Partnership, Limited Partnership, and Joint Venture Interests As Securities

Joseph C. Long
PARTNERSHIP, LIMITED PARTNERSHIP, AND JOINT VENTURE INTERESTS AS SECURITIES

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I. INTRODUCTION

Harry and Donald Hilleary organized Hilleary Franchise Systems, Inc., a Missouri corporation, to engage in the fast-food franchise business. They then developed a franchise restaurant package under the name "John Henry's". The plan for marketing the franchise was to form a series of limited partnerships to own and operate the individual franchise locations. Under this arrangement, the corporation, Hilleary Franchise, served as the general partner charged with the management and control of the franchise, which it sold to the partnership. The remaining partners were investors who each received a limited partner's interest. Through salesmen and advertising in various media, the Hilleary brothers sought to attract limited partners from the public. John and Rachel Garbo responded and purchased a limited partnership interest in a "John Henry's" franchise at Clearwater, Florida.

The Garbos soon were disenchanted with their investment. They tendered the limited partnership interest back to Hilleary Franchise and the Hilleary brothers and demanded the return of their money. Upon refusal of this demand, the Garbos filed suit against Hilleary Franchise, claiming the limited partnership interest they purchased was a security that had not been registered under the Missouri version of the Uniform Securities Act.¹ They claimed they were entitled, therefore, to recover their

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1. §§ 409.101-418, RSMo 1969. Apparently the petition did not allege that Hilleary Franchise or its agents had made any false or misleading statements or committed any fraud in the initial sale of the partnership interests; either would be grounds for recovery under section 409.411, RSMo 1969.
entire investment, plus interest from the date of their investment, and reasonable attorneys' fees. The defendant moved to dismiss for the failure to state a cause of action on the ground that the partnership interest was not a security.

The trial court granted the defendant's motion, and the plaintiff appealed. The Missouri Court of Appeals, in Garbo v. Hilleary Franchise Systems, Inc., reversed, concluding that the plaintiff's petition stated a cause of action under the Missouri Uniform Securities Act. The court's view was not that any limited partnership interest is a security that must either be registered or qualify for an exemption. Rather, the court stated:

The defendants vigorously assert that the Missouri Uniform Securities Act does not apply to the formation of limited partnerships or to the making of a certificate of partnership. We are inclined to agree that it does not apply to the formation of a true limited partnership . . . as provided in § 359.020. For example, could it reasonably be contended that the Missouri Uniform Securities Act is applicable to a limited partnership formed between an able, experienced but impoverished automobile mechanic who desires to start his own repair shop, and a wealthy individual who is willing as a limited partner to contribute to the partnership the funds necessary to start the business, to permit the mechanic as the general partner to have exclusive control over the operation of the enterprise, and to take a stated share of the profits, if any, provided that his liability was limited to the amount of his original contribution? We think not. Among other reasons, under the facts hypothesized there would be no sale of any security; and the formation of such a true limited partnership would be exempt from the Act as an "... isolated non-issuer transaction, . . ." under § 409.402 (b) (1).

Thus, the essence of the opinion is that the "John Henry's" franchise is not a bona fide limited partnership and that an interest in a bona fide limited partnership does not come within the purview of the Uniform Securities Act.

It is submitted that the court's analysis is incorrect on both counts. First, the "John Henry's" agreement is a bona fide limited partnership.

3. 479 S.W.2d 491 (Mo. App., D. St. L. 1972).
4. The person claiming an exemption from registration has the burden of establishing that the security or transaction is exempt. § 409.402 (d), RSMo 1969. Here, the defendant did not assert that the sale of the limited partnership interest to the Garbos qualified for either a transactional or securities exemption under section 409.402 (a) or (b). Rather, it argued that the limited partnership interest was not a security.
5. 479 S.W.2d at 498.
6. The quoted portion of the opinion reveals two other important errors. The first, a typical error for one not a securities specialist, is equating an exemption from registration with an exclusion from the coverage of the Act. If the limited partnership is not a security, it would not come within the provisions of the Act. But the isolated non-issuer exemption does not remove a security
Second, the interests of all limited partners are securities under both the federal securities acts\(^7\) and the various state blue sky laws, including the Missouri Uniform Securities Act.\(^8\)

The second contention above is neither new nor earth-shaking to securities experts. Attorneys who specialize in securities work\(^9\) and the legal scholars who work and write in the securities field\(^10\) have long maintained that many partnership and joint venture interests are securities. Yet many non-specialist lawyers and judges advise their clients or write opinions\(^11\) to the contrary. The failure of the judges and the securi-

from coverage by the Act. Section 409.301 provides that every security sold must either be registered or qualify for a security exemption under section 409.402(a) or a transactional exemption under section 409.402(b). Thus the isolated non-issue transaction exemption of section 409.402(b)(1), excuses registration under section 409.301. It does not, however, exempt the sale from the remaining provisions of the Act, especially the anti-fraud provisions of sections 409.101 and 409.411(a)(2).

The second error is the assumption that the isolated non-issuer exemption is available for the initial issuance of the partnership interests. Section 409.401(g) defines an issuer as “any person who issues or proposes to issue any security.” Section 409.401(i) then defines “person” to include any partnership. Thus, the drafters clearly intended that for this purpose the partnership is to be considered an entity and the issuer of partnership interests. This should be contrasted with certificates of interest or participation in oil, gas or mining titles, which section 409.402(g)(2) indicates are considered to have no issuers. However, transactions involving these interests are specifically excluded from the isolated non-issuer transaction exemption. § 409.402(b)(1); see L. Loss & E. Covett, BLUE SKY LAW 341 (1958). Thus the initial issuance of the partnership interests is an issuer transaction and cannot come within section 409.402(b)(1). However, as an issuer transaction it qualifies for an exemption under section 409.402(b)(9) if there are no more than 25 partners after the sale. Section 409.402(b)(9) of the Missouri Uniform Securities Act differs radically from its counterpart under the Uniform Act. The corresponding section of the Uniform Act is available to both issuers and non-issuers alike. It is limited to sales to 10 persons within any period of 12 consecutive months (as opposed to 25 total holders for the issuing entity after the sale) and therefore can be used time and time again. Moreover, the Uniform Act requires that the holder purchase for investment and prevents public solicitation. The Missouri provision includes neither requirement. If there had been a ban on public solicitation, the exemption would not have been available to the partnership in the Hilleary case, because public solicitation occurred through media advertising and the use of salesmen.


ties experts to elucidate their positions on the subject has caused this anomalous situation.

Most of the judicial opinions reflect an intuitive reaction that the securities acts were not intended to cover the type of partnership or joint venture interests in question. These opinions offer no explanation for such a conclusion; they merely cite earlier decisions based on the same type of intuitive response. Consequently, a general doctrine has developed that partnership and joint venture interests are never securities.

In contrast, the professional experts of the securities agencies and the securities bar have developed an acute intuitive sense of what is and what is not a security. Yet, with a few notable exceptions, they have not attempted to reduce this intuitive feeling to a systematic set of guidelines that the general bench and bar can use. The result is more than 60 years of securities regulation without any concerted effort by either the courts or the securities bar to isolate and identify those characteristics, common to all securities, that brought about restrictive legislation giving special protection to the investing public.

This article seeks to outline the characteristics common to all securities. Then partnership, limited partnership, and joint venture interests will be analyzed on the basis of these characteristics. This article will show that a limited partner's interest is always a security because of the unique statutory characteristics of such an interest. Further, it will dispute the doctrine that no general partnership and joint venture interests are securities. It will not, however, reach the equally untenable conclusion that all such interests are securities. Because these interests may vary according to the nature of the particular agreement executed by the parties, the

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14. For the history of the blue sky laws, see J. Moeisky, BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS (1971), and Marshall, History and Analysis of the Wisconsin Securities Law, 1942 Wis. L. Rev. 552.

15. In defense of the courts and securities bar, one is tempted to point out that the securities law is of legislative creation, and therefore the legislature could hamper an attempt to isolate and identify these characteristics by adding random additional categories of securities having little or nothing in common with the earlier classification. Although this excuse is appealing, it will not stand up. The definition of "security" went through a period of evolution prior to the enactment of the Securities Act of 1933. Fortunately this evolution took the form of adding particular instruments that were essentially compatible with the earlier ones and adding general terms such as "investment contracts" and "profit-sharing agreements" to cover unusual forms of investment. With the enactment of section 2 (1) of the Securities Act of 1933, 15 U.S.C. § 77b (1) (1970), the definition of "security" became stabilized. Most of the states have adopted this definition into their blue sky law without significant modification. Therefore, unreasoned legislative tampering with the definition has been minimized.
determination whether a particular interest is a security must be made on a case by case basis. Nevertheless, that determination should not be made solely upon the judge’s intuitive feel for the application of the securities act. Rather, it should be based upon a reasoned determination of whether the common elements of securities are present.

As the tests for determining whether partnership interests are securities are examined, one matter should be kept in mind. Assuming arguendo that the “John Henry’s” agreement, and the multitude of similar agreements, are valid limited partnerships and that it is intuitively agreed that the securities act should apply to a “John Henry’s” limited partnership interest because it is a pure investment situation, how can a “John Henry’s” interest be distinguished from the limited partnership interest of the wealthy man in the hypothetical in the Hilleary opinion? Both the Garbos and the wealthy man have purchased a limited partnership interest. Is one limited partnership interest acquired in one manner a security, while an identical partnership interest acquired in another manner is not? If so, by analogy the common stock acquired by a family member in a close family corporation would not be a security, while the same stock publicly offered to a stranger would be. The common stock and the limited partnership interest are securities in both situations, or they are securities in neither. Therefore, if the limited partnership interest is a security when sold through a public offering, it is a security when sold in a private offering.

II. THE HILLEARY AGREEMENT AS A BONA FIDE LIMITED PARTNERSHIP

Intuitive response similar to that mentioned above is probably largely responsible for the decision in Hilleary. Apparently, the reasoning was this: The limited partnership interests in this case were sold through media advertisement to the general public; consequently, the close prior personal association between the parties that characterizes the typical partnership or limited partnership is absent. Although the securities act probably was not intended to cover the typical partnership or limited partnership, the circumstances of the sale may affect the decision to exempt the transaction from the registration provisions of the securities act, but it in no way alters the determination whether a particular instrument is a security. See pt. II, § E of this article.


