

DEVELOPMENTS IN SECURITIES LAWS

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DEVELOPMENTS IN SECURITIES LAWS*

I. INTRODUCTION

As businesses increasingly embrace partnerships, limited partnerships, and limited liability companies ("*LLCs*") as the business organizations of choice, an entity's principals, as well as its investors, must be aware of the securities law issues affecting such pass-through entities. It is not uncommon for these entities to be organized with scant, if any, attention being paid to the securities laws. However, particularly if the deal does not meet the expectations of the investors, the principals, and sometimes their advisors, could be charged with a number of securities law violations, including those arising under the Securities Act of 1933, as amended¹ (the "*1933 Act*"), the Securities Exchange Act of 1934, as amended² (the "*1934 Act*"), and the securities or "blue sky" laws of one or more states.

Therefore, both before and after organizing a business venture as a partnership or limited liability company, it is critical that a thoughtful analysis of the applicability of the securities laws be made and the entity structured and its interests sold to avoid violations of any applicable securities laws. The balance of this outline addresses common securities law issues found in the offer and sale of interests in general partnerships, limited partnerships, and limited liability companies.

II. IS THE INTEREST A SECURITY?

A. General Background. Federal and state securities laws apply only if the partnership or limited liability company interest constitutes a "security" for purposes of the relevant statute, and thus any analysis of securities law compliance begins with the question: Is the partnership/limited liability company interest a security? Generally, "security" is similarly defined in the 1933 Act, the 1934 Act, and state "blue sky" statutes.³ The 1933 Act definition of "security" is as follows:

[A]ny note, stock, treasury stock, security future, 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, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option or privilege entered into on a national securities exchange relating to

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foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.⁴

While some blue sky statutes directly or indirectly define "securities" to include limited partnership and limited liability company interests⁵, the 1933 Act and 1934 Act definitions do not expressly specify whether such interests are indeed "securities." Case law analysis of this issue generally focuses on whether the partnership and limited liability company interests are "investment contracts".⁶

The phrase "investment contract" has been interpreted to be somewhat of a "catch-all" category that extends the protections of securities laws to investments that may not literally fall within the other categories of investments that are included in the definition of "security."⁷ In determining whether any investment is an investment contract included within the definition of "security," *SEC v. W. J. Howey & Co.*⁸ remains the seminal case. Under *Howey*, the following questions must be answered in the affirmative for an investment to be an investment contract:

- Is there an investment of money?
- Is the investment in a common enterprise?⁹
- Does the investor have an expectation of profits to come from the efforts of others?

This final factor concerning profits coming from the efforts of others was originally articulated as requiring the profits to come *solely* from the efforts of others. However, the "solely" requirement has been significantly weakened since *Howey* was decided and courts now focus more on whether the "essential managerial efforts" are performed by others.¹⁰

Interests in general partnerships, limited partnerships, and limited liability companies, as well as capital calls made by such entities, will now be analyzed against this general background.

B. General Partnership Interests.

A general partnership interest will generally satisfy the first two tests of *Howey* described above (investment of money in a common enterprise). However, in a traditional general partnership, each general partner has management authority and therefore cannot claim reliance on

the efforts of others for profits. Since the third prong of *Howey* is not met, there is no security.¹¹

If a general partnership is structured, either legally or practically, to alter the traditional management rights of a general partner or to make a general partner dependent on the promoter or manager for the effective exercise of partnership powers, a security may exist because the partner will be relying on the efforts of others for any profits.¹² The leading Fifth Circuit case in this area is *Williamson v Tucker*.¹³ That case set forth three different criteria that could indicate that a general partner was so dependent on the efforts of others that the general partnership interest was in fact a security. Each of those criteria is discussed below.¹⁴

1. *The Agreement Strips General Partner's Powers.* The court in *Williamson v. Tucker* opined that a general partnership interest is a security if the relevant partnership agreement deprives the general partner of the powers of management normally enjoyed by a general partner to the extent that the general partner has "so little power ... that the arrangement in fact distributes power as would a limited partnership"¹⁵

The focus is on whether the partnership agreement itself limits management rights. Thus, the existence of traditional management rights, even though not exercised, may preclude the finding of a security.¹⁶

If a general partner has the right to replace the managing partner or manager, that general partner may possess sufficient management authority to defeat a finding that the interest is a security.¹⁷

At least one court has concluded that the inquiry required with respect to general partnership interests should be limited to this criteria. If the legal powers of the general partners have not been altered by the partnership agreement, there can be no security.¹⁸ Another court has concluded that a general partner can, under no circumstances, delegate enough power away to cause the general partnership interest to be a security.¹⁹

The number of general partners may have some bearing on whether this test is met and the interests found to be securities, with a greater number of partners being more indicative of a security.²⁰

2. *Partner is Incapable of Intelligently Exercising Power.* According to the court in *Williamson v. Tucker*, if a general partner is "so inexperienced and unknowledgeable in business affairs that he is

incapable of intelligently exercising his partnership ... powers ...", the general partnership interest may be a security.²¹

Inexperience and a lack of sophistication on the part of the partner may give rise to a conclusion that this test is met.²² The difficulty with this test is that it seems to focus on each individual investor, requiring a partner-by-partner evaluation. Therefore, the general partnership interests could be found to be securities as to some partners but not as to others.²³ An additional difficulty is that it is unclear whether general experience and knowledge is sufficient or whether it should be industry specific.²⁴

3. *There Is No Meaningful Alternative for Different Management.* In *Williamson v. Tucker*, the court found that a general partnership interest could be found to be a security if the partner is "so dependent on some unique entrepreneurial or managerial ability of the promoter or manager" that there is no meaningful alternative for different management.²⁵

This inquiry involves an analysis of whether the promoter/manager has special expertise. There is some question as to whether the promoter/manager must actually have the expertise or whether it is sufficient that the promoter/manager tells the investor that it possesses such special expertise.²⁶

C. Limited Partnership Interests.

When analyzing a limited partnership interest under the *Howey* tests, the first two tests of *Howey* described above (investment in a common enterprise) will generally be satisfied. Furthermore, in a traditional limited partnership, the third test of expectation of profits from the efforts of others is almost always met. This is true because limited partners, in order to maintain their limited liability, have traditionally had no management authority. It is not surprising, therefore, to find that limited partnership interests are almost always found to be securities.²⁷

One legal commentator, focusing in large part on the "solely from the efforts of others" test of *Howey*, argues that if a limited partner takes a more active role in partnership affairs, as is permitted by the more modern limited partnership statutes (including the Texas Revised Limited Partnership Act), it is possible that a limited partnership interest would not be classified as a security.²⁸

Assuming that courts are receptive to an argument that not all limited partnership interests should automatically be classified as securities, the analysis applied to limited partnership interests in the future

should probably be very similar to that discussed above with respect to general partnership interests.

