# Limited Partnerships And The California Securities Law: Restricting The Public Sale Of Limited Partnership Interests

*This comment examines limited partnerships in light of the California securities law. Focusing on limited partners restricted management and interest transferability rights, it suggests further restrictions on the public sale of limited partnership interests in order to effectuate the California securities law investor protection policy.*

## INTRODUCTION

While the limited partnership is a relatively new development,[1] it is an accepted and often utilized business organization form. Entrepreneurs offer limited partnership interests publicly in such diverse business ventures as oil and gas explorations, feed lots, and real estate syndicates.[2] Limited partnerships offer advantages to both limited[3] and general[4] partners. Large public

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[1] Although the limited partnership form of business association dates back to the twelfth century accomeda of Italy, it is relatively new to common law countries. In the United States, New York passed the first Limited Partnership Act in 1822. 1822 N.Y. LAWS at 259 Ch. 244. Limited partnerships did not become prevalent until passage of the Uniform Limited Partnership Act by the Commissioners on Uniform State Laws in 1916. Shapiro, *The Need For Limited Partnership Reform: A Revised Uniform Act*, 37 MD. L. REV. 544 (1978). *See* Comment, *The Substantial Compliance Doctrine: Preserving Limited Liability Under the Uniform Partnership Act*, this issue at 923.

[2] Hrusoff & Cazares, *Formation Of The Public Limited Partnership*, 22 HASTINGS L.J. 87, 89 (1970).

[3] The principal advantages to limited partners are limited liability and conduit income tax treatment. CAL. CORP. CODE § 15501 (West 1977) provides that limited partners are not bound by the obligations of the partnership. *Id.* § 15507 (West 1977) provides that limited partners are not liable as general partners unless in addition to their exercise of rights and powers as limited partners, they take part in the control of the business. For a further discussion of § 15507, *see* notes 79-83 and accompanying text *infra*.

limited partnerships, however, present special problems.[5]

Conforming to the California securities law[6] presents one such problem since the law regulates the public sale of limited partnership interests.[7] This comment focuses on the basis for such regulation. It first considers the applicability of the securities law to sales of limited partnership interests. It next examines characteristics of limited partnerships which suggest their qualification for public sale should be restricted. Finally, the comment discusses limited partnerships which may be qualified for public sale under the California securities law and possible exemptions from the securities law requirements.

## I. Limited Partnerships and the California Securities Law

The limited partnership is a statutory creation[8] governed by the Uniform Limited Partnership Act[9] (hereinafter referred to

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The federal income tax provisions relating to partnerships are set forth in I.R.C. §§ 701-761. I.R.C. § 701 provides for conduit income tax treatment: "A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their individual capacities." *See also* Treas. Reg. § 301.7701-2 (1960); Cal. Rev. & Tax. Code §§ 17851-17932 (West 1970 & Cum. Supp. 1979).

[4] General partners enjoy the advantages of partnership income tax treatment, *see* note 3 *supra*, and the right to make managerial decisions. Cal. Corp. Code § 15509 (West 1977) provides that general partners in a limited partnership have all the powers and liabilities of a partnership without limited partners.

[5] *See generally* Augustine & Hrusoff, *Special Problems of Public Limited Partnerships: Investment Fees And Transferability Of Interest*, 7 Cal. W. L. Rev. 58 (1970); Hrusoff & Cazares, *supra* note 2; Comment, *Public Limited Partnerships In Northwest Real Estate Syndication*, 7 Willamette L. J. 74 (1971).

[6] The terms "state securities law" and "blue sky law" are often used interchangably in reference to state enacted securities laws. For an historical treatment of state securities laws, *see* J. Mofsky, Blue Sky Restrictions on New Business Promotions 5-15 (1971).

[7] *See* text accompanying notes 61 and 65 *infra* detailing the requirements for qualification of securities for public sale under the California Securities Law.

[8] *See, e.g.*, Evans v. Galardi, 16 Cal. 3d 300, 546 P. 2d 313, 128 Cal. Rptr. 25 (1976) where the court noted that, "[t]he form of business association known as 'limited partnership' was not recognized at common law and is strictly a creature of statute." *Id.* at 305, 546 P. 2d at 317, 128 Cal. Rptr. at 29.

[9] Forty-nine states, the District of Columbia, and the Virgin Islands have adopted the Uniform Limited Partnership Act. 6 Uniform Laws Annotated 99 (West Supp. 1980). Louisiana has not adopted the Uniform Limited Partner-

as the Act). A limited partnership is a partnership formed by one or more general partners and one or more limited partners.[10] The Act sets forth the requirements for forming limited partnerships.[11] It also defines the rights and liabilities of the limited and general partners *inter se,* during the existence of the limited partnership, as well as upon dissolution.[12]

The securities laws apply to limited partnerships if such interests fall within the statutory definition of securities. The California securities law[13] requires the qualification of securities prior to an offer or sale.[14] In considering regulation of limited partner-

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ship Act, but provides for partnerships in commendam which are similar to limited partnerships. *See* Comment, *Partnership In Commendam - Louisiana's Limited Partnership*, 35 TUL. L. REV. 815 (1961). California has adopted the Uniform Limited Partnership Act with minor changes in CAL. CORP. CODE §§ 15501-15532 (West 1977).

[10] CAL. CORP. CODE § 15501 (West 1977): "A limited partnership is a partnership formed by two or more persons having as members one or more general partners and one or more limited partners."

[11] CAL. CORP. CODE § 15502 (West 1977) requires that the limited partnership certificate set forth *inter alia*: name and principal place of business of the partnership, amount and description of each limited partner's contribution, method of distributing the profits, limited partners' right to substitute limited partners and the right of limited partners to vote on matters described in CAL. CORP. CODE § 15507. For a further discussion of § 15507 voting rights, *see* text accompanying notes 79-83 *infra*. The certificate must be signed and acknowledged, and recorded in the county where the partnership's principal place of business is located. Substantial compliance in good faith with these requirements of the certificate contents suffices to form the limited partnership. For a further discussion of the substantial compliance doctrine, *see* Comment, *supra* note 1.

[12] CAL. CORP. CODE §§ 15501-15532 (West 1977 & Cum. Supp. 1980).

[13] *Id.* §§ 25000-25804 (West 1977 & Cum. Supp. 1980).

[14] *Id.* § 25110 (West 1977) makes unlawful an offer or sale of any security in an issuer transaction unless the Commissioner of Corporations has qualified the security for sale.

Although the scope of this Comment is limited to the California securities law, it should be noted that the sale of securities within California may also have to comply with the registration requirements of the Federal Securities Act of 1933. 15 U.S.C. §§ 77a-77aa (1976). The use of interstate commerce or the mails to offer, sell or deliver securities triggers jurisdiction under the Securities Act of 1933. *Id.* § 77e (1976).

The Securities Act of 1933 exempts certain securities and transactions from the registration requirements. The most widely used exemptions involve intrastate offerings, *id.* § 77c(11) (1976), transactions by any person other than an issuer, underwriter, or dealer, *id.* § 77d(1) (1976), and the private placement exemption, *id.* § 77d(2) (1976). *See also* 17 C.F.R. § 230.147 (1979) regarding

ship interests under this law, the threshold question is whether such interests constitute securities.[15] The statutory definition of securities does not include limited partnership interests.[16] To fall within the California securities law, limited partnership interests must be classified under the category of investment contracts.[17] As the law does not specifically enumerate limited partnerships as securities,[18] it is thus necessary to examine these interests in light of the scope of investment contracts.[19]

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intrastate offerings, *id.* § 230.144 (1979) regarding transactions by a person other than an underwriter, and *id.* § 230.146 (1979) regarding the private placement exemption.

[15] *See* Coffey, *The Economic Realities Of A "Security": Is There A More Meaningful Formula*?, 18 W. RES. L. REV. 367, 371-72 (1976) noting that determination of whether an arrangement constitutes a security should not be equated with the question of whether the transaction is subject to securities law requirements for registration or qualification. "[T]he securities law clearly imply [sic] that the features of a transaction which dictate the requirements for registration or state approval are distinct from, and in addition to the criteria employed in deciding the prior and more basic question of security *vel non*."

[16] CAL. CORP. CODE § 25019 (West 1977) sets forth the definition of securities:

> "Security" means any note; stock; treasury stock; membership in an incorporated or unincorporated association; 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 or participation in an oil, gas or mining title or lease or in payments out of production under such a title or lease; any beneficial interest or other security issued in connection with a funded employees' pension, profit sharing, stock bonus, or similar benefit plan, or, in general, any interest or instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. All of the foregoing are securities whether or not evidenced by a written document.

[17] *Id.*

[18] *Id.*

[19] The leading case defining the parameters of investment contracts at the federal level is SEC v. W.J. Howey Co., 328 U.S. 293 (1946). *See* text accompanying notes 20-22 *infra*. Although California developed its own test to determine the existence of a security through the risk capital test, *see* notes 33-43 and accompanying text *infra*, the *Howey* test has also been followed in California, *see* notes 44-47 and accompanying text *infra*.

### *A. The Howey Test*

In *S.E.C. v. W.J. Howey Co.*,[20] the United States Supreme Court established a four part test for determining when a transaction involves an investment contract under the Federal Securities Act of 1933.[21] The Court held that an investment contract is present when a party (1) invests money (2) in a common enterprise (3) with the expectation of profits (4) solely from the efforts of others.[22] Therefore, a transaction satisfying the *Howey* standards is subject to securities regulation as an investment contract.

