exercise powers that are "substantially the same as the exercise of the powers of a general partner" will be absolutely liable for partnership debts regardless of whether any third parties were aware of their participation in control.[89] Thus, the exercise of rights and powers which would otherwise be protected under RULPA because they can be implemented without creditor knowledge, such as veto or consent rights, might nonetheless result in liability if it is found that these rights put the limited partners on an equal footing with the general partners.[90]

The other principal innovation of RULPA is the establishment of a "safe harbor" for specific conduct in which limited partners may engage without incurring general liability.[91] This includes the

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89. This reading of the statute is supported by the Official Comment to § 303 of RULPA, which provides that "in order to avoid permitting a limited partner to exercise all of the powers of a general partner while avoiding any direct dealings with third parties, the 'is not substantially the same as' test was introduced." *Id.* § 303 Official Comment. *See also Mount Vernon*, 679 F. Supp. at 527 ("Under [RULPA], a limited partner who disregards the limited partnership form to such an extent that he becomes substantially the same as a general partner has unlimited liability regardless of a plaintiff's knowledge of his role.").

90. Not surprisingly, there exists almost no authority as to what constitutes "substantially the same" powers as a general partner. One court, when faced with this issue, concluded that it means enjoying "at least an equal voice in partnership decisions." *Mount Vernon*, 679 F. Supp. at 528.

91. Section 303(b) of the 1976 version of RULPA provides as follows:

> A limited partner does not participate in the control of the business within the meaning of subsection (a) solely by doing one or more of the following:
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> (1) being a contractor for or an agent or employee of the limited partnership or of a general partner;
>
> (2) consulting with and advising a general partner with respect to the business of the limited partnership;
>
> (3) acting as surety for the limited partnership;
>
> (4) approving or disapproving an amendment to the partnership agree-

rights to advise and consult with general partners, to remove general partners, to approve sales of assets and the incurrence of debt outside of the ordinary course of business, and to serve as agents or employees of a limited partnership.[92] For the most part, however, the rights protected by the RULPA "safe harbor" are limited use rights which can be exercised only under extraordinary circumstances. As a result, they do not meaningfully reduce a limited partner's dependence on the general partners and, therefore, should not impact on the treatment of limited partnership interests under the federal securities laws.[93]

2. 1985 Amendments to the Revised Uniform Limited Partnership Act

In 1985, amendments to RULPA were adopted (1985 RULPA). This time, the drafters shed all inhibitions and adopted an unconditional "creditor reliance" standard. The 1985 RULPA limits the class of persons to whom a limited partner who takes part in control of the business may be liable to those persons "who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner."[94] Thus, under 1985 RULPA, only conduct that might con-

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ment; or

(5) voting on one or more of the following matters:

(i) the dissolution and winding up of the limited partnership;

(ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership other than in the ordinary course of its business;

(iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business;

(iv) a change in the nature of the business; or

(v) the removal of a general partner.

REVISED UNIF. LIMITED PARTNERSHIP ACT § 303(b), 6 U.L.A. 325 (West Supp. 1991) (1976 version).

92. *Id.*

93. One commentator has remarked that the RULPA "safe-harbor" rights are "strikingly similar to [those] of a corporate shareholder" to elect directors, approve mergers and the like. Nathan W. Drage, Note, *Are Limited Partnership Interests Securities? A Different Conclusion Under the California Limited Partnership Act*, 18 PAC. L.J. 125, 156-57 (1986). Of course, corporate shareholders are almost universally afforded the protection of the federal securities laws. *See* Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985).

94. REVISED UNIF. LIMITED PARTNERSHIP ACT (1976) WITH THE 1985 AMENDMENTS § 303(a), 6 U.L.A. 325 (West. Supp. 1991). The states which have enacted the 1985 RULPA Control Test (or modified versions thereof) are as follows:

ceivably mislead creditors into believing that the limited partner is a general partner will subject the limited partner to general liability.[95]

At first glance, there would appear to be numerous ways that a limited partner can enjoy meaningful rights and powers over partnership affairs without deceiving creditors about his status. Obvious examples include contractual rights of approval or consent over general partner decisions and rights of access to information. These rights are generally exercised out of the sight of creditors and, in any event, should not reasonably mislead creditors about the role of the limited partners.

Under 1985 RULPA, however, there is no reason why limited partners must be limited to behind-the-scenes activities. Logically, the only time that a creditor might ever justifiably believe that a limited partner is a general partner is when the limited partner acts like a traditional general partner. More specifically, when the limited partner contracts for or acts on behalf of the partnership in a representative capacity, the potential for liability exists.[96] Limited partners who want to play a more active role in partnership affairs, however, can easily avoid any confusion by simply letting creditors know who they are and that they are acting solely in their limited

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Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, and Wisconsin. Some states that still retain the RULPA control test have nevertheless adopted some of the 1985 RULPA "safe-harbor" provisions, most notably the corporate general partner "safe harbor." *E.g.*, ALA. CODE § 10-9A-42 (1987). New Jersey also adopted a reliance concept but has also retained the "is not substantially the same as" test from RULPA. N.J. STAT. ANN. § 42:2A-27 (West Supp. 1991). Georgia has abolished the control provision in its entirety.

95. Furthermore, by limiting liability under all circumstances to "persons who transact business with the limited partnership," 1985 RULPA effectively absolves limited partners from general liability for torts committed by the partnership and other non-contractual claims. REVISED UNIF. LIMITED PARTNERSHIP ACT § 303(a), 6 U.L.A. 325 (West Supp. 1991) (1976 version). *See* Stromholt v. Rands, 725 F. Supp. 506 (S.D. Fla. 1989) (limited partners are not individually liable in negligence actions under Florida's version of 1985 RULPA).

96. Thus, for example, the Alabama Supreme Court declined to disturb a judgment against a limited partner in a 1985 RULPA limited partnership who interceded on behalf of the partnership to obtain a line of credit from one of its creditors. Pitman v. Flanagan Lumber Co., 567 So. 2d 1335 (Ala. 1990). Under those circumstances, the court found that the trial court was justified in finding that the creditor reasonably relied on the solvency of the limited partner. *Id.* at 1337.

partner capacities.[97] So long as creditors know who the limited partners are and who the general partners are, they cannot possibly be deceived about the status of the partners, regardless of the scope of the limited partners' activities.

Indeed, it is questionable whether any action that a limited partner takes on behalf of a 1985 RULPA limited partnership should create a reasonable doubt about the limited partner's status.[98] For one thing, statutes based on 1985 RULPA require that the name of a limited partnership contain the words "limited partnership" or the abbreviation "L.P."[99] Thus, creditors are on notice that they are dealing with a limited partnership and should, therefore, be reasonably expected to check the certificate of limited partnership to determine the identities of the general partners. In fact, both RULPA and 1985 RULPA provide that the filing of a certificate of limited partnership constitutes constructive notice of who the general partners are, and by implication, who the general partners are not.[100]

Also, in view of the complexity of today's business transactions, it is certainly arguable that it is never reasonable for a creditor to simply assume that the persons acting on behalf of a statutory entity intend to stand behind its obligations. According to modern commercial practices, creditors who do business with limited liability vehicles typically perform some form of due diligence through the

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97. *See Alzado*, 752 P.2d at 553 (stating that even if the limited partner holds himself out to the public as a general partner, liability was not appropriate where the creditor "had no misconception concerning the function and role of [the limited partner] as a limited partner only"). In fact, limited partnerships oftentimes require that creditors with whom they are doing business specifically acknowledge in the contract documents that they are dealing with a limited partnership and that they will not seek to hold the limited partners personally responsible for the partnership's debts.