17. The circumstances of the sale may affect the decision to exempt the transaction from the registration provisions of the securities act, but it in no way alters the determination whether a particular instrument is a security. See pt. II, § E of this article.

18. The court’s casting the hypothetical in the form of the typical limited partnership with few partners and emphasizing the public sale feature of the Hilleary agreement when attempting to distinguish it from the hypothetical demonstrate its thinking. 479 S.W.2d at 498.

19. This intuitive response is supported by opinions in earlier cases. See, e.g., Lindemulder v. Shoup, 258 Mich. 679, 242 N.W. 807 (1932); Hanneman v. Gratz, 170 Minn. 38, 211 N.W. 961 (1927); Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956). An examination of these cases reveals that the holdings are based upon intuition. None provides a reasoned basis for holding that joint venture interests, with which each was concerned, are not securities.
the public sale and the lack of a prior relationship between Hilleary Franchise and the Garbos make the "John Henry's" agreement the type of investment that the securities act is intended to regulate. Therefore, so that the securities act will apply to this transaction, but not the more typical partnership or limited partnership, we hold that the "John Henry's" agreement is not a bona fide limited partnership.

An integral part of this reasoning process is the intuitive conclusion that no bona fide limited partnership can exist where the general partner attracts several limited partners to the partnership at varying times through public advertisement. It should be determined whether this conclusion is valid, in view of the nature of the limited partnership as determined by the limited partnership statutes. If it is not, and a public limited partnership is a bona fide limited partnership, the validity of using the bona fide-non-bona fide distinction to classify limited partnership interests as securities is undermined.

An unarticulated general objection underlies the specific objections to denomenating the organization a limited partnership. Some earlier decisions and attorneys general opinions indicate that partnerships and limited partnerships, as forms of business organization, should be limited to the usual two- or three-man type of partnership common in business and the professions prior to the ascendancy of business and professional corporations. These relationships are usually spawned by an acquaintance-ship or business association that allows each of the prospective partners to observe the talents and shortcomings of the others. Thus, the traditional partnership was a relationship of mutual respect and trust.

It is difficult indeed to reconcile the above concept of the partnership with the large, impersonal limited partnership arrangements, exemplified by *Hilleary*, where the partners are brought together by public advertisement. Often, these partners' only knowledge of the general partner comes from the public advertisement. Further, they may have no knowledge whatsoever of their fellow limited partners.


21. For example, in one limited partnership, 7,000 limited partnership interests are to be sold to the general public with a minimum investment of 5 units per person. Preliminary Prospectus, Monterey Vineyards (May 30, 1972).
The essential problem, however, is not the difficulty of reconciling the Hilleary-type arrangement with the traditional partnership. Rather, it is the unwillingness of courts to accept the partnership and the limited partnership as forms of business organization capable of adaptation to financing by large groups of unrelated individuals seeking merely an investment opportunity. This attitude is clearly exemplified by the Hilleary court's contrasting its auto mechanic hypothetical with the following one, which is identical to the Hilleary fact situation:

John Smith, the owner of an established business in Missouri, desires to expand its operation to other states. To that end he forms a corporation named the J.S. Company, but instead of issuing and selling stock or similar securities he forms a limited partnership between the corporation, as the general partners, and a nominal limited partner, in each of the localities in which he seeks to do business, by the terms of which the corporation grants a franchise to the limited partnership, but retains the right to admit any number of additional limited partners to the partnership for unspecified amounts. The corporation then, by means of an advertising campaign in the various media, and by numerous salesmen, induces individuals in each locality to acquire certificates of limited partnership for various shares of the profits of the limited partnerships on the representation to them that exceedingly large profits will thereby inure to them.22

If one assumes that the Hilleary arrangement is irreconcilable with the partnership concept and, further, that the Hilleary agreement fails to meet the statutory requirements for qualification as a limited partnership, what kind of business organization is it? Denominating an interest in it a security does not classify it as a particular type of business organization. It is not a corporation or a business trust. The law recognizes three other types of business organizations: The partnership; the joint venture; and the joint stock company.23 The joint venture can be eliminated from separate consideration, because most authorities consider a joint venture merely a partnership created for a limited purpose.24

A joint stock company usually is formed by an agreement similar to the articles of incorporation of a corporation. One feature of this form of organization is that it allows centralization of management. The management of the business rests in the hands of designated officers or directors. These officers or directors, like their corporate counterparts, need not own an interest in the enterprise.25 Interests in the company are represented by freely transferable shares of stock. The joint stock company is not

22. 479 S.W.2d at 498.
23. Actually, two additional types of business organization exist: the professional association and the cooperative association. The organization in Hilleary clearly fits neither of these categories.
dissolved by the death of a member, as is a partnership. One disadvantage of joint stock companies is the unlimited liability of the members.

The Hilleary agreement appears not to fit the joint stock company mold. First, nothing in the agreement indicates an intent to create a joint stock company. Second, management, although centralized, is vested in the general partner, who owns an interest in the organization. Moreover, the agreement purports to limit the liability of some of the members, which was impossible to do at common law in the joint stock company. Finally, a question exists whether Missouri law recognizes joint stock companies.

Thus, by a process of elimination one may conclude that the Hilleary agreement must create some type of partnership. This conclusion is supported by the fact that a partnership that tries and fails to comply with the Limited Partnership Act is still a partnership; it merely gains none of the advantages of that act.

Once it is determined that the Hilleary arrangement must be some type of partnership, the question becomes whether any of the courts' traditional objections to the use of the limited partnership as a public investment device are valid. Hilleary and earlier cases indicate that these objections center around (1) the transferability of the interests and the inclusion of new investors after the signing of the initial agreement; (2) the lack of knowledge of the identity of other limited partners in the purported public limited partnership; and (3) public solicitation of the purported limited partners by the general partner. Are any of these fea-

26. Placing restrictions on the alienation of joint stock company shares results in dissolution upon the death of a member, as in a partnership situation. Hammond v. Otwell, 170 Ga. 832, 154 S.E. 357 (1930). See also Haiku Sugar Co. v. Johnstone, 249 F. 103 (9th Cir. 1918).

27. This disadvantage has caused a decline in the use of this form of business organization. Probably the most famous of the modern joint stock companies was the American Express Co. Founded in 1858, it at one time had 27,000 "shareholders." In 1965, the company, threatened with massive personal liability on the part of its members as a result of its expanded activities, incorporated. See J. CRANE & A. BROMBERG, PARTNERSHIP § 34, at 178 n.16 (1968).

28. Mo. CONST. art. XI, § 1 provides that a joint stock company is to be classified a corporation for the purposes of the Missouri Constitution. (Whether that classification carries over into the corporate statutes is an open question). An interesting question arises here. Mo. CONST. art. XI, § 8 provides that shareholders of corporations have limited liability. Lack of limited liability was the element that caused the decline of the joint stock company as a form of business organization. Query whether the language of section 1 of article XI, classifying joint stock companies as corporations, means that in Missouri members of joint stock companies have limited liability. If it does, that is a significant reason to require joint stock companies to meet the corporate requirements; otherwise, a corporation could avoid state control by organizing as a joint stock company.

29. Of course, the primary advantage of a limited partnership is the shield from personal liability for the limited partners. In Missouri, section 359.070, RSMo 1969, creates this limited liability.

30. See Cheyenne Oil Corp. v. Oil & Gas Ventures, Inc., 42 Del. Ch. 100, 204 A.2d 743 (1964).
tutes repugnant to the Limited Partnership Act?31 If so, the agreement cannot qualify as a limited partnership even if it purports to be one. However, if these practices are consistent with the act and the parties fulfill the other requirements of the Limited Partnership Act, no court should deny limited partnership status simply because the arrangement does not fit the court's stereotype of a limited partnership.

First, may limited partners be admitted after the formation of the partnership? At common law, the admission of a new partner into a general partnership caused a technical dissolution of the old partnership and the formation of a new one.32 This is not necessarily so with the limited partnership. The Limited Partnership Act clearly envisions the admission of additional partners after the formation of the original partnership without dissolution resulting.33 Section 859.090, RSMo 1969, [all references to statutory sections are to the Missouri Revised Statutes unless otherwise indicated] provides that the general partners have the right to admit additional limited partners if such power is given them in the certificate of partnership.34 If this authority is given in the certificate, the limited partners have no further voice in the selection or admission of new limited partners. The general partners merely follow the procedure outlined in the certificate, select the additional limited partners, and induct them by filing an amendment to the certificate.35 Having approved in advance of the admission of additional limited partners, the original limited partners cannot prevent their induction by refusing to sign the

33. See §§ 859.080, .160(2); UNIFORM LIMITED PARTNERSHIP ACT § 1, Comment (1969).
34. One should distinguish the certificate of partnership from the partnership agreement. Although the same document often serves as both the certificate of partnership and the partnership agreement, (see, e.g., Certificate and Agreement of Partnership, Preliminary Prospectus, Monterey Vineyards, at A-1 (May 80, 1972)), the two are not necessarily the same. Section 359.020 requires that the certificate be recorded with the County Clerk in the county where the partnership conducts its business. The certificate must include certain information outlined in that section, including the authority of the general partners to admit additional limited partners. § 359.020 (1)(1), RSMo 1969. For a general discussion of this point, see Pittman, Missouri's "Uniform Limited Partnership Act", 14 Mo. L. Rev. 133 (1949). The certificate, however, need not contain the entire agreement of the partners. For example, the share of the profits to which each general partner is entitled may be omitted. Therefore, separate private partnership agreements from which the information required by the certificate is extracted are common. See J. CRANE & A. BROMBERG, PARTNERSHIP § 26, at 145 (1968). The Hilleary case is unclear whether a separate partnership agreement existed or whether the certificate doubled in brass; the failure of the parties to furnish the court with the separate partnership agreement, or the inept drafting of the certificate if no separate agreement existed, caused the court a number of unnecessary problems.
35. § 859.080, RSMo 1969.
amended certificate of partnership. Section 359.250(3) provides that the court can order the certificate amended without the signature of the objecting limited partner.\textsuperscript{36}

Next, does the Limited Partnership Act contemplate free transferability of a limited partner's interest? Section 359.190 concerns this question. Subsection 1 provides that a limited partnership interest is freely assignable. Subsection 3, however, reveals that the assignment alone does not make the assignee a substituted limited partner. The assignment merely entitles the assignee to receive the limited partner's share of the profits and a return of his capital contribution upon dissolution. Like the assignee of a general partner's interest at common law,\textsuperscript{37} the assignee of a limited partnership interest is not entitled to require an accounting by the partnership, to have access to any information concerning the partnership, or to inspect the partnership books.\textsuperscript{38} Subsection 4, however, outlines a method for making the assignee a substituted limited partner. The subsection provides that the certificate of partnership may give the assigning partner the right to designate his successor as a limited partner. Thus, the other partners can agree in advance to accept as a limited partner any person to whom a limited partner sells his interest.\textsuperscript{39}

From these provisions on the addition of new limited partners and the transfer of existing partnership interests, it is clear that the drafters of the Limited Partnership Act intended to depart from the traditional common law limitations on addition of partners and transferability of partnership interests. They intended to create a vehicle for investment more closely resembling the corporation. Therefore, the objections to the use of the limited partnership as a public investment device not only find no support in the statutory language, but also run contrary to the

\textsuperscript{36} For a discussion of the language of section 359.250 and its departure from the language of the Uniform Act, see Pittman, Missouri's "Uniform Limited Partnership Act", 14 Mo. L. Rev. 133, 145 (1949). To avoid circulating the amendment document to the various limited partners to obtain their signatures (a rather cumbersome process at best) one limited partnership provided that the general partner would serve as the attorney-in-fact for all the limited partners for the purpose of executing and signing any amendments to the certificate of partnership including the admission or substitution of limited partners. See Preliminary Prospectus, Monterey Vineyards, at A-7-A-9 (May 30, 1972).

