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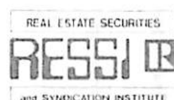

REAL ESTATE SECURITIES AND SYNDICATION INSTITUTE®

Joint Ventures — The Unexpected Real Estate Security

By Marc H. Morgenstern

Whether interests in real estate transactions are securities is an intriguing and continually recurring issue. Such transactions rarely are structured in conventional corporate form, and consequently, interests in real estate seldom bear recognizable security labels such as "stocks" or "bonds." As Professor Loss has noted: "substance governs rather than form. . .[J]ust as some things which look like real estate are securities, some things which look like securities are real estate."[1]

Judicial examination of real estate interests as securities typically requires an analysis whether they are "investment contracts,"[2] one of the defined terms for a security under the federal securities laws.[3] The scope of investment contract analysis is expansive, and under its aegis, securities have been found in surprising contexts, from investments in scotch whiskey casks[4] to earthworm farms.[5] Courts are repeatedly called upon to determine "which of the myriad financial transactions in our society come within the coverage of [the federal securities] statutes."[6]

In 1982, the Fifth Circuit Court of Appeals in Williamson v. Tucker[7] *explicated* the circumstances under which an interest in a real estate joint venture[8] constitutes an "investment contract," and thus a security. The court also formulated a test for making such a determination which has been adopted as the new touchstone by many federal courts.[9] This Article discusses the history of investment contract analysis, critically examines the *Williamson* test, and suggests methods for joint venture promoters and their counsel to respond to the test.

Definition of a Security

Section 2(1) of the Securities Act of 1933 defines a security as "any note,. . .evidence of indebtedness,. . .*investment contract*,. . .or, in general any interest or instrument commonly known as a 'security'."[10] The definition of a security in Section 3(a)(10) of the Securities Exchange Act of 1934[11] is identical in operative effect to that contained in the Securities Act of 1933, and for this purpose the two acts are to be construed *in pari materia*.[12]

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The definition of a security for state law purposes is substantially the same as the federal definitions. The Uniform Securities Act[13] defines a security as "any note; stock; treasury stock; bond; debenture; evidence of indebtedness;. . .*investment contract*;. . .or, in general, any interest or instrument commonly known as a 'security',. . ."[14]

Neither the federal nor the state definitions of a security expressly include joint venture interests.[15] Such interests are securities when they fall within the elastic category of "investment contracts."[16] Investment contract analysis has evolved in a series of key decisions, including *SEC* v. *C. M. Joiner Leasing Corp.*,[17] *SEC* v. *W.J. Howey Co.*,[18] *Commissioner* v. *Hawaii Market Center, Inc.*,[19] and *United Housing Foundation, Inc.* v. *Forman.*[20] An understanding of the implications of *Williamson* requires a review of these cases.

Case Law Development

SEC v. C.M. Joiner Leasing Corp.

The first of the investment contract cases was *Joiner.*[22] An oil drilling firm, Joiner Company, offered assignments of oil leases to numerous small investors. The sales literature[23] emphasized that Joiner Company was drilling a test well, the purpose of which was "to test the oil-producing possibilities of the offered leaseholds."[24] The literature also emphasized the investment character of the purchase and the opportunity afforded the investor to participate in an "enterprise."[25]

In holding that the assignments were investment contracts, the Supreme Court announced several standards which formed the basis for later investment contract analysis. First, the method by which an offer to sell an interest is communicated may play an important role in determining whether the interest is a security.[26] Second, the name that the interest bears is a starting point for analyzing whether the interest is a security, but the name, by itself, is not dispositive.[27] Finally, although the concept is implicit rather than explicit, "participation in an enterprise"[28] is a prerequisite to the existence of an investment contract.

The Joiner Company's drilling of the test well provided a common enterprise between the seller and buyer of the assignments. The exploration was an integral part of the value of the leasehold interests, and the agreement to drill the well "[ran] through the whole transaction as the thread on which everyone's beads were strung."[29] The exploration provided the inducement to invest, because a successful test for oil could cause the land to appreciate in value and permit the investors to make a profit.

SEC v. W.J. Howey Co.

The broad analytic principles articulated in *Joiner* were refined in *Howey.*[30] The W. J. Howey Company offered to sell land in a citrus grove development and its affiliate, Howey-in-the-Hills Service, offered to manage, cultivate, and market the crops, and to remit the proceeds to investors. The company offered each potential

investor both a land sales contract and a service contract and advised that it was not feasible to invest in a grove unless a service arrangement was made.[31]

The Supreme Court relied heavily upon federal and state[32] judicial interpretation of the term "investment contract" and held that four elements predicate the existence of an investment contract: (1) an investment; (2) a common enterprise; (3) the expectation of profits; and (4) profits that result solely from efforts of another.[33] This formulation is referred to as the *Howey* test, and subsequent decisions have subjected virtually every constituent clause and word of the test to judicial interpretation and modification.[34]

The Howey Company contended that the transaction was merely the sale of a fee simple interest in land, an interest clearly not a security. It argued that the sale of land was completely distinct from the service contract. The Court disagreed, however, and held that the investors were actually offered an opportunity "to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents."[35] This arrangement made the investors dependent on the managerial services of the service company to secure profits, and the interests were therefore investment contracts.[36]

Although the Court stated that the investors were dependent upon management by the service company, some investors did not enter into a separate service contract,[37] indicating that they felt they could manage their interest without the service company. The potential importance of this fact was minimized by the Court, which addressed the issue of the independent investors by noting that the Securities Act prohibits the offer as well as the sale of unregistered, non-exempt securities. "Hence, it is enough that the respondents merely *offer* the essential ingredients of an investment contract."[38]

In *Howey*, the investment contract and service contract were separate documents. A major focus of the Court's inquiry was whether there were two separate transactions or merely a single, integrated, transaction effected by two documents. Inquiry into the integration of ownership and management is frequently unnecessary in a real estate joint venture agreement. Customarily, both the ownership rights and the services to be performed with respect to joint venture property by each joint venturer are delineated in the joint venture agreement. Existence of a security under the *Howey* test, however, is unaffected by the number of documents involved in a transaction. The critical inquiry concerns the offeree's characteristics, particularly his ability to perform the managerial services upon which the success of the enterprise will depend, and the economic dependence and interrelationship between the offeror and the offeree.

Commissioner v. Hawaii Market Center, Inc.

The primary alternative to the *Howey* test is the "risk capital" test enunciated by the Supreme Court of Hawaii in *Hawaii Market*.[39] The court chose not to follow *Howey* in construing the term investment contract under state law. In determining whether a "Founder-Member Purchasing Contract Agreement" was a security within

the meaning of the Hawaii Uniform Securities Act,[40] the court dismissed the *Howey* test as too mechanical to protect the investing public adequately. The principal weakness of the *Howey* test, in the court's view, was its overemphasis on investor participation in the enterprise and the unduly restrictive requirement that the investors' expectations of profits must derive *solely* from the efforts of another. Noting that the fundamental policy of the securities laws is to afford broad protection to investors, the court held that securities exist "even in those situations where an investor is not inactive, but [instead] participates to a limited degree in the operation of the business."[41]

The *Hawaii Market* court adopted a "risk capital" test, which states that an investment contract is created whenever:

1. An offeree furnishes initial value to an offeror;
2. A portion of this initial value is subjected to the risks of the enterprise;
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
4. The offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.[42]

Although each element of the risk capital test differs from its *Howey* counterpart, the fourth element of the test represents a major departure from the *Howey* formula. Rather than focusing on whether the investor reasonably expects to make profits based "solely on the efforts of others," the risk capital test looks to the quality, not the quantity, of the investor's participation in, and control over, the common enterprise. "[I]n order to negate the finding of a security the offeree should have practical and actual control over the managerial decisions of the enterprise. For it is this control which gives the offeree the opportunity to safeguard his own investment, thus obviating the need for state intervention."[43]

The *Hawaii Market* and *Howey* courts agree that the nature of the investor's participation in the enterprise is critical in determining whether a security exists. Under a literal application of *Howey*, even a modicum of investor participation would remove the arrangement from the definition of a security. Under the "risk capital" test, identifying the investor participation is only a preliminary step in analyzing the quality of the participation. Only actual and practical control of the enterprise by each investor would remove the arrangement from the definition of security. Although no federal courts appear to have formally adopted the "risk capital" test, several, including the *Williamson* court, analyze investor participation in terms similar to those that would apply had they adopted the fourth element of the "risk capital" test.

United Housing Foundation, Inc. v. Forman

In *United Housing*,[44] the first Supreme Court case involving investment contracts after *Hawaii Market*, the Court faced the converse of the factual situation present

in *Joiner, Howey*, and *Hawaii Market*. The earlier cases involved financial arrangements not normally regarded as securities. In *United Housing*, the issue was whether stock in a corporation, an interest that is almost invariably denominated a security, was outside the purview of the federal securities laws.[45]

Ownership of stock in a nonprofit housing cooperative entitled the holders to lease an apartment in buildings owned by the cooperative. The Court held that the stock was not a security because it had none of the normal indicia of "stock." The stockholder had neither the right to receive dividends[46] nor the expectation of earning profits.[47] As a consequence, the stock did not satisfy the definition of an investment contract.

In reaching its holding, the Court reaffirmed the *Howey* test as the basis for distinguishing a securities transaction from other commercial dealings, and quoted the entire formula in full.[48] The Court introduced a certain analytical ambiguity, however, by paraphrasing the original *Howey* language in what may be referred to as the "touchstone" test. The Court stated that "[t]he touchstone is [1] the presence of an investment [2] in a common venture [3] premised on a reasonable expectation of profits [4] to be derived from the entrepeneurial or managerial efforts of others."[49] The "touchstone" test omits the word "solely" from the fourth element of the *Howey* test.