98. *See* Craig B. Smith, *Limited Partnerships—Expanded Opportunities Under Delaware's 1988 Revised Uniform Limited Partnership Act*, 15 DEL. J. CORP. L. 43, 66-67 (1990) (interpreting Delaware's version of 1985 RULPA).

99. REVISED UNIF. LIMITED PARTNERSHIP ACT (1976) WITH THE 1985 AMENDMENTS § 102, 6 U.L.A. 275 (West. Supp. 1991).

100. *Id.* § 208, 6 U.L.A. at 319. Section 208 of 1985 RULPA provides that a certificate of limited partnership constitutes notice that "the partnership is a limited partnership and [that] the persons designated therein as general partners are general partners, but it is not notice of any other fact." *Id.* The Official Comment to this section explains that its purpose is "to preserve by implication the limited liability of limited partners." *Id.* § 208 Official Comment. In fact, Colorado expressly conditions creditor recovery upon their belief being reasonable "notwithstanding the fact that the limited partner is not designated as a general partner in the certificate of limited partnership." COLO. REV. STAT. § 7-62-303(1) (1990).

verification of records, examination of government filings, or other forms of precautionary investigation. When not satisfied about the solvency of an entity, these creditors routinely demand security or personal guaranties of performance from the principals rather than merely relying on their solvency.[101]

Finally, 1985 RULPA greatly expands the "laundry list" of specific activities in which a limited partner may engage without incurring liability.[102] Two of the new "safe harbors" are worthy of

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101. Pursuant to this reasoning, the only time that a creditor would ever be justified in relying on the limited partner's assets is when the limited partner actually represents that he will guaranty the partnership's obligations and/or when the partners deceive the creditor about the role of the limited partner. For instance, a creditor doing business with a ULPA limited partnership was told that the partnership "consisted of other general partners . . . with assets and capital sufficient to make the payments called for in the agreement." Continental Waste Sys. v. Zoso Partners, 727 F. Supp. 1143, 1148 (N.D. Ill. 1989). Although the court doubted that reliance was a condition to liability under the ULPA, it determined that the statements made during the negotiations created an issue of fact as to whether reliance by the creditor on the assets of the limited partner was appropriate under the circumstances. *Id.*

102. Section 303(b) of 1985 RULPA provides:

> A limited partner does not participate in the control of the business within the meaning of subsection (a) solely by doing one or more of the following:
>
> (1) being a contractor for or an agent or employee of the limited partnership or of a general partner or being an officer, director, or shareholder of a general partner that is a corporation;
>
> (2) consulting with and advising a general partner with respect to the business of the limited partnership;
>
> (3) acting as surety for the limited partnership or guaranteeing or assuming one or more specific obligations of the limited partnership;
>
> (4) taking any action required or permitted by law to bring or pursue a derivative action in the right of the limited partnership;
>
> (5) requesting or attending a meeting of partners;
>
> (6) proposing, approving, or disapproving, by voting or otherwise, one or more of the following matters:
>
> (i) the dissolution and winding up of the limited partnership;
>
> (ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership;
>
> (iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business;
>
> (iv) a change in the nature of the business;
>
> (v) the admission or removal of a general partner;
>
> (vi) the admission or removal of a limited partner;
>
> (vii) a transaction involving an actual or potential conflict of interest between a general partner and the limited partnership

particular mention. First, 1985 RULPA provides that merely being "an officer, director or shareholder" of a corporate general partner of a limited partnership does not constitute taking part in the control of the partnership.[103] In other words, limited partners in 1985 RULPA jurisdictions can now participate directly in the management of the partnership's affairs through their interests in a corporate general partner without any fear of losing their limited liability.[104] This

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> or the limited partners;
> (viii) an amendment to the partnership agreement or certificate of limited partnership; or
> (ix) matters related to the business of the limited partnership not otherwise enumerated in this subsection (b), which the partnership agreement states in writing may be subject to the approval or disapproval of limited partners;
> (7) winding up the limited partnership pursuant to Section 803; or
> (8) exercising any right or power permitted to limited partners under this [Act] and not specifically enumerated in this subsection (b).

REVISED UNIF. LIMITED PARTNERSHIP ACT (1976) WITH THE 1985 AMENDMENTS § 303(b), 6 U.L.A. 325 (West. Supp. 1991).

103. REVISED UNIF. LIMITED PARTNERSHIP ACT (1976) WITH THE 1985 AMENDMENTS § 303(b)(1), 6 U.L.A. 325 (West Supp. 1991). Some states have clarified that this protection exists regardless of whether the limited partner is the sole shareholder of the corporate general partner and/or the corporate general partner is the sole general partner of the limited partnership. *See* NEB. REV. STAT. § 67-251(b)(1) (Supp. 1990); MD. CORPS. & ASS'NS CODE ANN. § 10-303(b)(1)(i) (Supp. 1990).

104. By allowing limited partners to interpose a wholly-owned and controlled corporate general partner between themselves and the creditors of the limited partnership, this "safe harbor" effectively creates a new type of business organization which combines the limited liability feature of the corporation with the tax advantages and management prerogatives of a general partnership. One commentator, assessing a ULPA case which sanctioned the use of a corporate general partner in a limited partnership, had this to say about the impact of the case on traditional business practices:

> [T]he court has expanded the permissible forms of business organizations. . . . [B]usinessmen now can combine the advantages of both the partnership and the corporation. The desirability of the court's decision is demonstrated by the fact that under such an arrangement the limited partners may enjoy the conduit theory of income taxation as well as complete protection from personal liability. The additional benefit flowing from the . . . decision is that the businessman now can take advantage of these previously existing benefits without forfeiting managerial control of the organization.

David Greenhaw, Note, *Limited Partnerships—Absent Creditor Reliance, a Limited Partner who is a Director of the Corporate General Partner is not Personally Liable for Partnership Obligations*, 6 TEX. TECH. L. REV. 1171, 1175-76 (1974) (citations omitted).

remains true, however, only when the corporation is adequately capitalized and all corporate formalities are respected.

The corporate general partner "safe harbor" of 1985 RULPA has revolutionized traditional general partnership and joint venture practice because parties to erstwhile general partnerships and joint ventures can now achieve substantially the same allocation of managerial power in the form of a limited partnership without the corresponding exposure to general liability. They can accomplish this by placing their managerial powers in wholly-owned corporate general partners and retaining the balance of their interests as individual limited partners.[105]

The other noteworthy "safe harbor" is the so-called catch-all "safe harbor," which allows limited partners to enjoy contractual rights of approval over any "matters related to the business of the limited partnership" so long as such rights are expressly granted in writing in the limited partnership agreement.[106] This provision ef-

105. Consider, for example, a traditional "sweat-equity" business arrangement between an "equity" partner, who advances the capital, and a "sweat" partner, who runs the business. Assume that the "equity" partner wants to stay out of day-to-day management but retain control over important decisions, policy matters, budgets, and the like. Assume further that the partnership form is the appropriate form for owning the business. Prior to the enactment of 1985 RULPA, the only options available to the "equity" partner would have been to take an interest either as a general partner with unlimited liability or as a limited partner and risk general liability on account of his control powers. Now, however, the "equity" partner can completely insulate himself from liability, while retaining his control powers, by vesting his control powers in a wholly-owned corporate general partner and retaining the balance of his interest as an individual limited partner.

