OPINION
68-324

November 15, 1968 (OPINION)

Mr. Donald R. Holloway

Securities Commissioner

RE: Securities - Limited Partnership Interest - Subject to Act

You recently requested an opinion from this office as to whether the sale or offer for sale of a limited partnership interest constitutes a sale or offer for sale of a "security" as that term is used in Chapter 10-04 of the North Dakota Century Code, more commonly referred to as the North Dakota Securities Act of 1951, as amended, hereinafter called the Securities Act. More particularly, you ask whether the sale of such an interest under the following circumstances comes within the regulatory provisions of the Securities Act. A real estate broker, after locating farmland for sale, locates from three to fifteen investors and suggests that they form an association to purchase the property; the broker becomes the general partner in the newly formed association and each investor becomes a limited partner; each partner contributes an equal amount of money, the total of which is the amount necessary to purchase the land; the land is then purchased by the partnership and each limited partner assigns to the general partner full power to operate, manage, sell, lease or assign the property; the general partner, in managing the enterprise, may distribute profits and earnings to the limited partners, and each limited partner may be assessed in equal amounts for losses suffered by the partnership.

A "Security" is defined by Section 10-04-02(12) of the Securities Act as follows:

> "'Security' shall mean any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation, certificate of interest in oil, gas, or other mineral rights, collateral trust certificates, pre-organization certificates or subscription, transferable share, investment contract, voting trust certificate, or beneficial interest in title to property, profits or earnings, or any other instrument commonly known as a security, including any guarantee of, temporary or interim certificate of interest or participation in, or warrant or right to subscribe to, convert into or purchase, any of the foregoing."

Although the above quoted definition does not specifically include limited partnership interests, the language of the Act is broad enough to include any instrument that has the attributes of a security and is the proper subject of regulation. An interest can properly be classified as a security if it, in substance, is either the same as one or more of the securities enumerated in the above quoted definition or "any other instrument commonly known as a security".

The North Dakota Supreme Court has not dealt with the question of

whether the sale of a limited partnership interest constitutes the sale of a security. In State v. Davis, 131 N.W.2d. 730 (N.D. 1964), however, in discussing the statute in question, the Court stated at page 732: "In defining the word 'security', the legislature intended to include all transactions which were the legitimate subject of its regulation and this section should not be construed narrowly". This liberal construction of acts regulating the sale of securities has been adopted by most jurisdictions. See Securities Exchange Commission v. C. M. Joiner Leasing Corporation, 320 U.S. 344, 64 S.Ct. 120, 88 L.Ed. 88 (1943); State v. Simons, 193 Ore. 274, 238 P. 2d. 247 (1951); Anno: 163 ALR 1050.

In construing statutes defining the term "security", most of which acts are quite similar to the definition contained in the North Dakota Securities Act, the courts will look through form to substance to determine the nature of the interest, and may find that a security is involved despite the lack of an express and literal application of the statute, if the scheme is of the type contemplated by the legislature or by Congress. All of the circumstances of the transaction must be considered to determine the true nature of the interest being sold. The Supreme Court stated in the Joiner case at page 123:

> "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 (124) 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 are widely offered or dealt in under terms or courses of dealing which establish their character in commerce as 'investment contracts', or as 'any interest or instrument commonly known as a 'security'."

The commonly accepted test for determining if a particular instrument is a security is whether or not the plan or scheme involves an investment of money in a common enterprise whereby the investor expects profits or earnings to result solely from the efforts of others. Securities Exchange Commission v. W. J. Howey Co., 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946); Conroy v. Schultz, 80 N.J. Super 443, 194 A. 2d. 20 (1963). In other words, whenever an investor relinquishes control over his funds and submits their control to another for the purpose and hopeful expectation of deriving profits therefrom, he is in fact investing his funds in a security.

Two recent cases in other jurisdictions have dealt with limited partnership interests and both held that the transaction involved a security. In Reiter v. Greenberg, 21 N.Y. 2d. 388, 235 N.E.2d. 118 (1968), a limited partnership was formed for the purpose of purchasing real property and deriving a profit therefrom solely through the managerial efforts of the general partner. The Court in that case rejected a contention that the transaction involved a sale of realty instead of personalty and was therefore not a security. Two separate transactions were found to be involved. One was the organization of the syndicate itself and the obtaining of investors, and the other was the purchase of the land by the partnership. The

investors did not acquire a title to real estate, but instead received a right to share in the profits of the enterprise, an interest which was personalty and a security. (In regard to this question of what the true nature of the interest is that has been obtained by the limited partner, the Howey case, cited above, discounts the importance of whether realty instead of personalty is involved by holding that even if the investor did receive an interest in real property, the transaction could properly be construed as a security. As the Court stated at Page 1103 of that opinion, it is "* * * immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interest in the physical assets employed in the enterprise.")

In Curtis v. Johnson, 92 Ill. App. 2d. 141, 234 N.E.2d. 566 (1968), in discussing the limited partnership it was dealing with, the Court stated at page 572:

> "Generally speaking, the rights of the limited partner are confined to the right to have full information, a share of the income and to have the same rights as a general partner in reference to dissolution and winding up by a decree of court. Under the plan here set forth, the general partner would have the management of the business and be responsible for the (573) making of profits for distribution. We do not think that certain formal controls such as those possessed by limited partners prevent the enterprise from being one in which the investor expects to receive his profits solely from the efforts of others."

In regard to your first question of whether or not the limited partnership interest you ask about is a security, it appears that, on the basis of a broad interpretation of the Securities Act and the weight of authority, the answer is "yes".

Also, it seems clear that the transaction wherein an investor becomes a limited partner involves a "sale" or "offer for sale" of a security which comes within the regulatory provisions of the Securities Act. Section 10-04-02(7) of the Securities Act provides as follows: "'Sale' or 'sell' shall mean every sale or other disposition of a security or interest in a security for value, and every contract to make any such sale or disposition." The formation of the partnership clearly involves a "sale" within the meaning of this statute. The contention that the acquisition by the investor of a limited partnership interest herein involved arises from joining a common or joint venture should be considered untenable. In construing the Act liberally, the acquisition is properly considered to have been accomplished by accepting an "offer of sale" from the general partner. See in this connection, Curtis v. Johnson, supra.

Thus, the sale of limited partnership interests from or within the State of North Dakota is subject to the various provisions of the North Dakota Securities Act.

In answer to your second question, as to whether our answer would be otherwise if some other association were formed but the substance remained the same, we rely on the reasoning above and it matters not whether the association is a limited partnership. The substance of

the entire scheme clearly makes it a security, regardless of the form used.

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Attorney General