The Fifth Circuit in *Williamson* makes much of this omission, and suggests that it has great significance.[50] A careful reading of *United Housing*, however, suggests that omission of the word "solely" in the "touchstone" test has minimal significance. First, the central issue in *United Housing* was the meaning of the word "profits." The Court found no profit inducement in purchasing the cooperative stock and, as a consequence, no investment contract. It had no need, therefore, to examine the fourth element of the *Howey* test. Second, the Court carefully noted that it was expressing no view whatsoever as to the correct interpretation of the word "solely."[51] When the Supreme Court next considered the term "investment contract" in *International Brotherhood of Teamsters* v. *Daniel*,[52] it again quoted with approval the original *Howey* test[53] and the "touchstone" test created in *United Housing*.[54] This would appear to rebut the *Williamson* court's suggestion that the word "solely" has been deleted from the *Howey* test by the Supreme Court.

The *United Housing* court also rejected a request that it adopt the "risk capital" test,[55] although it did not directly repudiate the doctrine. The Court stated: "Even if we were inclined to adopt such a risk capital approach we would not apply it in the present case. Purchasers of apartments in Co-op City take no risk in any significant sense. If dissatisfied with their apartments, they may recover their initial investment in full."[56]

The holding in *United Housing* emphasized clearly that in determining the existence of an investment contract, the substance of the arrangement, and not its form or name, governs. As a gloss on the analysis of investment contracts, it added an explication of the term "profits," and tacitly acknowledged the lower federal courts' growing concern over the limitations of the word "solely" in the fourth

element of the *Howey* test. The preceding discussion depicts the state of the law at the time that the Fifth Circuit decided *Williamson*.

Williamson v. Tucker

In *Williamson*, the Fifth Circuit Court of Appeals focused on joint venture interests as securities. The court specifically considered whether the retention of meaningful managerial powers by investor joint venturers excluded the joint venture interest from the category of investment contracts. The court held that absent certain "limited circumstances" the possession of those powers precludes a finding that such interests are securities.[57] The court's discussion of the genesis and meaning of the phrase "investment contract," and its explicit formulation of the appropriate investment contract test for a joint venture interest have unusual importance because of the limited amount of federal law in this area.[58]

Williamson concerned development of a 160-acre tract of land (the "Venture Property") located between Dallas and Fort Worth, Texas, near the then proposed Dallas-Fort Worth airport. Through a series of four sales that occurred between 1969 and 1971, three separate joint ventures (Reg Air I, Reg Air II, and Reg Air IV) each came to own an undivided one-third interest in the Venture Property.

M. L. Godwin Investments, Inc., or its employees, executed contracts to purchase an interest in the Venture Property, formed each joint venture, and then attracted potential investors to participate in the ventures. The offering materials for each venture described, in similar terms, the management expertise of Godwin and the investment potential of the Venture Property. Godwin managed the Venture Property on behalf of each joint venture. Each joint venture acquired its one-third undivided interest at a different time and paid a different purchase price. Each joint venture financed its purchase with a promissory note to the seller with several, but not joint, liability among the joint venturers. Despite numerous other similarities in the transaction, the ownership of each joint venture, however, was not identical. Although there were differences in the specific provisions of the various joint venture agreements, the Court concluded that "[n]evertheless, the transactions were all arranged by Godwin Investments and are identical in all other relevant respects."[59]

Because of the factual setting, the *Williamson* court had no reason to comment extensively about the first three elements of the *Howey* test. The first element was satisfied because of the joint venturers' liability under the promissory notes. There was no dispute about the existence of a common enterprise, so satisfaction of the second element was not raised. As to the third element, the investors reasonably anticipated making profits and the promotional literature emphasized that such profits would occur.

Only the fourth element of the *Howey* test, the managerial efforts from which the investor expected to receive profits, was an open issue. In the Fifth Circuit, however, this element has been modified from the original *Howey* test. In *SEC* v. *Koscot International, Inc.*[60] the Fifth Circuit expressly adopted the standard artic-

ulated by the Ninth Circuit in *SEC* v. *Glenn W. Turner Enterprises, Inc.*,[61] where the Ninth Circuit held that:

> . . . in light of the remedial nature of the legislation, the statutory policy of affording broad protection to the public, and the Supreme Court's admonitions that the definition of securities should be a flexible one, the word "solely" should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities. . . *[W]e adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.*[62]

This modification permits finding an investment contract where none may have existed under the original test. Under a literal application of *Howey*, even a scintilla of managerial involvement by the investor would arguably be sufficient to preclude a finding of an investment contract. The Fifth Circuit's modification provides that even a finding of a scintilla of investor involvement would still require further analysis as to who provided the essential managerial services, the promoter or the investor.

The *Williamson* court articulated a three-part factual test to determine whether the fourth element of the *Howey* test was satisfied for a joint venture interest. The court stated that such a characterization required "that (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers."[63]

One troublesome aspect of the *Williamson* test is the premise that joint venture or general partnership interests are properly subject to a specific investment contract analysis different from any other investment. A joint venture agreement results from negotiation, and the parties to the agreement establish their own rules for governing their relationship. There is no standard or statutory distribution of power. The consistent teaching of the Supreme Court from *Joiner* through *Marine Bank* v. *Weaver* is that the name of an interest does not alone establish if it is a security. The *Williamson* test offers an alluring formula purporting to delineate the investment contract inquiry for a joint venture interest. The test, however, should not be taken as an independent formulation removed from conventional investment contract analysis. It is properly only a specific application of, and not a replacement for, the broader principles of *Howey*.

The *Williamson* test directs judicial inquiry, in turn, to: (1) the enterprise's document; (2) the investor; and (3) the promoter.[64] An analysis of each variable reveals the existence, and reasonableness, of the investors' managerial expectations. The conclusion that the investor reasonably expected to receive profits based on essential managerial services of another, can be based upon: (1) the formal, documentary, distribution of power; (2) the fact that the investors' efforts could not conceivably give rise to any profits; or (3) the fact that the promoter's talents are so remarkable or unique that the investors' efforts could not have any significant effect on making profits.

The test must be applied to each investor. One possible analytical anomaly is that a joint venture interest could be a security as to some investors and not as to others. Investors' abilities to participate in the enterprise vary. A real estate developer who invests in another developer's enterprise may have the reasonable expectation that he will participate in management and help make profits. His joint venture interest might not constitute an investment contract. Conversely, the same ownership interest and the same right to vote owned by a doctor with little or no management expertise might constitute an investment contract under the *Williamson* test because no reasonable expectation of managerial involvement may exist.

The Fifth Circuit's statement that a joint venture interest can be a security "only" if it satisfies one of the three elements of the *Williamson* test suggests a judicial presumption that ordinarily such interests are not securities. This implicit presumption has support from commentators.[65] Even while articulating the formidable barriers to finding that a joint venture interest is a security, the *Williamson* court acknowledged the possibility that the test might be satisfied.[66]

The court's premise that the distribution of power of the enterprise "as in a limited partnership" necessarily leads to a conclusion that the agreement is an investment contract warrants some discussion. Certain courts have held that interests in limited partnerships are investment contracts,[67] as a matter of law. The Securities and Exchange Commission routinely treats limited partnership interests as securities.[68] The better view, however, was expressed in *Stowell* v. *Ted S. Finkel Investment Services, Inc.*,[69] in which the Florida District Court referred to the economic reality tests enunciated by the Supreme Court in *Tcherepnin* v. *Knight*[70], *United Housing*, and *Daniel* and held that the crucial issue in each case was whether the partnership agreement entered into by the parties met established investment contract criteria. Resolution of the issue is only possible on a case-by-case inquiry.[71] It cannot be overemphasized that the name of an interest, including any implications arising from the standard distribution of power for such interests, does not establish whether the interest is an investment contract. Interests in limited partnerships, general partnerships, or joint ventures may or may not constitute investment contracts. The decision can be made only by reviewing the precise facts of each transaction.

The Fifth Circuit's initial inquiry under the *Williamson* test required an examination of how the joint venture agreement distributed power among the joint ven-

turers. The promoter and manager, Godwin, was a party to the joint venture agreements.[72] In the offering materials, Godwin represented that it would ultimately pursue the sale or development of the Venture Property, and "would perform all management duties, including efforts to have the land rezoned from single-family residential to its best uses."[73] The materials emphasized: "OUR FIRM AGGRESSIVELY PURSUES ALL ZONING AND PROPER LAND PLANNING EFFORTS TO ASSURE THE MAXIMUM PROFIT POTENTIAL OF EACH INVESTMENT."[74] Based solely on these facts, which indicated that Godwin would play an active management role, an investor joint venturer might reasonably have believed that Godwin would supply the essential managerial efforts from which the enterprise would realize its profits.

The *Williamson* court, however, did not stop its inquiry after discovering those facts. Even if Godwin were to provide those managerial services, the court made further examination of whether the investor retained control over the manager. The difficulty of answering this critical question was magnified because each joint venture had approximately fifteen venturers.[75] As the court stated, "[A] complication is added where the investment asset is not owned directly, but is held instead through a joint venture or general partnership. While the partnership per se may have full ownership powers over the asset, each individual partner has only his proportionate vote in the partnership."[76]

Each joint venture agreement gave the venturers the right to control certain areas of management. Decisions to borrow money or to deliver any bonds, mortgages, or deeds required the affirmative vote of all joint venturers.[77] Any development proposal for the Venture Property likewise required the approval of a significant number of venturers.[78] Regardless of whether the Venture Property was developed, a significant number of the venturers could remove Godwin as manager and "make any other decision regarding the Property."[79] The joint venturers, in the aggregate, thus had significant opportunity to control the management of the joint venture and the development of the Venture Property.

Although the venturers, in the aggregate, had significant management control, there remained the further question of whether each investor also had significant control. Each joint venture consisted of approximately fifteen venturers. The four plaintiffs, Blake, Lilley, Williamson, and Wilson each held minority interests in the ventures. Williamson had the largest individual interest, with a twenty percent interest in Reg Air I, II and IV, while Wilson and Blake held only five percent interests in Reg Air II.[80] Although the court noted the dilutive effect on management control created by selling interests to numerous investors, it drew no adverse conclusions based on the sale of venture interests by Godwin to an average of fifteen investors.[81]

Having fifteen investors actively participate in, or simply control, management presents significant practical problems. Conflicts arise in scheduling and attending meetings. *Even when the investors in the aggregate retain latent management con-*

trol, the logistical inertia created by a group of otherwise unconnected investors may prevent their actual exercise of those powers.