Although many federal and state courts follow *Howey*,[23] the test has been criticized.[24] Much of the criticism centers around

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[20] 328 U.S. 293 (1946). The Court held that the sale of citrus grove plots along with management contracts for maintaining and marketing the crops constituted the sale of investment contracts.

[21] 15 U.S.C. § 77b(1) (1976) sets forth the definition of a security under the Securities Act of 1933:

> The term "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, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

[22] SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

[23] *See, e.g.*, Gallion v. Alabama Mkt. Center, 282 Ala. 679, 213 So. 2d 841 (1968); Lowery v. Ford Hill Inv. Co., 556 P.2d 1201 (Colo. Sup. Ct. 1976); Raymond Lee Organization v. Division of Sec., 556 P.2d 1209 (Colo. Sup. Ct. 1976); Georgia Mkt. Centers, Inc. v. Fortson, 225 Ga. 854, 171 S.E.2d 620 (1969); Sire Plan Portfolios, Inc. v. Carpentier, 8 Ill. App. 2d 354, 132 N.E.2d 78 (1956); AMR Realty Co. v. State Bureau of Sec., 149 N.J. Super 329, 373 A.2d 1002 (Super Ct. App. Div. 1977); Jet Set Travel Club v. Corporations Comm'r., 21 Ore. App. 362, 535 P.2d 109 (1975); McClellan v. Sundholm, 89 Wash. 2d 527, 574 P.2d 371 (1978).

[24] *See* Coffey, *supra* note 15 at 373-76; Long, *Partnership, Limited Partnership, And Joint Venture Interests As Securities*, 37 Mo. L. Rev. 581, 601-03 (1972); Newton, *What Is A Security?: A Critical Analysis*, 48 Miss. L.J. 167, 185-192 (1977); Comment, *Is A Limited Partnership Interest A "Security"?: The Current State Of the California And Federal Definitions Add A Legal Dimension To Economic Speculation*, 16 Santa Clara L. Rev. 311, 328-32 (1976).

the language "solely from the efforts of others."[25] This ambiguous language resulted in a split of authority over the issue of investor participation.

The degree of investor participation sufficient to remove the transaction from securities regulation is the focus of this split of authority. Courts literally interpreting the "efforts" element find any investor effort sufficient to remove the interest from coverage under the *Howey* test.[26] As an alternative to this literal interpretation, the Ninth Circuit in *SEC v. Glenn W. Turner Enterprises*[27] required a determination of "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."[28] A number of other courts have adopted this Ninth Circuit modification of the *Howey* test.[29]

### *B. The California Tests*

Even if limited partnership interests fall within the definition of securities under the *Howey* test, the California tests must still

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[25] Long, *supra* note 24, at 601-03 notes that the Court's failure to make clear the type of efforts to be considered resulted in a split of authority. In SEC v. Glenn W. Turner Enterprises, 474 F.2d 476, 482 (9th Cir. 1973), the court criticized a strict interpretation of the "solely from the efforts of others" element of the Howey test as leading to a mechanical, unduly restrictive view of what is and what is not an investment contract.

[26] *See* Georgia Mkt. Centers v. Fortson, 225 Ga. 854, 171 S.E.2d 620 (1969); Gallion v. Alabama Mkt. Center, Inc., 282 Ala. 679, 213 So. 2d 841 (1968). *See also* Chapman v. Rudd Paint & Varnish Co., 409 F.2d 635 (9th Cir. 1969); Emery v. So-Soft of Ohio, Inc., 30 Ohio Op. 2d 226, 199 N.E.2d 120 (Ct. App. 1964); Koscot Interplanetary, Inc., v. King, 452 S.W.2d 531 (Tex. Civ. App. 1970), *Writ ref. no rev. err.*, 466 S.W.2d (Tex. 1970); Bruner v. State, 463 S.W.2d 205 (Tex. Crim. App. 1970). Under this interpretation, promoters could avoid securities regulation simply by allowing investors to perform physical or ministerial acts, even though the investors' efforts did not affect the investment of the outcome of the enterprise.

[27] 474 F.2d 476 (9th Cir. 1973). The court in *Glenn Turner* held that the sale of franchises in a pyramidal sales scheme constituted the sale of investment contracts.

[28] *Id.* at 482. Thus, where the investor has a right to share in these managerial decisions, his interest is not a security. An interest is a security, however, where the investor leaves control and management of the enterprise to others.

[29] *See* SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974); D.K. Properties, Inc. v. Osborne, 143 Ga. App. 832, 240 S.E.2d 293 (Ct. App. 1977).

be considered.[30] California courts have adopted two tests to determine the existence of a security; the risk capital test[31] and the *Howey* test as modified by *Glenn Turner*.[32]

*Silver Hills Country Club v. Sobieski*[33] first articulated the risk capital concept;[34] that the securities law should protect investors furnishing capital risked in a promoter's enterprise.[35] Al-

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[30] The proper test for the existence of a security in California is unclear. Both the risk capital and *Howey* tests have been used by California courts. *See* notes 33-51 and accompanying text *infra*. Thus, transactions potentially involving securities should be considered in the light of both tests.

[31] For a discussion of the risk capital test, *see* notes 33-43 and accompanying text *infra*.

[32] In People v. Park, 87 Cal. App. 3d 550, 151 Cal. Rptr. 146 (1st Dist. 1978), the court applied the *Howey* test as modified by *Glenn Turner*. *See* discussion notes 45-47 and accompanying text *infra*.

[33] 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961). The promoter sold country club memberships to investors, using the proceeds to construct club facilities, with the promoters retaining the right to operate the club and receive profits from the operation. Investors received only the right to use the facilities. *Id.* at 812-15, 361 P.2d at 906-08, 13 Cal. Rptr. at 186-87. In holding that the sale of memberships constituted the sale of securities, the court noted that;

> Petitioners are soliciting the risk capital with which to develop a business for profit. The purchaser's risk is not lessened because the interest he purchases is labelled a membership. Only because he [the investor] risks his capital along with other purchasers can there be any chance that the benefits of club membership will materialize.

*Id.*

[34] Although the California Supreme Court is generally credited with the development of the risk capital concept, Browne Oil Co. v. Railroad Comm'r., 207 Wis. 88, 240 N.W. 827 (1932) was probably the first decision utilizing this concept. *See* Long, *An Attempt To Return "Investment Contracts" To The Mainstream Of Securities Regulation*, 24 OKLA L. REV. 135, 169 (1971). *Browne Oil* involved the sale of coupon books and goodwill bonds, with the proceeds used to build gas stations and plants. Holders of goodwill bonds received regular distributions from a fund in which the company deposited one-half cent from each gallon of gasoline it sold in Wisconsin. In holding that the bonds constituted securities, the court noted:

> He [the investor] acquires the right to have the funds accumulate and to receive his distribution share when it is accumulated. He accepts the risk that the enterprise will be unable to get into operation and that the period of its operation will be neither sufficiently long nor successful to bring him the expected returns.

207 Wis. 88, 90, 240 N.W. 827, 829.

[35] *See* Hannan & Thomas, *The Importance Of Economic Reality And Risk In Defining Federal Securities*, 25 HASTINGS L. J. 219 (1974); Long, *supra* note 34, at 167-70; Comment, *Franchise Sales: Are They Sales Of Securities*? 34

though the *Silver Hills* court did not specify guidelines for applying the risk capital test,[36] analysis under the test requires consideration of two separate but interrelated questions. First, the economic reality of the transaction must be examined.[37] This involves a determination of the party bearing the principal risk of loss.[38] Second, the promoter's use of investors' capital must be considered. This inquiry focuses on whether the promoter uses investors' capital to commence the business operations.[39] Thus, a security exists if investors bear the principal risk of loss and provide a substantial portion of the initial capital used in the business operations.[40] Accordingly, the risk capital test is broader than the *Howey* test.[41] The risk capital[42] approach ex-

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ALB. L. REV. 383, 388-92 (1970); Note, *Expanding The Definition Of "Security": Silver Hills Country Club v. Sobieski*, 14 HASTINGS L. J. 181 (1962). In Mr. Steak, Inc. v. River City Steak, Inc., 324 F. Supp. 640 (D. Colo. 1970), the court noted that when solicitation of funds for speculative, poorly financed business ventures is involved, and even when the investor can particpate in or control some phase of the enterprise, he is "gambling 'risk capital.' " "Because of the substantial risk of loss, to include such operations within the purview of the 1933 Act would fulfill the purpose of protecting passive investors by compelling disclosure of the disquieting aspects of a scheme. *Id.* at 646.

[36] The court in Great W. Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976) set forth six factors measuring the degree of risk involved in loans characterized as investment contracts under the risk capital test: (1) term of the loan, (2) whether or not the loan is secured by collateral, (3) form of the obligation, (4) circumstances of the issuance, *i.e.* whether the obligation is issued to a single party or to the public at large, (5) relationship between the amount borrowed and the size of borrowers's business, and (6) the contemplated use of the funds. *Id.* at 1258.

[37] Hannan & Thomas, *supra* note 35, at 241-44.