\textsuperscript{37} See J. CRANE & A. BROMBERG, PARTNERSHIP § 42 (1968).

\textsuperscript{38} These rights seem of limited value to an investor, especially where he is entitled to receive the same information as a result of the partnership interests being registered as securities. Assignment requires no further formal action by the partnership. On the other hand, accession to the status of substituted limited partner requires filing of an amendment to the certificate of partnership. The amendment must be signed by all the partners, general and limited. As this can be a very cumbersome process in a large public partnership, whether the substitution process is necessary to protect the assignee's interests or whether the simpler assignment provides sufficient protection should be considered.

\textsuperscript{39} As in the case of the newly admitted partner, the actual substitution does not take place until the certificate of partnership is amended in accordance with section 359.250, thereby giving public notice of the substitution. § 359.190(5), RSMo 1969.
intent of the Uniform Commissioners as expressed in their comments to the act.40

Another reason that the courts have been reluctant to recognize a public investment vehicle as a true limited partnership is that the purported limited partners have no knowledge of the identity of their fellow investors. As pointed out before, however, the statute specifically authorizes a provision in the partnership certificate abolishing prior approval by the limited partners as a condition to the admission of new limited partners or the substitution of assignees for existing limited partners. Therefore, it would be absurd to use this objection to deny limited partnership status to those organizations having certificates that include such provisions. Where the limited partners have contracted away their voice in the selection and admission of other limited partners, it is irrelevant whether the limited partners know the identity of those to be admitted. In this regard, the limited partnership is like a corporation. In neither case does the investor have any control over the acceptance of the other individuals into the organization. Further, the Uniform Commissioners make clear their general purpose to restrict the function and, correspondingly, the liability of the limited partner. Actually, he is no longer a partner with the resultant common law partnership duties; rather, he is a passive investor seeking a return on his capital through the operation of the enterprise by others.41 In this context, a limited partner's knowledge of those running the enterprise, the general partners, is relevant to an intelligent investment decision, but his knowledge of the other passive investors is irrelevant.

The courts' final objection is to the public solicitation of investors. Here the Limited Partnership Act itself is silent. Most authorities agree that the Uniform Commissioners did not foresee the use of the act to form large public limited partnerships.42 Does that mean that such partnerships cannot take advantage of its provisions? Is the statute inflexible and incapable of adapting to meet the needs of a changing business climate? It need not be. First, no provision in the act limits the number of limited partners that the partnership can contain. This, coupled with the provisions just outlined concerning induction of new members and transferability of partnership interests, which were included to make the interests a medium for investment, results in an investment vehicle essentially impersonal in nature. Further, the limited partners have no effect on the actual conduct of the business. Essentially, their investment differs little from an investment in the stock of a corporation or the deposit of funds in a savings account. Yet the courts allow the corporation and the bank, under regulated conditions, to seek investors from the general public. Why should they restrict the limited partnership? Obviously, they

40. See Uniform Limited Partnership Act § 1, Comment (1969).
41. Id.
42. See, e.g., J. Crane & A. Bromberg, Partnership § 26, at 146 (1968).
should not. Courts that have attempted to deny limited partnership status because of the public nature of the enterprise have confused the limited partnership with the general partnership. The relationship may result from prior social or business contact, as the auto mechanic hypothetical suggests, but the statute does not require that it result from such contact. Therefore, the courts should not engraft additional requirements of knowledge of and association with the other limited partners on to those stated in the statute.

The court registered specific objections to the Hilleary agreement. First, the introductory paragraph of the certificate indicates that the agreement is made between the persons named in paragraph 3. However, paragraph 3 contains no names, but refers the reader to Exhibit I. That is consistent with the Limited Partnership Act. Section 359.020 requires that the names and addresses of all the partners be included in the certificate, but it does not require that they appear in any particular place. As Exhibit I was attached and incorporated by reference, it is clearly a part of the certificate. Thus, there is substantial, if not literal, compliance with the statutory provisions, which is sufficient to create a limited partnership.

The court further attempts to distinguish the Hilleary agreement from a "bona fide" limited partnership because Exhibit I indicates that the Garbos as the sole limited partners are entitled to 5.76 percent of the partnership profits, but makes no provision for Hilleary Franchise, the only general partner, to receive any of the remainder. From this, the court concludes that Hilleary Franchise cannot share in the partnership profits. Therefore, according to the court, Hilleary Franchise has nothing to transfer under the rights granted it in paragraph 8 of the certificate (dealing with assignment of interests and substitutions of partners) except its right to receive royalty income from the sale of the "John Henry's" franchise to the partnership.

It is submitted that the omission does not prevent the agreement from being a bona fide limited partnership, nor does it prevent Hilleary franchise from sharing in the profits. The document reproduced in the report of the case purports to be nothing more than a certificate of part-

43. 479 S.W.2d at 500. Under paragraph 8 of the agreement, dealing with substitution, the parties evidently contemplated assignment of interests after the formation of the partnership. Therefore, to simplify amending the recorded certificate, they probably chose to set out their names, addresses, and interests in Exhibit I rather than in the body of the certificate.

44. § 359.020 (2), RSMo 1969. Good drafting principles dictate that the initial paragraph should refer directly to Exhibit I, but the arrangement does not alter the legal effect of the instrument.

45. Cf. Electric Supply Co. v. United States Fidelity & Guar. Co., 79 N.M. 722, 449 P.2d 324 (1969). In that case the plaintiff alleged that a limited partnership of which he was a member was invalidly formed because the partnership agreement indicated that members of a certain group (identified in an exhibit attached to the agreement and including the plaintiff) were to be limited partners and share 40 percent of the profits. The individual share of the profits of each
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A partnership, executed by the partners pursuant to Section 359.020. This document need not contain the entire agreement between the partners. One item of information that section 359.020 requires the certificate of partnership to contain is the share of the profits to which each limited partner is entitled. It is not required, however, that the shares of the general partners be disclosed. Thus, the omission of this information from the recorded certificate does not cause the Hilleary agreement to fail to comply with the disclosure provisions of the Limited Partnership Act.

Further, what of the assumption that Hilleary Franchise is entitled to none of the partnership profits? From the discussion in the previous paragraph, one can see that the interest of Hilleary Franchise may be set out in a separate document. Moreover, a valid oral agreement allocating a share of the profits to Hilleary Franchise may exist. Nothing requires that a written instrument evidence a general or limited partnership agreement; the partnership agreement can be entirely oral, entirely written, or partly written and partly oral. Furthermore, under general contract law, the limited partner was to be set out in detail in the exhibit. However, the exhibit showed the detailed division of only 36 percent of the profits, leaving 4 percent unallocated. The court held that this did not prevent creation of a valid limited partnership. The unallocated 4 percent was "a matter for adjustment between the partners themselves and there is ample provision under the Uniform [Limited] Partnership so that an adjustment can be made. . . ." 79 N.M. at 727, 449 P.2d at 328.

46. Common practice is to have a separate partnership agreement containing the details of the partnership. The information required to be published in the certificate is extracted and filed as a public record. See J. CRANE & A. BROMBERG, PARTNERSHIP § 26, at 145 (1968).

47. § 359.020 (1)(i), RSMo 1969.

48. One reason for separate partnership agreements is avoidance of disclosure of the division of profits among the general partners. J. CRANE & A. BROMBERG, PARTNERSHIP § 26, at 145 (1968). A model certificate that does not list the capital contribution or share of the profits for the general partners is set out at J. CRANE & A. BROMBERG, PARTNERSHIP, app. VII (1968). For a sample form of the certificate and a separate partnership agreement, see J. MULDER & M. VOLTZ, THE DRAFTING OF PARTNERSHIP AGREEMENTS 40-53 (rev. ed. 1955). Of course, where there is a single general partner, as in the Hilleary agreement, his interest normally can be determined simply by subtraction.

49. Two additional factors suggest the existence of another agreement between the parties. First, the title of the document normally indicates if it is used as both certificate and agreement. See, e.g., Certificate and Agreement of Partnership, Preliminary Prospectus, Monterey Vineyards, at A-1 (May 30, 1972). Second, the existence of a second document of agreement would help explain the delay of over a month between the purported execution date of the agreement and the date of acknowledgment of the certificate. The agreement may have been entered into on November 28, 1969, as the certificate recited, (479 S.W.2d at 494), but the information not extracted nor the certificate executed and acknowledged until sometime in 1970. The original agreement of partnership need not be acknowledged, but the certificate must be. § 359.020, RSMo 1969.

50. The limited partnership agreement must be in writing to the extent of the certificate that section 359.020 requires. Nothing prevents this certificate from merely being the partial memorandum of an oral partnership agreement. For a discussion of the application of the statute of frauds to partnership agreements, see J. CRANE & A. BROMBERG, PARTNERSHIP § 23 (1968).
law, parol evidence of such an agreement is admissible, whether its omission from the written memoranda was purposeful or unintentional.