It is important to remember, however, that, as discussed above, many statutes (including, since the 1993 legislative session, the Texas Securities Act) specifically include limited partnership interests within the definition of "security."²⁹ If courts interpreting state blue sky laws were to find guidance in the Supreme Court's holding in *Landreth Timber Co. v. Landreth*,³⁰ it may be that the express inclusion of a limited partnership interest in the statutory definition of the term "security" prevents any further inquiry or analysis, although the holding in *Reves v. Ernst & Young*³¹ may keep the door open for an argument that additional inquiry and analysis is appropriate.

D. Limited Liability Company Interests.

Similar to the *Howey* analysis of general and limited partnership interests, an analysis of limited liability company interests will generally satisfy the first two prongs of the *Howey* test requiring a financial investment in a common pool. However, given the hybrid nature of the limited liability company interest,³² whether or not a limited liability company satisfies the third prong of the *Howey* test (expectation of profits from efforts of others) is a case-specific question, and the courts have looked both to the organizational and operational documents and practical economic realities of the limited liability company in question.³³

Generally, recent cases have indicated the willingness of the federal courts to treat interests in limited liability companies that are member-managed as less likely to constitute securities,³⁴ and interests in limited liability companies that are manager-managed as more likely to be securities.³⁵ A few courts have recently looked beyond the four corners of the operating agreement to determine whether members have management responsibility or are simply passive investors, despite the fact that members may be afforded management rights under the terms of the agreement or, in the absence of agreement, under state law.³⁶

In addition to actual management and economic arrangements of the LLC, the size of the offering may play a part in the analysis of the LLC interests as securities. The Securities and Exchange Commission ("SEC") has had success in initiating enforcement actions against unregistered limited liability company interests that have been marketed to large numbers of investors, asserting that such interests are investment contracts.³⁷

The legal debate on the question of whether LLC interests are securities is not left to the courtroom. Recent articles from legal commentators further illustrate the diversity of opinion in this area, with

some legal scholars arguing that LLC interests should not be securities, others advocating a presumptive rule that LLCs are securities, and still others arguing for a middle ground, with interests in LLCs analyzed on a case-by-case basis.³⁸

III. SO WHAT IF IT'S A SECURITY?

A number of implications flow from a determination that the interests being offered are securities. The principal implication is that the offer and sale of interests must either be registered under the 1933 Act and applicable state securities laws or an exemption must be found from such registration.

A. Securities Registration Issues.

A precise description of the registration process is beyond the scope of this outline. However, it is worth noting that registration is *extremely* expensive and time-consuming, and that in addition to federal registration, registration may also be required under state securities laws, with separate filings, fees, and sometimes review standards.

The National Securities Markets Improvements Act of 1996³⁹ ("*NSMIA*") was an attempt by Congress to clean up the muddied waters of federal and state securities registration requirements and exemptions therefrom. Indeed, it provided welcome relief from state registration of certain covered securities and related transactions in such securities, including those securities that are nationally traded and securities of registered investment companies. NSMIA also clarified, in certain instances, the state registration requirements for partnership and limited liability company securities (assuming they were neither nationally traded nor registered investment company securities), providing, for example, that securities offerings relying on Rule 506 of Regulation D promulgated under the 1933 Act were not required to be registered under state securities laws.⁴⁰ The interplay between the federal securities registration exemptions and state registration requirements can be complex, and it is generally good practice to consult securities counsel before offering or selling partnership or limited liability company interests in order to ensure the proper federal and state securities compliance.

B. Regulation D Exemption from Securities Registration.

1. *General.* It is not surprising to find that an issuer would prefer not to register the interests it is offering for sale if they are determined to be securities. Therefore, deals are frequently structured to fall within an exemption from registration. Perhaps the most frequently used federal exemptions involve a "private placement" under Section 4(2) of the 1933 Act or an exemption under Regulation D.⁴¹ Other exemptions may be available, depending on

the particular facts of the situation, including exemptions available for "intrastate offerings" under Section 3(a)(11) of the 1933 Act and Regulation A offerings (which may not exceed \$5,000,000 and require certain filings and disclosures, although not as burdensome as those required for registration). This outline will focus only on Regulation D.

Section 4(2) of the 1933 Act is the statutory exemption for sales "not involving any public offering." The case law under that section was frequently inconsistent and gave little certainty or comfort to people attempting to rely on its provisions. In an effort to provide more certainty and comfort, the SEC adopted Regulation D in 1982 as a "safe harbor." Regulation D consists of eight separate rules, numbered 501 through 508.⁴² A detailed discussion of Regulation D is beyond the scope of this outline. However, a summary of certain of the more significant provisions of Regulation D is set forth below.

2. Size of the Offering. Three of the rules found in Regulation D specify the specific requirements for the three different size offerings addressed by the rule: those not exceeding \$1,000,000 (Rule 504); those not exceeding \$5,000,000 (Rule 505); and all others, without regard to dollar amount (Rule 506).