106. REVISED UNIF. LIMITED PARTNERSHIP ACT (1976) WITH THE 1985 AMENDMENTS § 303(b)(6)(ix), 6 U.L.A. 326 (West Supp. 1991). Delaware's version of the catch-all "safe harbor" is even more radical. First, its coverage is not limited to "matters related to the business of the limited partnership" but extends to all rights granted to the limited partners. DEL. CODE ANN. tit. 6, § 17-303(b)(8)(*l*) (Supp. 1990). Furthermore, in addition to rights of consent or approval, Delaware also protects limited partners who "act or cause the taking or refraining from the taking of any action," suggesting that limited partners in Delaware can direct general partner actions or even perhaps act themselves on behalf of the partnership and still be covered by the "safe harbor." *Id.* § 17-303(b)(8). In fact, another provision of the Delaware partnership law expressly provides that a partnership agreement can authorize limited partners to take partnership actions "without the vote or approval of any general partner"! *Id.* § 17-405(a). Finally, the Delaware catch-all "safe-harbor" clause protects the exercise of rights which are created by the partnership agreement as well as in "any other agreement or in writing." *Id.* § 17-303(b)(8)(*l*). This would presumably include oral agreements because the Delaware statute allows oral partnership agreements. *Id.* § 17-101(10). Nebraska, Rhode Island, and Tennessee have enacted substantially similar provisions. NEB. REV.

fectively abrogates the restriction against limited partners taking part in the control of the partnership. As one commentator stated, "It makes it disappear! If a limited partner may avoid liability to creditors while exercising all powers agreed upon by all the partners, the problem is avoided by giving the limited partner unlimited control in the agreement."[107]

In the final analysis, under 1985 RULPA, a limited partner will be generally liable for the partnership's obligations only in truly extraordinary circumstances. Specifically, in order to be liable, the limited partner's activities would have to fall outside of the protective scope of the "safe harbors" and also somehow mislead creditors into reasonably believing that the limited partner is in fact a general partner. One state, Georgia, has taken the next logical step and eliminated the control restriction altogether.[108]

As a final point, most states have enacted specific choice of law legislation which provide that the laws of the state of the limited partnership's formation will govern the liability of its limited partners.[109] Accordingly, if the limited partnership statute of the state in

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STAT. § 67-251(b)(4)(xii) (1990); R.I. GEN. LAWS § 7-13-19(b)(5)(xv) (Supp. & 1990); TENN. CODE ANN. § 61-2-302(b) (1989). Likewise, the Pennsylvania statute provides that a limited partner can exercise "any . . . right or power stated in the partnership agreement." 15 PA. CONS. STAT. ANN. § 8523(b)(12) (1991).

Some states that have enacted a catch-all "safe harbor" require that the limited partner rights of approval appear in the certificate of limited partnership as well. *See* N.J. STAT. ANN. § 42:2A-27b(7) (Supp. 1991). Also, one state conditions protection on the rights of approval in question covering only "material matters" related to the partnership business. KAN. STAT. ANN. § 56-1a203(b)(7) (Supp. 1990).

107. Lucille T. Freedberg, *The Shield of the Limited Partnership*, 28 N.Y.L. SCH. L. REV. 561, 575 (1983).

108. GA. CODE ANN. § 14-9-303 (Michie 1989). Specifically, the Georgia statute provides that "[a] limited partner is not liable for the obligations of a limited partnership by reason of being a limited partner and does not become so by participating in the management or conduct of the business." *Id.*

109. As of the date of this article, every state except for the two ULPA states (and Louisiana) has adopted this sort of choice of law provision. They are generally based on § 901 of RULPA, which provides that "[s]ubject to the Constitution of this State, the laws of the state under which a foreign limited partnership is organized govern its organization and internal affairs *and the liability of its limited partners* . . . ." (emphasis added). REVISED UNIF. LIMITED PARTNERSHIP ACT (1976) WITH THE 1985 AMENDMENTS § 901, 6 U.L.A. 383 (West Supp. 1991).

Assume, for example, that the partners of a prospective limited partnership intend to undertake a project in Arizona and that they want the partnership agreement to authorize the limited partners to approve the expenditure of partnership monies by the general partners. This right of approval, however, is not expressly covered by Arizona's "safe-harbor" statute. Moreover, Arizona is still governed

which a limited partnership intends to do business does not expressly protect the full range of powers contractually retained by the limited partners, but does contain the choice of law provision, the limited liability of the limited partners can be ensured by organizing the partnership under the laws of a state where those rights would be protected. The general partners would then qualify the partnership as a foreign limited partnership in the state in which they intend to do business.

VI. JUDICIAL RESPONSE

In light of recent developments in limited partnership law allowing limited partners greater flexibility to partake in control activities, some courts have taken a second look at the traditional treatment of limited partnership interests under the federal securities laws. On a few occasions, particular limited partnership interests have, in fact, been found not to constitute securities.[110]

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by RULPA so that even if this right could be exercised out of the sight of creditors, it might still be deemed to give the limited partners substantially the same powers as a general partner and, therefore, result in the imposition of general liability. On the other hand, because the right would be expressly provided by the partnership agreement, it would fall squarely within Delaware's catch-all "safe-harbor" provision. Additionally, the Arizona partnership statute contains the appropriate choice of law language. The obvious solution, therefore, would be to organize the limited partnership under Delaware law and qualify it to do business in Arizona.

110. *See, e.g.*, *Gordon*, 684 F.2d at 741-42 (limited partnership interests in a real estate limited partnership were not securities where investors retained control over significant management decisions); Bamco 18 v. Reeves, 675 F. Supp. 826, 830 (S.D.N.Y. 1987) (privately negotiated limited partnership interest did not constitute a security); Bank of Am. Nat'l Trust & Sav. Ass'n v. Hotel Rittenhouse Assocs., 595 F. Supp. 800, 807 (E.D. Pa. 1984) (sale of limited partnership interest due to alleged fraudulent inducement did not constitute a transaction in securities); *Frazier*, 484 F. Supp. at 452 (limited partnership interests held by an individual who was also a general partner were not securities); Darrah v. Garrett, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,472 (N.D. Ohio 1984) (where limited partners exercised extensive control over profit and loss potential, their interests were not securities). *See also* Maritan v. Birmingham Properties, 875 F.2d 1451 (10th Cir. 1989) (investment interest held not to constitute an "investment contract" where investor had access to critical information about the venture and the right to participate in the management of the project). In *Maritan*, although the court was skeptical that the interest in question was in fact a limited partnership interest, it concluded that the label given to the relationship was not determinative. *Id.* at 1459. The investor, the court reasoned, possessed sufficient power under the governing instrument to adequately protect his investment and gain access to information about the business. *Id.* at 1458.