Even if the parties did not discuss or agree on the interest Hilleary Franchise was to receive, all is not lost. In Electric Supply Co. v. United States Fidelity & Guaranty Co., the court held that a similar failure to allocate was a matter to be worked out by the partners among themselves. The obvious solution is amendment of the partnership agreement to make an allocation. If the parties are unwilling to do this, the statutes apparently give the courts two alternatives. The remaining 94.26 percent

51. If the omission of Hilleary Franchise's share of the profits was intentional, the writing was not intended a complete integration of the agreement. In that case, under contracts law, parol evidence is admissible to establish those items not covered by the written portion of the agreement. See generally S. Williston, Contracts § 633 (3d ed. 1961).

The parties may have intentionally omitted Hilleary Franchise's interest because Hilleary Franchise did not want the interest to be made public, or perhaps because it contemplated admission of additional partners under paragraph 8 and assignment to them of part of its interest, and therefore was uncertain of the final extent of its interest. It was contemplated that each investor would execute and receive a single copy of the partnership certificate. 479 S.W.2d at 496. This copy would show only the interest of the currently inducted limited partner. Apparently Hilleary would maintain a composite copy and record a composite copy according to the requirements of section 359.020. Listing Hilleary's interest would be misleading if another partner were inducted, because Hilleary's interest would decrease accordingly.

52. If the parties intended a complete integration of their agreement and through oversight failed to list the agreed-upon interest that Hilleary Franchise was to receive, Exhibit I is obviously ambiguous on its face. Here, too, contract law indicates that parol evidence is admissible to establish what the parties agreed to be Hilleary Franchise's share of the profits. See generally S. Williston, Contracts § 631 (3d ed. 1961).

53. 79 N.M. 722, 449 P.2d 324 (1969); see note 47 supra.

54. The parties perhaps intended to do so. Capital of $10,001 was likely insufficient to open the restaurant operation. Additional capital logically would come from the admission of new limited partners. Previously unallotted shares of the profits commensurate with their capital contributions could be allotted to them. The partners may have intended that paragraph 8 permit implementation of such a plan, but that paragraph fails to provide the necessary authorization. It is an enabling provision authorized by section 359.190, allowing the limited partners to assign their interests and appoint the assignee a substitute limited partner without the consent of the other partners. See text accompanying note 41 supra. As the certificate stands, it does not reflect any limited partnership interest in Hilleary Franchise, although section 359.120 specifically permits a person to be both a limited partner and a general partner at the same time. Section 359.190 applies only to limited partnership interests, because section 359.090 clearly indicates that new general partners cannot be admitted by action of the general partner alone. Nor does the act contain any provision for the conversion of a general partner's interest to that of a limited partner; this would not raise the necessary capital anyway, because it is a transfer of an existing interest rather than the creation of a new interest. Hilleary Franchise, rather than the partnership, would be entitled to the proceeds of such an assignment.

One solution is inclusion of a provision authorizing the general partner to admit new limited partners. The provision should establish the capital contribution each new partner is to make, the percentage of the profits he is to receive, and the formula for readjusting the shares of the existing partners (assuming that all of the profits have already been allocated). Sections 359.080 and 359.090 (6) authorize such provisions, which must be included in the certificate
PARTNERSHIP INTERESTS AS SECURITIES

could be divided equally between the two existing partners, or the profits could be left unallocated, to accumulate and be distributed as capital upon dissolution of the partnership. Only if a court were to hold that the unallocated profits must accumulate and be distributed as capital after dissolution would Hilleary Franchise have nothing to assign under paragraph 8 of the certificate.

Finally, in the attempt to distinguish the Hilleary agreement from a true limited partnership, the court observes that the certificate of partnership stated that the partnership was created on November 28, 1969, but Hilleary Franchise did not make its corporate acknowledgment until January 6, 1970, some 89 days later. The court concluded from this and the previous points that the original partnership was not formed between the Garbos and Hilleary Franchise, but that the Garbos joined as limited partners at a later date.

Other possible explanations exist for the difference in dates. The document reproduced in the opinion purports to be nothing more than a certificate of partnership; it is not necessarily the original partnership agreement. Therefore, Hilleary Franchise and the Garbos may have entered into a separate written or oral agreement of partnership on November

55. Section 358.060 (2) provides that the provisions of the Missouri Uniform Partnership Act apply equally to limited partnerships unless inconsistent with the provisions of the limited partnership act. Section 358.180 provides all partners share equally in the profits of the partnership unless the articles of partnership provide otherwise. Limited partners share equally in the profits unless some special agreement is included in the certificate of partnership. § 359.140, RSMo 1969. In conjunction, these two provisions provide a basis for arguing that the Garbos should receive 5.76 percent as a preference stated in the certificate and then share equally with all the other partners (in this case only Hilleary Franchise) in the remaining undivided profits. The problem with this approach is that section 359.020 (1) (i) requires that the share of profits of each of the limited partners be set out in the certificate of partnership. However, the language of section 359.140 suggests that such listing is only necessary when the limited partners do not share equally. Thus interpreted, the sections indicate the preference that the Garbos enjoy is set out in the certificate, and that this may be sufficient.

56. Section 359.230 provides priorities for distribution of assets upon dissolution. Return of capital is to be based upon the percentage of each partner's contribution to the original capital, if this priority is unaltered by the certificate or subsequent agreement. The Hilleary case contains no indication of an altering agreement. The Hilleary case contains no indication of an altering agreement. Clearly, if the partnership lost money, each limited and general partner's share would be ratably reduced. Logic dictates that if the partnership makes money and the money is not allocated as profits, the partner's shares should be ratably increased as well.

57. Such a holding is unlikely. Even then it would have the right to receive a portion of the returned capital based upon its percentage of contribution, and this is an assignable right. Its share would likely be quite small, because it contributed only $1, as compared to the Garbos' $10,000. 479 S.W.2d at 496.

58. Id. at 500.

59. See text accompanying note 49 supra.

60. See text accompanying note 50 supra.
28. Another possibility is that the parties signed the certificate on November 28, as the certificate recites, but that Hilleary Franchise simply delayed acknowledgment of its act until January 6, 1970. If this possibility is true, the agreement would create the partnership as of November 28, because the partnership agreement need not be acknowledged.

Even if the court is correct that the partnership was formed on November 28 between other parties, the admission of the Garbos as limited partners at some time after its original formation would not destroy limited partnership status. Sections 359.080 and 359.090 envision the admission of new limited partners after the formation of the original partnership interests and the substitution of assignees as limited partners. Therefore, the court's conclusion that admission of the Garbos after the formation of the partnership deprives it of limited partnership status flies in the face of specific statutory authority.

III. What Types of Partnership and Joint Venture Interests Are Securities?

From the preceding discussion it is clear that a public limited partnership, and particularly the Hilleary arrangement, can be a bona fide limited partnership. The basic, underlying questions remain unanswered, however. First, what are the proper criteria for determining whether partnership and joint venture interests are securities? In an attempt to answer this question, section A of this part discusses the general securities concepts applicable to partnership interests. Second, under these criteria which interests are securities? Sections B, C, and D discuss the application of the general concepts to interests in partnerships, limited partnerships, and joint ventures, in an attempt to develop specific guidelines for the practitioner's use in determining whether each is or is not a security.

A. General Applicable Securities Rules

The obvious starting point is the statutory definition of a security. Section 409.401 (1) defines "security":

61. Section 359.010 requires that there be at least one general partner and one limited partner at the time of formation of the partnership. Although section 359.120 states that the same person can be, concurrently, a limited partner and a general partner of the same partnership, two persons are required for the initial formation. See § 359.020, RSMo 1969. That the Garbos were the only limited partners listed in the certificate strongly implies that they were the limited partners at the formation.

62. Some authority suggests that the status of a partnership interest as a security is determined by whether the interest was acquired at the formation of the partnership or by subsequent purchase of an existing partnership interest or admission as an additional partner. See Op. Att'y Gen. (Cal.) No. 9073 (1933); Op. Att'y Gen. (La.), [1946-1954 Transfer Binder] Blue Sky L. Repr. § 70,031 (1947); 1921-22 Op. Att'y Gen. (Nebr.) 163.

63. See text accompanying notes 34-38 supra. If the certificate failed to grant the necessary authority to the general partners, as allowed by section 359.090, admitting additional limited partners would require the consent of all the partners, limited and general. § 359.090 (6), RSMo 1969. In the Hilleary agreement, the general partner probably had no authority to admit new limited partners. See note 54 supra.
“Security” means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; reorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease; or any contract or bond for the sale of any interest in real estate or deferred payments or on installment plans when such real estate is not situated in this state or in any state adjoining this state; 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.

This definition is part of the Uniform Securities Act, which has been adopted in 25 states, the District of Columbia, and Puerto Rico. The definition in the Uniform Act is based upon that in the Securities Act of 1933. The definition does not cover interests in partnerships and joint ventures specifically. However, in addition to the specific categories of securities, the statute contains three general classifications: (1) Investment contracts; (2) certificates or interests in profit-sharing plans; and (3) any interests or instruments commonly known as securities. Interests in partnerships and joint ventures must fit within one of these general categories if they are securities.

During the evolution of the definition under state law prior to the passage of the Securities Act of 1933, the state legislatures realized the difficulty of including every possible kind of security by specific enumeration. Instead of identifying the common elements of the various types of securities and drafting a definition based on these elements, however, the state legislatures sought to provide flexibility in the securities acts by introducing general phrases that were to cover new plans as they developed. By the time Congress passed the Securities Act of 1933, the above three general phrases had become common, and were included in that act without further definition. Thus the task of determining the scope of the phrases went to the courts.

64. 15 U.S.C. § 77b (1) (1970). For purposes of this article, the definitions can be treated as identical. Because of the strong influence of the federal act and also because the federal act was based upon earlier state legislation, the definitions found in the laws of states that have not adopted the Uniform Act closely resemble the definitions in the Uniform Act and the federal act. It may be assumed that the definition involved in any case discussed follows the language of the Uniform Act unless otherwise noted.

65. Although the drafters of the early statutes probably intended that each of the general phrases cover a different type of financial arrangement, the tendency today is to lump the general phrases together, as if they were interchangeable.

In the mid-1940's, the Supreme Court handed down two decisions involving the definition of "investment contract" that shaped the development of the general phrases for the next 25 years. In the first of these cases, SEC v. C.M. Joiner Leasing Corp., the SEC sought to enjoin the Joiner Corporation from selling assignments of oil leases in conjunction with contracts requiring the Joiner company to drill test wells to determine whether the land would produce oil. The investor was completely passive, because the value and development of his property was solely in the hands of the Joiner company. The Court declined to define "investment contract," on the ground that the definition would immediately be evaded by the development of some new financing interest. Instead, the Court determined that the instruments were securities because "trading in these documents had all the evils inherent in the securities transactions which it was the aim of the Securities Act to end."