The facts in *Williamson* support this conclusion. From the time the joint ventures were formed between 1969 and 1971, until at least late 1975, the plaintiffs relied entirely on Godwin "and made no attempt to oversee or participate in the management of the Property . . ."[82] It was not until late 1975, when the plaintiffs claimed they first became aware of alleged securities laws violations, that any of the plaintiffs participated in joint venture meetings.[83] There is no bright-line test for determining when an enterprise has so many investors that their individual vote is meaningless to safeguard their investment or to control either the enterprise or the manager. The results in *Williamson*, however, support a conclusion that where an enterprise has fifteen otherwise unrelated investors, none of them may possess meaningful rights to control the enterprise.

An issue not raised by the litigants or addressed by the *Williamson* court is whether the offerings in the three joint ventures should have been "integrated" and considered as a single offering of interests. The ventures may have involved a single plan of financing, class of securities, and type of consideration. Within broad parameters, the agreements were executed at approximately the same time for the general purpose of developing the Venture Property.[84] Although not free from doubt, the offerings could have been integrated, thereby increasing considerably the total number of investors even after allowing for some duplication of investors. Whether the presence of 20 or 30 investors would have prompted the *Williamson* court to directly address the issue of the meaningfulness of the powers retained by an individual investor under those circumstances is conjectural.

Whether the offerings are considered as separate or integrated, the sheer number of investors in *Williamson* diluted voting power, as well as creating logistical complications. The presence of many investors would appear directly and negatively to affect an individual investor's ability to exercise meaningful management control. Given the court's emphasis on the significance of the distribution of power and the investor's actual ability to exercise power, the court's failure to provide guidance by stating what importance, if any, should be attached to the actual number of joint venturers is unfortunate and disappointing.

The first element of the *Williamson* test calls for a probe of the power retained by the investor. The thrust of the inquiry is whether the investor has power to manage the enterprise, or, at a minimum, to control the manager of the enterprise. This latter aspect of the *Williamson* test is consistent with a series of cases decided by the Eighth and Tenth Circuits,[85] and relied on by the Fifth Circuit, which held that investors possessing potential control over management did not purchase securities.[86]

Based on *Williamson*, possession, rather than exercise, of power determines if an interest is an investment contract. This concept is consistent with the consequences of holding that an interest is an investment contract. If a joint venture interest is a security, then the promoter, as issuer, is subject to the full panoply of

registration and disclosure requirements of the federal securities laws. Either the joint venture interest must be registered pursuant to the provisions of Section 5[87] of the Securities Act of 1933 or it must be exempt. The issuer must fully and fairly disclose all material facts and is accountable under Sections 12[88] and 17[89] of the Securities Act of 1933, and Section 10(b)[90] of the Securities Exchange Act of 1934 for failure to comply.

Compliance with the registration and disclosure provisions can occur only if the offeror can determine that the joint venture interest is a security prior to the offer and sale. As a consequence, when determining the existence or nonexistence of a security, only those facts determinable when the offer and sale occurred should be considered. Otherwise, an interest that appeared to be a non-security on the basis of facts that existed at the time of sale could become a security based on events that transpired subsequent to sale. Promoters can comply with the federal securities laws only if the determinative control is the control apparently exercisable by the investor when he purchases the interest.

Although the *Williamson* test is based on the potential control available to the investor, the opinion does not preclude judicial examination of the powers actually exercised by the investors. Examination of this power may assist the trier of fact in determining whether the control expectations of the parties were realistic when the interest was purchased.

An examination of the joint venture agreements in *Williamson* reveals that the investors were not precluded from participating in management. They retained numerous controls, including the right to replace the manager. Therefore, under the first element of the *Williamson* test, the joint venture agreements were not investment contracts.

The joint venture document provided investors theoretical rights to control. The second and third elements of the *Williamson* test mandate a critical examination of the investor, the promoter, and the relationship of the investor to the promoter to confirm whether the investor could have had the reasonable expectation or capacity to exercise those rights. This feasibility inquiry was crucial, in the *Williamson* court's view, because "[i]nsofar as the power retained by the investors is a real one which they are in fact capable of exercising, courts have uniformly refused to find securities in such cases."[91]

If the joint venture document provides the investors with certain latent management powers, investment contract analysis compels two additional investigations respecting those powers. The first line of inquiry is whether the power is real. The second is whether the investors are capable of exercising that power.

The *Williamson* court made no independent statement concerning the reality of the plaintiffs' retained powers. The court did, however, analyze the background and abilities of the investors to determine if the investors could exercise their latent management power.

The four plaintiffs were executives with Frito-Lay, Inc., a subsidiary of Pepsico, Inc. Williamson was Chairman of the Board during Lilley's tenure as President.

The Plaintiffs owned differing percentages of the joint ventures.[92] Williamson and Lilley had participated in other joint ventures organized by Godwin.[93] The court concluded without further inquiry that "it is clear that plaintiffs had the business experience and knowledge adequate for the exercise of partnership powers in a real estate joint venture."[94] This conclusion, however, is not as "clear" as the court assumed.

The issue of the standard for investor sophistication, knowledge, and competence is a recurring one in securities analysis. Broker-dealers must evaluate investor sophistication to sell securities that are "suitable" to an investor's individual circumstances.[95] Investor sophistication is also raised specifically when evaluating an investor as an offeree for a private placement conducted pursuant to Section 4(2) of the Securities Act of 1933, or as a nonaccredited investor pursuant to Rule 506[96] promulgated thereunder.

An investor has the requisite sophistication only when he has "sufficient investment, business, and other experience, education, and actual knowledge to understand the mechanics and risks of the investments. . ."[97] General business sophistication is not sufficient.[98] Rather, investor sophistication is a product of the investor's experience and knowledge. Williamson, Lilley, Blake, and Wilson were executives of a national snack food corporation. Despite that status, however, they may have lacked any knowledge relevant to the development of the Venture Property. Mastery of zoning, building codes, and construction costs and methods is not a prerequisite to success as a purveyor of food. Sophistication and expertise in one business arena, without more, does not imply sophistication or knowledge in another.

The *Williamson* court may have been correct in concluding that the plaintiffs were capable of exercising their latent control. Reaching that conclusion, however, solely by reason of the plaintiff's executive status with Frito-Lay and the investment by two of the plaintiffs in other real estate joint ventures requires an awe-inspiring leap of faith. Meaningful exercise of control requires both the substantive knowledge to evaluate problems and sufficient leverage to effect the decision-making process. The Court apparently accepted a substitution of sophistication standard. This concept should be rejected because an apparently sophisticated investor who lacks the relevant experience may in fact be so dependent on the promoter or manager that he satisfies the fourth element of the *Howey* test.

After the court concluded than the joint venture interests were not investment contracts under either of the first two elements of the *Williamson* test, it examined the third element of the test: whether the promoter has talents so unique that either (1) he cannot be replaced or (2) as a consequence of the importance of his talents to the venture, the investor, as a practical matter, cannot exercise the latent or nominal powers that he possesses.[99] To the extent that the standards under the third test are absolute, this portion of the *Williamson* test goes beyond the boundaries of *Howey*. Nothing suggested that the talents of the service company in *Howey*

were unique or irreplaceable, only that those talents were the ones that would produce profits for the investors.

As an example of a theoretical application of this statement, the court noted that investors may enter a venture on the promise that the manager has a unique understanding of the local market.[100] The agreement may provide the investors with the legal right to fire the manager. Exercise of that right would, however, forfeit the management ability upon which the success of the venture depends. When the putative right is effectively non-exercisable, the illusion of power to remove will not preclude a finding that an investment contract exists. The court concluded that this theoretical statement did not apply to the facts in *Williamson*. Plaintiffs alleged a generalized argument that they were dependent on Godwin. They did not, however, raise "the possibility of a dependence on the unique or irreplaceable expertise of Godwin Investments as an issue in this case."[101]

Judicial determination as to the satisfaction of the second element of the *Williamson* test does not necessarily mean that a similar conclusion will be reached with respect to the third element. Inquiry under the second element focuses on what may be characterized as "investor dependence" while inquiry under the third element seeks "promoter independence." While the concepts are similar, they are not necessarily corollary. An otherwise qualified investor under the second element may still hold an investment contract if, under the third element, the manager is determined to have unique talents. The *Williamson* court, however, failed to find either "investor dependence" or "promoter independence" in the facts before it, so it did not explore the subtle distinctions between the second and third elements of the test.

The Fifth Circuit's articulation of investment contract theory as applied to a joint venture is comprehensive. The test enunciated by the court has been widely followed and is apparently the new federal standard for investment contract analysis of joint ventures or general partnerships. The remainder of this Article accordingly examines the analytical problems faced by joint venture promoters and their counsel in light of the *Williamson* test.

After Williamson v. Tucker

The consistent theme of *Howey* and its progeny, including *Williamson*, is that although investors have a difficult burden to sustain, joint venture interests can be securities. When organizing a joint venture, therefore, the real estate promoter and his counsel must make three initial determinations: (1) whether the joint venture interest is a security; (2) what compliance with state and federal securities law is required if the interest is a security; and (3) what compliance with state and federal securities law is possible without conceding that the interest is a security. The factual analysis that determines the existence of an investment contract is sensitive and subject to error. Even a good faith determination that under the *Williamson* and *Howey* tests an interest is not a security should not prevent consideration of the consequences of the alternative conclusion that the interest is a security.

Section 5 of the Securities Act[102] makes unlawful the selling of any security unless a registration statement is in effect as to the security. Sale of the interest must be registered under the Securities Act and the relevant state "blue sky" laws, or an exemption from registration under such laws must be obtained. Similarly, the seller of the security must either be registered as a broker-dealer under the Exchange Act and the applicable "blue sky" laws, or an exemption from registration under such laws must be available. Under all circumstances, full, fair, and complete disclosure of material information required to permit the investor to make an informed decision must be provided to each investor.

If the joint venture promoter and his counsel conclude that the interest is a security, their course of action is clear. A disclosure document will be prepared and the security will be registered with the appropriate state and federal regulatory agencies, or the available registration exemptions will be secured. Similar precautions will be effected with respect to the seller of the interests.