Additionally, there are cases in which, although the court ultimately concluded

The first modern case to hold that a limited partnership interest was not a security was *Gordon v. Terry*.[111] *Gordon* involved five speculative real estate syndications in central Florida.[112] Four of the syndicates took the form of trusts while the fifth took the form of a limited partnership.[113] In each instance, the governing agreement gave the investors, the beneficiaries under the trusts and the limited partners of the limited partnership, "control over all decisions which would affect the success of the ventures," including the disposition of the properties.[114] The investors eventually sued the promoters under the federal securities laws.

The district court granted summary judgment in favor of the promoters on the grounds that the investors' various interests did not constitute securities.[115] On appeal, the Eleventh Circuit stated, "An investor who has the ability to control the profitability of his investment, either by his own efforts or by a majority vote in group ventures, is not dependent upon the managerial skill of others."[116] The court reasoned that, because the governing instruments placed "control over the significant decisions in the hands of the investors,"

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that the limited partnership interests in question were in fact securities, a more thoughtful analysis was applied. In Stowell v. Ted S. Finkel Inv. Servs., Inc., 489 F. Supp. 1209 (S.D. Fla. 1980), *aff'd after remand*, 641 F.2d 323 (5th Cir. 1981), for example, the court rejected the argument that, as a matter of law, limited partnership interests in limited partnerships formed under the ULPA are always securities. The court stated:

> [T]he [ULPA] grants the partners a great deal of latitude in drafting their limited partnership agreements. The nature of the interests held by limited partners may vary according to the partnership agreement executed by the parties. In each case the issue is whether, under the partnership agreement entered by the parties, the limited partnership interests meet the criteria of an investment contract. This sort of determination must be made on a case by case basis.

Id. at 1220.

There is also scattered academic support for this position. Professor Loss "questioned whether in statutory context a private offering of limited partnership interests . . . involves a 'security'." Loss, *supra* note 29, at 505. *See also* Angela Saitta, Note, *General Partnership Interests as Securities:* Goodwin v. Elkins & Co., 6 BRIDGEPORT L. REV. 359, 388 (1985) ("The words used to describe the partnership agreement are inconsequential. Be it a general or a limited partnership, the determination of whether an agreement constitutes an investment contract should focus on the facts underlying the transaction.").

111. 684 F.2d 736 (11th Cir. 1982), *cert. denied*, 459 U.S. 1203 (1983).

112. *Id.* at 738.

113. *Id.* at 740.

114. *Id.*

115. *Id.*

116. *Id.* at 741.

their interests could not constitute securities unless they fell within one of the narrow exceptions set forth in *Williamson*.[117]

Ultimately, the court upheld the grant of summary judgment with respect to all of the promoters except for one who had apparently represented that his unique expertise and experience in the local real estate market would enable the syndicates to buy and sell properties for substantial profits.[118] With respect to this promoter, the court determined that there was an issue of fact as to whether the statement made by him had created the sort of dependency which precluded the investors from meaningfully exercising their control rights.[119]

VII. FRAMEWORK FOR ANALYSIS

It can no longer be assumed that all limited partners will be deterred from acquiring meaningful control powers by the threat of general liability. Limited partners in most jurisdictions can now engage in a wide range of supervisory and control activities without the risk of losing their limited liability. In fact, limited partners often enjoy the same powers which, if possessed by investors in other investment settings, would almost certainly preclude their interests from being classified as securities.[120]

Thus, for the purpose of determining whether a limited partnership interest is a security, limited partnership interests should not be treated any differently under the federal securities laws than other investment vehicles in which the investors possess the ability to control the enterprise.[121] Instead, as with general partnership interests, the dispositive inquiry in each case should be whether the limited partners have retained the legal as well as practical ability to exercise control over the partnership.

Fortunately, there is a well developed body of case law, based on *Williamson*, dealing specifically with the issue of control.[122] Gen-

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117. *Id. See supra* notes 38-60 and accompanying text.

118. *Gordon*, 684 F.2d at 740.

119. *Id.* at 743.

120. *See* cases cited *infra* note 145.

121. As the Supreme Court recently reaffirmed: "In discharging our duty [under the federal securities laws], we are not bound by legal formalisms, but instead take account of the economics of the transaction under investigation." Reves v. Ernst & Young, 494 U.S. 56, 61 (1990).

122. Recall that *Williamson* dealt with the issue of whether general partnership interests were securities. Because of the increased role that limited partners may

erally, these cases have sought to resolve the issues raised by *Williamson*'s two-prong test. The first issue is whether the investor has acquired the legal right to control the enterprise. If so, the next issue is whether the legal control powers are realistically exercisable.

A. *Whether the Limited Partner Possesses Legal Control Powers*

The first step in ascertaining whether a limited partner has "control" is to determine whether the limited partner has acquired the *legal* right to control the enterprise. More specifically, does the limited partner possess the rights and powers that will enable him to protect himself from dependence on the general partners for running the business and enable him to gain access to information about the business? This inquiry involves an examination of the applicable limited partnership statute; the ownership structure of the limited partnership; the source of decision-making authority; the allocation of power under the partnership agreement; and, in some cases, the expectations of the parties.

1. The Statute

The obvious starting point for determining the scope of a limited partner's legal powers is the statute under which the limited partnership is organized. The first thing to recognize, however, is that limited partnership statutes do not give limited partners meaningful rights of control over general partner conduct.[123] Even the revised statutes give limited partners express rights of approval only over the most extraordinary matters, such as the admission of additional general partners.[124] More meaningful powers of accountability and supervision can only be created by contract.[125]

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now enjoy in the management of the partnership business, the determination of whether a limited partnership interest is a security should be similar to that undertaken for general partnership interests.

123. *See supra* note 31.

124. *See, e.g.*, REVISED UNIF. LIMITED PARTNERSHIP ACT (1976) WITH 1985 AMENDMENTS § 303(b)(6)(v), 6 U.L.A. 326 (West Supp. 1991) ("A limited partner does not participate in the control of the business . . . solely by . . . approving . . . the admission or removal of a general partner.").

125. In effect, the newer statutes are enabling statutes. They enable limited partners who have the wherewithal to bargain for and obtain contractual powers of control to do so without incurring general liability. The rights themselves, however, can only be created by contract. In fact, the Delaware "safe-harbor" provision

Limited partnership statutes do, however, create important powers for limited partners with respect to access to information. The ULPA, for example, provides that limited partners have the right to receive "on demand true and full information of all things affecting the partnership."[126] Later statutes are more comprehensive.[127] These provisions by themselves arguably give knowledgeable limited partners access to the same kind of information that they would receive if their limited partnership interests were registered under the federal securities laws.[128]

2. Ownership Structure

The ownership structure of the limited partnership is another factor in the legal control analysis. One important consideration is whether the limited partner, through his ownership interest or executive position in a general partner of the limited partnership, is in position to affect the conduct of the partnership's business. In that situation, the limited partner does not need the additional protection of the federal securities laws because the powers already possessed are sufficient to obtain access to information and control the enterprise. Typically, this situation arises when a limited partner is also an officer, director, or shareholder of a corporate general partner of the limited partnership. These circumstances are becoming increasingly prevalent in light of the enactment of "safe-harbor" legislation by the overwhelming majority of states, which enables limited partners to serve in such capacities without incurring general liability.[129]

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specifically provides that it "does not create rights or powers of limited partners. Such rights and powers may be created only by a certificate of limited partnership, a partnership agreement or any other agreement or in writing, or other sections of this chapter." DEL. CODE ANN. tit. 6, § 17-303(e) (Supp. 1990).