The Joiner case was soon followed by SEC v. W.J. Howey Co. The Howey company was an established Florida citrus fruit growing firm that sought to expand its production. The company secured an additional 500 acres of land suitable for citrus cultivation. To finance the purchase of the land and to meet the costs of bringing it into production, the company decided to sell half of the new acreage to individual investors in plots of 5 acres or less. Along with the sale contract, the investor was offered

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66. SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943); SEC v. W. J. Howey Co., 328 U.S. 293 (1946). These decisions were under the Securities Act of 1933 and therefore were not binding on the state courts in their interpretation of the blue sky laws; however, they were literally followed (see, e.g., Emery v. So-Soft, Inc., 30 Ohio Op. 2d 226, 199 N.E.2d 120 (Ct. App. 1964); Gallion v. Alabama Mkt. Centers, Inc., 282 Ala. 679, 213 So.2d 841 (1968)) until the Supreme Court of Hawaii rejected them in State v. Hawaii Mkt. Center, 485 P.2d 105 (Hawaii 1971). The Hawaii Market Center case appears to have replaced the Supreme Court cases as the landmark decision in the area.

67. 320 U.S. 344 (1943).

68. This case would not arise under the Uniform Act because it includes in the definition of a security any "certificate of participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease." § 409.401 (f), RSMo 1969.

69. 320 U.S. at 349.

70. 328 U.S. 293 (1946).
a management contract by an affiliated corporation, Howey-in-the-Hills Service, Inc. Under the management contract, the affiliated company was to care for the fruit trees and harvest and market the mature fruit. The landowner could not enter his tract to pick and market the fruit without the consent of the management company. The fruit from the various groves was pooled, processed, and marketed together. The investor received payment based on the amount of fruit taken from his plot at the time the fruit was picked, less a management fee and the cost of caring for the tract. The Court stressed that most sales were made to non-resident business and professional people who lacked the skill, knowledge, or equipment to care for their property; therefore, the purchase by them was strictly an investment.\footnote{71} Moreover, the Court noted, it would be uneconomical to run the separate tracts as individual units. For these reasons, more than 85 percent of the land purchasers had also purchased the management contract.\footnote{72}

Rather than simply detailing these facts and concluding, as in \textit{Joiner}, that the contracts were investment contracts because they contained the evils the Securities Act sought to control, the Court chose to provide a definition of “investment contracts”:

\begin{quote}
[An investment contract] is where individuals were led to invest money in a common enterprise with the expectation that they will earn a profit solely through efforts of the promoter or of some one other than themselves. . . .

. . . In other words, an investment contract for the purpose of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party. . . .\footnote{73}
\end{quote}

In addition to stating the definition, the Court issued an admonition

\footnote{71. 328 U.S. at 296.  
72. That the remaining persons did not purchase the management contract is of no importance. If the land and management contracts offered together constitute a security, offering the contracts for sale without registration is prohibited. 15 U.S.C. § 77e (1970). \textit{See also} § 409.301, RSMo 1969.  
73. 328 U.S. at 298-99. The Court maintained that it was not formulating a new definition, but merely summarizing the states' experience with the concept of investment contracts under their securities acts. A careful reading of the state cases cited by the Court in support of its definition reveals, however, that part of the Court's definition was made from new cloth. For example, the prior state experience provides no basis for that portion of the \textit{Howey} definition that refers to “efforts of others.” The concept appears to have originated in the definition of securities found in \textit{37 Corp. Jur. Licenses} § 168 (1925). That definition was based upon the case of \textit{Lewis v. Creasey}, Corp. 198 Ky. 409, 248 S.W. 1046 (1923). The state courts did not widely accept either the \textit{Corpus Juris} or \textit{Lewis} definitions. Similarly, there is some question concerning the “common enterprise” requirement of the \textit{Howey} definition. The state and federal case development of the \textit{Howey} definition is beyond the scope of this article. For a discussion, see \textit{Long}, \textit{An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation}, 24 Okla. L. Rev. 185 (1971).}
that has been ignored too often in the succeeding 25 years. This admonition is at least as important as the Court's definition:

The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae.\footnote{328 U.S. at 301. See also Tcherepnin v. Knight, 389 U.S. 332, 336 (1967), where the Court said: "Form should be disregarded for substance and the emphasis should be on economic reality."}

Thus, the Court appears to say that its definition should be used only as long as it fulfills the needs of securities regulation. If it fails to bring within the coverage of the securities acts those interests that, in light of the policies behind the acts, should be covered, the state and lower federal courts should feel no compunction about changing it.

The \textit{Howey} definition contains four elements: (1) The investment of money;\footnote{Money here means value or money's worth. A corporation may issue stock in exchange for property, goods, or services previously performed. § 351.160 (1), RSMo (1969). Should not the same principle apply to an investment contract? Recently a District of Columbia court considered this problem in Murphy v. Dare to Be Great, Inc., Civ. A. No. 3826-72 (D.C. Super. Ct., Sept. 20, 1972). The court first concluded that the investment of money provision should be interpreted as the giving of any kind of consideration in the general contract sense. It then held that all the activities of a prospective independent sales agent or trainee for Dare to Be Great done in order to qualify for that status and to sell the Dare to Be Great programs was consideration for his right to share in the profits of future sales as much as the money he paid to join the organization originally. \textit{Cf.} Continental Marketing Associates, Inc., 3 Blue Sky L. Rptr. ¶ 71,016 (Ind. Sec. Comm'n 1969).} (2) in a common enterprise; (3) with the expectation of a profit; (4) to be made solely through the efforts of others. Attempted applications of this definition have varied,\footnote{See, e.g., Commonwealth ex rel. Pennsylvania Sec. Comm'n, 414 Pa. 253, 199 A.2d 428 (1964). There, the court determined that the word "profit" should be taken literally. Thus, a contract providing for the payment of money regardless of the overall profitability of the enterprise could not be an investment contract. One need only contrast the corporate bond and debenture with the investment contract to show that the interpretation is improper. The interest obligation is a fixed charge on the enterprise; interest must be paid even if the enterprise is profitable. Clearly, the profit that the definition refers to is the investor's rather than that of the enterprise. The definition might more properly embrace the expectation of "benefit" rather than "profit." See Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961), where the expected return was the use of country club facilities.} but since 1946 most of the courts deciding cases involving investment contracts have followed, or purported to follow, the \textit{Howey} definition.

\footnote{328 U.S. at 301. See also Tcherepnin v. Knight, 389 U.S. 332, 336 (1967), where the Court said: "Form should be disregarded for substance and the emphasis should be on economic reality."}
However, cases within the last five years evince growing dissatisfaction with the *Howey* test.77 Much of this dissatisfaction centers around the last element. The Court failed to make clear in *Howey* what type of efforts it meant. As a result a split of authority developed. In the late 1960's, a few courts, ignoring the Court's admonition about the application of irrelevant formulae, interpreted the "efforts" test literally.78 These courts determined that investor participation in the enterprise in any manner was sufficient to remove the investor's interest from the coverage of the *Howey* definition. That his participation had no effect upon his investment or the outcome of the enterprise was unimportant. It was only necessary that he be required to do some work, usually physical, to further the enterprise. Thus, two courts held sufficient to avoid the *Howey* definition a requirement that an investor in a membership-only discount department store hand out 50 cards to potential customers.79

Some courts, however, determined that the efforts to which the Court

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77. The dissatisfaction can largely be traced to Coffey, *The Economic Realities of "Security": Is There a More Meaningful Formula?*, 18 Western Res. L. Rev. 367 (1967).


referred were managerial efforts. Under this view, the crucial question is whether the investor has the right to participate in those management decisions that determine whether the venture will be successful. If the investor has the right to share in the making of such decisions, his interest is not a security; however, if he merely invests, leaving the control and management to other active investors or paid managers, his interest is a security.

The dispute over the kinds of efforts sufficient to avoid classification as a security has climaxed in the litigation involving pyramid schemes and founder-member contracts. The interpretation of Howey that equates “efforts” with “managerial efforts” is ascendant, because no case since the 1970 case of Koscot Interplanetary, Inc. v. King has followed the literal interpretation of Howey that any efforts will suffice. The Idaho court in State ex rel. Park v. Glenn Turner Enterprises, Inc. summed up the opposition to this literal interpretation when it said:

[This] arbitrary position could not possibly serve the objectives of the Securities Act to protect the investing public from the depredations of any unscrupulous individuals bent on fraud. As a matter of fact, such a test provides a built-in loophole for any such person to devise methods to avoid the purpose of the Securities Law.

The following quotation from SEC v. Glenn W. Turner Enterprises, Inc. typifies the position of most courts that have recently decided the issue:


81. The accuracy of this interpretation of the efforts test is verified by the following quotation from the Howey case itself: “Thus all the elements of a profit-seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control, and operate the enterprise.” 328 U.S. at 300 (emphasis added).


87. Id. at 67,200.


http://scholarship.law.missouri.edu/mlr/vol37/iss4/1
The most essential consistency in the cases which have considered the meaning of "investment contract" is the emphasis on whether or not the investor has substantial power to affect the success of the enterprise. When his success requires professional or managerial skill on his part, and he has authority corresponding with his responsibility, his investment is not a security within the meaning of the securities acts. When he is relatively uninformed and unskilled and then turns over his money to others, essentially depending upon their representations, and their honesty and skill in managing it, the transaction is an investment contract.  

The early tendency to construe "efforts" to include physical non-managerial efforts caused some courts to reject the Howey test completely. Looking for an alternative test, these courts generally turned to the "risk capital" test developed in Silver Hills Country Club v. Sobieski. In that case, the promoters solicited investments in a newly formed country club. The investor's contribution was used in the construction of club facilities. The investor received only the right to use the facilities; he received no ownership right or interest in them. The ownership remained entirely in the promoters, who also had exclusive rights to profits from the operation of the club. Justice Traynor, writing for the majority, said:

We have here nothing like the ordinary sale of a right to use existing facilities. Petitioners are soliciting the risk capital with which to develop a business for profit. The purchaser's risk is not lessened merely because the interest he purchases is labelled a membership. Only because he risks his capital along with other purchasers can there be any chance that the benefits of the club membership will materialize.