The requirements for offerings of smaller dollar amounts are less onerous than the requirements of the larger offerings. In fact, for Rule 504 offerings, Regulation D imposes no limit on the number of purchasers, no requirements as to the information to be furnished, no restrictions on the manner in which the offering is made, and no resale restrictions, if the offering complies with or is subject to certain exemptions from the registration requirements of state securities laws.⁴³ In addition, as discussed above, securities offerings relying on Rule 506 are not required to be registered with any state.⁴⁴

3. Limitation on Number of Purchasers. For offerings over \$1,000,000, there may be no more than 35 non-accredited investors but there may be an *unlimited* number of accredited investors.⁴⁵ All investors are non-accredited unless they fit within one of the eight categories of "accredited investors" defined in Rule 501(a).
4. Limitation of Manner of Offering. For offerings over \$1,000,000, there may be no general solicitation or general advertising.⁴⁶ The terms "general solicitation" and "general advertising" are terms of art and are frequently the source of confusion and unintentional violations of Regulation D. For instance, an offer may not be

directed to people with whom the person directing the offer does not have a pre-existing relationship of some sort.

The types of relationships with offerees that may be important in establishing that a general solicitation has not taken place are those that would enable the issuer (or a person acting on its behalf) to be aware of the financial circumstances or sophistication of the persons with whom the relationship exists or that otherwise are of some substance and duration.⁴⁷

Note that it makes no difference that the offeree is an accredited investor because it is the nature of the offer--not the offeree--that is the focus of this requirement.⁴⁸

5. Resale Restrictions. For offerings over \$1,000,000, the issuer is required to exercise "reasonable care" to prevent resales of the securities unless registered or exempt.⁴⁹ Specific steps that an issuer may take to meet this "reasonable care" standard are set forth in Rule 502(d), although those steps are not the exclusive means of satisfying the requirement. Rule 502(b)(2)(vii) also contains an express requirement that the resale restrictions be furnished in written form to all unaccredited investors in Rule 505 or 506 offerings. The form of Subscription Agreement attached to this outline as Exhibit A contains language intended to address these requirements. If a Subscription Agreement is not used, it would be prudent to include representations similar to those found in the Subscription Agreement in the partnership agreement or governing agreement of the limited liability company. Also, a legend appearing at the beginning of the partnership agreement or governing agreement of the limited liability company that indicates that the securities are not registered under the federal or state securities laws and may not be freely offered or sold except in compliance with such laws may be used to help assure the provisions of Regulation D relating to restrictions on resale are met.
6. Opportunity to Ask Questions. Rule 502(b)(2)(v) requires an issuer relying on Rule 505 or 506 to make available to each purchaser an opportunity to question the issuer about the offering. The form of Subscription Agreement attached to this outline as Exhibit A contains language in which the purchaser represents it had such an opportunity. If a Subscription Agreement is not used, consider including similar language in the partnership or LLC agreement.
7. Information Requirements. The type of information expressly required to be furnished by Regulation D depends in part on the size of the offering and in part on the nature of the issuer. No

specific information is required under federal law for Rule 504 offerings or for offerings made to any accredited investor, even if made under Rule 505 or 506. For offerings made under Rule 505 or 506 to non-accredited investors, Rule 502(b)(2) specifies the required information. If the issuer is not currently subject to the reporting requirements of the 1934 Act,⁵⁰ it is subject to different information requirements than issuers that are subject to those reporting requirements. Furthermore, the type of information required of such non-reporting issuers varies with the dollar amount of the offering.

In very general terms, the information required by Rule 502(b)(2) is described in terms of "the same kind of information as would be required in" a specified registration statement or other SEC-promulgated form. As a result of this cross-reference, exhibits to the specified form are picked up, although Rule 502(b)(2)(iii) expressly permits the issuer not to furnish those exhibits to each purchaser to whom information is required to be furnished "if the contents of material exhibits are identified and such exhibits are made available to a purchaser, upon his written request, a reasonable time prior to his purchase."

8. *Anti-fraud Considerations.* It is *critical* to understand that the anti-fraud requirements of the 1933 and 1934 Acts apply to every sale of a security, even those that are exempt from registration. Therefore, even if there are no specific information delivery requirements, as is the case with respect to accredited investors under Regulation D, the purchaser may be able to successfully assert an anti-fraud claim if the issuer fails to furnish the purchaser with all information material to the investment or makes a material misstatement in its offering materials. It is for this reason that one frequently sees some sort of disclosure memorandum being given even to accredited investors in an exempt offering. Obviously, the most conservative and safest approach to avoiding a successful claim of fraud is to furnish the same information that is required by the form of registration statement that would be used if the offering were registered. However, there is no absolute requirement that the disclosure conform to the specific requirements of any registration statement or other form because the issuer is merely trying to provide the *material* information in order to meet the anti-fraud standard. Frequently, the disclosure may consist of an executive summary, some financial information or projections, other deal specific information, including the partnership agreement or governing agreement of the limited liability company, and risk factors. The type of disclosure may vary with the sophistication of the investors, with large institutional investors receiving less information than less sophisticated investors.

One warning is in order. If an issuer furnishes any "material written information concerning the offering" to an accredited investor in a Regulation D offering made under Rule 505 or 506, which is frequently done to satisfy anti-fraud concerns, the issuer is required to inform all non-accredited investors of the nature of such information and furnish such information to the non-accredited purchasers to the extent requested.⁵¹ Therefore, it is important to review all information given to accredited investors with an eye to the fact that it may end up in the hands of a non-accredited investor. This could be particularly troublesome if, for instance, projections are prepared for an accredited investor who has a great deal of sophistication in reviewing and analyzing projections. In preparing projections for such an audience, the issuer may not be as careful to explain the assumptions and include the caveats that would normally be made if the projections were intended for a less sophisticated audience.