126. UNIF. LIMITED PARTNERSHIP ACT § 10, 6 U.L.A. 590 (1969).

127. Delaware, for example, provides that limited partners have the enforceable right to receive, among other things, copies of partnership tax returns, a description of each partner's obligation to contribute capital, and any other information "regarding the status of the business and financial condition of the limited partnership" which they desire. DEL. CODE ANN. tit. 6, § 17-305(a) (Supp. 1990). This right, however, is subject to a general partner's right to withhold trade secrets and other confidential information and to adopt "reasonable standards" for the disclosure of information. *Id.* § 17-305(b).

128. Regulation S-K sets forth the standard disclosure requirements for first-time registrants under the Securities Act of 1933. 17 C.F.R. § 229 (1982).

129. Additionally, some of the more recent statutes also permit a limited partner

The other obvious consideration is whether the limited partner is also a general partner of the limited partnership. If so, then, absent unusual circumstances, the limited partner cannot possibly meet the investment contract test because he is, at least in part, relying on his own efforts as a general partner for the success of the venture.[130]

Thus, in this context, it is important to work through the ownership structure of the limited partnership to locate the actual source of decision-making authority. If, for example, a limited partner wholly-owns a corporate general partner of the limited partnership or serves the corporation as a director or in an executive capacity, then he clearly is in a position to influence partnership affairs and command access to information.[131]

In other circumstances, however, the limited partner's ability to affect the profitability of his investment is not as readily ascer-

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to serve as a partner of a general partner where the general partner is itself a general or limited partnership. *E.g.*, DEL. CODE ANN. tit. 6, § 17-303(b)(1) (Supp. 1990); R.I. GEN. LAWS § 7-13-19(b)(1) (1985). In fact, modern joint venture arrangements are frequently structured as multiple-tiered limited partnerships. This is done primarily to insulate the original partners from securities liability and fiduciary obligations in the event that one of the partners desires to subsequently syndicate his interest to outside investors. Also, it ensures that, even if outside investors are brought in, the original partners only have to deal among themselves, because each original partner would presumably retain control over his respective second-tier partnership.

130. *See* Frazier v. Manson, 484 F. Supp. 449 (N.D. Tex. 1980), *aff'd*, 651 F.2d 1078 (5th Cir. 1981). In *Frazier*, the plaintiff, a real estate developer, was a general partner in a general partnership. *Id.* at 450-51. This general partnership was itself a general partner in several real estate syndication limited partnerships. *Id.* at 451. By his own admission, the plaintiff was charged with the responsibilities of "managing the properties" and making the "partnership properties profitable." *Id.* at 452 n.6. Plaintiff nonetheless attempted to invoke the protections of the federal securities laws because he claimed that he also owned limited partnership interests in the various syndicates. *Id.* at 450, 451 & n.3. The district court held that the plaintiff's "managerial rights negate[d] the possibility that his limited partnership interests were securities." *Id.* at 452. On appeal, the Fifth Circuit affirmed, holding that investors do "not always need the extensive protection of the federal securities laws when [they have] partial control of an enterprise." *Frazier*, 651 F.2d at 1080. *But see Hirsch*, 396 F. Supp. at 1227 ("Because limited partners must . . . rely on the effects of others for their profit, limited partnership interests have been held to be securities in this district.").

131. At the other end of the spectrum, if a limited partner is a minority shareholder of a corporate general partner, or serves only in a ministerial capacity, his status for securities law purposes should probably be unaffected because the essential managerial efforts of the enterprise remain in the hands of others. *See supra* text accompanying note 27.

tainable. *Darrah v. Garrett*[132] illustrates this point. This case involved a limited partnership whose sole purpose was to acquire and own the shares of stock of a holding company that owned an active company engaged in the spare parts business.[133] Although the partnership agreement vested all formal partnership authority exclusively with the general partner, the limited partners served as the principal executive officers of the holding company.[134] In these capacities, they "actively participated" in running the acquired business.[135] The limited partners brought an action under the securities laws for alleged misrepresentations by the general partner.

At trial, the district court granted summary judgment against the limited partners on their federal securities law claims.[136] The substance of the transaction, the court reasoned, was the operation of the underlying business, the success of which was largely dependent on the limited partners' own efforts as officers of the holding company.[137] Since the fate of the venture was at least partially in the limited partners' hands, the court concluded that their limited partnership interests were not securities.[138]

3. Employment Relationship

Both RULPA and 1985 RULPA allow limited partners to serve as contractors, employees, or agents of a limited partnership or a general partner without incurring liability.[139] At first glance, one might suppose that certain employment or agency relationships would give limited partners considerable say over the conduct of the limited partnership's business. This would seem to be especially true where the limited partner or an affiliate is employed as a manager of the partnership's business. What little authority exists, however, suggests that these relationships are not relevant for securities law purposes because the ultimate decision-making power remains vested in the general partners.[140]

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132. [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,472, at 98,363 (N.D. Ohio 1984).
133. *Id.* at 98,363-98,364.
134. *Id.* at 98,364.
135. *Id.*
136. *Id.* at 98,365.
137. *Id.*
138. *Id.*
139. *See supra* notes 91 & 102.
140. *See* Long, *supra* note 22, at 611 n.141 ("[M]anagement authority derived

While this general rule probably makes sense in most instances, there are exceptions. Assume, for example, that a limited partner in a real estate development partnership is engaged by the partnership to be the property manager. In this capacity, he is empowered to set leasing policy, enter into leases as an agent of the partnership, handle the collection and disbursement of cash, and assist the partnership's accountants in preparing financial statements. Under these circumstances, it would be difficult to imagine how the limited partner could persuasively argue that he did not have meaningful control over the profitability of his investment.

4. Partnership Agreement

By far, the most likely source of limited partner rights and powers will be the limited partnership agreement. To determine whether the interest is a security, the key is to distinguish between those contractual rights and powers that effectively reduce a limited partner's dependence on the general partners and those that do not.

In the first place, it is no longer out of the question for a partnership agreement to give limited partners the right to actively participate in running the business. Georgia, for example, has abolished all restrictions against limited partners taking part in control.[141] Furthermore, in 1985 RULPA jurisdictions, limited partners can take any action related to the partnership as long as there is no reasonable likelihood that creditors will be deceived.[142] Obviously, if a limited partner has the right to engage in the partnership's business, he is not dependent on others and most likely has access to information about the business.

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from an employment relationship is irrelevant in determining whether an interest is a security."). *See also* L & B Hosp. Venture, Inc. v. Healthcare Int'l, Inc., 894 F.2d 150, 153 (5th Cir.), *cert. denied*, 111 S. Ct. 55 (1990) (concluding that the "essential managerial efforts of the entity were undertaken in fact and by contract by the [general partner]"). *L & B Hospital* involved a Texas limited partnership which operated an inpatient psychiatric facility. *Id.* at 151. While the limited partners were responsible for running the medical aspect of the partnership's business, all management and administrative authority remained vested solely with the general partner. *Id.* The Fifth Circuit concluded that, despite the important role that the limited partners played in the overall enterprise, the fact that all "essential managerial efforts" were to be performed solely by the general partner created an issue of fact as to whether the limited partners remained dependent on the general partner's efforts. *Id.* at 153.