(Hawaii 1971). For an interest to avoid securities classification, the investor's authority in the enterprise must result from his investment and not from the position that he holds within the enterprise. A corporation president's stock is no less a security because he also holds the chief management position within the corporation; his management position is not a necessary concomitant of his stock ownership. Similarly, the executive status of an investor in a pyramid scheme in the corporation promoting the scheme does not prevent the investment from being a security. See Continental Marketing Associates, Inc., 3 BLUE SKY L. REP. ¶ 71,016, at 67, 179 (Ind. Sec. Comm'n 1969).

92. 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186.
93. The Silver Hills case was not the first decision to expound the risk capital concept. The Wisconsin Supreme Court recognized it in Brownie Oil Co. v. Railroad Comm'r, 207 Wis. 88, 240 N.W. 827 (1932). See also 27 Op. ATT'Y-GEN. (Wis.) 598 (1938); 26 Op. ATT'Y-GEN. (Wis.) 370 (1937). An early exposition of the concept is in State v. Gopher Tire & Rubber Co., 146 Minn. 52, 177 N.W. 937 (1920); it was the first case to consider investment contracts.
94. 55 Cal. 2d at 814, 361 P.2d at 908, 13 Cal. Rptr. at 188.
An interest comes within the risk capital test if the investor contributes to the capital necessary to finance or operate the enterprise and receives in exchange the right to some benefit. Under the Silver Hills decision the contribution need not result in the investor receiving an equity interest, nor does the benefit have to be in the form of a monetary return or "profit." Although Silver Hills discusses contributions to initial risk capital, a more recent case suggests that the investment is a security whenever there is a contribution to capital, whether initial or additional.

In the 1971 case of Commissioner v. Hawaii Market Center, Inc., the Hawaii Supreme Court rejected the Howey test despite its modification by the trial court to read "substantially through the efforts of others." Impressed by the risk capital test and Professor Coffey's plea for recognition of the economic realities of securities, the court created a new test that combines the best elements of the Howey and the risk capital tests:

[W]e hold that for the purposes of the Hawaii Uniform Securities Act (Modified) an investment contract is created whenever:

1. an offeree furnishes initial value to an offeror, and

2. a portion of this initial value is subjected to the risks of the enterprise, and

3. the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and

94. This is the critical point in a discussion of franchises as securities. If the franchisee invests an amount greater than the fair market value of the franchise, and the additional proceeds are used to sustain the franchisor's operation so that it can fulfill its obligations to the franchisee, the franchisee has contributed to the risk capital of the franchisor. The franchisee expects benefits from the contribution in the form of performance by the franchisor. Finally, he has no control rights in the franchisor's business (in most cases he does control his own franchise operation, but that is irrelevant). Clearly, franchises can be securities. See 49 Op. Att'y-Gen. (Cal.) 124, 3 BLUE SKY L. REP. ¶ 70,747 (1967); Op. Att'y-Gen. (Ga.) No. CS 05622, 3 BLUE SKY L. REP. ¶ 70,893 (1971). See also Venture Inv. Co. v. Schaefer, 3 BLUE SKY L. REP. ¶ 71,031 (D. Colo., June 16, 1972); Mr. Steak, Inc. v. River City Steak, Inc., 324 F. Supp. 640 (D. Colo. 1970), aff'd, 460 F.2d 666 (10th Cir. 1972).

95. One should distinguish capital in the broad economic sense from capital in the narrow balance sheet sense. A person who lends the enterprise money and receives a bond or promissory note contributes to the economic capital of the enterprise, but he has no equity share in it. The same may be true in the investment contract situation.


97. 485 P.2d 105 (Hawaii 1971).


(4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.\textsuperscript{100}

Two other state courts\textsuperscript{101} and two federal district courts\textsuperscript{102} have adopted this test in the short time since its formulation. It may be destined to replace the \textit{Howey} test as the pre-eminent test for an investment contract.

Contemporaneously with the development of the general law of investment contracts in \textit{Howey} and \textit{Joiner}, another special test was suggested to determine whether interests in partnerships, limited or general, and joint ventures are securities. This test is the one that the \textit{Hilleary} court champions; it is that a bona fide partnership (limited or general) is never a security, because there is no public offering of the partnership interests. Conversely, if interests are offered to the public, the organization is not a bona fide partnership, and the interests are securities. Prior to 1945, some judicial authority supported this position,\textsuperscript{103} but no real attempt had been made to articulate the reasoning behind it.

In 1945, a series of articles entitled "Regulation and Liability Under California Corporate Securities Act" appeared in the California Law Review.\textsuperscript{104} This series, written by T.W. Dahlquist, a practicing attorney, became a classic in securities regulation in California. The first article supports the position that bona fide partnership interests, limited or general, are not securities within the California Act.\textsuperscript{105} The article first asserts generally that three factors determine the interests that are securities under the California Act. The first two, discussed above, require an investment with expectation of profit and an absence of control over the enterprise by the investor. The third factor, which concerns the question of good faith and lack of intent to evade the statute, involves the extent to which the interests are offered to the public.\textsuperscript{106}

The article then applies these general criteria specifically to partnership interests. The author asserts, without citing authority, that the

\textsuperscript{100} 485 P.2d at 109.
\textsuperscript{103} See, \textit{e.g.}, Lindemulder \textit{v.} Shoup, 258 Mich. 679, 242 N.W. 807 (1932); State \textit{v.} Golden, 216 Minn. 97, 12 N.W.2d 617 (1943); Hanneman \textit{v.} Gratz, 170 Minn. 38, 211 N.W. 961 (1927). \textit{See also OP. ATT’y-GEN.} (Cal.) No. 9073 (1933); 1921-1922 OP. ATT’y-GEN. (Nebr.) 163.
\textsuperscript{104} Dahlquist, \textit{Regulation and Civil Liability Under the California Corporate Securities Act} (pt. 1), 33 \textit{CALIF. L. REV.} 343 (1945), (pts. 2-4), 34 \textit{CALIF. L. REV.} 344, 543, 695 (1946).
\textsuperscript{105} Dahlquist, \textit{Regulation and Civil Liability Under the California Corporate Securities Act}, 33 \textit{CALIF. L. REV.} 343, 359, 361-65 (1945).
\textsuperscript{106} \textit{Id.} at 359.
prior administrative interpretation of the California act was that bona fide partnership interests were not securities within the meaning of that act.\textsuperscript{107} He then states:

It is believed that one of the chief criteria for determining whether an interest in a partnership is a "security" under the Act is the element of selection of the partners. In all general partnerships, and also in \textit{bona fide} limited partnerships, there is the right of \textit{delectus personarum}, the right to determine membership. No partner is admitted without unanimous approval of every other partner. A true partnership is a relation [sic] of personal confidence and is a select closed group. Its memberships are never indiscriminately offered at random to the public at large.\textsuperscript{108}

Thus, the essence of this test proposed by Dahlquist is whether all of the members have control over the selection of other members of the purported partnership. If this factor is present, the organization is a bona fide partnership or joint venture, and the interests are not securities. Conversely, if some of the members have no control over the membership selection process, the organization is not a bona fide partnership or joint venture, and the interests are securities.

The California Court of Appeals adopted this test in a series of cases.\textsuperscript{109} It appears, however, that no other case except \textit{Hilleary} has adopted the test.\textsuperscript{110}

It is submitted that the Dahlquist formula is incorrect in making the determination whether partnership interests are securities depend on whether the members have control over the admission of new members. Therefore, that part of the test should be omitted from the list of factors for determining whether interests in general or limited partnerships or joint ventures are securities. Several reasons exist for this position.

First, the test was developed for use in circumstances that are not present today in most states. At the time of the article, the California securities act provided that no company, regardless of size, could sell any securities of its own issue, including the initial issue, without obtain-

\textsuperscript{107} \textit{Id.} at 361.  
\textsuperscript{108} \textit{Id.} at 363.  
\textsuperscript{109} Solomont v. Polk Dev. Co., 245 Cal. App. 2d 488, 54 Cal. Rptr. 22 (1966); Rivlin v. Levine, 195 Cal. App. 2d 13, 15 Cal. Rptr. 587 (1961). \textit{See also} Farnsworth v. Nevada-Cal Management, Ltd., 188 Cal. App. 2d 382, 10 Cal. Rptr. 531 (1961). The \textit{Farnsworth} court discusses the Dahlquist test, but properly based its decision on the absence of public sale. Each of these cases was decided by a different division of the Second District Court of Appeals. No other district of the California Court of Appeals has approved the Dahlquist test.  
Because the California act defined "company" to include associations and partnerships of every kind, the question immediately arose whether the act required every partnership or joint venture, whether it consisted of 2 men, both of whom were actively engaged in the partnership business, or 100 men, only 1 of whom was actively engaged in the business, to secure a permit. Securing the permit was difficult and required disclosure of information that otherwise partners would probably keep confidential. Therefore, the permit requirement was an onerous and unnecessary hindrance to anyone desiring to do business in the non-public partnership form. Therefore, a need existed for a legal theory that would exempt non-public partnerships from the permit requirement. It was against this background that Dahlquist developed his idea that partnership interests had never been securities. Then, in an attempt to reconcile this idea with the obvious need for regulation when interests are sold at random to the general public and with earlier California cases holding interests in various types of partnerships to be securities, Dahlquist developed his dichotomy of bona fide and non-bona fide partnership interests.

Today in most states, including California, the securities acts are based on the premise that an interest is always a security or never a security. If it is a security, it may be exempt from the registration requirements of the act depending on its nature or its method of sale, but the remaining portions of the act apply to it, particularly the anti-fraud provisions. Thus, if a given partnership or joint venture interest is a security, it is always subject to the anti-fraud sections of the act, but if sold to a small group in a particular manner it need not be registered.

Consequently, in most states the purported distinction between bona fide and non-bona fide interests is unnecessary. The anti-fraud provisions protect the purchaser when any interests are sold, but the burden of registration is imposed only when the need exists for additional protection.