9. *Capital Calls.* It is not unusual to see a partnership or LLC agreement contemplate future capital calls. If the interest on which the call is being made is a security, these calls may themselves involve the separate sale of a security. The securities laws focus on protecting investors each time an investment decision is made. Accordingly, optional capital calls on partnership or LLC interests that are securities are likely to be found to be a security because the partner or member must decide whether to pay the call or not. Mandatory capital calls that are agreed to at the time the original investment is made do not appear to involve any new investment decision and so should not be found to be new securities.⁵² However, one line of judicial reasoning has held that if the partners have the right to terminate the partnership or to take other action that would eliminate the need to make a capital call, they are, in fact, making a new investment decision when they make a mandatory call.⁵³
10. *Integration.* Whenever analyzing a particular offering to determine if it is exempt from registration, it is important to remember that the particular offering could be "integrated" with one or more other offerings. If that happens, the entire integrated offering must meet the requirements for exemption. This concept of integration is applicable to all exemptions, not just Regulation D.

Whether two offerings will be integrated is a question of fact and sometimes difficult to predict.⁵⁴

In addition, recognizing the uncertainties associated with integration, the SEC provided a safe harbor from integration of

Regulation D offerings made by an issuer. Rule 502(a) specifies that:

Offers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering, so long as during those six month periods there are not offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Regulation D, other than those offers or sales of securities under an employee benefit plan as defined in Rule 405 under the Act [citation omitted].

If an issuer makes two or more offerings under Regulation D (or Regulation D and some other exemption) and is unable to take advantage of this safe harbor, it may have to otherwise show that the offerings should not be integrated. The factors relied on by the SEC in determining whether offerings should be integrated are set forth in Rule 502(a) and are as follows:

- Whether the sales are part of a single plan of financing;
- Whether the sales involve issuance of the same class of securities;
- Whether the sales have been made at or about the same time;
- Whether the same type of consideration is received; and
- Whether the sales are made for the same general purpose.

In the partnership and LLC context, certain troublesome issues arise when trying to determine whether an offering should be integrated with another. For instance, in *SEC v. Murphy*,⁵⁵ it was held that the sponsor of the limited partnership--and not the partnership itself--was the issuer for purposes of conducting the integration analysis. Therefore, the fact that separate partnerships were offering securities did not prevent the offerings from being integrated.⁵⁶ This case served as the basis for at least one state integrating all offerings made by a number of different limited partnerships because the same general partner was involved.⁵⁷

- C. Broker Dealer Compliance. A broker is defined in Section 3(a)(4) of the 1934 Act as "any person engaged in the business of effecting transactions in securities for the account of others" Before selling securities,

brokers must either be registered as brokers under the 1934 Act or be exempt from such registration.⁵⁸ Similar broker-dealer registration requirements exist under state law.⁵⁹

An issuer is not itself a broker because it acts for its own account.⁶⁰ However, the employees and agents of an issuer who are involved in the selling efforts could be found to be brokers.⁶¹ The SEC has adopted a rule that would provide a safe harbor for these people.⁶²

D. Other Requirements. In addition to registration requirements, additional regulatory issues may apply, particularly if the partnership or LLC is structured as an investment fund or other hedge fund that invests in publicly traded securities. While a complete overview of all regulatory issues is beyond the scope of this outline, a brief discussion of certain issues is provided below.

1. Rule 144.

The 1933 Act imposes limitations on the resale of restricted stock and of all stock held by affiliates. Each person who directly or indirectly controls the issuer is an affiliate. This is generally thought to include each executive officer, director, and persons who own more than ten percent of an issuer's stock. In addition, each person who is controlled by, or under common control with, the issuer is an affiliate. Rule 144 under the 1933 Act provides a safe harbor for certain resales of restricted stock and stock held by an affiliate.⁶³

Under Rule 144, non-affiliate persons who purchase stock in a private transaction from the issuer or an affiliate (called "restricted stock") may not sell the stock publicly for one year.⁶⁴ After the one-year holding period, the restricted stock may be sold in the open market, subject to certain volume and manner of sale limitations.⁶⁵ Generally, the amount that may be sold in any three-month period may not exceed the greater of (i) one percent of the outstanding stock or (ii) the average weekly trading volume (determined by averaging volume for the four weeks preceding the week in which the Form 144 is filed or, if the volume increases, an amended Form 144). The sales must be through brokers, who cannot solicit bids or otherwise engage in selling activity,⁶⁶ or in transactions directly with a market maker. The seller of the securities may not solicit or arrange for solicitation of orders to buy the securities or make any payments in connection with the sale other than to the executing broker.⁶⁷ Rule 144 also requires, prior to a sale, a filing on Form 144 indicating an intention to sell under the Rule.⁶⁸ After restricted stock has been held for two years, it may be sold publicly by non-affiliates without the Form

144 filing or complying with volume or manner of sale limitations.⁶⁹

Also under Rule 144, affiliates may sell non-restricted stock in the open market, subject to the filing, volume, and manner of sale limitations discussed above. The holding period requirements, however, are not applicable to affiliates who sell non-restricted stock.

It is common for partnerships and limited liability companies to convert into corporations before making public offerings. The SEC has provided guidance in recent no-action letters⁷⁰ that, unless certain conditions are met, the one-year holding period required by Rule 144(d) for stockholders who receive common stock in exchange for their partnership/LLC interests begins on the *date of the exchange*, rather than on the *earlier date on which the interests were acquired*. In order for the holding period to tack to the date on which the limited partner/LLC interests were issued, it is advisable to include in the partnership agreement or other governing document explicit language that contemplates the conversion into corporate form in advance of a public offering. In addition, partners or members should not retain any voting or veto power with respect to the conversion. Taking these steps will help to establish the fact that the partners or members have made their decision to acquire stock and have been at economic risk with respect to the stock at the time they acquired partnership or LLC interests.

2. 1940 Act.