[38] *Id.*

[39] Courts applying the risk capital test appear to distinguish between risk capital used to capitalize new business ventures and risk capital used to maintain the enterprise's existing financial situation. *See* Great W. Bank & Trust v. Kotz, 532 F.2d 1252, 1258 (9th Cir. 1976), noting that "[p]roceeds constituting an essential ingredient of enterprise formation are generally securities. On the other hand, those used to maintain current financial position generally are not." (Citations omitted.) *See also* State *ex. rel.* Healy v. Consumer Business Systems, Inc., 5 Ore. App. 19, 482 P.2d 549 (1971); Cordas v. Specialty Restaurants, Inc., 470 F. Supp. 780 (D. Ore. 1979).

[40] Hannan & Thomas, *supra* note 35, at 241-44.

[41] Two important characteristics of the risk capital test distinguish it from the *Howey* test. First, the risk capital test recognizes the loss of initial investment as an essential attribute of a security. *See* Coffey, *supra* note 15. Second, *Howey* requires the receipt of monetary profits while the risk capital test requires only the receipt of some benefit, not necessarily a monetary profit. The

pands the definition of securities to include inventive and unconventional means of capital formation.[43] Under the *Howey*

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Court in United Hous. Foundation v. Forman, 421 U.S. 837 (1975), *rehearing denied*, 423 U.S. 884 (1975) noted that the profits (as used in the *Howey* test) traditionally referred to capital appreciation resulting from development of the initial investment or earnings resulting from the use of investors' funds. *Id.* at 852. For a further discussion of the profits element of the *Howey* test in the limited partnership context, *see* note 56 *infra*. *See* International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979). In holding that the employee interests in a noncontributory compulsory pension plan did not constitute securities, the Court noted that although employees received benefits from the plan, such benefits did not constitute profits under the *Howey* test. *Id.* at 561-62.

[42] A number of courts have adopted the risk capital test, especially when franchises or loans used to capitalize a business are involved. *See, e.g.*, El Khadem v. Equity Sec. Corp., 494 F.2d 1224 (9th Cir. 1974), *cert. denied*, 419 U.S. 900 (1974) (although the *Howey* test is the prevailing test in the federal courts, the *El Khadem* court relied on language in *Howey* that the definition of securities is a flexible principle, and in searching for its meaning and scope, form should be disregarded for substance, as justification for applying the risk capital test); Great W. Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976); United California Bank v. THC Financial Corp., 557 F.2d 1351 (9th Cir. 1977); Cordas v. Specialty Restuarant, Inc., 470 F. Supp. 780 (D. Ore. 1979). *See also* Hunt, *Madame El Khadem, The Ninth Circuit, And The Risk Capital Approach*, 57 ORE. L. REV. 3 (1977).

Alaska has adopted the risk capital approach by statute. ALASKA STAT. § 45.55.130(12) (1962), including in the definition of security an "investment of money or money's worth including goods furnished or services performed in the risk capital of a venture with the expectation of some benefit to the investor where the investor has no direct control over the investment or policy of the venture."

[43] A number of courts have considered the applicability of the *Howey* and risk capital tests to different factual situations. In State *ex. rel.* Healy v. Consumer Business Systems, Inc., 5 Ore. App. 19, 482 P.2d 549 (1971), the court considered the applicability of the *Howey* and risk capital test to franchises and stated that, "[w]e hold that the *Howey* test is not exclusive and that the 'risk capital' test is also to be used in determining whether a particular financial activity constitutes an offer of an 'investment contract' which must be registered." *Id.* at 29, 482 P.2d at 554. *Cf.* Mr. Steak, Inc. v. River City Steak, Inc., 324 F. Supp. 640 (D. Colo. 1970) which limited the use of the risk capital test to situations where exceptionally high risk speculative franchises are involved." *Id.* at 647.

In United Hous. Foundation v. Forman, 421 U.S. 837 (1975), the Court held that sales of shares of stock entitling the holders to lease apartments in a state subsidized nonprofit housing cooperative did not constitute the sale of securities under the Securities Act of 1933. The Court refused to adopt the risk capital test and abandon the profits element of the *Howey* test, noting that, "[e]ven 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

test, inventive and unconventional means of raising capital which involve no investor effort would escape classification as a security.

Despite the California Supreme Court's development of the risk capital test,[44] *People v. Park*[45] disregarded this approach.[46] Citing *Howey* and *Glenn Turner*, the court held that there is a prima facie showing of the existence of an investment contract when the profits to be realized are expected solely from the promoter's efforts and the investors retain no control over management of the enterprise.[47]

The adoption of the *Howey* test in *Park* leaves the test of a security in California uncertain. Although the two tests are not mutually exclusive,[48] the risk capital test focuses on the economic risk involved in the transaction while the *Howey* test fo-

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no risk in any significant sense. If dissatisfied with their apartments, they may recover their initial investment in full." *Id.* at 857 n.24.

The risk capital test is not free from criticism. It has been criticized as being ambiguous, Comment, *The Definition Of A Security Under The California Corporate Securities Law of 1968: The Risk Capital Test*, 6 PAC. L.J. 683 (1975), and as being overbroad, Hirsch v. du Pont, 396 F. Supp. 1214 (S.D.N.Y. 1975). In *Hirsch*, the court noted that, "[u]nder this test, virtually every conceivable investment. . .would qualify as securities." *Id.* at 1222.

[44] Subsequent to *Silver Hills*, the court in Hamilton Jewelers v. Dept. of Corps., 37 Cal. App. 3d 330, 112 Cal. Rptr. 387 (3d Dist. 1974) clearly identified the risk capital test as the appropriate test in California. "Thus California follows the 'risk capital' approach in ascertaining whether a transaction involves a 'security' within the meaning of the Corporate Securities Law." *Id.* at 335, 112 Cal. Rptr. at 390.

[45] 87 Cal. App. 3d 550, 151 Cal. Rptr. 146 (1st Dist. 1978).

[46] Despite the California Supreme Court's pronouncement of the risk capital test, and its subsequent use in determining the existence of a security, the *Park* court did not mention or distinguish the applicability of the risk capital test when considering whether or not the interests involved constituted securities.

In *Park*, two unsophisticated investors contributed capital through their agent for the acquisition of land to develop condominiums. The agreement made no provision for control, discretion or participation by the investors. *Id.* at 557-60, 151 Cal. Rptr. at 148-50.

[47] *Id.* at 563, 151 Cal. Rptr. at 152.

[48] The court in SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 477 n.7 (5th Cir. 1974) noted that some overlap exists between the risk capital test and the managerial control approach in *Glenn Turner*, attributting the overlap "to the fact that the element of managerial control is implicit in the risk capital test as derived from *Silver Hills Country Club v. Sobieski.*" (citations omitted.) *See also* Hannan & Thomas, *supra* note 35, at 235-53.

cuses on the investor's degree of management in the enterprise.[49] Perhaps *Park* represents a move toward the adoption of a standard combining elements of both the risk capital and *Howey* tests.[50] Thus, until the California Supreme Court clarifies the California test for the existence of a security, limited partnership interests should be examined in the light of both tests.[51]

### *C. Limited Partnership Interests As Securities*

Although the *Howey* and risk capital tests focus on different aspects of a transaction possibly involving securities, application of either test to limited partnership interests should produce consistent results. Limited partnership interests are likely to be considered securities under either test.[52]

As limited partners invest money[53] in a common enterprise,

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[49] See note 41 *supra* discussing differences between the risk capital and *Howey* tests; Coffey, *supra* note 15 at 373-76.

[50] Taking note of criticism of the risk capital and *Howey* tests, the Hawaii Supreme Court in Commissioner v. Hawaii Mkt. Centers, Inc., 52 Haw. 642, 485 P.2d 105 (1971) set forth an alternative analysis combining elements of the *Howey* and risk capital tests. Under the *Hawaii Market Center* test, an investment contract is created whenever:

> 1. an offeree furnishes initial value to an offeror, and
> 2. a portion of this initial value is subjected to the risk of the enterprise, and
> 3. the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and
> 4. the offeree does not receive the right to exercise practical and actual control over the enterprise.

*Id.* at 649, 485 P.2d at 109. It has been suggested that California should follow the *Hawaii Market Center* test. *See* Comment, *supra* note 24, at 333.

[51] This is similar to the approach suggested in State *ex. rel.* Healy v. Consumer Business System, Inc., 5 Ore. App. 19, 29, 482 P.2d 549, 554 (1971). *See* note 43 *supra*.

[52] Some consider limited partnership interests generally to be within the definition of securities. *See* R. JENNINGS & H. MARSH, SECURITIES REGULATION 253 (4th ed. 1977); H. MARSH & R. VOLK, PRACTICE UNDER THE CALIFORNIA CORPORATE SECURITIES LAW § 5.11[2] at 5-31 (1979). *See also* Erwin, *Partnership Interests As Securities: An Alice In Wonderland Tour*, 9 CREIGHTON L. REV. 310 (1975).

*Contra* NEB. REV. STAT. § 9-1101 (1976) which exprssly excludes non-transferable limited partnership interests from the definition of securities.