If counsel concludes, however, that the interest is not a security, there is no reason to register either the security or the seller of the interests with the state or federal regulatory agencies. The joint venture promoter, however, may not be certain that an interest is not a security. Because of the possibility of a subsequent adverse judicial determination that the interest is a security, the conservative promoter and his counsel may explore the circumstances, if any, under which an interest can be sold in compliance with state and federal securities law without taking affirmative action with the regulatory agencies. The following discussion will explore both the laws to be complied with and the degree of compliance possible without concluding or declaring that the joint venture interest is a security.

Federal Exemption From Registration

The preliminary inquiry is whether an exemption from the registration provisions of the Securities Act exists. The primary exemptions are the "intrastate" exemption and the "private placement" exemption.[103] These exemptions, however, exempt the interest only from the registration provisions of the Securities Act, and do not exempt an issuer from compliance with the antifraud and antimisstatement requirements.[104]

If the joint venture, its partners, and its property are all located within one state, then the "intrastate" exemption may be available under Section 3(a)(11)[105] of the Securities Act and Rule 147[106] promulgated thereunder. Section 3(a)(11) provides that the registration provisions of the Securities Act do not apply to a class of securities when the security "is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident, doing business within, or if a corporation, incorporated by and doing business within, such State or Territory."[107] Rule 147 delineates the "safe harbor" provisions of Section 3(a)(11).[108]

If the "intrastate" exemption is available, the joint venture agreement should detail the facts supporting that conclusion. The same representations that would be

obtained from the investor in an acknowledged intrastate offering should be procured. The investor should represent that (1) he is a bona fide resident of the state; (2) he will remain such for at least nine months following his purchase of the joint venture interest; and (3) he is purchasing his interest with an investment intent and without a view to the resale or redistribution of his interest. Transfers by the investor of his interest to nonresidents of the state should be subject to an opinion of counsel that the transfer is lawful.

The second major exemption from the registration provisions of the Securities Act is the so-called "private placement" exemption provided by Section 4(2)[109] of the Securities Act and Rule 506[110] promulgated thereunder. If the joint venture partners are limited to a small number of investors who possess the requisite investment sophistication to qualify as "private placement" offerees the Section 4(2) exemption may be available.

Exemption under Regulation D, which requires absolute compliance with each of its terms, will not be available. The rule requires filing Form D with the appropriate SEC regional office,[111] and failure to file destroys the availability of the exemption. Because the joint venture promoter and its counsel have concluded that the interest is not a security, consistency of interpretation requires them to not file Form D. It is important to note, however, that failure to perfect a Regulation D exemption is not fatal to a claim that the issuer has a valid exemption under Section 4(2) since the rule is a "safe harbor" and is not the exclusive method of complying with Section 4(2). Even in the absence of a Regulation D exemption, the joint venture could still have a valid "private placement" exemption.

A joint venture promoter seeking to preserve a private placement exemption should obtain representations that the investor: (1) can bear the economic risk of the investment; (2) is aware of the risks of real estate investment and its illiquid character; (3) is purchasing the interest for his own account and not with a view to resale or redistribution; and (4) is aware that the interest cannot be assigned, transferred, or sold without an opinion of counsel that the transfer is lawful. The promoter should verify these representations with the investor and his advisers.

The presence of sophisticated investors with the capacity to fend for themselves is a predicate for both the private placement exemption and a finding under the second element of the *Williamson* test that a joint venture interest is not a security. Whether the promoter is seeking to preserve the private placement exemption or avoid a determination that the joint venture interest is a security, it is imperative that he offer the interests only to appropriate investors. If the investor is unsophisticated, his presence may render a private placement exemption unavailable. An unsophisticated investor may likewise be incapable of exercising managerial control and thereby cause his joint venture interest to be deemed a security. The outcome of involving inappropriate investors may be catastrophic, and accordingly, the promoter should restrict all offers to investors who either by themselves, or in conjunction with their advisers, are sophisticated.

Disclosure

If either the intrastate or private placement exemption is available the interest will be exempt from the federal registration provisions. Neither exemption, however, exempts the issuer from the disclosure requirements, including the antifraud provisions, which can be satisfied only be providing full disclosure. The promoter and his counsel should prepare and distribute to each offeree written information containing all available information regarding the venture and the promoter. The investor should represent that he has received the written information and all the information regarding the joint venture, the promoter, and the venture's operations that he has requested. Verification of investor representations should be as comprehensive as if the offer were, in fact, an offering of securities. Prophylactic securities procedure and prudent business practice mandate that the promoter determine that his partners have the financial and educational sophistication required to meaningfully participate in management. The same logic compels providing investors with all material information.

If the joint venture promoter follows these procedures, he will prepare an effective substitute for a due diligence file. He will possess written evidence that he has investigated both the investment and the investors, just as he would have for an acknowledged securities offering. The file should contain all correspondence with investors, including all written materials and projections furnished. Although the file will not contain a document directly corresponding to a prospectus, the aggregation of information may demonstrate that the investor received most, if not all, of the substantive information found in a prospectus. Depending upon the quality of the information provided, the promoter's due diligence file may permit him to demonstrate that he satisfied the disclosure requirements of the securities laws.

State Exemptions From Registration

Although some states have a registration exemption similar to the private placement exemption, the number of permitted offerees and the exact requirements for the exemption vary widely. Many states require a filing with the state securities division to secure the exemption, either before or after the sale.[112] No state has a registration exemption patterned after the intrastate exemption. As a consequence, except in the relative handful of states which have a private placement exemption automatically available without filing, there is no exemption from state registration. If the joint venture interest is a security, then its offer and sale will violate the state registration provisions.

Federal Registration of Broker-Dealers

In addition to registration and disclosure requirements, the securities laws require that the seller of a security either be registered as a broker-dealer pursuant to Section 15[113] of the Securities Exchange Act or be exempt therefrom. There are two primary exemptions from the broker-dealer registration provisions, the intrastate ex-

emption and the issuer exemption. There is not, however, a federal broker-dealer exemption parallel to the private placement registration exemption.

A broker-dealer exemption exists that parallels the intrastate registration exemption. The rule states:

> It shall be unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer who is a person other than a natural person (*other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange*) . . . to induce or attempt to induce the purchase or sale of, any security . . . unless such broker or dealer is registered in accordance with subsection (b) of this section.[114]

If sale of the joint venture interest would qualify for the intrastate exemption from registration, and all of the promoter's sales activities are restricted to residents of a single state, then the exemption from broker-dealer registration may also exist.

The other broker-dealer exemption which may be available is the issuer exemption. The Securities Exchange Act defines a broker or dealer as an individual "engaged in the business" of effecting securities transactions. Individuals who effect only an isolated sale of a security are not "engaged in the business" of selling securities.[115] When an issuer of securities sells its own securities, using only its officers, partners, directors, and/or employees as the case may be, registration may not be required because the issuer is only effecting transactions on its own account. The individual seller of the security may also be exempt from registration because he likewise is not engaged in the business of selling securities. The sale of joint venture interests by its promoter, who is not engaged in the business of selling securities, may be exempt from the federal broker-dealer registration provisions.[116]

State Registration of Broker-Dealers

The Uniform Securities Act contains a definitional exemption from registration as a broker-dealer similar to federal law.[117] The Act defines "broker-dealer" as "any person engaged in the business of effecting transactions in securities for the account of others or for his own account. " 'Broker-dealer' does not include. . .an issuer,. . ."[118] Certain state statutes contain issuer exemptions which are comparable to the issuer exemption outlined in the proposed SEC regulations.[119] For example, the Florida Securities Act provides that the term "broker" means "dealer"[120] and limits the meaning of the term "dealer."[121]

Certain states provide an alternative exemption from broker or dealer registration for persons selling securities in private placements. The Florida Securities Act provides that "the registration requirements of this section [Registration of dealers, associated persons, and investment advisers] shall not apply in a transaction exempted by Section 517.061(1)-(16) [the private placement exemption]."[122]

In states such as Florida, a promoter who forms and sells joint venture interests in only a single private placement transaction each year, may be exempt from state registration as a broker or dealer exemption, under either an issuer or private placement exemption, even if the interests are securities. In other states with no private placement exemptions, the promoter of infrequent joint ventures may rely on the issuer exemption. The frequent joint venture promoter, however, will have no exemption.

Summary of State and Federal Securities Laws

The foregoing review indicates that without concluding that the joint venture interest is a security, even the careful joint venture promoter cannot insure compliance with all of the state or federal securities laws if the joint venture interest is in fact a security. Exemption from registration of the security and the broker-dealer is sometimes available at the federal and state level. Exemption from the disclosure requirements is never available. Although planning can increase the possibility that the promoter will comply with the securities laws even without conceding that the interest is a security, satisfaction of the full sweep of the disclosure and registration provisions is unlikely. As a consequence, every effort must be expended to structure the joint venture agreement to maximize the probability that an interest in the joint venture cannot constitute a security.

Drafting a Joint Venture Agreement After Williamson

No matter how the agreement is drafted, a typical joint venture agreement will normally satisfy the first three elements of the *Howey* test. The investor partners will make an investment in a common enterprise with the expectation of making profits. Effective planning and drafting, however, may eliminate an investor's potential claim that he anticipated making those profits based on the efforts of others. The failure to satisfy the fourth element of the *Howey* test will prevent a determination that the joint venture interest is a security.

The salient theme of *Williamson* is that a joint venture interest is a security only when the investor is effectively precluded from exercising managerial control of the enterprise. To respond to this concern, the joint venture agreement should provide that all major joint venture decisions require approval of a majority in interest of the venturers. Decisions subject to venturer approval should include, at a minimum, whether to buy, sell, or refinance the venture's property, or proceed with a development plan. The agreement should specify that regular, periodic meetings of all the venturers will be held to receive reports from the manager and to approve any management decisions implemented between meetings. Written notification stating when and where meetings will be held with an agenda should be sent to each investor. Accurate minutes of the meetings, reflecting discussions and votes on important issues, should be maintained.