The Investment Company Act of 1940⁷¹ (the "1940 Act") regulates "investment companies", as defined in the 1940 Act. A partnership or limited liability company that invests in securities may be deemed to fall within the ambit of the 1940 Act and thus would be subject to federal registration and regulation unless an exemption is applicable. Similar to the federal registration requirements under the 1933 Act, registration under the 1940 Act can be costly and time-consuming, and most issuers will endeavor to find an exemption. The two most commonly used exemptions are those found in Sections 3(c)(1) and 3(c)(7) of the 1940 Act. In general, the exemption found in Section 3(c)(1) requires that the partnership/limited liability company securities are beneficially owned by fewer than 100 persons. However, the rules for attributing beneficial ownership may in some cases require the issuer to "look-through" an entity, requiring the issuer to count it (the actual owner of the securities) as well as each of its beneficial owners. The exemption found in Section 3(c)(7) does not limit the

number of beneficial owners to whom an issuer may sell securities, so long as each beneficial owner is a type of sophisticated investor known as a "qualified purchaser". The financial investment requirements for qualified purchaser status are higher than those required of accredited investors under the 1933 Act.

3. USA PATRIOT Act of 2001.

In response to the events of September 11, Congress passed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "*Patriot Act*"). The Treasury Department recently published an update and regulations relating to the implementation of the Patriot Act with respect to the adoption of anti-money laundering programs by certain financial institutions.⁷² While a temporary exemption was given to private investment funds (including hedge funds and other private equity partnerships and LLCs) until October 24, 2002, it is likely that private investment companies will be required to establish anti-money laundering programs similar to those required of mutual funds. The regulations do not set forth how an anti-money laundering program should be structured or implemented, but rather place the responsibility on the funds to develop a program based on the business structure of each fund. The program must be in writing, should set forth the details of the program, including the responsibilities of individuals involved, and must be approved by the fund's governing body. The Treasury Department has indicated that additional regulations regarding remaining industry sectors (including investment companies) will be forthcoming.

IV. Conclusion.

Certainly, this outline is neither intended nor able to comprehensively guide an issuer through the maze of securities laws that may be involved in the offer and sale of partnership and limited liability company interests. It can be used, however, to help an issuer who is organizing a partnership or limited liability company to recognize that the offer of securities may be involved and to highlight some of the more troublesome issuers requiring the attention of an experienced securities practitioner. Ideally, it will help reduce the potential for claims of securities violations against both the readers and their clients if the deal fails to live up to the expectations of the investors.

¹ 15 U.S.C. § 77a-77aa (West 1997 and Cum. Supp. 2002).

² 15 U.S.C. § 78a-78jj (West 1997 and Cum. Supp. 2002).

³ 1933 Act §2(1); 1934 Act §3(a)(10); Uniform Securities Act § 401(j)(1956); Uniform Securities Act §101(18)(1985).

⁴ 1933 Act §2(1).

⁵ The Uniform Securities Act §101(18)(1985) expressly includes "limited partnership interests" in the definition of "security". Only about half a dozen states have adopted the 1985 Act. Many states have adopted the 1956 Act, which does not expressly include limited partnership interests in the "security" definition. See Alan R. Bromberg & Larry E. Ribstein, III BROMBERG AND RIBSTEIN ON PARTNERSHIP (1988 and Cum. Supp. 2002)(hereinafter, "*Bromberg and Ribstein*") §12.14 at 12:136. A 1996 survey of state laws, regulations, and securities administrators indicates that at least 35 states have either formally or informally indicated that LLC interests may be securities for purposes of state law. See Elaine A. Welle, *Limited Liability Company Interests As Securities: An Analysis of Federal and State Actions Against Limited Liability Companies Under the Securities Laws*, 73 DENV. L. REV. 425 (1996)(hereinafter, "*Welle*") at n. 19.

⁶ See, e.g., Siebel v. Scott, 725 F.2d 995, 999 (5th Cir.), cert. denied, 467 U.S. 1242 (1984) (limited partnership interests, "if they are securities at all, are best described as investment contracts."). See also Koch v. Hankins, 928 F.2d 1471, 1475 (9th Cir. 1991) (because general partnership interests "do not constitute any of the other types of securities protected by the [1933 and 1934] Acts, the critical threshold inquiry is whether the general partnerships [interests] constitute 'investment contracts' within the meaning of the Act"). See generally Everhard, *The Limited Partnership Interest: Is It A Security? Changing Times*, 17 DEL J. CORP. L. 441, 444 n.22 (1992)(hereinafter, "*Everhard*"); and Burke, Jr., *Limited Liability Companies and the Federal Securities Laws: Congress Should Amend the Securities Laws to Avoid Coverage*, 76 IND. L.J. 749, 752 (2001)(hereinafter, "*Burke, Jr.*")(...the relevant test for LLCs appears to be the *Howey* test for investment contracts...").

⁷ See SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946)(the term "investment contract" "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.").

⁸ 328 U.S. 293 (1946).

⁹ The precise focus of the "common enterprise" requirement is the subject of some dispute. Some courts focus on horizontal commonality, which requires a number of investors to be involved and pool their funds. Under such an approach, it is possible that a limited partnership with only one limited partner may not be a security under the 1933 Act. See, e.g., Salcer v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 682 F.2d 459 (3rd Cir. 1982); SEC v. Lauer, 52 F. 3d 667 (7th Cir. 1995); DeWit v. Firststart Corp., 904 F. Supp 1476 (N.D. Iowa 1995); United States v. Holtzclaw, 950 F. Supp. 1306 (S.D. W. Va. 1997). Other courts focus on vertical commonality, which requires the fortunes of the promoter and the investor(s) to rise and fall together. See, e.g., Long v. Acultz Cattle Co., 881 F.2d 129 (5th Cir. 1989); SEC v. Eurobond Exchange, Ltd., 13 F.3d 1334 (9th Cir. 1994). See Bloomenthal, Harold S., SECURITIES LAW HANDBOOK, VOL. I, § 2.01, 2002 ed. (hereinafter, "*Bloomenthal Handbook*") for a discussion of various cases that have addressed the common enterprise requirement. For purposes of this outline, it is assumed that both horizontal and vertical commonality are present when discussing any form of entity.