[53] CAL. CORP. CODE § 15504 (West 1977). Limited partners may contribute

the investment of money and common enterprise elements of the *Howey* test[54] are clearly satisfied. The requirement that investors expect a profit solely from the efforts of others,[55] however, may pose some analytical problems. For example, arguably, a literal interpretation of the profits element could take tax shelter limited partnerships outside the securities definition.[56] Also, formal controls granted limited partners under the Act may constitute management of the enterprise.[57] Thus, it could be argued that limited partnerships possessing these characteristics do not fall within the definition of securities under the *Howey* test. Despite these potential problems, however, courts have held that

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cash or other property, but not services.

[54] The four elements of the *Howey* test are (1) an investment of money (2) in a common enterprise (3) with the expectation of profits (4) solely from the efforts of others. *See* text accompanying note 22 *supra*.

[55] *See* note 54 *supra* and text accompanying note 22 *supra* setting forth the elements of the *Howey* test.

[56] A literal interpretation of the profits element may take certain limited partnerships outside the definition of investment contracts under the *Howey* test. For example, investors in limited partnership real estate syndicates may seek a tax shelter rather than profits. *See generally* Dahlk, *Real Estate Partnerships And The Securities Laws: A Primer*, 12 CREIGHTON L. REV. 781 (1979); Hrusoff, *Securities Aspects of Real Estate Partnerships*, 11 CAL. W. L. REV. 425 (1975); Comment, *SEC Regulation Of California Real Estate Syndicates*, 61 CALIF. L. REV. 205 (1973).

However, even when limited partnership real estate syndicates are used as a tax shelter rather than as a profit making vehicle, policy considerations of investor protection militate in favor of providing securities law protection when the other elements of the *Howey* test are present. *See* Sharp v. Coopers & Lybrand, 457 F. Supp. 879 (E.D. Pa. 1978) where the court held that the limited partnership interests in oil wells constituted securities although motivation for investor purchases may have been to obtain a tax shelter. For consideration of the securities law investor protection policy, *see* text accompanying note 63 *infra*.

[57] There is some question of whether limited partners' exercise of rights under § 10 of the Act constitutes management of the limited partnership business. Section 10 of the Uniform Limited Partnership Act grants limited partners the right to inspect the partnership books, full information of all things affecting the partnership, a formal accounting when just and reasonable, and a court decreed dissolution and winding up. CAL. CORP. CODE § 15510 (West 1977).

Curtis v. Johnson, 92 Ill. App. 2d 141, 234 N.E. 2d 566 (1968) considered limited partners' rights under § 10, and held that despite these formal controls possessed by limited partners, the enterprise still may be one in which the investor expects to receive his profits "solely from the efforts of others." *Id.* at 153, 234 N.E. 2d at 572-73.

limited partnership interests fall within the definition of securities under the *Howey* test.[58]

Unlike the *Howey* test, courts have not yet applied the risk capital test to limited partnership interests. However, application of the risk capital test should result in finding that limited partnership interests constitute securities.[59] Limited partners' contributions clearly constitute all or part of the partnership capital. The placing of limited partners' investments at risk in the partnership venture should bring the interests within the definition of securites under the risk capital test.

Thus, limited partnership interests should be considered securities under either the *Howey* or risk capital tests. As securities, these interests are subject to the California securities law.

## II. Limiting the Public Sale of Limited Partnership Interests

As limited partnership interests constitute securities, they may be sold publicly[60] by meeting the California securities law

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[58] McGreghar Land Co. v. Meguiar, 521 F.2d 822 (9th Cir. 1975) held that the complaint stated a cause of action under Rule 10b-5 of the Securities Exchange Act of 1934 as, "[t]he limited partnership purchased by McGreghar possesses the essentials of an 'investment contract' as that term has been interpreted by the Supreme Court in *SEC v. W.J. Howey Co.*" *Id.* at 824. *Accord* Hirsch v. du Pont, 396 F. Supp. 1214, 1227-28 (S.D.N.Y. 1975) (limited partnership interests in brokerage firm); Weinberger v. New York Stock Exch., 403 F. Supp. 1020, 1028 (S.D.N.Y. 1975) (limited partnership interests in brokerage firm); Kroungold v. Triester, 407 F. Supp. 414, 417 (E.D. Pa. 1975) (limited partnership interest in real estate venture).

[59] Under the distinction made between risk capital used to capitalize new business ventures and risk capital used to maintain an enterprise's existing financial situation, *see* note 39 and accompanying text *supra*, certain limited partnerships may not fall within the definition of securities under this test. For example, the general partners of a limited partnership may authorize the sale of additional limited partnership interests to maintain current financial conditions. Arguably, such a limited partnership interest would not fall within the risk capital test of a security. However, this distinction has been made principally in the context of loans characterized as securities. *See, e.g.*, Great W. Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976). As the risk capital test has not yet been applied to limited partnership interests, whether or not this distinction would be used is uncertain.

[60] However, it has been suggested that the principle of *delectus personae*- the right of a partner to select the new members of the partnership - prohibits the public sale of limited partnership interests. *See, e.g.*, Johnston v. Winn, 105 S.W.2d 398 (Tex. Civ. App. 1937). Thus, memberships in partnerships are

requirements.[61] Although securities laws in general follow four different regulatory methods,[62] all securities laws incorporate an

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never indiscriminately offered at random to the public at large. Dalquist, *Regulation And Civil Liability Under The California Corporate Securities Act* (pt. 1), 33 CALIF. L. REV. 343, 361-65 (1945); H. HENN, LAW OF CORPORATIONS 109-10 § 79 (2d ed. 1970). *Compare* Farnsworth v. Nevada-Cal Mgt. Ltd., 188 Cal. App. 2d 382, 10 Cal. Rptr. 531 (2d Dist. 1961) *with* Rivlin v. Levine, 195 Cal. App. 2d 13, 15 Cal. Rptr. 587 (2d Dist. 1961) *and* Solomont v. Polk Dev. Co., 245 Cal. App. 2d 488, 54 Cal. Rptr. 22 (2d Dist. 1966). *See also* A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP § 26, at 152 (1968); Note, *Sale Of Limited Partnership Interests: Rivlin v. Levine*, 14 HASTINGS L.J. 176 (1962).

what analogous to registration of securities under the Federal Securities Act of 1933. Upon approval through the registration or qualification procedure, securities may be publicly sold. *See* note 14 *supra* discussing the overlapping jurisdiction of the California and Federal securities laws over certain securities and securities transactions. However, there are major substantive differences between qualification and registration requirements. *See* note 62 *infra* discussing these differences.

Securities may be sold upon qualification under CAL. CORP. CODE §§ 25111, 25112, or 25113 (West 1977). *Id.* § 25111 provides for the qualification of any security in connection with an offering for which a registration statement has been filed under the Securities Act of 1933. *Id.* § 25112 provides for the qualification of any security issued by an issuer registered under § 12 of the Securities Exchange Act of 1934 or security issued by an investment company registered under the Investment Company Act of 1940. Section 25112 applies only to securities not registerable under § 25111. *Id.* § 25113 provides for the qualification by coordination or notification. These securities are qualified by the Commissioner of Corporations' issuance of a permit.

[62] Jennings, *The Role Of The States In Corporate Regulation And Investor Protection*, 23 L. & CONTEMP. PROB. 193, 207-16 (1958). The four methods of securities regulation are by fraud acts, licensing acts, disclosure acts, and regulatory or merit acts.

The California and Federal securities laws illustrate the contrast between merit and disclosure acts. As a disclosure act, the Federal Securities Act of 1933 permits the public sale of securities upon the SEC's approval of information required to be disclosed in a registration statement. Under the California securities law, however, not only must there be disclosure, but the securities must meet the merit requirements before they may be publicly sold. *See* notes 65-67 *infra* and accompanying text for a discussion of the merit requirements. H. BALLANTINE & G. STERLING, CALIFORNIA CORPORATIONS LAWS § 433 at 844-46 (4th ed. 1979).

For consideration of arguments supporting and opposing merit regulation in securities regulation, *see* J. MOFSKY *supra* note 6; Bloomenthal, *Blue Sky Regulation And The Theory Of Overkill*, 15 WAYNE L. REV. 1447 (1969); Hueni, *Application Of Merit Requirements In State Securities Regulation*, 15 WAYNE L. REV. 1417 (1969); Mofsky, *Blue Sky Restrictions On New Business Promotions*, 1969 DUKE L.J. 273.

investor protection policy.[63] The California securities law is a regulatory or merit act,[64] authorizing the Commissioner of Corporations to qualify for public sale only those securities which meet the fair, just and equitable merit standard.[65]

The merit standard and investor protection policy of the California securities law should be the underlying considerations in determining whether limited partnership interests qualify for public sale.[66] The unrestricted qualification of such interests for public sale, however, poses serious public policy questions. Thus, the Commissioner of Corporations should not qualify limited partnerships for public sale.[67] Limited partners' restricted management and transferability rights support this policy of limiting qualification of limited partnerships for public sale.

### *A. Management Rights*

Prior to adoption of the Uniform Limited Partnership Act, courts were reluctant to uphold the limited liability investment

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[63] *See, e.g.*, Hall v. Geiger-Jones Co., 242 U.S. 539 (1917). The Court upheld the constitutional validity of Ohio's Blue Sky Law and observed, "[t]hat the law is a regulation of business, constrains conduct only to that end, the purpose being to protect the public against the imposition of unsubstantial [sic] schemes and the securities based upon them." *Id.* at 550.

[64] H. BALLANTINE & G. STERLING, *supra* note 62, § 433, at 846.