Counsel for real estate developers will readily recognize the difficulty of achieving compliance with the procedures outlined above. Including such provisions in

the joint venture agreement, however, should evince the promoter's intention of establishing an enterprise to be managed by its partners. If the investor is unable, unwilling, or uninterested in attending meetings or receiving reports, his failure to do so represents a deliberate choice to decline managerial control. One inescapable conclusion from *Williamson* and the Eighth and Tenth circuit cases upon which it relied is that an investor's decision to play a passive role when an active role is possible does not convert a non-security interest into a security.[123] As the *Williamson* court stated, "[a]n investor who is offered an interest in a general partnership or joint venture should be on notice, therefore, that his ownership rights are significant, and that the federal securities acts will not protect him from a mere failure to exercise his rights."[124]

The second element of the *Williamson* test emphasizes that an investor who has the ability to exercise his managerial power does not purchase a security. The promoter's investigation of each investor should document the investor's capabilities based on his educational and business background. The investor should represent that he is financially and/or educationally sophisticated and that it is his present intention to actively exercise his management powers.

If the promoter's investigation reveals that the potential investor is patently incapable of exercising such control, then serious consideration should be given to excluding the investor as a joint venture partner. An alternate response to excluding an unsophisticated investor may be to permit the investor to designate a sophisticated agent. The agent could investigate the joint venture, vote on behalf of the investor, and attend joint venture meetings. The promoter may thus create a joint venture analog to the purchaser representative concept of Rule 506.[125] The presence of an investment adviser may rehabilitate the investor as an appropriate partner by providing him with the financial sophistication and ability to exercise control otherwise lacking. Although this concept is not suggested in *Williamson*, it seems responsive to the Court's principal concerns.

The third element of the *Williamson* test discusses the investor's dependence upon the promoter. In many respects, it is difficult to eliminate such dependence if in fact the promoter has unique talents. A real estate developer is generally able to form joint ventures, either with institutional or individual investors, precisely because his prior performance demonstrates exceptional talent. Although those talents may not be unique in the sense that they are not literally irreplaceable, they are talents not widely available or easily acquirable. There are fewer truly gifted real estate developers than there are investors with funds.

Because it may not be possible to respond to the "unique" aspects of managerial control, the joint venture agreement should squarely attempt to rebut the alternative formulation under the third element of the *Williamson* test, namely that the manager is irreplaceable. The agreement should provide mechanics delineating when and how the promoter/manager may be replaced and the procedure for selecting a new manager. Removal may be permitted only if the manager fails to achieve certain development goals on time or specified levels of operating income. An alternative,

based on the Eighth Circuit cases discussed in *Williamson*,[126] is to limit the promoter/manager's right to manage to a fixed time period. After the expiration of the period, the appointment of a manager would be periodically determined by all venture partners. By providing mechanics for removal in the first approach, and a time limitation in the second, the promoter may refute an argument that the investor is dependent upon an irreplaceable manager.

In practice, many joint venture promoters would not want to participate in a venture which they no longer manage. The agreement should therefore permit the promoter to sell his interest to the venture and/or its partners at a price and terms based on a specific formula if he is replaced as manager. The obvious danger of this approach is that the buy-out provisions will be found to be so prohibitive that they cannot be exercised. Such a finding would leave the analysis where it began, that is, that the manager is irreplaceable.

Conclusion

Investment contract analysis is necessarily conducted on a transaction by transaction basis. Uncertain theory is applied to inherently unique facts. The *Williamson* test, although somewhat ambiguous and not above criticism, provides some basis for joint venture promoters and their counsel to design an interest that is not a security. By responding to the guidelines, restricting offers to sophisticated investors, and preserving meaningful management powers for such investors, a joint venture promoter can successfully steer the real estate securities course between Scylla and Charybdis.

REFERENCES

1. L. Loss, Securities Regulation 493 (2d ed. 1961).
2. 15 U.S.C. § 77b(1) § 78c(a)(10) (1976).
3. *See*, Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1) (1976); Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78a (1976).
4. *See, e.g.*, SEC v. Haffenden-Rimer Int'l, Inc., 496 F.2d 1192 (4th Cir. 1974); SEC v. M.A. Lundy Assoc., 362 F. Supp. 226 (D.R.I. 1973).
5. Smith v. Gross, 604 F.2d 639 (9th Cir. 1979).
6. United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 848 (1975).
7. 645 F.2d 404 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981).
8. A joint venture is commonly defined as a partnership organized for a specific project, or more generally as a "form of partnership." Long, *Partnership, Limited Partnership, and Joint Venture Interests as Securities*, 37 Mo. L. Rev. 581, 587 (1972). There are technical differences between the two forms of entities. The Uniform Partnership Act has been adopted with some revisions in all states delineating the respective rights and obligations of partners in a partnership. There is no statutory counterpart for joint venture partners. Among the more important differences to the practitioner between a general partnership and a joint venture is that a partner has the right to contractually

bind the partnership, while a joint venture partner has no such right absent specific authorization in the joint venture agreement.

While these differences may be of practical interest in choosing an entity form, they do not necessitate separate analytical treatment in determining the existence of a security. From a conceptual standpoint, whether an agreement is denominated a general partnership or a joint venture is irrelevant—both are subject to the same investment contract analysis. Most courts have agreed that interests in joint ventures and general partnerships may be securities under appropriate factual circumstances. This Article, therefore, draws no distinction between the analysis of a joint venture or general partnership interest.

9. Since *Williamson*, there have been several federal cases involving the issue whether interests in joint ventures or general partnerships can be securities, most of which have cited *Williamson* as expressing the applicable investment contract analysis for such entities. *See, e.g.*, Gordon v. Terry, [1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶98,787 (11th Cir. 1982) [real estate general partnership interest could be a security if the investor could prove dependence upon efforts of the promoter in accordance with the *Williamson* test]; Odom v. Slavik, [1982-1983 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶99,130 (6th Cir. 1983) [citing *Howey* and *Williamson*, the court held that a general partnership interest was not a security because the partners had the power to exercise managerial control]; Cadiz v. Jimenez, [Current] Fed.Sec.L.Rep. (CCH) ¶99,644 (D.C. Puerto Rico 1983) [based on the *Howey* test, when plaintiff invested in the corporation as a joint venturer relying at least partially on his own efforts, his interest was not a security]; McConnell v. Frank Howard Allen & Co., [Current] Fed.Sec.L.Rep. (CCH) ¶99,538 (N.D. Cal. 1983) [citing *Williamson*, motion for summary judgment was denied because the interest could be a security as to the non-managing general partners]; Pfohl v. Pelican Landing, [Current] Fed.Sec.L.Rep. (CCH) ¶99,461 (N.D. Ill. 1983) [although failing to rule on whether a real estate general partnership interest constituted an investment contract, the court cited the *Williamson* test as articulating the applicable standard for making such a determination]; Morrison v. Pelican Land Development, [1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶99,863 (N.D. Ill. 1982) [motion for summary judgment denied because, in accordance with the *Williamson* test, a general partnership interest in a land development company may be a security]; Goodwin v. Elkins, [1982-1983 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶99,192 (E.D. Pa. 1983) [in reliance upon *Howey* and *Williamson*, the court held that a general partnership interest in a brokerage firm is not a security]; Wagner v. Bear Stearns & Co., [1982-1983 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶99,032 (N.D. Ill. 1982) [relying upon the *Howey* test, the court denied defendant's motion for summary judgment because a general partnership interest can be a secur-

ity]; and Slevin v. Pedersen Associates, Inc., [1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶98,726 (S.D.N.Y. 1982) [when investor in joint venture was actively involved, then in accordance with the *Howey* test his interest was not a security].

10. 15 U.S.C. § 77b(1) (1976) (emphasis added).
11. 15 U.S.C. § 78c(a)(10) (1976).
12. Tcherepnin v. Knight, 389 U.S. 332, 336 (1967). The term "security" is defined in the federal securities statutes as follows. Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1) (1976); Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1976); Public Utility Holding Company Act of 1935, § 2(a)(16), 15 U.S.C. § 79b(a)(16) (1976); Investment Company Act of 1940, § 2(a)(35), 15 U.S.C. § 80a-2(a)(35) (1976); Investment Advisers Act of 1940, § 202(a)(17), 15 U.S.C. § 80b-2(a)(17) (1976). The Trust Indenture Act of 1939, § 303(17), 15 U.S.C. § 77ccc(1) (1976) adopted the same definition as the Securities Act of 1933. There are some differences among these statutory definitions, but none that affect this Article.

    For an analysis of the different definitions of the term "security" in the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, and the Investment Company Act of 1940, *see* Hannan & Thomas, *The Importance of Economic Reality and Risk in Defining Federal Securities*, 25 HASTINGS L. J. 219, 221, & n. 13 (1974).

13. The Uniform Securities Act has been adopted in whole, or in part, in 36 states, the District of Columbia, Puerto Rico, and Guam. 1 BLUE SKY LAW REP. (CCH) ¶5501.
14. UNIFORM SECURITIES ACT § 401(A) (emphasis added).

    The Uniform Act also includes in its definition of securities "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." *Id.* This aspect of state regulation of interests in foreign real estate as securities will not be addressed in this Article.

15. The American Law Institute Federal Securities Code Project also does not define a joint venture interest as a security. Professor Loss, the Reporter of the Code, indicates that the statutory definition should not be substantially changed since "there is now a considerable body of jurisprudence and because it [the statutory definition] was substantially followed in the Uniform Securities Act, so that there is also a degree of uniformity at both state and federal levels." A.L.I. FED. SEC. CODE § 202(150), Comment 1 at 198 (Official Draft 1980).

    Section 202(150) of the proposed Code defines a security as follows:

    > (a) General.—"Security" means a bond, debenture, note, evidence of indebtedness, share in a company (whether or not transferable or denominated "stock"), preorganization certifi-

> cate or subscription, *investment contract*, certificate of interest or participation in a profit-sharing agreement, collateral trust certificate, equipment trust certificate (including a conditional sale contract or similar interest or instrument serving the same purpose), voting trust certificate, certificate of deposit for a security, or fractional undivided interest in oil, gas, or other mineral rights, or, in general, an interest or instrument commonly considered to be a "security", or a certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or buy or sell, any of the foregoing.

Id. (emphasis added).