The Dahlquist test is supportable under neither prior nor subsequent California case law. In People v. Simonsen, the court held the evidence

114. The former securities act was repealed completely in 1968 and replaced by the Corporate Securities Law of 1968.
115. § 409.301, RSMo 1969.
117. The exemption typically applicable to partnership interests that are securities is that in section 402 (b) (9), which exempts sales to 10 or fewer persons within any 12-month period under certain conditions. Uniform Sec. Act § 402 (b) (9). In Missouri, this exemption applies to sales by issuers only, where the total number of securities holders after the sale does not exceed 25, § 409.402 (b) (9), RSMo 1969.
118. 64 Cal. App. 97, 220 P. 442 (1923).
sufficient to support the trial court’s conclusion that the agreement created a general partnership, and also held that the interests were securities. Similarly, People v. Dysart held that a criminal complaint charging the defendant with the sale of an unregistered limited partnership interest stated a public offense under the securities act. These cases and others caused the Executive Deputy Commissioner of Corporations to conclude in 1944 that limited partnership interests were within the statutory definition of securities, and thus could not be sold without a permit. Cases subsequent to the Dahlquist article are also inconsistent with its proposed test. In 1947, People v. Woodson reaffirmed that partnership and limited partnership interests could be securities. In 1961, in Farnsworth v. Nevada-Cal. Management, Ltd., the court discussed the test, but found the interests exempt from the statute because no public sale had occurred. Admittedly, both Rivlin v. Levine and Solomont v. Polk Development Co. adopt the Dahlquist test. Nevertheless, it is clear that in both cases the partnerships were not bona fide partnerships under the limited partnership statutes; therefore, no need existed to resort to the Dahlquist test to bring the interests within the securities act.

121. Smith, Limited Partnership Interests as Securities Under the Corporate Securities Act, 19 L.A. Bar Bull. 257 (1944). Dahlquist acknowledged the article and the cases, but countered by stating that the cases all involved non-bona fide partnership interests. He pointed out that no law firm, brokerage house, or accounting firm had ever filed for a permit, yet the corporation commission had not brought action against any such organization. Dahlquist, supra note 105, at 361-62. The Dahlquist test was not necessary to reach the desired result. The California act required that a partnership obtain a permit to issue securities. See text accompanying note 111 supra. Dahlquist assumed that, absent some rule about public sale and bona fide partnerships, all partnership interest would have to be registered. That assumption is incorrect; partnership interests that are also securities, must be registered, because the act governs only interests that are securities. The Smith article and the California cases (see cases cited supra note 120) indicate that only those partnership interests that gave the investor no management rights were considered securities. As the discussion in part II, section B of this article demonstrates, all limited partnership interests qualify. This is consistent with the language of the securities act because it would be possible for a partnership to issue interests other than interests in itself that would be securities, e.g., interests in gas and oil leases, long-term promissory notes, and the like.
123. 188 Cal. App. 2d 382, 10 Cal. Rptr. 531 (1961).
127. In Solomont v. Polk Dev. Co., id., the court found that the signature
Nor is the Dahlquist test supportable under general partnership law. Clearly, the basis of partnership is mutual agency. Any agency relationship is built upon consent—the consent of the agent to act as agent and the consent of the principal that the agent act on his behalf. If no consent is given no agency is created; if consent is withdrawn, the agency terminates immediately. One effect of this rule on the partnership situation is that no person can be admitted to a partnership without the agreement of all the existing partners. If some partners include a new partner without the consent of all, dissolution of the original partnership results, because mutual consent is no longer present. Thus, the Dahlquist test is correct that no partnership, limited or general, exists unless the members consent to admit each additional partner. However, characterizing an organization that requires no such consent as a non-bona fide partnership is incorrect; by definition, it is not a partnership at all.

Similarly objectionable is the conclusion that partnership interests cannot be offered to the public. Admission of new partners to a general partnership requires the consent of each existing partner. However, nothing in the partnership statute prevents the existing partners from seeking new partners by public solicitation. Admittedly, entry into a partnership was procured by fraud. Under California law, the partnership was, therefore, void ab initio. Miller v. Kraus, 155 P. 834 (Cal. App. 1915). In Rivlin v. Levine, 195 Cal. App. 2d 13, 15 Cal. Rptr. 587 (1961), no limited partnership was created as to the plaintiffs. They were purportedly admitted to an existing limited partnership, but the statutory requirements for the admission of new partners were not met.

Section 9 of the Uniform Partnership Act provides that each partner is the agent of the partnership. The partnership is not a legal entity; therefore, each partner is the agent of every other partner when he is performing partnership business. See also § 358.090, RSMo 1969. Restatement (Second) of Agency § 1 (1958).

§ 358.180 (7), RSMo 1969. See generally J. Crane & A. Bromberg, Partnership § 5 (c) (1968).

Firpo v. Piper, 111 Cal. App. 403, 295 P. 886 (1931). Other cases suggested that the admission of a new partner causes technical dissolution of the old partnership and the formation of a new one. See, e.g., White v. White, 5 Gill. 359 (Md. App. 1847). Bromberg, Partnership Dissolution—Causes, Consequences, and Cures, 43 Texas L. Rev. 631, 636 n.24 (1965), collects and discusses the cases that take this position. It refutes the principle that dissolution occurs only when new partners are admitted without the consent of all the old partners. The result, for present purposes, is the same under either theory, because if admission of new partners results in dissolution, consent of the others is a prerequisite to anyone becoming a member of the new partnership.

No reasons have been expressed that would prevent a prior agreement to accept as a partner any person nominated by a particular partner. J. Crane & A. Bromberg, Partnership § 7, at 44 (1968); cf. Pawgan v. Silverstein, 265 F. Supp. 898 (S.D.N.Y. 1967); Polikoff v. Levy, 55 Ill. App. 2d 229, 204 N.E.2d 807, cert. denied, 382 U.S. 903 (1965). Nonetheless, the partners can still reject the nominee; if they do so, no partnership comes into existence with the nominee as a partner. However, the rejection might subject them to liability for breach of the contract to accept the nominee. Compare the Hohfeldian distinction between the right to act and the power to act. W. Hohfeld, Fundamental Legal Conceptions (1919).

See the discussion of the running battle between Judge Frank, as chair-
fiduciary relationship as a consequence of a newspaper advertisement may be unusual, but the statute does not preclude such a partnership. To that extent a public general partnership is indistinguishable from a partnership formed between lifelong friends.\textsuperscript{134}

Public solicitation of additional limited partners is easier. The Limited Partnership Act provides for the subsequent admission of new limited partners.\textsuperscript{135} If the original partnership agreement and the recorded certificate of partnership so authorize, the general partners may admit additional limited partners without obtaining the consent of the existing limited partners as each new partner is admitted.\textsuperscript{136} The limited partners cannot withdraw this authorization. If the limited partners refuse to execute the necessary amendment to the certificate to make the nominee a limited partner, the court can order the certificate amended without their signatures.\textsuperscript{137} Therefore, nothing prevents the general partner from seeking additional limited partners by public advertisement. The restricted role of the limited partner removes most objections to entering into a fiduciary relationship with a stranger.

The basis for the final objection to the Dahlquist test is that it makes the test of whether a partnership or joint venture interest is a security different from the tests to determine whether other interests are securities. For example, a pyramid sales contract does not become a security because the purchaser has no control over the identity of future purchasers. Nor are promissory notes or debentures classified as securities because the holders lack control over who may become holders of these interests; that the holders have no such control is treated as insignificant. And surely no one would contend that a first refusal and pre-emptive right provision in corporate shares make the shares no longer securities. Yet the holder of such a share practically has as much control over the admission of new shareholders as the partner in the general or limited partnership has over the admission of new partners. It is submitted that unless the peculiar nature of a financial interest demands the application of a special test, the interest should be measured by attributes common to all securities to determine whether it is a security. As demonstrated above, the “control-

\textsuperscript{134} An advertisement may constitute the public offering of a security, depending upon the provisions of the partnership agreement. See pt. III, § D of this article.

\textsuperscript{135} See text accompanying note 33 supra.

\textsuperscript{136} § 359.090, RSMo 1969.

\textsuperscript{137} § 359.250, RSMo 1969. Whether the limited partner who objected to the admission of a particular new limited partner could request an immediate dissolution of the new partnership after it is formed by the court-ordered amendment is open. Logically, he should not be allowed to do so. See generally J. Crane & A. Bromberg, Partnership § 90B (1968).
PARTNERSHIP INTERESTS AS SECURITIES

over-admission-of-new-members” test singles out partnership and joint venture interests for special treatment; therefore, it should not be applied to these interests.

In summary, the important distinction in this area is “between the public offering of securities parading as 'limited partnership interests' and 'an offering of a half interest in a hamburger stand'.” The Dahlquist test of control over the selection of new members, with its corresponding classification of partnership interests as bona fide or non-bona fide, is of no help in making this distinction. However, the tests developed by the courts in other investment contract situations will properly distinguish between those partnership and joint venture interests that are securities and those that are not. Therefore, each type of partnership or joint venture interest should be considered in light of these recently developed tests. As previously discussed, the applicable test provides: Any contract, agreement, or other instrument whereby the investor invests money or money's worth in a common venture with the recipient, over which the investor has no managerial control over the venture as a result of his investment, and where the investment becomes a part of the risk capital of the venture, and where the investor expects some benefit to accrue to him as a result of his investment is a security.

B. Limited Partnership Interests Are Always Securities

Limited partnership interests are always securities under this test. There is an investment of money or money's worth. The investors participate in the common venture of the partnership business, although limited partners are restricted to contributing capital and advising the general partners in a general, non-binding way. The investment becomes a part of the risk or venture capital used to operate the partnership business. Moreover, the limited partner expects a return on his investment from partnership profits.

139. See text accompanying note 100 supra.
140. § 359.040, RSMo 1969. The section states that the limited partnership contribution may be cash or other property, but not services. It is unclear why services performed before the formation of the partnership are insufficient as capital contributions. Contrast capital stock of corporations; work performed to organize the business of the corporations can be a sufficient contribution to exchange for capital stock.
141. Weil v. Diversified Properties, 319 F. Supp. 778 (D.D.C. 1970); Silvola v. Rowlett, 129 Colo. 522, 272 P.2d 287 (1954). The Silvola case suggests that the limited partner can work for the partnership as an employee without losing his status as a limited partner, but any decisions he makes concerning the partnership or any managerial functions he performs must be subject to reversal by the general partner. Managerial control derived from the investment should be distinguished from that derived from an employment relationship; management authority derived from an employment relationship is irrelevant in determining whether the interest is a security.
142. Each limited partner's share of the profits must be listed in the certificate. § 359.020, RSMo 1969; see text accompanying note 47 supra.