141. *See supra* note 108.

142. *See supra* notes 88-109 and accompanying text.

For the most part, however, limited partner contract rights take the form of rights of approval or consent over general partner decisions. These rights can be divided into two general categories: rights of approval over extraordinary matters, such as sales of assets, refinancings, mergers, partnership amendments, and the like; and rights of approval over the general partners' day-to-day conduct of the partnership's business.

As a general rule, contractual rights of approval over extraordinary matters should not be relevant for securities law purposes because they do not appreciably reduce limited partner dependence on the general partners.[143] Stated differently, whether or not these powers are exercised, it still remains entirely up to the general partners to fashion the course of conduct that will ultimately make or break the venture.[144]

Contractual rights that reduce limited partner dependence on the general partners are rights of approval over the general partners day-to-day conduct of the partnership's business. Obvious examples include the right to approve budgets, the expenditure of funds, the borrowing of monies, the granting of security interests, the hiring of personnel, the execution of contracts, the creation of leasing guidelines, and the undertaking of capital development or improvement work. There are several instances in which investment interests have been held not to be securities because the investors possessed these sorts of rights.[145] Also, the right to remove a general partner

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143. *See* Albanese v. Florida Nat'l Bank of Orlando, 823 F.2d 408, 412 (11th Cir. 1987) (right to enforce preference of location of underlying asset); Waterman v. Alta Verde Indus., 643 F. Supp. 797, 806 (E.D.N.C. 1986), *aff'd*, 833 F.2d 1006 (4th Cir. 1987) (right to approve sale of underlying asset); *McConnell*, 574 F. Supp. at 786 (right to remove managing partner and to approve amendments to the partnership agreement, the sale of all of the assets, and the dissolution of the partnership).

144. A good illustration of this point can be found in Long v. Shultz Cattle Co., 881 F.2d 129 (5th Cir. 1989). In *Long*, the promoters of a fraudulent scheme to sell interests in a cattle feeding program argued, among other things, that the independent decision by one of the investors to hedge part of his cattle demonstrated that the investors had the power to protect themselves and that, therefore, their interests were not securities. *Id.* at 136-37. The Fifth Circuit disagreed. While the ability of the investors to reduce their exposure to risk through the hedging device was "undeniably significant," it was still in the sole discretion of the promoters to do those things which were necessary to make the risk pay off, such as feed, care for, maintain, and fatten up the cattle. *Id.* at 137.

145. *See Marine Bank*, 455 U.S. at 560 (veto right over future borrowings);

is likely to give limited partners substantial say over how their investments are being managed.[146] Finally, a stipulation in the part-

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Matek, 862 F.2d at 731 (rights of approval over lending monies, borrowing monies, transferring assets, the admission of partners, amendments to the partnership agreement, and the withdrawal of capital); *Rivanna Trawlers Unltd.*, 840 F.2d at 241 (rights of approval over borrowing monies in excess of a specified dollar amount, selling or leasing assets, hiring the managing agent, appointing or removing the managing partner, transferring partnership interests, the admission of partners, and the distribution of profits); Youmans v. Simon & Bid Co., 791 F.2d 341, 346-47 (5th Cir. 1986) (right to terminate joint venture and replace managing general partner by majority vote); *Williamson*, 645 F.2d at 424 (dictum) (right to remove manager and rights of approval over confessing judgments, borrowing monies, granting security interests, amending the partnership agreement, and developing the underlying property); Ballard & Cordell Corp. v. Zoller & Dannenberg Exploration, 544 F.2d 1059 (10th Cir. 1976), *cert. denied*, 431 U.S. 965 (1977) (right to remove manager and rights of approval over expenditure of funds in excess of a specified dollar amount, drilling new wells, and reworking existing wells); *In re* National Mortgage Equity Corp., 723 F. Supp. 497 (C.D. Cal. 1989) (rights of access to information, removal of trustee, and power to amend the partnership agreement); *Casablanca Prod.*, 697 F. Supp. at 1567 (non-managing general partner retained "significant managerial powers"); Bank of Am. Nat'l Trust & Sav. Ass'n v. Hotel Rittenhouse Assocs., 595 F. Supp. 800 (E.D. Pa. 1984) (rights of approval over the appointment of the project manager, selling or leasing assets, the admission of partners, and the execution of contracts in excess of a specified dollar amount).

146. An issue which frequently arises is whether the right to remove a managing general partner, without more, is sufficient to preclude the underlying interests from being securities. In the general partnership context, when the right of removal is unconditional, it has been held sufficient to preclude this characterization. *See Fargo Partners*, 540 F.2d at 915; *Perry*, 583 F. Supp. at 1233. *But see* McConnell v. Frank Howard Allen & Co., 574 F. Supp. 781 (N.D. Cal. 1983) (investment was held to be a security despite the fact that non-managing general partners could remove managing partners). There is, however, a subtle difference between limited and general partnerships. When partners of a general partnership revoke their contractual delegation of authority to the managing partner, the right to run the business, by statute, reverts back to them. *See* UNIF. PARTNERSHIP ACT § 18(e), 6 U.L.A. 213 (1969). On the other hand, absent specific authority in the partnership agreement, when limited partners do the same thing, the only right they acquire is to elect another general partner because limited partnership statutes do not create express rights of management for limited partners. Thus, whether or not the right of removal is exercised, ultimately the limited partners remain dependent on somebody else to run the business. *Stowell*, 489 F. Supp. at 1223. As a result, the better reasoned approach is that the right to remove a general partner alone is not enough to take the limited partner out of the protective scope of the securities laws. *Id.*; Henkind v. Brauser, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,488 (S.D.N.Y. May 16, 1989) (right to vote to dismiss an agent of the general partner held insufficient to remove the limited partnership from protection under the federal securities laws); Rodeo v. Gillman, 787 F.2d 1175, 1178 (7th Cir. 1986) (right to buy out general partner without more was not enough to preclude limited partner's interest from being a security).

nership agreement providing rights of access to information may also be relevant. Many partnership agreements, for example, provide for comprehensive disclosure to the limited partners, including the delivery of audited annual financial statements, unaudited financial statements for lesser periods, status reports, copies of all leases, contracts, draw requests, and other noteworthy communications.

5. Expectations of the Parties

One final factor that may be applicable to the security determination in certain cases is the expectations of the parties. There may be circumstances in which, notwithstanding the formal execution of a limited partnership agreement that enumerates the rights and obligations of partners, the partners in fact intend that the limited partners stay active in the business. In these cases, prior course of conduct, other dealings between the parties, and possibly even custom in the industry would be relevant.[147] Additionally, subsequent actions by the limited partners might confirm prior informal understandings.[148]

B. Whether the Limited Partner's Control Powers are Realistically Exercisable

The legal right to control the enterprise cannot by itself preclude a limited partner from owning a security. If that was the rule, promoters could easily evade the security statutes by giving limited partners formal, unrealistic rights of control.[149] Thus, the important

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147. One case where this approach would seem especially appropriate is Goodman v. Epstein, 582 F.2d 388 (7th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979). *See supra* notes 2-20 (discussing the *Goodman* case). Although Mr. Freeman retained no formal partnership powers, in light of his considerable role in getting the project off the ground and obtaining third-party financing, it was unrealistic to expect that he would simply drop out of the picture once the partnership agreement was signed. In fact, he demonstrated his continued influence over partnership affairs by removing Mr. Douglas as a general partner. *Id.* at 393.