16. Numerous commentators have explored the parameters of investment contracts as securities. See Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula*? 18 W. Res. L. Rev. 367 (1967); Faust, *What Is A Security? How Elastic Is The Definition*? 3 Sec. Reg. L.J. 219 (1975); Hannan & Thomas, *supra* note 12; Long, *An Attempt to Return 'Investment Contracts' to the Mainstream of Securities Regulation*, 24 Okla. L. Rev. 135 (1971); Long, *Introduction to Symposium; Interpreting the Statutory Definition of a Security: Some Pragmatic Considerations*, 6 St. Mary L.J. 96 (1974); Long, *supra* note 8; Marx, *What Is A Security? Under the Blue Sky Laws*, 1 Sec. Reg. L.J. 3 (1973); Rapp, *The Role of Promotional Characteristics in Determining the Existence of a Security*, 9 Sec. Reg. L.J. 26 (1981); Comment, *Franchise Sales: Are They Sales or Securities*?, 34 Alb. L. Rev. 383 (1970); Note, *The Expanding Definition of 'Security': Sale-Leasebacks and Other Commercial Leasing Arrangements*, 1972 Duke L.J. 1221.
17. 320 U.S. 344 (1943).
18. 328 U.S. 293 (1946).
19. 52 Hawaii 642, 485 P.2d. 105 (1971).
20. 421 U.S. 837 (1975).
21. In addition to *Joiner, Howey*, and *United Housing*, the Supreme Court has also construed the term "investment contract" in several cases. *See* Marine Bank v. Weaver, 455 U.S. 551 (1982) (neither a certificate of deposit nor a profit-sharing agreement were securities within the meaning of the Exchange Act); International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979) (noncontributory pension plan was not a security within the meaning of the federal securities acts); Tcherepnin v. Knight, 389 U.S. 332 (1967) (withdrawable capital shares of a savings and loan association were securities under the Exchange Act); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) (flexible fund annuity contracts were securities within the meaning of the Securities Act); SEC v. Variable Annuity Life Ins. Co. of America, 359 U.S.

65 (1959) (variable annuity contracts were securities within the meaning of the Securities Act).

22. SEC v. C.M. Joiner Leasing Co., 320 U.S. 344 (1943).
23. The following statement appeared on the circulars and selling letters:

    > Because these securities are believed exempted from registration, they have not been registered with the Securities and Exchange Commission; but such exemption, if available, does not indicate that the Securities have been either approved or disapproved by the Commission or that the Commission has considered the accuracy or completeness of the statements in this communication.

    Id. at 347, n.3.

    The Supreme Court, however, gave little consideration in its analysis to whether the assignments were securities to the promoters' own characterization of such interests as securities. 320 U.S. 344 *passim*.
24. *Id.* at 346.
25. *Id.*
26. "[D]efendants were not, as a practical matter, offering naked leasehold rights. Had the offer mailed by defendants omitted the economic inducements of the proposed and promised exploration well, it would have been a quite different proposition." *Id.* at 348.

    For a thorough discussion of the importance of the manner of the offer in determining the existence of a security, *see generally*, Rapp, *supra*, note 16.
27. The Court stated:

    > In the Securities Act the term "security" was defined to include by name or description many documents in which there is common trading for speculation or investment. Some, such as notes, bonds, and stocks, are pretty much standardized and the name alone carries well settled meaning. Others are of more variable character and were necessarily designated by more descriptive terms such as "transferable share," "investment contract," and "in general any instrument commonly known as a security" . . . Instruments may be included within any of these definitions, as a matter of law, if on their face they answer to the name or description. However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as "investment contracts," or as "any interest or instrument commonly known as a 'security.' "

320 U.S. at 351.

28. *Id.* at 346.
29. *Id.* at 348.
30. SEC v. W. J. Howey Co., 328 U.S. 293 (1946).
31. *Id.* at 295.
32. The author of the *Howey* opinion, Justice Murphy, stated that he relied heavily on state court interpretation of the term "investment contract" in formulating the test. Some commentators have suggested that at least a portion of the *Howey* opinion, however, was created from whole cloth:

    > There is considerable support for the view that "solely" did not spring from prior judicial precedent. None of the state cases cited in Justice Murphy's opinion even use the word. Indeed, State v. Gopher Tire & Rubber Co., apparently the principal source of Murphy's definition, placed no such limitation on investment contracts. An investment contract was there held to mean a contract or scheme for "placing of capital or laying out of money in a way intended to secure income or profits from its employment."

    Hannan & Thomas, *supra*, note 12 at 250.
33. The Court held that "an investment contract, for purposes 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, . . ." 328 U.S. at 298-99.

    It should be noted that the Court itself did not divide the test into constituent elements. Professor Loss apparently was the first commentator to do so. *See* L. Loss, *supra*, note 1, at 491 (2d ed. 1961). The *Williamson* court also discusses the *Howey* test as a three-part test. This Article, however, treats the test as having four elements.
34. For a discussion of the meaning of "investment of money," *see*, International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 559-61 (1979). For secondary examination of the first element of the *Howey* test, *see* Long, *An Attempt to Return 'Investment Contract' to the Mainstream of Securities Regulation, supra* note 16, at 161-62.

    A divergence of judicial opinion has developed with respect to the concept of "common enterprise." One approach is to analyze the relationship between the investor and promoter, while the other approach analyzes the relationships among the investors. The former is referred to as the vertical approach, while the latter is referred to as the horizontal approach. The horizontal approach has been adopted by the Third, Sixth, and Seventh Circuits. Wasnowic v. Chicago Board of Trade, 352 F. Supp. 1066 (M.D. Pa. 1972), *aff'd without opinion*, 491 F.2d 752 (3rd Cir. 1973), *cert. denied*, 416 U. S. 994 (1974); Curran v. Merrill Lynch, Pierce, Fenner and Smith,

622 F.2d 216 (6th Cir. 1980), *aff'd* 456 U.S. 353 (1982); and Milnarik v. M-S Commodities, Inc. 457 F.2d 274 (7th Cir. 1972), *cert. denied*, 409 U. S. 887 (1972). The Fifth Circuit has championed the vertical approach. *See* SEC v. Continental Commodities Corp., 497 F.2d 516 (5th Cir. 1974).

Under the horizontal approach, Florida courts have held that more than a single investor is required to constitute a common enterprise. Le Chateau Royal Corp. v. Pantaleo, 370 So. 2d 1155 (Fla. 4th Dist. Ct. App. 1979); Brown v. Rairigh, 363 So. 2d 590 (Fla. 4th Dist. Ct. App. 1978). *See also* Moreno, *Discretionary Accounts*, 32 U. MIAMI L. REV. 401 (1978); 8 FLA. ST. U.L. REV. 129 (1980).

For a discussion of the fourth element of the *Howey* test and the limitations of the word "solely," *see* Hannan & Thomas, *supra*, note 12, at 233-235, 249-252. *See also* note 39 *infra*.

35. 328 U.S. at 299.
36. The District Court in *Howey* noted that 51 purchasers acquired property from the Howey Company during the time period which was examined in the litigation. Only 42 purchasers, however, entered into contracts with the service company. SEC v. W.J. Howey Co., 60 F. Supp. 440, 441 (S.D. Fla. 1945). The Supreme Court decision in *Howey* emphasized the inability of the investors to manage their land interests by themselves. The trial court's opinion, however, makes it clear that, in fact, almost 20% of the investors were able to manage, or cause to be managed, their interest in the land. *Id.*
37. 328 U.S. at 300.
38. *Id.* at 301 (emphasis added). The Supreme Court apparently held that investors who purchased land but did not enter into service contracts were offered a security but purchased a nonsecurity. Investors who purchased land and entered into a service contract were offered, and purchased, a security. The distinction is that investors who either managed their land or caused it to be managed actively participated in the making of profits. As a result of their active participation, they failed to meet the requirement that an investment contract exists only where the investor anticipates profits solely from the efforts of another.
39. Commissioner v. Hawaii Market Center, Inc., 52 Hawaii 642, 485 P.2d 105 (1971).

In addition to certain state court's rejection of *Howey*, some federal courts have also deviated from application of the *Howey* test. The Ninth Circuit held that "the word 'solely' should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities." SEC v. Glen W. Turner Enterprises, 474 F.2d 476, 482 (9th Cir. 1973), *cert. denied* 414 U.S. 821 (1973). *See also*, SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974);

Miller v. Central Chinchilla Group, Inc., 494 F.2d 414 (8th Cir. 1974); Nash & Assoc. v. Lum's of Ohio, Inc., 484 F.2d 392 (6th Cir. 1973). The Supreme Court in United Hous. Foundation, Inc. v. Forman, 421 U.S. 837 (1975), explicitly avoided ruling on this aspect of the *Howey* definition. *See* notes 44-56 *infra* and accompanying text.

40. The Hawaii statute provides:

> "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, preorganization certificate or subscription, transferable share, *investment contract*, voting trust certificate, certificate of deposit for a security, certificate of interest in an oil, gas, or mining title or lease, 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, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

HAWAII REV. STAT. § 485-1(12) (1976) (emphasis added).

41. 52 Hawaii at 647, 485 P.2d at 108.
42. *Id.* at 649, 485 P.2d at 109. The court acknowledged its debt to Professor Coffey as the source of this definition. *Id. See* Coffey, *supra*, note 16.

Perhaps the earliest proponent of the "risk capital" theory was the court in Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906, 13 CAL. RPTR. at 188-189 (1961), in which Justice Traynor employed the phrase but did not define it. The court held that charter memberships in a country club were within the regulatory purpose of the California Blue Sky Law. "[I]ts [the California blue sky law's] objective is to afford those who risk their capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return of their capital in one form or another." *Id.* at 815, 361 P.2d at 908-09, 13 CAL. RPTR. at 188-89.

See also, 50 CAL. L. REV. 156 (1962); 14 HASTINGS L. J. 181 (1962).

43. 52 Hawaii at 652, 485 P. 2d at 111 (citations omitted).
44. United Hous. Foundation, Inc. v. Forman, 421 U.S. 837 (1975).
45. The *United Housing* decision generated comment from the legal community. *See, e.g.*, Deacon & Prendergast, *Defining a 'Security' After the Forman Decision*, 11 PAC. L. J. 213 (1980); 9 LOY. L.A.L. REV. 206 (1975); 298 SW. L.J. 987 (1976); 53 TEX. L. REV. 623 (1975).
46. 421 U.S. at 851.
47. *Id.*
48. *Id.* at 852.
49. *Id.*
50. 645 F.2d at 418-19.