¹⁰ See, e.g., SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 (9th Cir.), cert. denied, 414 U.S. 821 (1973); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 483 (5th Cir. 1974); Williamson v. Tucker, 645 F.2d 404, 418 (5th Cir.), cert. denied, 454 U.S. 897 (1981). Cf. Georgia Securities Act of 1973 §10-5-2(26), BLUE SKY L. REP. (CCH) ¶18,102. Standards other than those enunciated in *Howey* are sometimes used in determining whether a particular investment is an investment contract, including whether risk capital is involved. See, e.g., Silver Hills Country Club v. Sobieski, 361 P.2d 906, 55 Cal. 2d 811, 13 Cal. Rptr. 186 (1961). See also Michigan Uniform Securities Act §451.801(1), BLUE SKY L. REP. (CCH) ¶32,131; Oklahoma Securities Act. §2(s)(16), BLUE SKY L. REP. (CCH) ¶46,102.

¹¹ See, e.g., *New York Stock Exchange, Inc. v. Sloan*, 394 F. Supp. 1303, 1314 (S.D.N.Y. 1975); *Hirsch v. DuPont*, 396 F. Supp. 1214, 1220 (S.D.N.Y. 1975), *aff'd*, 553 F.2d 750 (2nd Cir. 1977); *Wizard Parks, Inc.*, [1977-78 Decisions Transfer Binder] FED. SEC. L. REP. (CCH) ¶81, 402 (SEC no-action letter avail. Dec. 30, 1977); *Goodwin v. Elkins & Co.*, 730 F.2d 99, 103 (3rd Cir.), *cert. denied*, 469 U.S. 831 (1984); *Youmans v. Simon*, 791 F.2d 341, 346 (5th Cir. 1986); *Sparks v. Baxter*, 854 F.2d 110, 114 (5th Cir. 1988). *Cf.* *Brown v. Cole*, 291 S.W.2d 704, 709 (Tex. 1956) (Texas Securities Act doesn't apply to joint ventures). See generally *Schneider, The Elusive Definition of a "Security" - 1990 Update*, 24 SEC. & COMMODITIES REG. 13, 22 (1991) (hereinafter, "*Schneider*").

¹² See, e.g., *Pawgan v. Silverstein*, 265 F. Supp. 898 (S.D.N.Y. 1967); *Williamson v. Tucker*, 645 F.2d 404, 422-24 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981); *Koch v. Hankins*, 928 F.2d 1471, 1475-76 (9th Cir. 1991); *SEC v. Continental Wireless Cable Television, Inc.*, 1997 U.S. App. LEXIS 5899 (9th Cir. 1997); *K.B.R., Inc. v. L.A. Smoothie, Corp.*, 1996 U.S. Dist. LEXIS 4552, *13-14 (E.D. La. 1996) ("if the partner...lacks the business experience and expertise necessary to intelligently exercise partnership powers, or the partner...is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager...the partnership may be an investment contract"); *SEC v. Shreveport Wireless Cable Television Partnership*, 1998 U.S. Dist. LEXIS 23086 (D. D.C. 1998).

¹³ 645 F.2d 404 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981).

¹⁴ These three tests should not be viewed as the only tests by which reliance on others may be proved. See *Williamson v. Tucker*, 645 F.2d at 424, n.15; *Hocking v. Dubois*, 885 F.2d 1449, 1460 (9th Cir. 1989), *cert. denied*, 494 U.S. 1078 (1990).

¹⁵ 645 F.2d at 424.

¹⁶ See, e.g., *New York Stock Exchange, Inc. v. Sloan*, 394 F. Supp. 1303, 1314 (S.D.N.Y. 1975).

¹⁷ *Cf.* *Wizard Parks, Inc.*, [1977-78 Decisions Transfer Binder] FED. SEC. L. REP. (CCH) ¶81, 402 (SEC no-action letter avail. Dec. 30, 1977). *But see* *McConnell v. Frank Howard Allen & Co.*, 574 F. Supp. 781, 786 (N.D. Cal. 1983) (rights granted to general partners, including right to remove managers, no greater than rights usually granted to limited partners so general partners did not possess sufficient authority to preclude finding the general partner interests to be securities).

¹⁸ See *Matek v. Murat*, 862 F.2d 720, 729-30 (9th Cir. 1988) (which decision was, according to the court in *Koch v. Hankins*, 928 F.2d 1471, 1476 (9th Cir. 1991), replaced by the holding in *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989), *cert. denied*, 494 U.S. 1078 (1990)).

¹⁹ See *Goodwin v. Elkins & Co.*, 730 F.2d 99, 107 (3rd Cir. 1984) (because partnership agreement cannot thwart power of a general partner to bind the partnership as to third parties "[e]ven if the [partnership agreement] contained the most draconian restrictions on the rights of non-management partners ... such partners would still possess a quantum of powers and responsibilities which, as a matter of law, would preclude their interest from being considered a security under the [1934] Act."). This holding has been expressly rejected by some courts. See, e.g., *Matek v. Murat*, 862 F.2d at 727.

²⁰ See *Williamson v. Tucker*, 645 F.2d at 423 ("at some point there would be so many partners that a partnership vote would be more like a corporate vote, each partner's role having been diluted to the level of a single shareholder in a corporation."). *Contra* *Goodwin v. Elkins & Co.*, 730 F.2d at 107 n. 14 (indicating that a large number of general partners would not result in the finding of a security because "[g]eneral partners, no matter how many or few they may be, are still, as a group, legally responsible for the management of the firm.").

²¹ 645 F. 2d at 424.

²² See, e.g., *McConnell v. Frank Howard Allen & Co.*, 574 F. Supp. 781, 786 (N.D. Cal. 1983).

²³ Cf. *Siebel v. Scott*, 725 F.2d 995, 999 (5th Cir), *cert. denied*, 467 U.S. 1242 (1984) ("The characterization of an interest as a security or not can vary with the relationship of its holder to the venture.").