148. *See Maritan*, 875 F.2d at 1459 ("[L]ater participation sheds light on how the parties regarded [the investor's] rights and status under the agreement all along."). Post-investment conduct is also sometimes relevant to demonstrate an investor's ability to adequately exercise his powers. *See Matek*, 862 F.2d at 730 n.15 (actual exercise of control powers by investors negates any subsequent claims that these powers were not realistically exercisable).

149. *See Koch*, 928 F.2d at 1475; *Bailey*, 904 F.2d at 922. In both cases, the court rejected or limited prior decisional authority purporting to restrict the scope of the control inquiry to the legal powers retained by the investors.

question that remains is whether those rights are realistically exercisable. To paraphrase Professor Loss, the objective is to distinguish between the proverbial "offering of a half interest in a hamburger stand," now taking the form of a limited partnership, and traditional, passive investment limited partnerships.[150]

As the Ninth Circuit recently stated, this inquiry involves looking "not only to the partnership agreement itself, but also to other documents structuring the investment, to promotional materials, to oral representations made by the promoters at the time of the investment, and to the practical possibility of the investors exercising the powers they possessed pursuant to the partnership agreements."[151] Generally, the discussion over whether partners can exercise a given power has revolved around the last two factors set forth in *Williamson*.[152]

1. Knowledge of Limited Partners

The legal right to control an enterprise is meaningless if the limited partner is not knowledgeable enough in the arena of business management to understand and apply his control powers. In that case, the limited partner remains practically dependent on the general partners despite his nominal control position.[153]

That is not to say, however, that every investor must be personally sophisticated. Institutional investors, like banks, pension funds, and insurance companies, as well as wealthy individuals possess the resources to obtain whatever professional assistance is necessary for them to exercise their legal powers.[154] These investors are generally familiar with the use of experts and can protect themselves regardless of their degree of sophistication.[155] Thus, with respect to these inves-

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150. Loss, *supra* note 29, at 505 (quoting Judge Frank, *Saturday Evening Post*).

151. *Koch*, 928 F.2d at 1478.

152. The *Williamson* court recognized that other factors might be relevant. *See supra* note 52 and accompanying text.

153. *Williamson*, 645 F.2d at 423.

154. *Id.*

155. *Id.* at 424. A partner "is not dependent only on the degree of his own business sophistication in order to exercise intelligently his partnership powers." *Rivanna Trawlers Unltd.*, 840 F.2d at 242 n.10. He has the ability to review partnership records, consult with "more knowledgeable partners or third parties," and employ experts. *Id. See also Deutsch Energy Co.*, 813 F.2d at 1570 (investors in an oil and gas venture clearly knew "how to read financial statements" and were "familiar with the use of experts such as accountants, attorneys and geologists").

tors, the ability to exercise legal rights of control should be presumed in most cases.

With respect to small investors, however, the basic test articulated by *Williamson* is whether the investor "is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his [contractual] powers."[156] Obvious considerations include employment history, investment experience, and educational background.

There appears to be confusion over whether the knowledge inquiry is satisfied by generalized business experience or whether it requires the investor to be conversant "in the field of business at issue."[157] *Williamson* itself suggests that generalized expertise is sufficient[158] in that, while the non-managing joint venturers in *Williamson* were all sophisticated businessmen, they were not real estate professionals.[159] Nevertheless, their interests were held not to be securities.[160] More recently, however, the Fifth Circuit remarked that the knowledge inquiry cannot be limited to the investor's overall business experience but "must be tied to the nature of the underlying venture."[161]

A sensible approach may be to make the degree of knowledge required commensurate with the degree of specialization in the venture. With respect to conventional investment schemes, such as garden variety real estate projects and ordinary commercial businesses, some degree of sophistication in general business affairs is all that would be required to satisfy the knowledge inquiry. With

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156. *Williamson*, 645 F.2d at 424.

157. *Long*, 881 F.2d at 133.

158. *Williamson*, 645 F.2d at 424-25. The Ninth Circuit apparently subscribes to this view. Deutsch Energy Co. v. Mazur, 813 F.2d 1567 (9th Cir. 1987). In *Deutsch Energy*, for example, investors in an oil and gas venture argued that they were incapable of exercising their "significant managerial powers" due to their lack of experience in the industry. *Id.* at 1570. The Ninth Circuit pointed out that the investors owned and operated a business, previously inspected the oil sites, were involved in similar ventures, and had been represented by counsel in the relevant transaction. *Id.* The "high degree of business acumen" which they derived from their overall business experiences, the court reasoned, negated any possibility that the investors could not reasonably exercise their contractual powers. *Id.* This line of reasoning was recently affirmed by the Ninth Circuit in Stewart v. Ragland, 934 F.2d 1033 (9th Cir. 1991).

159. *Williamson*, 645 F.2d at 424-25.

160. *Id.* at 425.

161. *Long*, 881 F.2d at 134 n.3. *See also Bailey*, 904 F.2d at 924; *Albanese*, 823 F.2d at 412 (although investors were "experienced businessmen," none had any background in the business of the partnership).

respect to more specialized undertakings, however, like the much maligned cattle feeding programs, a greater degree of expertise in the business of the partnership might be expected.[162]

2. Dependence on Unique Ability of General Partners

The other circumstance in which a limited partner's legal rights of control might also be disregarded is where the general partners are so well suited to the task at hand that even sophisticated limited partners would have no choice but to rely on their judgment. This situation is the one contemplated in the last exception set forth in *Williamson*.[163] In fashioning this exception, the *Williamson* court stressed that it was not creating a simple reliance standard.[164] It is not enough, therefore, that the investor relied on the promoter's expertise in the business,[165] the promoter's promise to perform managerial tasks,[166] the investor's "clear preference" that the promoter manage the business,[167] or the fact that "[t]he relationship . . . facilitated the running of the venture."[168] Instead, the investors must show either that the promoter was "uniquely capable" of managing the business or that he was irreplaceable.[169]

Typically, the issue of reliance arises when the promoters represent that they possess some special abilities or relationships that will enable the venture to prosper. One example, which the *Williamson* court mentioned, is that of a promoter of a real estate partnership who promises potential investors that they will profit because of his

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162. This appears to be the direction in which the Fourth Circuit was leaning in *Bailey*. *Bailey*, 904 F.2d at 923-24. That case involved a cattle breeding program. The court noted that, while "generalized business experience" might have prepared the investors for the cattle care component of the scheme, more "specialized knowledge pertinent to the business venture" was required for them to be meaningfully involved in the breeding process. *Id.* at 924 n.13.

163. *Williamson*, 645 F.2d at 424. The court identifies this situation as one in which "the partner or venturer is so dependent on some unique entrepreneurial or managerial ability . . . that he cannot replace the manager . . . or otherwise exercise meaningful . . . power." *Id.*

164. *Id.* at 423-24. *See supra* note 48 and accompanying text.