51. *Id.* (citations omitted) (emphasis added).
52. 439 U.S. 551 (1979).
53. *Id.* at 558.
54. *Id.* at 561.
55. 421 U.S. at 857. The Court in *United Housing* attributed the "risk capital" test to the California Supreme Court's opinion in *Silver Hills County Club* rather than to *Hawaii Market*. *See* note 42 *supra* and accompanying text.
56. *Id.* at 857 n.24.
57. The procedural posture of *Williamson* is unusual but does not diminish the importance of the court's holding and analysis. Appellants alleged violations of the Securities Act of 1933 and the Securities Exchange Act of 1934, contending that the joint venture interests were securities within the meaning of both. Appellees filed motions for summary judgment under Rule 56 of the Federal Rules of Civil Procedure, or, in the alternative, to dismiss for lack of subject matter jurisdiction under Rule 12(b)(1). The district court dismissed the suit without indicating upon which Rule it was relying. The Fifth Circuit concluded that the district court's dismissal was for lack of subject matter jurisdiction, and was improper. After remand to the district court for substantive determination, the Fifth Circuit had no reason to reach the merits of the case. In the interests of judicial economy, however, the Fifth Circuit dealt with the substantive issues and formulated the *Williamson* test. 645 F.2d 404 (5th Cir.), *cert. denied,* 454 U.S. 897 (1981).
58. Federal case law on joint venture or general partnership interests as investment contracts prior to Williamson v. Tucker was relatively sparse. For some of the more important cases, see Andrews v. Blue, 489 F.2d 367, 371 (10th Cir. 1973) (when a joint owner of real property invested money, and devoted substantial time to the development of the property, but was "not given the right to share in the management or in any decision to sell, mortgage, or dispose of the property," his interest was a security); Nor-Tex Agencies, Inc. v. Jones, 482 F.2d 1093, 1099 (5th Cir. 1973) (when the promoter was to take the initiative and the joint venture investor in an oil and gas transaction was to remain "comparatively passive," the joint venture interest was a security), *cert. denied,* 415 U.S. 977 (1974); Sandusky Land, Ltd. v. Uniplan Groups, Inc., 400 F. Supp. 440, 445, (N.D. Ohio 1975) (no security when a general partner was "actively. . .involved in the decision-making process"); Hirsch v. duPont, 396 F. Supp. 1214, 1221 (S.D.N.Y. 1975) (when general partners had a degree of managerial control which afforded them access to information about the issuer, the partnership interests were not securities); *aff'd,* 553 F.2d 750 (2d Cir. 1977); New York Stock Exchange, Inc. v. Sloan, 394 F. Supp. 1303, 1314-15 (S.D.N.Y. 1975) (when a general partner chooses to delegate his day-to-day managerial responsibilities to a committee, his retained ability to vote and responsibility for partnership acts compel a conclusion that his interest was not a security); Oxford Finance Companies Inc.

v. Harvey, 385 F. Supp. 431, 433-34 (E.D. Pa. 1974) (when a joint venturer had authority over many decisions, including approval of all plans and specifications and all expenditures in excess of $10,000 there was no security); Bryant v. Uland, 327 F. Supp. 439, 442 (S.D. Tex. 1971) (a joint venture interest in undivided working interests was conceded to be a security by the defendant-promoter); Pawgan v. Silverstein, 265 F. Supp. 898, 900 (S.D.N.Y. 1967) (when a general partnership agreement gave controlling power to three managing partners, the partnership interests of other general partners were securities).

59. 645 F.2d at 408.
60. 497 F.2d 473, 483 (5th Cir. 1974).
61. 474 F.2d 476 (9th Cir. 1973), *cert. denied,* 414 U.S. 821 (1973). *See* 52 N.C.L. REV. 476 (1973); 51 TEX. L. REV. 788 (1973); 27 U. MIAMI L. REV. 487 (1973).
62. 474 F.2d at 482. (emphasis added).
63. 645 F.2d at 424.
64. The *Williamson* court specifically noted that these factors should not be considered exhaustive. "[T]his is not to say that other factors could not also give rise to such a dependence on the promoter or manager that the exercise of partnership powers would be effectively precluded." *Id.* at 424 n. 15.
65. JENNINGS & MARSH, SECURITIES REGULATION 252 (4th ed. 1977). The authors state:

    > An interest in a joint venture or general partnership normally is the antithesis of an "investment contract" or "profit-sharing agreement." The Uniform Partnership Act defines a partnership to be "an association of two or more persons to carry on as *co-owners* a business for profit." Thus the right to participate in the management and control of the business is a fundamental characteristic of the partnership. The general partners of a partnership are not passive investors who place money in an enterprise with the expectation of deriving profits *solely* from the efforts of others. Rather, they expect to reap profits through their own active participation in the control and management of the business.

    Id. (emphasis in the original).
66. 645 F.2d at 424.

    The court had stated earlier:

    > It should be clear from the context of the cases discussed above, however, that the mere fact that an investment takes the form of a general partnership or joint venture does not inevitably insulate it from the reach of the federal securities laws. . . .
    > A scheme which sells investments to inexperienced and unknowledgeable members of the general public cannot escape

> the reach of the securities laws merely by labeling itself a general partnership or joint venture. Such investors may be led to expect profits to be derived from the efforts of others in spite of partnership powers nominally retained by them.

67. *See, e.g.* Goodman v. Epstein, 582 F.2d 388 (7th Cir. 1978), *cert. denied,* 440 U.S. 939 (1979); Doran v. Petroleum Management Corp. 545 F.2d 839 (5th Cir. 1977); Nor-Tex Agencies, Inc. v. Jones, 482 F.2d 1093 (5th Cir. 1973), *cert. denied,* 415 U.S. 977 (1974).
68. In 17 C.F.R. § 240.3(a)11-1 (1981), for example, the Securities and Exchange Commission expressly includes interests in limited partnerships and joint ventures in the definition of "equity security" for purposes of §§ 12(g) and 16 of the Securities Exchange Act of 1934. The Commission states:

    > The term "equity security" is hereby defined to include any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate of subscription, transferrable share, voting trust certificate or certificate of deposit for an equity security, *limited partnership interest, interest in a joint venture,* or certificate of interest in a business trust; or any security convertible, with or without consideration into such security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.

    Id. (emphasis added). *See* SEC Rel. No. 33-4877, (August 8, 1967), 32 Fed. Reg. 11, 705 (1967), which states in pertinent part:

    > Under the federal securities laws, an offering of limited partnership interests and interests in joint or profit sharing real estate ventures generally constitutes an offering of a "profit sharing agreement" or an "investment contract" which is a "security" within the meaning of Section 2(1) of the Securities Act of 1933.
    >
    > . . .[I]f the promoters of a real estate syndication offer investors the opportunity to share in the profits of real estate syndications or similar ventures, particularly when there is no active participation in the management and operation of the scheme on the part of the investors, the promoters are, in effect, offering a "security."

    [1973] 1 Fed. Sec. L. Rep. (CCH) ¶1046 at 2062. *See also,* SEC Rel. No. 34-14273 (Dec. 15, 1977), [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶81,387.
69. 489 F. Supp. 1209 (S.D. Fla. 1980).
70. 389 U.S. 332 (1967).

71. 489 F. Supp. at 1220.
72. Although the *Williamson* court does not refer to Godwin as a joint venturer, an examination of the Reg Air I joint venture agreement shows that Godwin was a signatory. The agreement is attached as Appendix Number 1, Brief for Appellees James F. Mason, L. R. Polan, Jr., and M. L. Godwin Investments, Inc. The agreement for Reg Air I provided that:

    > Subject to the reservation of control in the Joint Venturers as specified in this Article VIII and until further action by the Joint Venturers, the Joint Venturers hereby designate M.L. Godwin Investments, Inc. as manager of the Venture Property to do all things necessary and proper to carry out the purposes of this Joint Venture. So long as the Venture Property remains undeveloped, M.L. Godwin Investments, Inc. shall not be entitled to receive any compensation for its services as manager of the Venture Property other than the compensation to be received at the closing of the purchase of the Venture Property. As space becomes available for rent, M.L. Godwin Investments, Inc. shall be entitled to compensation as manager and the Joint Venture shall enter into a management contract with M.L. Godwin Investments, Inc.

    Reg Air I Joint Venture Agreement § 8.03 at 6, Brief for Appellees, app. 1, Williamson v. Tucker, 645 F.2d 404 (5th Cir.), *cert. denied,* 454 U.S. 897 (1981).
73. 645 F.2d at 408.
74. *Id.*
75. *Id.* Reg Air I had 13 venturers, Reg Air II had 17 venturers, and Reg Air IV had 10 venturers. Brief for Appellees Trustees of the Home Interiors and Gifts Employees Profit Sharing Trust, at 4, Williamson v. Tucker, 645 F.2d 404 (5th Cir.), *cert. denied,* 454 U.S. 897 (1981).
76. 645 F.2d at 421.
77. Each joint venture agreement requires unanimous consent of the venturers to confess a judgment; to make, execute or deliver any bond, mortgage, deed of trust, guarantee, indemnity bond, surety bond or accommodation paper or accommodation endorsement; to borrow money in the name of the joint venture or use joint venture property as collateral; and to amend the agreement to modify the rights of the venturers. *Id.* at 408-09.
78. *Id.* at 409.
79. *Id.* Depending upon the joint venture, the vote of 60% or 70%, in interest, of the venturers was required.
80. *Id.* at 407. *See* note 92 *infra.*
81. *Id.* at 423. The court stated:

    > . . .[O]ne would not expect partnership interests sold to large numbers of the general public to provide any real partnership

> control; at some point there would be so many partners that a partnership vote would be more like a corporate vote, each partner's role having been diluted to the level of a single shareholder in a corporation. Such an arrangement might well constitute an investment contract.

Id.