[65] CAL. CORP. CODE § 25140 (West 1977) grants the Commissioner of Corporations authority to refuse issuance of a permit for the sale of securities unless he finds that the securities are fair, just, and equitable. Guidelines for the application of this standard are set forth in Cal. Admin. Code, tit. 10 §§ 260.140 - .140.1. *See* Olson, *The California Securities Law of 1968*, 9 SANTA CLARA LAW. 75 (1968); Volk, *The California Corporate Securities Law of 1968 - A Significant Change From Prior Law*, 24 BUS. LAW. 77 (1968).

[66] Freshman, *California "Blue Sky" Regulations And Real Property Limited Partnerships*, 42 L.A.B. BULL. 303, 312 (1967), suggests there are two basic principles in determining what is fair, just, and equitable in the context of limited partnerships. First, to the extent reasonably possible, corporate democracy rights should be incorporated into the limited partnership certificate. Second, the promoter should not be permitted a greater degree of profit or control by adopting the limited partnership form of business organization rather than the corporation.

[67] *See* notes 68-122 and accompanying text *infra* for support of this position. Limited partnership real estate syndicates meeting the requirements of Cal. Admin. Code, tit. 10 §§ 260.140.110.1 - .119.1 are the exception to this policy. *See* notes 124-37 and accompanying text *infra* for a further discussion of limited partnership real estate syndicates.

vehicle.[68] This reluctance resulted in part from two competing policies. The first policy is that creditors and third parties should be able to rely on their justifiable expectations in repayment of loans and contract performance.[69] The second policy is that business associates should be permitted, by agreement, to limit liability to the amount of their investment.[70] The Act resolved this conflict by requiring that a general partner assume unlimited liability for partnership obligations and control the investment of those seeking limited liability.[71] In resolving this conflict, however, the Act's drafters minimized a third competing policy of investor supervision over their investment.[72] State securities laws with their underlying investor protection purpose reflect and to some degree effectuate this policy of granting investors supervision.[73]

Comparing limited partnerships and public corporations illustrates the limited partners' lack of management rights. In public corporations, stockholder voting rights are of paramount importance in ensuring that investors are afforded an opportunity to exercise their management rights within the enterprise.[74] Exercise of voting rights assures that investors have some degree of control over the enterprise's policies and operation. Furthermore, it assures that investors are able to supervise the use of their investment.[75] Even if stockholders do not directly exercise their voting rights, the right to vote is an unstated influence on managerial action in the conduct of even the most routine corporate affairs.[76] Thus, recognizing the similarity between large public limited partnerships and public corporations,[77] it is appropriate to carry over stockholder voting rights from corpora-

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[68] *See* A. BROMBERG, *supra* note 60, at 143-44 nn. 22 & 25.

[69] Coleman & Weatherbie, *Special Problems In Limited Partnership Planning*, 30 SW. L.J. 887, 897 (1976).

[70] *Id.*

[71] *Id. See also* UNIFORM LIMITED PARTNERSHIP ACT § 1, *reprinted in* 6 UNIFORM LAWS ANNOTATED 562 (West 1969) [hereinafter cited as U.L.P.A.]. As a result, creditors and limited partners are afforded maximum protection as they both rely on the general partner to assume all the extraordinary business risks.

[72] Coleman & Weatherbie, *supra* note 69, at 897.

[73] *See id.* at 898 n. 87.

[74] Z. CAVITCH, BUSINESS ORGANIZATION § 109.01, at 109-2 (1979).

[75] *Id.* at 109-2 to 109-3.

[76] *Id.* at 109-3.

[77] H. MARSH & R. VOLK, *supra* note 52, § 31.09, at 31-47.

tions laws, and apply them to such limited partnerships.[78]

To some extent, California's Limited Partnership Act reflects the necessity for investor supervision over their investment.[79] It contains a somewhat unique provision[80] granting limited partners voting rights affecting the basic structure of the limited partnership.[81] This provision permits limited partners to vote on

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[78] *Id.* This is especially applicable in the area of limited partnership real estate syndicates. *See* notes 129-32 and accompanying text *infra.*

[79] For a discussion of issues raised when limited partners exercise control, *see* Augustine, Fass, Lester & Robinson, *The Liability Of Limited Partners Having Certain Statutory Voting Rights Affecting The Basic Structure Of the Partnership*, 31 BUS. LAW, 2087 (1976); Feld, *The "Control" Test For Limited Partnerships*, 82 HARV. L. REV. 1471 (1969); Comment, *Control In The Limited Partnership*, 7 JOHN MARSHALL J. PRAC. & PROC. 416 (1974); Note, *Partnership: Can Rights Required To Be Given Limited Partners Under New Tax Shelter Investment Regulations Be Reconciled with Section 7 Of The Uniform Limited Partnership Act?*, 26 OKLA. L. REV. 289 (1973).

[80] CAL. CORP. CODE § 15507 (West 1977). The Limited Partnership Acts in Oregon, ORE. REV. STAT. § 69.280 (1977), Washington, WASH. REV. CODE ANN. § 25.08.070 (1972), Nevada, NEV. REV. STAT. § 88.080 (1973), and Delaware, DEL. CODE ANN. tit. 6, § 1707 (1975) also permit limited partners to exercise similar rights without losing their limited liability.

[81] Section 7 of the Uniform Limited Partnership Act provides that a limited partner is not "liable as a general partner unless, in addition to his rights and powers as a limited partner, he takes part in the control of the business." U.L.P.A., *supra* note 71, § 7. In addition to providing for the limited partner's non-liability, California's version of § 7 in CAL. CORP. CODE § 15507(b) (West 1977) specifies a non-exclusive list of activities a limited partner may participate in without losing their limited liability:

> A limited partner shall not be deemed to take part in the control of the business by virtue of his possessing or exercising a power, specified in the certificate, to vote upon matters affecting the basic structure of the partnership, including the following matters or others of a similar nature:
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> (I) Election or removal of general partners.
> (II) Termination of the partnership.
> (III) Amendment of the partnership agreement.
> (IV) Sale of all or substantially all of the assets of the partnership.

The Revised Limited Partnership Act, adopted by the National Conference of Commissioners on Uniform State Laws in 1976, follows the California model. Revised Limited Partnership Act § 304(b), *reprinted in* 6 UNIFORM LAWS ANNOTATED 141-142 (West Supp. 1980), enumerates a non-exclusive list of activities which a limited partner may carry on without being deemed to have taken part in control of the business. The Revised Limited Partnership Act has not yet been adopted in any state. *See* Hecker, *The Revised Uniform Limited Partnership Act: Provisions Affecting The Relationship Of The Firm*

the election or removal of general partners, to terminate the partnership agreement, and to sell all or substantially all the partnership assets.[82] These voting rights do not affect the limited partners' limited liability.[83]

While these rights can be analogized to stockholder rights[84] to elect[85] or remove directors,[86] voluntarily dissolve the corporation,[87] and amend the bylaws,[88] several factors distinguish limited partners' rights from stockholder rights. One factor which tends to erode investor democracy rights within the enterprise is the ability to restrict limited partners' rights in the partnership certificate.[89] Such a limitation reduces the statutorily permissible voting rights granting limited partners some degree of investment supervision. Limited partners also have narrower statutory voting rights than stockholders.[90] As a result of the similarity between large public limited partnerships and public

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*And Its Members To Third Parties*, 27 KAN. L. REV. 1, 47-61 (1978); Comment, *Limited Partner Control And Liability Under The Revised Uniform Limited Partnership Act*, 32 SW. L.J. 1301 (1979).

[82] CAL. CORP. CODE § 15507 (West 1977).

[83] *Id.*

[84] California's amendment of the Uniform Limited Partnership Act providing these rights for limited partners reflects an acknowledgement of the similarity between large public limited partnerships and public corporations. H. MARSH & R. VOLK, *supra* note 52, § 31.09, at 31-47.

[85] CAL. CORP. CODE § 301 (West 1977) provides for annual shareholder meetings to elect directors. Shareholders elect directors for a one year term.

[86] *Id.* § 301 authorizes shareholders to remove directors without cause upon approval by the outstanding shares.

[87] A simple majority vote of shareholders is sufficient to voluntarily dissolve the corporation under *Id.* § 1900.

[88] *Id.* § 211 provides that bylaws may be adopted, amended or repealed by approval of a majority of the outstanding shares.

[89] *Id.* § 15507. The language of this section:

> A limited partner shall not be deemed to take part in the control of the business by virtue of his possessing or exercising a power, *specified in the certificate*, to vote upon matters affecting the basic structure of the partnership, including the following matters or others of a similar nature. (emphasis added)

indicates that the rights are subject to modification in the partnership agreement.

[90] Van Camp, *Securities Regulation Of Real Estate Investment: The California Model*, 35 OHIO ST. L.J. 309, 311 (1974); Comment, *The Regulation Of Real Estate Syndicate Securities In California*, 16 SAN DIEGO L. REV. 399, 403 (1979).

corporations,[91] the Commissioner of Corporations strongly favors maximum investor democracy in limited partnerships.[92] Stockholder voting rights include; cumulative voting,[93] removing directors,[94] electing directors annually,[95] and voting by proxy.[96] These rights sufficiently ensure investor supervision over their investment.[97] Limited partners are not afforded these investor

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[91] H. MARSH & B. VOLK, *supra* note 52, § 31.09, at 31-47.