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The remaining question is whether the investor has control over management or investment decisions. The rights of limited partners are narrowly circumscribed and specifically enumerated by section 10 of the Uniform Limited Partnership Act.\textsuperscript{143} The limited partner has four rights under the Act: (1) To have the general partner maintain partnership books and to inspect those books; (2) to demand and receive full information concerning the partnership business and to an accounting when appropriate; (3) to dissolution of the partnership when ordered by a court of competent jurisdiction; and (4) to receive the share of the partnership profits allocated in the certificate of partnership and to the return of his contribution upon dissolution, or earlier as provided in the partnership agreement. Any other attempted participation by a limited partner in the business, including an attempt to interfere with management and control, constitutes a breach of the partnership agreement and entitles the general partner to dissolution of the partnership.\textsuperscript{144}

Confronted with the contention that the statutory rights of the limited partner were sufficient to constitute control and avoid securities classification, the court in \textit{Curtis v. Johnson}\textsuperscript{145} said:

\begin{quote}
[T]he general partner would have the management of the business and be responsible for the making of profits for distribution. We do not think that certain formal controls such as those possessed by limited partners [under the Uniform Act] prevent the enterprise from being one in which the investor expects to receive profits "solely from the efforts of others".\textsuperscript{146}
\end{quote}

Several courts and attorneys general concur in this view.\textsuperscript{147}

C. Partnership Interests Are Sometimes Securities, Sometimes Not

Classifying a general partnership interest as a security depends upon the last element of the proposed test, managerial control. The other elements are clearly present.

Three variations of the general partnership merit examination. First is the situation in which the general partners all actively engage in the control and management of the partnership business. At the other extreme is the general partnership in which the partnership agreement designates one or two partners as managing partners; the remaining

\begin{footnotes}
\item 143. \textit{Uniform Limited Partnership Act} § 10. The Missouri statute is section 359.100, RSMo 1969.
\item 146. 234 N.E.2d at 572-73.
\end{footnotes}
partners are inactive in the business, or they are active only as employees. In the intermediate situation, no provision in the partnership agreement designates some of the partners as managing partners, but the location, skill, and knowledge of some general partners indicate that the parties contemplate that a few of the partners would run the business. In effect, the non-active partners become silent partners.\textsuperscript{148}

The language of the Partnership Act is the starting point. The Partnership Act provides, in contrast to the Limited Partnership Act, that all partners have an equal right to share in the management and conduct of the partnership business.\textsuperscript{149} If a partner is active in the partnership business and shares in management and control, his interest is not a security. Even registration under the security act could not give him more complete access to information. Moreover, the investor actively participates in the operations that make his investment a success or failure. Therefore, he has no need for the protection of the securities act. Most general partnerships involve active participation by all the partners; therefore, interests in them are not securities.

The Partnership Act contains an important caveat, however: “The rights and duties of the partners in relation to the partnership shall be determined, subject to any agreement between them . . . .”\textsuperscript{150} The general partner’s statutory right to share in the control and management of the partnership can be altered. Typically, in a large partnership, control and management is concentrated in the hands of a few of the senior partners; the document creating the investor’s interest also restricts his right to participate in partnership affairs. For purposes of the securities laws, little difference exists between this and a limited partnership interest.\textsuperscript{151}

\textit{Pawgan v. Silverstein}\textsuperscript{152} involved a general partnership entered into to buy and lease back to the seller a motel in New York City.\textsuperscript{153} Three of the twenty partners were designated managing partners. The partnership agreement provided: “The Managing Partners will run the business of the Partnership. However, consent of a majority in interest of all Partners shall be required for a sale of the property or refinancing of the mortgage, provided the Managing Partners are a part of the majority.”\textsuperscript{154}

\textsuperscript{148} See, e.g., Warner v. Modano, 340 Mass. 439, 164 N.E.2d 904 (1960) (holding that a silent partner is a general partner and, therefore, liable for the debts of the partnership). See generally J. Crane & A. Bromberg, Partnership § 142 (1968).

\textsuperscript{149} § 358.180 (5), RSMo 1969.

\textsuperscript{150} § 358.180, RSMo 1969 (emphasis added).

\textsuperscript{151} Of course, a non-managing general partner does not escape liability for partnership debts. See McEvoy v. Grant, 302 Pa. 539, 153 A. 763 (1931); White v. Houston, 103 S.W.2d 1073 (Tex. Civ. App. 1936).

\textsuperscript{152} 265 F. Supp. 898 (S.D.N.Y. 1967).

\textsuperscript{153} The defendant Silverstein had entered into several real estate syndications. Some had been cast in limited partnership form, and at least two had been cast in general partnership form. No attempt was made when forming the general partnership to comply with the Limited Partnership Act.

The agreement gave the managing partners sole authority to admit new partners upon payment of a cash contribution of $72,000. Several non-managing partners assigned their interests with the knowledge and consent of the managing partners. This partnership closely resembles a limited partnership, although the agreement is consistent with the provisions of the general partnership law. The court readily determined that the partnership interests were securities under the federal acts.

Admittedly, this type of partnership is seldom used, because unlimited liability exists for the investor. Nevertheless, large law firms, accounting firms, and brokerage houses are commonly organized as general partnerships with the control in the hands of a small group of managing directors. If the new partner is required to invest upon being admitted to such a partnership, one may argue that he buys a security. If so, he is entitled to the protection of the anti-fraud provisions of the securities act.

The final, difficult problem is how to classify the general partnership if the agreement makes no provision for managing partners to run the partnership, but the surrounding circumstances indicate that one of the partners is to control the business. Take, for example, an oil drilling venture formed between several California doctors and an experienced Kansas oil drilling expert. The drilling site is on Kansas land secured by the oil expert. The partnership agreement is silent as regards authority to oversee the drilling. Clearly, however, the geographical location of the doctors and their lack of skill and expertise show that they are in no position to actively participate. They have the right to participate in control, but it is anticipated that they will not and, in fact, they do not: Are their interests securities? The court considered identical facts in

Metzner's opinion in Pawgan v. Silverstein incorporated the statement of facts from this earlier case.

155. An attempt to comply with the Limited Partnership Act would probably have succeeded.

156. See also Moulin v. Der Zakarian, 191 Cal. App. 2d 184, 12 Cal. Rptr. 572 (1961), involving a general partnership formed to trade in commodities and commodities futures. The agreement provided that one partner was "expressly authorized to exercise his sole and complete discretion in determining the trades to be made for the partnership." 191 Cal. App. 2d at 186, 12 Cal. Rptr. at 573. The court found that the partnership interests were not sold to the public and, therefore, were exempt from the California securities act. Law of May 23, 1949, ch. 384, § 1, [1949] Cal. Stat. 700 (repealed 1969), exempted any general or limited partnership interest not sold to the public. It is submitted that the interests here would have been securities in states that have adopted the Uniform Act.


158. These interests would certainly be exempt from registration, because the interests are not offered to the public. Most states have a provision similar to that in the Uniform Sec. Act § 402 (b) (9), which exempts interests offered to only a small number of persons each year. However, Missouri firms with more than 25 non-managing members may have problems, because section 409.409 (b) (6), limits such sales to 25 total securities holders. Of course the act may be inapplicable also because there is no investment made by the newly admitted junior partner. Query, however, whether in this situation past services on behalf of the firm could be considered his investment.
Vicioso v. Watson, but the question remains unanswered. The case was decided under the former California Securities Act, with its exemption for partnership or joint venture interests not sold to the public. The court found that the doctors had the right to control, but that they deferred the control to the oil expert. The court held that this right of control created a joint venture under California law. Because no public sale occurred, the interests were exempt.

This case should be decided differently under the federal act or the Uniform Securities Act. The recent cases, both federal and state, emphasize the realities of the transaction and disregard form. If circumstances indicate that the investor will be passive and will not exercise his technical right of control, his investment is as much a security as that of the investor who does not have the right of control.

D. Joint Venture Interests

As previously pointed out, joint ventures are a form of partnership. Therefore, the analysis in the previous section concerning partnership interests is equally applicable here. Nevertheless, one point requires clarification. One court has said that no joint venture can exist unless each venturer has a right to share in the control. Although technically correct, the statement is misleading if interpreted to mean the joint venture may contain no provision stating that the management or control will be concentrated in one or two managing venturers. Control consolidation provisions are acceptable in joint venture agreements, just as in general partnership agreements. A surrender of the right to control, expressly or impliedly, makes the joint venture interest a security. If the joint venturer actively participates in the business, however, his interest, like that of the active general partner, is not a security.

E. Exemption of Partnership Interests from Registration

One point deserves further emphasis. A security does not necessarily have to be registered. The Uniform Act contains several exemptions from registration for certain securities and transactions. The drafters included one exemption, contained in section 402 (b) (9), because they realized that forcing an enterprise, whether a corporation or a partnership, to register

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161. In fact, the doctors exercised more control than in the example in the text, because they selected the well sites and the drilling times.
165. § 409.402, RSMo 1969; Uniform Sec. Act § 402.
each time it sold a small quantity of securities in a private sale would be counterproductive. The securities acts contain more than the registration provisions, however. All of them contain provisions that give the purchaser a remedy of his purchase is induced by fraud. Therefore, although partnership and joint venture interests that are securities are exempt from registration, the purchaser of them will still be able to recover if his purchase was induced by fraud.

IV. CONCLUSION

The ideas and test discussed in this article are neither new nor revolutionary. Many members of the securities bar have long understood them. Yet, only recently, in connection with the rash of pyramid sales and founder-membership cases, have the courts articulated these tests. Moreover, they have never systematically applied them to that narrow group of investment contracts involving interests in partnerships and joint ventures. It is hoped that clear enunciation of these tests and discussion of them in the framework of the partnership and joint venture can eliminate the confusion surrounding their application to interests in these organizations. Thus, perhaps decisions like Hilleary can be avoided in the future as limited partnerships and joint ventures become more common media of public investment.

166. Uniform Sec. Act §§ 101, 410. It is interesting to note that section 101 covers fraud in either the purchase or sale of securities, while section 410 only gives a remedy to the purchaser. Section 10 (b) of the Securities and Exchange Act, 15 U.S.C. 78j (b) (1970), and SEC rule 10b-5, 17 C.F.R. § 240.10b-5 (1972), have been interpreted to cover both the buyer and the seller. See, e.g., Mac-Andrews & Forbes Co. v. American Barmag Corp., 339 F. Supp. 1401 (D.S.C. 1972).