82. *Id.* at 409.
83. *Id.* at 424.
84. In SEC Release No. 33-4552 (November 6, 1962), 27 Fed. Reg. 11,316 (1962) the SEC enunciated the principles to be considered in determining whether purportedly separate offerings should be integrated and treated as a single offering:

> A determination whether an offering is public or private would also include a consideration of the question whether it should be regarded as a part of a larger offering made or to be made. The following factors are relevant to such question of integration: whether (1) the different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, (5) the offerings are made for the same general purpose. What may appear to be a separate offering to a properly limited group will not be so considered if it is one of a related series of offerings. A person may not separate parts of a series of related transactions, the sum total of which is really one offering, and claim that a particular part is a non-public transaction. Thus, in the case of offerings of fractional undivided interests in separate oil or gas properties where the promoters must constantly find new participants for each new venture, it would appear to be appropriate to consider the entire series of offerings to determine the scope of this solicitation.

Id.

For an analysis of these principles, including a new proposal to deal with the integration issue, *see, Integration of Partnership Offerings: A Proposal for Identifying a Discrete Offering,* 37 BUS. L. 1551 (1982).

85. *See, e.g.*, Schultz v. Dain Corp., 568 F.2d 612, 615 (8th Cir. 1978) (when the purchasers of an apartment complex executed a non-revocable three-year management agreement with the seller, the purchaser retained "ultimate control" over the apartment complex, and there was no security); Ballard & Cordell Corp. v. Zoller & Dannenberg Exploration, Ltd., 544 F.2d 1059, 1065-66 (10th Cir. 1976) (when an oil drilling operating agreement permitted the investor to approve certain expenses and to leave the enterprise under

certain circumstances, there was no security), *cert. denied,* 431 U.S. 965 (1977); Fargo Partners v. Dain Corp., 540 F.2d 912, 915 (8th Cir. 1976) (when the purchasers of an apartment complex executed a management agreement with the seller that permitted the purchaser to terminate the management agreement upon 30 days notice, there was no security); Mr. Steak, Inc. v. River City Steak, Inc., 460 F.2d 666, 669-70 (10th Cir. 1972) (when a franchise agreement envisioned substantial operation by the franchisor but left some meaningful control in the hands of the franchisee, there was no security).

86. *Williamson,* 645 F.2d at 421.

> These cases from the Tenth and Eighth Circuits—dealing in turn with the purchase of franchise, oil and gas, and real estate interests—are consistent in their treatment of latent investor control. *In each case the actual control exercised by the purchaser is irrelevant.* So long as the investor has the right to control the asset he has purchased, he is not dependent on the promoter or on a third party for "those essential managerial efforts which affect the failure or success of the enterprise."

Id. (emphasis added).

87. 15 U.S.C. § 77e (1976).
88. *Id.* § 77l (1976).
89. *Id.* § 77q (1976).
90. *Id.* § 78j (1976).
91. 645 F.2d at 419.
92. The holdings of the plaintiffs in the Joint Ventures are as follows:

Reg Air I		Reg Air II		Reg Air IV	
Williamson	20%	Williamson	20%	Williamson	20%
		Lilley	10%	Lilley	10%
		Wilson	5%		
		Blake	5%		

Id. at 407.

93. *Id.* at 425.
94. *Id.*
95. New York Stock Exchange Rule 405 provides:

> Every member organization is required through a general partner, a principal executive officer or a person or persons designated under the provisions of Rule 342(b)(1) to

> (1) Use due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization.

[1978] 2 NYSE GUIDE (CCH) 3697.

Article III, § 2 of the Rules of Fair Practice of the National Association of Securities Dealers provides:

> In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

NASD MAN. (CCH) ¶2152 (1976).

17. C.F.R. § 240.15(b)10-3 (1981) provides:

> Every non-member broker or dealer and every associated person who recommends to a customer the purchase, sale or exchange of any security shall have reasonable grounds to believe that the recommendation is not unsuitable for such customer on the basis of information furnished by such customer after resonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other information known by such broker or dealer or associated person.

Id.

96. 17 C.F.R. § 230.506 (1982).
97. For an excellent article discussing these factors, *see* Soraghan, *Private Offerings: Determining 'Access', 'Investment Sophistication' and 'Ability to Bear Economic Risk'*, 8 SEC. REG. L.J. 3,24 (1980).
98. As Soraghan explains the problem:

> Business experience, or success in a business occupation, will suffice in place of actual investment experience only when such business or occupational experience establishes general knowledge of financial and other risk concepts applicable to businesses generally, not only the risks of the business of the investor. General business sophistication will not suffice; the occupation should be one in which the investor deals regularly with financial matters, such as that of an accountant or a corporate attorney actually dealing with such affairs.

Id. at 25.

99. 645 F.2d at 425 (emphasis added).
100. *Id.* at 423.
101. *Id.* at 425.

102. 15 U.S.C. § 77e (1976).

103. In addition to these commonly used exemptions, a registration exemption is available for offerings made to foreign investors, whether the offering is made exclusively abroad or in conjunction with an intrastate or private placement exemption. For a discussion of the mechanics involved in securing an offshore exemption, *see,* Morgenstern, *Real Estate Securities and the Foreign Investor—Some Problems and a Proposal,* 11 SEC. REG. L.J. 332 (1984). For an analysis of the application of the antifraud provisions to transactions exempt from registration based upon the offshore exemption, *see,* Morgenstern, *Extraterritorial Application of United States Securities Laws—A Matrix Analysis,* 7 HASTINGS INT'L L.J. 201 (1984).

104. *See* text accompanying notes 88-90 *supra.*

105. 15 U.S.C. § 77c(a)(11) (1976).

106. 17 C.F.R. § 230.147 (1981).

107. 15 U.S.C. § 77c(a)(11) (1976).

108. A discussion of the intricacies of the "intrastate exemption" is beyond the scope of this Article. Numerous commentators, however, have explored the problems in detail. *See,* Carney, *Exemptions from Securities Regulation for Small Issuers: Shifting from Full Disclosure—Part II: The Intrastate Offering Exemption and Rule 147,* 11 LAW & WATER L. REV. 161 (1976); Cummings, *The Intrastate Exemption and the Shallow Harbor of Rule 147,* 69 NW. U.L. REV. 167 (1974); Gardiner, *Intrastate Offering Exemption: Rule 147—Progress or Stalemate?,* 35 OHIO ST. L. J. 340 (1974); Hicks, *Intrastate Offerings Under Rule 147,* 72 MICH. L. REV. 463 (1974).

109. 15 U.S.C. § 77d(2) (1976). "The provisions of section 77e of this title [registration provisions] shall not apply to. . .transactions by an issuer not involving any public offering." *Id.*

   Secondary sources have extensively considered the problems of compliance with the private placement exemption at the federal level under Rule 506, and its predecessor Rule 146. *See* Donahue, *New exemptions from the registration requirements of the Securities Act of 1933: regulation D,* 10 SEC. REG. L.J. 235 (1982); Kinderman, *The Private Offering Exemption: An Examination of its Availability Under and Outside Rule 146,* 30 BUS. LAW. 912 (1975); Parnall, Kohl, and Huff, *Private and limited offerings after a decade of experimentation: the evolution of Regulation D,* 12 N.M.L. REV. 633 (1982); Schwartz, *Rule 146: The Private Offering Exemption—Historical Perspective and Analysis,* OHIO ST. L.J. 1 (1976); Soraghan, *supra* note 97.

110. Securities Act Release No. 6389 (March 8, 1982), 17 C.F.R. § 230.501-230.506. Regulation D consists of six rules, Rules 501 through 506. Rule 506 is the successor to Rule 146 and is more predictable and easier to comply with. *See* Powers, *Regulation D Offerings of Real Estate Syndication Inter-*

ests: An Update, 3 REAL EST. SEC. J. 37 (1982).

111. 17 C.F.R. § 230.503 (1982).

112. *See, e.g.*, OHIO REV. CODE ANN. §1707.03(Q) (Page Supp. 1980), which requires the filing of Form 3-Q with the Ohio Division of Securities within 60 days after the sale of a security sold in a private placement.

For a discussion of the blue sky statutory provisions corollary to the federal rules, *see*, Note, *State Exemptions from Securities Regulation Coextensive with SEC Rule 146*, 61 CORNELL L. REV. 157 (1975).

113. 15 U.S.C. § 78o (1976).

114. *Id.* 78o(a) (1) (emphasis added).

115. Section 3(a) (4) of the Securities Exchange Act provides that the term "broker" means any person engaged in the business of effecting transactions in securities *for the account of others*. 15 U.S.C. § 78c (1976) (emphasis added). Section 3(a) (5) of the Exchange Act provides that the term "dealer" means: "any person engaged in the business of buying and selling securities *for his own account*, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, *but not as part of a regular business.*" *Id.* (emphasis added).

116. The issuer exemption, however, may be unavailable to the frequent promoter of joint ventures if he were deemed a professional real estate syndicator whose regular business is to establish and sell joint venture interests.

In SEC Rel. No. 34-20943 (May 9, 1984), the Commission re-proposed the adoption of a new rule to the Exchange Act that would provide a "safe harbor" within which persons associated with an issuer would be deemed not to be brokers. The release stresses that the issuer exemption is not available to professional real estate syndicators since they are engaged in the business of selling securities. The issuer exemption may be unavailable even for the first issue if the individuals effecting the distribution intend to engage in the business of selling securities. Since the promoter of multiple joint ventures may be engaged in the business of forming and selling such interests, he may derive little comfort from the existence of the issuer exemption.

117. For limitations of the definitional exemption, see note 116, *supra*.

118. UNIFORM SECURITIES ACT, § 401(c).

119. *See* note 114, *supra*.

120. Florida Securities Act, FLA. STAT. ANN. § 517.021(4) (West Supp. 1981).

121. *Id.* § 517.021 (6) defines "dealer" as

> . . .any person associated with an issuer of securities if such person is a bona fide employee of the issuer who has not participated in the distribution or sale of any securities within the preceding 12 months and who primarily performs, or is intended to perform at the end of the distribution, substantial

duties for, or on behalf of, the issuer other than in connection with transactions in securities.

122. *Id.* § 517.12(3).
123. *See* note 86, *supra*.
124. 645 F.2d at 422.
125. 17 C.F.R. § 230.501 (h) (1982).
126. *See* note 86, *supra*.