[92] *Id.*

[93] CAL. CORP. CODE § 708 (West Cum. Supp. 1980). Under cumulative voting, stockholders may multiply the number of votes their total shares give them by the number of directors to be elected and cast the total for one nominee or split the total in any proportion they see fit for two or more nominees.

[94] CAL. CORP. CODE § 303 (West 1977). Subject to certain limitations, a majority of the outstanding shares may remove any or all directors.

[95] *Id.* § 301 limits directors terms of office to one year.

[96] CAL. CORP. CODE § 705 (West Cum. Cupp. 1980) authorizes the voting of shares by proxy and creates a presumption of the validity of proxies executed according to the statutory requirements.

[97] Participants in limited partnerships do not have the same rights and protections afforded stockholders. "The statutory and case law dealing with the rights of corporate shareholders provides a vast inventory of rights, remedies, procedures, and guarantees, designed to protect shareholders and their investments." Van Camp, *supra* note 90, at 311. Examination of the basis for these stockholder voting rights demonstrates the role they play in assuring investor control over their investments.

Cumulative voting serves to secure minority shareholder representation on the board of directors. The concept of cumulative voting did not develop out of common law, but rather grew out of John Stewart Mill's belief that minority representation is an essential part of democracy. Sobieski, *In Support Of Cumulative Voting*, 15 BUS. LAW. 316 (1960). Without cumulative voting, even a group holding 49% of the voting shares could not elect a single director, though obviously they are entitled to representation. This minority representation facilitates a flow of information to stockholders as to corporate management and mismanagement. *See* N. LATTIN, THE LAW OF CORPORATIONS § 91, at 374-79 (2d ed. 1971); 5 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2048, at 189-91 (rev. perm. ed. 1976); Sobieski, *supra*.

Without proxies, there would be no practical method of ensuring that shareholders could exercise the voting franchise of widely dispersed shares. N. LATTIN, *supra* at 365. Although it has been suggested that the proxy device favors management when managerial disputes arise, *id.* it is nevertheless desirable to permit appointment of agents so that voting rights may be exercised.

Annual election of management provides the investor with both direct and indirect influence. Clearly, if a majority of investors disagree with management policies, annual election of directors ensures their ability to replace the incumbent management. Moreover, even the remote possibility that investors may exercise their vote to oust existing management and replace them with abler or more traceable individuals has a real, if indirect influence on managerial ac-

rights to vote by proxy, cumulatively, or annually for general partners.[98]

Several competing policies arise when considering limitations on qualification of limited partnership interests for public sale due to limited partners' restricted management rights. The principal conflict occurs between the policy that investors should be granted limited liability through the limited partnership vehicle[99] and the policy that investors should be afforded some supervision over their investment.[100] Although both limited partners and corporate stockholders place capital at risk in business ventures, stockholders enjoy substantial investor democracy rights that limited partners do not possess.[101] Thus, the similarity between public limited partnerships and public corporations and the underlying securities law protective policy suggest that limited partnerships should not be qualified for public sale unless limited partners hold investor democracy rights sufficient to safeguard their interests.[102]

### *B. Transferability of Interests*

Investment liquidity is another key criterion determining

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tion. *See* Z. CAVITCH, *supra* note 74, § 109.01, at 109-3.

[98] There are two other significant stockholder rights not held by limited partners; the right to call limited partner meetings and annual reports of the limited partnership. H. MARSH & R. VOLK, *supra* note 52, § 31.09, at 31-47. For a discussion of these two rights in the limited partnership context, *see* notes 129-31 and accompanying text *infra*.

[99] *See* U.L.P.A., *supra* note 71, § 1, comment, setting forth the proposition that, "[n]o public policy requires a person who contributes to the capital of a business, acquires an interest in the profits, and some degree of control over the conduct of business, to become bound for the obligations of the business. . . ."

[100] Coleman & Weatherbie, *supra* note 67, at 898.

[101] *See* notes 93-98 and accompanying text *supra*, discussing differences between stockholder and limited partner rights with regard to annual election of directors, cumulative voting and proxy voting.

[102] Arguably, limited partnerships possessing such investor democracy rights do not constitute limited partnerships as contemplated by the Uniform Limited Partnership Act. As demonstrated by limited partnership real estate syndicates in California, however, limited partnerships possessing such characteristics do not necessarily fall outside the purview of the Act. *See* notes 129-32 and accompanying text *infra*, describing limited partners' management rights in California real estate syndicates complying with the corporate securities rules.

whether a security should be qualified for public sale.[103] As a matter of policy, public investors should not be burdened with restrictions on the transferability of their interests.[104] Differences between stockholder and limited partner rights with respect to interest transferability illustrate the need to restrict public sale of limited partnership interests.[105]

A limited partner's interest in the partnership is assignable[106] personal property.[107] The investor's right to assign a limited partnership interest, however, can be restricted by the partnership certificate. The qualification of limited partnerships should be denied[108] when the partnership certificate significantly limits transfer of the limited partnership interests.[109]

Arguably, denying qualification of limited partnerships which impose restrictions on transferability exceeds the standards applicable to corporate stock. Articles of incorporation may include reasonable restrictions on the right to transfer shares of stock.[110]

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[103] Van Camp, *supra* note 90, at 311. Under the fair, just, and equitable standard, no open qualifications are approved for the issuance of securities which impose restrictions on the transfer of such securities in the charter document or other instruments pursuant to which the securities are issued. Cal. Admin. Code, tit. 10, § 260.140.8.

[104] Shares of corporate stock and limited partnership interests are viewed as property rights. Early cases involving issues over the validity of transfer restrictions on corporate stock held such restriction invalid. *See, e.g.*, Bunkerhoff-Farris Trust & Sav. Co. v. Home Lumber Co., 118 Mo. 447, 24 S.W. 129 (1893). The rationale for invalidating these restrictions was that such restrictions constituted unreasonable restraints on the alienation of property. This rationale carries forth to the present as restrictions on transfer of corporate stock are limited to those which are reasonable. *See* note 110 and text accompanying notes 111-12 *infra*.

[105] "[A] partnership investment generally lacks liquidity, perhaps the single most important feature of a corporate security. In the usual case a partnership investment cannot be readily and conveniently converted to cash through the sale or transfer of the partnership interest." Van Camp, *supra* note 90, at 311.

[106] CAL. CORP. CODE § 15519 (West 1977).

[107] *Id.* § 15518.

[108] For example, the corporate securities rules set limits on restrictions on transfer of limited partnership real estate syndicates. *See* notes 135-36 and accompanying text, *infra*.

[109] Under Cal. Admin. Code, tit. 10 § 260.140.8, open qualifications are not issued for securities imposing restrictions on the transfer of the securities in the charter document or other instruments pursuant to which the securities are issued. *See* Van Camp, *supra* note 90, at 311 noting that investment liquidity is perhaps the single most important characteristic of securities.

[110] CAL. CORP. CODE § 204(b) (West Cum. Supp. 1979). Articles of incorpora-

It is permissible to restrict transfers of corporate stock if such restrictions do not unreasonably curtail the right of alienation or unreasonably deprive the stockholder of substantial rights.[111] For example, reserving the right of first refusal in other stockholders or the corporation in future sales does not unreasonably restrict the right to transfer stock.[112]

Although it may appear inconsistent to impose higher standards ensuring free transferability of limited partnership interests, these standards are justifiable and necessary to protect investors.[113] First, as a practical matter, the limited partnership tax consequences must be considered.[114] One characteristic distinguishing corporations from partnerships is the degree to which the interests are freely transferable.[115] Free transferability is a characteristic of corporations,[116] potentially subjecting the

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tion may set forth "reasonable restriction upon the right to transfer. . .shares of any. . .class. . ." *See* Groves v. Prickett, 420 F.2d 1119 (9th Cir. 1970); Tu-Vu Drive In Corp. v. Ashkins, 61 Cal. 2d 283, 391 P.2d 828, 38 Cal. Rptr. 348 (1964).

[111] Tu-Vu Drive In Corp. v. Ashkins, 61 Cal. 2d 283, 286, 391 P.2d 828, 830, 38 Cal. Rptr. 348, 350 (1964) (provision reserving the right of first refusal in other stockholders not unreasonable restriction on right of alienation).

[112] *Id.*

[113] *See* note 4 and accompanying text *supra.*

[114] One of the principal advantages of the limited partnership business form is conduit income tax treatment. *See* note 3 *supra.*

[115] I.R.C. § 7701(2)(3) defines corporations and partnerships. The Treasury Regulations enumerate six characteristics of the corporation which distinguish it from other business organizations: (1) associates, (2) an objective to carry on business and divide the profits therefrom, (3) continuity of life, (4) centralization of management, (5) liability for corporate debts limited to corporate property, and (6) free transferability of interests. Treas. Reg. § 301.7701-2(a)(1). *See also* Morrissey v. Commissioner of Internal Revenue, 296 U.S. 344 (1935); Larsen v. Commissioner, 66 T.C. 159 (1976).

All businesses have business associates and a profit objective. Thus, partnerships possessing three of the remaining characteristics would be subject to corporate taxation as an association. B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 2.04., at 2-11 (4th ed. 1979).