²⁴ Compare *Holden v. Hagopian*, 978 F.2d 1115, 1121 (9th Cir. 1992) ("The proper inquiry is whether the partners are inexperienced or unknowledgeable 'in business affairs' generally, not whether they are experienced and sophisticated in the particular industry or area in which the partnership engages and they have invested.") with *Deutsch Energy Co. v. Mazur*, 813 F.2d 1567, 1570 (9th Cir. 1987) ("it appears to be an open question whether sophistication in one field of business will always transfer to another field ..."). Cf. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 296 (1946) (the purchasers "are predominantly business and professional people who lack the knowledge, skill and equipment *necessary for the care and cultivation of citrus trees* [emphasis added].").

²⁵ 645 F.2d at 424. See, e.g., *Morrison v. Pelican Land Dev.*, [1982 Decisions Transfer Binder] FED. SEC. L. REP. (CCH) ¶98, 863 (N.D. Ill. 1982).

²⁶ See *Gordon v. Terry*, 684 F.2d. 736, 742 (11th Cir. 1982), *cert. denied*, 459 U.S. 1203 (1983) (if representations not made by promoter to induce reliance on entrepreneurial abilities or if representations don't involve claims of unique entrepreneurial abilities, the dependency required by *Williamson v. Tucker* not shown). Cf. *Williamson v. Tucker*, 645 F.2d at 423 ("investors may be induced to enter a real estate partnership on the *promise* that the partnership's manager has some unique understanding of the real estate market in the area in which the partnership is to invest ... [emphasis added].").

²⁷ See, e.g., *Goodman v. Epstein*, 582 F.2d 388, 408-09 (7th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979); *SEC v. Murphy*, 626 F.2d 633, 640-41 (9th Cir. 1980); *Stowell v. Ted S. Finkel Inv. Servs., Inc.*, 489 F. Supp. 1209, 1224 (S.D. Fla. 1980), *aff'd as to unrelated issue*, 641 F.2d 323 (5th Cir. 1981); *Siebel v. Scott*, 725 F.2d 995, 999 (5th Cir.), *cert. denied*, 467 U.S. 1242 (1984); *Lawrence v. Cohen*, 932 F. Supp. 564 (S.D.N.Y. 1996). See generally *Bromberg & Ribstein* §12.14; Long, *Partnership, Limited Partnership, and Joint Venture Interests as Securities*, 37 MO. L. REV. 581, 611 (1972); *Schneider* at 22. But see *Adickes v. Andreoli*, 600 S.W.2d 939, 945 (Tex. Civ. App. - Houston [1st Dist.] 1980, *writ dismissed*); *Frazier v. Manson*, 484 F. Supp. 449, 452 (N.D. Tex. 1980), *aff'd*, 651 F.2d 1078 (5th Cir. 1981) (co-general partner who is also a limited partner does not own a security).

²⁸ See *Everhard* at 482. See also *Bank of America Nat. Trust & Sav. Assoc. v. Hotel Rittenhouse Assocs.*, 595 F. Supp. 800 (E.D. Pa. 1984) (limited partnership agreement requiring approval of limited partner before general partners could encumber or transfer property of partnership, remove or appoint a property manager, or admit an additional general partner indicates interests are not securities).

²⁹ See note 5 *supra*; Texas Securities Act §4, BLUE SKY L. REP. (CCH) ¶55,104.

³⁰ 471 U.S. 681, 691-92 (1985).

³¹ 494 U.S. 56, 65 (1990).

³² A limited liability company generally provides the limited liability of a corporation but has the advantage of "pass-through" tax status of a partnership. In addition, LLC members are statutorily permitted more management responsibility than limited partners while still retaining limited liability status.

³³ While the *Howey* analysis is the legal theory of choice for the majority of courts that analyze whether LLC interests are securities, other theories have been applied or discussed, including the risk capital theory and the characteristics of stock theory. See *Welle*, *supra* note 5, at nn. 337-339 and nn. 420-421 for a discussion of case law and statutes defining the risk capital and characteristics of stock theory.

³⁴ See, e.g., *Nelson v. Stahl*, 173 F. Supp. 2d 153 (S.D.N.Y. 2001)(finding members had ultimate control over LLC affairs); *Great Lakes Chemical Corp. v. Monsanto Co. and Sweet Technologies, Inc.*, 96 F. Supp. 2d 376 (D. Del. 2000) (finding no common enterprise and no profit solely from others' efforts despite the use of the term "securities" in selling documents because member retained manager removal rights); *Tschetter v. Berven*, 621 N.W.2d 372 (S.D. 2001)(finding member management); *Keith v. Black Diamond Advisors, Inc.*, 48 F. Supp. 2d 326 (S.D.N.Y. 1999) (finding member management).

³⁵ See, e.g., *SEC v. Parkersburg Wireless LLC*, 991 F. Supp. 6, 8 (D. D.C. 1997); *SEC v. Shreveport Wireless Cable Television Partnership*, 1998 U.S. Dist. LEXIS 23086 (D. D.C. 1998); *Ak's Daks Communications, Inc. v. Maryland Sec. Div.*, 771 A.2d 487 (Md. App. 2001)(rejecting *Williamson* presumption that general partner interests are not securities as applied to LLC interests because members are less involved in management than general partners).

³⁶ See *Parkersburg*, 991 F. Supp. at 8 ("Regardless of the general treatment of LLCs under the applicable state law, the 'ultimate power' over [the LLC] rested not with the geographically dispersed, inexperienced, predominantly retired...investors, but with [management]. While the investors theoretically may have possessed a right to manage the affairs [of the LLC] under the terms of the Operating Agreement, the inexperience and geographic diversity of the 700-odd investors essentially precluded this from ever coming to pass."); *Nutek Info. Systems, Inc. v. Arizona Corp. Comm'n*, 977 P.2d 826 (Ariz. App. Div. 1 1998), 1998 Ariz. App. LEXIS 193 (despite member management in agreement, members had little or no practical input into economic decision); *Cogniplex, Inc. v. Hubbard Ross, L.L.C.*, 2001 U.S. Dist. LEXIS 11113 (N.D. Ill. 2001)(whether an LLC interest is a security under *Howey* "depends on the particular facts and circumstances of the particular investment arrangement").