165. *See* Sparks v. Baxter, 854 F.2d 110, 114 (5th Cir. 1988); *Gordon*, 684 F.2d at 742 ("In our opinion, dependency upon the skills of one or more [promoters] does not establish dependency on all [promoters].").

166. *Williamson*, 645 F.2d at 425.

167. *Perry*, 583 F. Supp at 1233.

168. Rivanna Trawlers Unltd. v. Thompson Trawlers Inc., 650 F. Supp. 1378, 1385 (W.D. Va. 1986), *aff'd*, 840 F.2d 236 (4th Cir. 1988).

169. *Williamson*, 645 F.2d at 425.

"unique understanding of the [local] real estate market."[170] In that situation, the participants in the venture might be justifiably reluctant to question the promoter's apparent superior judgment.

The other obvious context where this arises is with respect to specialized or technical undertakings that necessarily require "unusual experience and ability" to manage.[171] Thus, for example, schemes to farm jojoba,[172] to produce a superior cross-breed of cattle,[173] and to operate a resort condominium complex like a hotel[174] have all been held to be too esoteric for summary judgment in favor of the promoters on the issue of whether the investors' limited partnership interests were securities, despite the fact that the investors retained legal control of the enterprise. In each case, the court concluded that there was a genuine issue of fact as to whether the investor could exert any real influence over the conduct of the business due to its specialized nature.

C. *Number of Limited Partners*

The number of investors in an enterprise is also relevant. Common sense dictates that "at some point there would be so many partners that a partnership vote would be more like a corporate vote, each partner's role having been diluted to the level of a single shareholder in a corporation."[175] If that point is reached, the limited partner's interest is a security regardless of his legal rights because his control powers are effectively diluted.

This does not mean that a partner must obtain absolute discretion over partnership matters in order to meaningfully protect his investment.[176] Even if a partner's control powers are somewhat diluted

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170. *Id.* This is precisely what happened in Gordon v. Terry, 684 F.2d 736 (11th Cir. 1982). *See supra* text accompanying notes 111-19.

171. *Williamson*, 645 F.2d at 423.

172. *Koch*, 928 F.2d at 1481. In pertinent part, the court pointed out that "jojoba farming was a relatively new undertaking in the United States, and that there were few individuals with expertise in the area." *Id.* at 1478.

173. *Bailey*, 904 F.2d at 925. Here the court remarked that the investors would have to go out-of-state in order to find anyone else with the kind of expertise required to run the venture. *Id.* at 924 n.11. This alone, the court figured, raised serious questions about the investors' ability to affect the profitability of their investments. *Id.*

174. *Hocking*, 885 F.2d at 1462.

175. *Williamson*, 645 F.2d at 423.

176. In *Williamson*, for example, there were approximately fifteen joint venturers in each of the affected enterprises. *Id.* at 408. *See also Matek*, 862 F.2d at 723 (involving 12 investors); *Rivanna Trawlers Unltd.*, 840 F.2d at 238 (involving 23 investors).

by a voting structure, they still give him sufficient leverage, in most cases, to access information about the business and to influence partnership affairs.[177] Where, however, an investment scheme consists of a large number of investors, it is likely that a court would look for a preexisting relationship between the parties as well as a realistic mechanism for them to act in concert before it would consider placing their interests outside the scope of the federal securities laws.[178]

Finally, an issue as to the ability to exercise control sometimes arises when promoters put together a package of services specifically tailored to meet the needs of the venture. In *Albanese v. Florida National Bank of Orlando*,[179] promoters sold ice machines coupled with various agreements to find locations for the machines, maintain and repair the machines, and collect revenue from the machines.[180] The Eleventh Circuit remarked that, while individually none of these services were particularly extraordinary, it would be difficult to find anybody else who could provide the same complement of services.[181] As a result, although the investors were vested with some degree of control, they

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177. *See Koch*, 928 F.2d at 1479 n.12 ("Although an investor participating in a general partnership obviously relinquishes some control since decisions must be made by majority vote, this type of diminution in control by itself would not satisfy the [last] prong of *Howey* unless the numbers of partners became so large" that their partnership powers are effectively diluted.); *Banghart*, 902 F.2d at 808 (citing *Rivanna Trawlers Unltd.*, 840 F.2d at 241); *Gordon*, 684 F.2d at 741; *Williamson*, 645 F.2d at 422.

178. *See* Koch v. Hankins, 928 F.2d 1471 (9th Cir. 1991). In *Koch*, the promoters devised a scheme whereby 35 separate general partnerships consisting of *160 investors* purchased 2700 acres of land for the cultivation of jojoba. *Id.* at 1473. Each general partnership consisted of approximately fifteen investors and took title to an eighty acre parcel of land. *Id.* The partnerships engaged the on-site manager and the experts selected by the promoter. *Id.* at 1473-74. Furthermore, the partnerships agreed to purchase from the promoters all of the materials required to cultivate their crops. *Id.* at 1473. The Ninth Circuit surmised that the investors had retained the legal right to control their respective general partnerships, including the right to remove the on-site manager. *Id.* at 1478-79. There was no formal mechanism, however, for the general partnerships to act together to terminate their relationships with the promoters. *Id.* at 1480. Additionally, the partners of the various general partnerships did not know each other, making it even more improbable that the general partnerships could act in unison. *Id.* Finally, it was economically unfeasible for any one general partnership to pull out of the overall venture and cultivate its particular parcel on its own. *Id.* Under these circumstances, the court concluded that there was a genuine issue of fact as to whether, as a practical matter, the investors were stuck with the promoters despite their legal controls. *Id.* at 1481.

179. 823 F.2d 408 (11th Cir. 1987).

180. *Id.* at 410.

181. *Id.* at 412.

had "no realistic alternative" other than to rely on the promoter's judgment.[182]

VIII. CONCLUSION

Traditional doctrine discouraging limited partner involvement in partnership affairs is rapidly being replaced by statutes that promote freedom to contract for control of the partnership business. In fact, it is now possible in most jurisdictions to structure a limited partnership so that the limited partners enjoy the same rights and powers traditionally possessed only by general partners and joint venturers.

The federal securities laws must keep pace with these developments or they will wind up encompassing ordinary business relationships that were never intended to be subject to securities regulation. This does not mean that limited partnership interests can never be securities. To the contrary, most limited partnership interests are securities. Courts should, however, consider limited partnership interests on a case by case basis to determine the economic reality of each transaction. Specifically, a court must ascertain whether the limited partner has retained the legal right to control the enterprise and, if so, whether those rights are realistically exercisable. Under this reasoning, if a limited partner has, in fact, acquired no meaningful rights of control, his interest will continue to be a security. Where, however, a limited partner is capable of affecting the partnership's affairs, he can protect himself from the general partners and should not be afforded the additional protection of the federal securities laws.

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182. *Id.* In another case, the promoter of a resort condominium complex, which was operated like a hotel, offered standard maintenance services, a rental pool arrangement, and hotel management services. Hocking v. Dubois, 885 F.2d 1449, 1452-53 (9th Cir. 1989). The court found that the unusual combination of services was "much more difficult . . . to replace" than the types of services which are ordinarily performed by rental managers. *Id.* at 1461.