[116] Treas. Reg. § 301.7701-2(e), specifically considers the transferability characteristics of corporations and limited partnerships. The corporate characteristic of free transferability of interests would exist when limited partners have the unrestricted power to "substitute for themselves in the same organization a person who is not a member of the organization." *Id.* Although the Internal Revenue Service proposed amendments to these regulations, the amendments were withdrawn for reconsideration. The proposed amendments would virtually classify all limited partnerships as associations. Under the pro-

limited partnership to corporate tax liability.[117] Although free transferability of interests does not conclusively determine that an organization is a corporation, restricting transferability helps ensure taxation as a partnership.

Moreover, the nature of limited partnerships makes the transfer of limited partner's rights a difficult and cumbersome process. Limited partners may assign their interests in profits or income from the partnership.[118] However, the assignee does not receive the assignor's limited rights to participate in management[119] or inspect the partnership books[120] unless the assignee is a substituted limited partner.[121] This occurs only if all the members of the limited partnership approve and amend the partnership certificate.[122]

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posed regulations, the Internal Revenue Service would have adopted a resemblence test. Thus, an organization with associates and a business objective would be classified as an association if it more nearly resembled a corporation. B. BITTKER & J. EUSTICE, *supra* note 115, ¶ 2.04, at 2-16.

*See generally* Fisher, *Classification Under Section 7701- The Past, Present, And Prospects For the Future*, 30 TAX. LAW 627 (1977); Comment, *Tax Classification Of Limited Partnerships: The IRS Bombards Tax Shelters*, 52 N. Y. U. L. REV. 408 (1977); Note, *Tax Classification Of Limited Partnerships*, 90 HARV. L. REV. 745 (1977).

[117] A partnership characterized as a corporation not only would be subject to the corporate tax provisions, but also could not take advantage of the conduit income tax provision for partnerships.

[118] A limited partner's interest is personal property, CAL. CORP. CODE § 15518 (West 1977), and is assignable, *Id.* § 15519(1).

[119] *Id.* § 15507 (West 1977) grants limited partners voting rights affecting the basic structure of the partnership. For a discussion of this section, *see* notes 79-98 and accompanying text *supra*.

[120] CAL. CORP. CODE § 15510 (West 1977) grants limited partners the right to inspect the partnership books, full information of all things affecting the partnership, a formal accounting when just and reasonable, and a court decreed dissolution and winding up.

[121] *Id.* § 15519(3) provides that:

> An assignee, who does not become a substituted limited partner, has no right to require any information or account of the partnership transactions, to inspect the partnership books, or to vote on any of the matters as to which a limited partner would be entitled to vote pursuant to the provisions of Section 15507 and the certificate of limited partnership; he is only entitled to receive the share of the profits or other compensation by way of income, or the return of his contributions, to which his assignor would otherwise be entitled.

[122] *Id.* § 15519(4).

These limits on transferability inherent in limited partnerships create the need to prevent further restrictions in the certificate on transfer of interests. Certificate restrictions prohibiting limited partners from transferring their interests results in a non-liquid investment which should not be qualified for public sale.

## III. Qualifying Limited Partnership Interests for Public Sale

The characteristics of limited partnerships suggest that their unrestricted qualification for public sale under California's securities laws may be contrary to public policy.[123] However, limited partnerships meeting the fair, just and equitable merit standard and providing adequate investor democracy rights without unduly restricting transferability should be qualified for public sale.

### *A. Limited Partnerships Subject To Qualification*

Some limited partnerships meet the qualification standards for public sale. An example is a limited partnership real estate syndicate under the corporate securities rules.[124] Some requirements under these rules relate exclusively to real estate. Examples include limits on the commission for reinvesting proceeds of a sale,[125] limits on services rendered to the syndicate by the sponsor,[126] and real estate acquisitions to be supported by independent appraisals.[127] In addition to these requirements for real

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[123] The basic policy underlying the Securities Law is investor protection. *See* note 63 and accompanying text *supra*.

[124] Cal. Admin. Code, tit. 10, §§ 260.140.1 - 260.140.119.1 sets forth the requirements for real estate syndicates to be qualified under the Corporate Securities Law. *See generally* Miller, *Real Estate Syndication Under The California Corporate Securities Law of 1968*, 16 U.C.L.A. L. Rev. 371 (1969); Van Camp, *supra* note 90; Comment, *Real Estate Syndicate Securities, supra* note 90.

[125] Cal. Admin. Code, tit. 10, § 260.140.114.4 prohibits payment of a commission to a sponsor of the syndicate in connection with the reinvestment of the proceeds of the resale, exchange or refinancing of syndicate property.

[126] Among the services regulated under *Id.* § 260.140.114.5 are insurance and property management services. These regulations are intended to prevent self-dealing on the part of the syndicate promoters.

[127] *Id.* § 260.140.114.13 requires that an independent appraisal support all real estate acquisitions. The promoters must make the appraisal available for

estate syndicates, there are specific provisions relating to investor management rights and transfer of interests.[128]

The partnership agreement must provide certain investor rights in order for real estate syndicates to qualify for public sale. Limited partners holding more than ten percent of the outstanding limited partnership interests may call limited partner meetings.[129] Limited partners can vote to amend the partnership agreement, dissolve the partnership, remove the general partner and approve or disapprove the sale of all or substantially all the partnership assets.[130] The syndicate must distribute annual reports to the limited partners[131] and give limited partners access to the records of the syndicate at all reasonable times.[132]

The rules also limit the ability of the general partners or sponsors to restrict the transfer of limited partnership interests. The rules require quarterly amendment of the certificate to effect substitution[133] of limited partners.[134] Restrictions on substitution of limited partners are disfavored and permitted only to the extent necessary to preserve the partnership tax status of the limited partnership.[135] Restrictions on assignment of limited partnership interests are not permitted.[136]

While these rules govern only limited partnership real estate syndicates, the requirements regarding investor rights and transferability of interests should apply to other types of limited

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inspection and duplication by the limited partners.

[128] *Id.* §§ 260.140.116.2 - 260.140.116.7. *See* notes 129-32 and accompanying text *infra.*

[129] Cal. Admin. Code, tit. 10, § 260.140.116.1 provides that either the general partner(s) or limited partner(s) holding more than 10% of the outstanding limited partnership interests may call a meeting of the limited partners. Furthermore, the syndicate must provide a list of limited partners upon request and give notice to all partners of the meeting.

[130] The limited partnership agreement must provide for these rights, and a majority vote of the limited partners is sufficient. *Id.* § 260.140.116.2. These rights are identical to the rights enumerated under CAL. CORP. CODE § 15507 (West 1977). *See* notes 79-83 and accompanying text *supra.*

[131] Cal. Admin. Code, tit. 10 § 260.140.116.3.

[132] *Id.* § 260.140.116.4.

[133] Under CAL. CORP. CODE § 15519 (West 1977), only a substituted limited partner has all the rights of a limited partner. *See* notes 118-22, 130-32 and accompanying text *supra.*

[134] Cal. Admin. Code, tit. 10 § 260.140.116.5(b).

[135] *Id.* § 260.140.116.7.

[136] *Id.*

partnerships.[137] Thus, limited partnerships with investor management and transfer rights similar to those required of real estate syndicates should be qualified for public sale.

The profile of limited partnership interests meeting these requirements parallels that of corporate stock.[138] These requirements reconcile competing policies between the need for a limited liability investment vehicle and the need for some investor supervision over their investment. Although all-encompassing rules may not be possible nor desirable, these requirements indicate that limited partnerships may be qualified for public sale on a case by case basis.

### *B. Exemptions From Qualification*

Although this comment is principally concerned with the qualification of limited partnerships for public sale, exemptions from qualification should not be overlooked.[139] A private placement exemption is available under the California securities law.[140] However, California's adoption of an exemption similar to Rule 242 under the Federal Securities Act of 1933[141] may facilitate the use of limited partnerships while still ensuring adequate investor protection.

California exempts from the qualification requirements offers of a bona fide limited partnership[142] to fewer than twenty-five

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[137] There are no substantive differences between limited partnership real estate syndicates and limited partnerships formed in accordance with the requirements of the Uniform Limited Partnership Act. The provisions required in the limited partnership certificate parallel those required under the Uniform Limited Partnership Act. *See id.* § 260.140.119.1 setting forth the provisions required to be included in a limited partnership real estate syndicate.

[138] *See* text accompanying notes 84-98 *supra.*

[139] The underlying purpose of the California Securities Law is investor protection. However, exemptions from the Securities Law regulation are made for certain classes of securities and securities transactions where such regulation is unnecessary in the public interest or for protection of investors. H. MARSH & R. VOLK, *supra* note 52, § 1.06[2], at 1-53.

[140] *See* text accompanying notes 142-47 *infra* detailing the requirements of the California private placement.

[141] 45 Fed. Reg. 6363 (1980)(to be codified in 17 C.F.R. § 230.242).

[142] The principle of *delectus personae* reflects a basic premise underlying partnership law. *See* note 60 *supra.* In addition *delectus personae* or mutual selection has been used as a characteristic distinguishing bona fide limited partnerships from non-bona fide limited partnerships. *See* Rivlin v. Levine, 195 Cal. App. 2d 13, 15 Cal. Rptr. 587 (2d Dist. 1961)(bona fide limited part-

persons, and sales to fewer than ten offerees.[143] Failure to meet the statutory and administrative private offering standards,[144] however, does not result in a presumption that a public offering is involved.[145] In this situation, a private offering is determined on a case by case basis.[146]

While this exemption offers the obvious advantage of reducing the time and expense involved in qualifying an issue of securities, it is not without drawbacks. The principal limitation is the amount of capital that can be raised within the twenty-five offerees, ten sales restriction under this exemption.[147] This limitation deters the utility of the private offering exemption.

California's adoption of an exemption similar to Rule 242[148]

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nership not formed as the element of mutual selection of those who would constitute the membership of the partnership was not present). *See also* Farnsworth v. Nevada-Cal Mgt. Ltd., 188 Cal. App. 2d 382, 10 Cal. Rptr. 531 (2d Dist. 1961); Solomont v. Polk Dev. Co., 245 Cal. App. 2d 488, 54 Cal. Rptr. 22 (2d Dist. 1966).

[143] CAL. CORP. CODE § 25102(f)(West Cum. Supp. 1980).

[144] Cal. Admin. Code, tit. 10, § 260.102.2 sets forth two requirements for the private offering exemption. First, offers must be made to less than 25 persons and sales made to less than 10 offerees. Second, the offerees must either have a pre-existing personal or business relationship with the offeror or have the capacity to protect themselves in the transaction because of their business or financial experience.

[145] *Id.* § 260.102.2. The Department of Corporations has promulgated guidelines for determining whether a transaction qualifies as a private offering California Department of Corporations, Guidelines For Determining When Securities Are Being Offered To The Public, Bull. No. 67-5 (1967). The factors to consider under these guidelines are: (1) number of offerees, (2) the relationship of the offerees to each other, (3) relationship between issuer and offerees, (4) size of offering, (5) manner of offering, (6) character of security offered. These guidelines are similar to jury instructions approved by the court in Edwards v. United States, 374 F.2d 24 (10th Cir. 1966) which considered factors determining whether an offering is public or private. *See* People v. Humphreys, 4 Cal. App. 3d 693, 84 Cal. Rptr. 496 (4th Dist. 1970)(applying these guidelines to the sale of demand notes, characterized as securities, in connection with a mobile home development plan).

[146] Cal. Admin. Code, tit. 10, § 260.102.2.

[147] *See* J. MOFSKY, *supra* note 6, at 25 noting that the limit on the number of offerees under the private offering exemption forces the promoter to raise a proportionately greater amount from each offeree than from a larger number of offerees he might approach if he was not attempting to utilize the exemption. For a general discussion of the limits of the private placement exemption, *see id.* at 19-30.

[148] The Rule 242, 45 Fed. Reg. 6368-6370 (1980) (to be codified in 17 C.F.R. § 230.242), exemption from the registration requirements under the Securities

under the Securities Act of 1933[149] would alleviate some limitations of the private offering exemption. The Rule 242 exemption is intended to provide issuers, particularly small issuers, an effective means of raising limited amounts of capital through unregistered public offerings consistent with the protection of investors.[150]

Under Rule 242 issuers can sell a maximum of two million dollars worth of securities per issue[151] to an unlimited number of accredited persons[152] and up to thirty-five non-accredited persons.[153] The concept of accredited persons introduced in Rule 242 encompasses banks, insurance companies, investment companies, and purchasers of more than $100,000 worth of securities.[154] When sales are made to accredited persons, these purchasers are assumed sufficiently sophisticated to ask for and

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Act of 1933 is in the form of an experiment. For an appropriate period of time after its adoption, the Securities and Exchange Commission will monitor the use of Rule 242 to determine its effectiveness. After this monitering period, the SEC will decide whether the Rule should be retained, and possible revisions to the provisions of the Rule. Securities and Exchange Commission Release No. 33-6180, 45 Fed. Reg. 6362 (1980) [hereinafter cited as SEC Release No. 33-6180].

[149] Rule 242 is enacted as an exemption under § 3(b) of the Securities Act of 1933, 15 U.S.C. § 77(b) (1976) which grants the Securities and Exchange Commission authority to add by rules and regulations classes of securities exempt from registration.

[150] SEC Release No. 33-6180, *supra* note 148.

[151] 45 Fed. Reg. 6362, 6369 (1980)(to be codified in 17 C.F.R. § 230.242(c)). The dollar limit on each issue is imposed by § 3(b) of the Securities Act of 1933. "[N]o issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds $2,000,000." 15 U.S.C. § 77c(b) (Supp. II 1979)(amending 15 U.S.C. § 77c(b) (1976)).

[152] 45 Fed. Reg. 6362, 6369 (1980)(to be codified in 17 C.F.R. § 230.242(e)(2)(iv)).

[153] *Id.* (to be codified in 17 C.F.R. § 230.242(e)(1)).

[154] *Id.* at 6368 (1980)(to be codified in 17 C.F.R. § 230.242(a)(1)). The concept of accredited purchasers is one of the key attractions of Rule 242. Prior to Rule 242, small issuers found exemptions under Rule 146 (private offerings) and Rule 240 (exemption permitting issuer with fewer than one hundred beneficial owners to sell $100,000 worth of securities in any 12 month period without registration) inadequate. The offeree sophistication and disclosure requirements of Rule 146 and the restrictions of Rule 240 made these exemptions unsuitable for small issuers. [1980 Current] FED. SEC. L. REP. (CCH) ¶ 82,426. The concept of accredited purchasers and the two million dollar limit alleviate these problems associated with Rules 146 and 240.

obtain information necessary to their investment decision.[155] Thus, the Rule does not specify the information which must be furnished to accredited persons.[156] When any sale of securities is made under Rule 242 to unaccredited persons, the issuer must provide information regarding its history, business, and the securities offered.[157]

Rule 242 could be modified to conform with the statutory scheme of the California securities law. Essential differences between the regulatory methods of the California securities law and the Securities Act of 1933[158] require that the California version of Rule 242 incorporate a merit standard.[159] To effectuate the California securities law policy, the fair, just and equitable standard[160] must be imposed on sales to unaccredited purchasers.[161]

Adoption of an exemption similar to Rule 242 as an alternative to the current private offering exemption offers advantages to both promoters of limited partnerships and potential limited partners. Such an exemption removes the limitations of the private offering exemption[162] allowing promoters greater flexibility

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[155] 45 Fed. Reg. 6362 (1980).

[156] Id. at 6369 (to be codified in 17 C.F.R. § 230.242(f)(1)).

[157] *Id.* (to be codified in 17 C.F.R. § 230.242(f)(1)). Part I of Form S-18 specifies which information must be disclosed. Such required information must not be misleading. If it is, further information clarifying the required information, in light of the circumstances under which it is furnished, must also be disclosed. *Id.* Upon a non-accredited purchaser's written request, the issuer must provide any additional information obtained by an accredited purchaser. *Id.*

[158] The Securities Act of 1933 only requires disclosure of information deemed material to an investment decision while the California securities law incorporates a merit standard. *See* notes 61-65 and accompanying text *supra.*

[159] To create uniformity between this exemption and California's present private offering exemption, the 35 unaccredited purchasers under Rule 242 can be modified to 10 unaccredited purchasers under the California version of Rule 242. *See* notes 141-42 and accompanying text *supra* detailing the California private placement exemption. The rule 242 limitation on the number of unaccredited purchasers derives from the number of purchasers permitted under the private offering provision of the Securities Act of 1933. *See* 17 C.F.R. § 230.146(g) (1979).

[160] *See* notes 64-65 and accompanying text *supra* discussing the fair, just and equitable merit standard.

[161] Accredited persons presumptively do not need the protections of the Securities Law. *See* text accompanying note 155 *supra.*

[162] *See* text accompanying note 147 *supra* regarding the limitations of the California private offering exemption.

in raising capital.[163] At the same time, the investor protection policy is not diluted.[164] Imposition of the merit standard on sales to unaccredited purchasers ensures that limited partnership interests and other securities sold under this exemption meet the merit requirements of the California securities law. Beyond the merit requirement, accredited purchasers occupy a bargaining position vis-a-vis the promoter that they would be able to obtain any relevant information desired regarding the investment.

## CONCLUSION

The public sale of limited partnership interests involves possible abuse of this investment vehicle. California courts have used both the *Howey* and risk capital tests in determining the existence of a security. Although both tests have been used, limited partnership interests are likely to be considered securities under either test. In light of the California securities law's underlying investor protection policy, the lack of management rights and limits on the transferability of limited partnership interests suggest the need to restrict qualification of these interests for public sale.

It is necessary to balance competing interests of the promoter in raising capital through limited partnerships and protecting limited partner investors. An absolute prohibition on the qualification for public sale of limited partnership interests would discourage promoters from utilizing the limited partnership form of business organization. Thus, limited partnerships providing adequate investor management rights without unduly limiting transferability of interests should be qualified for public sale under the California securities law. Additionally, limited partnership interests may be sold on a quasi-public basis under the current private offering exemption, or a new limited offering exemption. Public sales under these circumstances ensure investor protection while permitting utilization of the limited partnership

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[163] This is one of the major purposes in promulgating Rule 242. *See* text accompanying note 150 *supra*. Rule 242 is designed to address problems small businesses encounter in existing exemptions, and to facilitate small business capital formation in a manner consistent with investor protection. [1980 Current] FED. SEC. L. REP. (CCH) ¶ 82,426.

[164] *Id.*

form of business organization.

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