³⁷ See, e.g., *Parkersburg*, 991 F. Supp. 6 (D. D.C. 1997); *SEC v. United Communications, Ltd.*, Civil Action No. 95-0400 (JR)(D.D.C.), Litig. Release No. 15,018 (Aug. 19, 1996), 1996 SEC LEXIS 2180; *SEC v. Future Vision Direct Marketing, Inc.* Civil Action No. 94-4806 (D.N.J.), Litig. Release No. 14,884 (April 19, 1996), 1996 SEC LEXIS 1166; *SEC v. Bloch*, Litig. Release No. 14511 (May 25, 1995), 1995 SEC LEXIS 1241.

³⁸ See, e.g., Larry E. Ribstein & Robert R. Keatinge, 1 RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES (1998 and Cum. Supp. 2001), §14.02 at 14-6 (LLC interests should be nonsecurities); Carol R. Goforth, *Why Limited Liability Company Membership Interests Should Not be Treated as Securities and Possible Steps to Encourage this Result*, 45 HASTINGS L.J. 1223 (1994)(concluding LLC interests should not be securities); Mark A. Sargent, *Are Limited Liability Company Interests Securities?*, 19 PEPP. L. REV. 1069 (1992) (same); *Burke, Jr.*, *supra* note 6 (same); Marc I. Steinberg and Karen L. Conway, *The Limited Liability Company as a Security*, 19 PEPP. L. REV. 1105 (1992)(concluding that LLC interests should generally be considered securities); *Welle*, *supra* note 5 (test for LLC interest as "security" should be on a case-by-case basis based on economic realities, not operational documents).

³⁹ 15 U.S.C. §78a *et. seq.* (West 1997).

⁴⁰ 1933 Act §18(b)(4)(D). Note, however, that the exemption does not prohibit a state from imposing notice filing requirements.

⁴¹ FED. SEC. L. REP. (CCH) ¶7341.

⁴² Technically, Rules 504 and 505 are promulgated under Section 3(b) of the 1933 Act, which permits the SEC to exempt, by regulation, certain offerings from registration, while Rule 506 is promulgated under Section 4(2) of the 1933 Act.

⁴³ See Rule 504(b)(1). See also NASAA Model Accredited Investor Exemption.

⁴⁴ See note 40 *supra*.

⁴⁵ Rule 505(b)(2)(ii) and Rule 506(b)(2)(i).

⁴⁶ Rule 505(b)(1) and Rule 506(b)(1), by referencing Rule 502(c).

⁴⁷ Mineral Lands Research & Marketing Corp., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2811 (Dec. 4, 1985).

⁴⁸ See SEC Release No. 33-6455, Question 60 (1983), FED. SEC. L. REP. (CCH) ¶2380.

⁴⁹ Rule 505(b)(1) and Rule 506(b)(1), by referencing Rule 502(d).

⁵⁰ An issuer generally becomes subject to the reporting requirements of the 1934 Act by virtue of (a) having a class of securities listed on a national securities exchange, (b) having a class of equity securities held of record by at least 500 persons and at least \$1 million of assets, or (c) having had a registration statement under the 1933 Act become effective during the fiscal year in question. See §§12(b), 12(g), and 15(d) of the 1934 Act.

⁵¹ Rule 502(b)(2)(iv).

⁵² Cf. *Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876 (2nd Cir. 1972); *Freschi v. Grand Coal Venture*, 551 F. Supp. 1220 (S.D.N.Y. 1982), FED. SEC. L. REP. (CCH) ¶98,819; *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646 (9th Cir. 1988).

⁵³ See *Goodman v. Epstein*, 582 F.2d 388 (7th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979). See also *Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808 (9th Cir. 1981)(absence of personal liability for assessment indicative of new investment decision); *Hill v. Der*, 521 F. Supp. 1370 (D. Del. 1981).

⁵⁴ The SEC has provided some general guidance with respect to integration in SEC Release No. 33-4434, FED. SEC. L. REP. (CCH) ¶2270 (Dec. 6, 1961) and SEC Release No. 33-4552, FED. SEC. L. REP. (CCH) ¶2770 (Nov. 6, 1962). See also *Integration of Partnership Offerings: A Proposal for Identifying a Discrete Offering*, 37 BUS. LAW. 1591 (1982); *Integration of Securities Offerings: Report of the Task Force on Integration*, 41 BUS. LAW 595 (1986); *Bromberg & Ribstein* §12.20.

⁵⁵ 626 F.2d 633, 643-44 (9th Cir. 1980).

⁵⁶ *But see* *Donohoe v. Consolidated Operating and Prod. Corp.*, 982 F.2d 1130, 1992 U.S. App. LEXIS 33675, at **29 (7th Cir. Ill. 1992)(affirming lower court opinion that a string of partnerships, each organized by the same general partner in connection with separate oil drilling operations, were not for the same general purpose because each partnership was designed to "stand or fall [economically] on its own merits").

⁵⁷ See Opinion Letters of the Oklahoma Securities Administrator (1981 and 1982), BLUE SKY L. REP. (CCH) ¶46,646.

⁵⁸ 1934 Act §15(a)(1).

⁵⁹ See, e.g., Texas Securities Act §12, BLUE SKY L. REP. (CCH) ¶55,112.

⁶⁰ See *The Woodmoor Corp.*, [1971-72 Decisions Transfer Binder] FED. SEC. L. REP. (CCH) ¶78,653 (SEC no-action letter avail. Feb. 3, 1972). Cf. *Choice Communities, Inc.*, [1972-73 Decisions Transfer Binder] FED. SEC. L. REP. (CCH) ¶79,203 (SEC no-action letter avail. Dec. 29, 1972).

⁶¹ Cf. *AFL-CIO Housing Investment Trust*, [1990-91 Decisions Transfer Binder] FED. SEC. L. REP. (CCH) ¶79,637 (SEC no-action letter avail. Aug. 27, 1990).

⁶² See Rule 3a4-1, FED. SEC. L. REP. (CCH) ¶21,152.

⁶³ See Rule 144.

⁶⁴ See Rule 144(d).

⁶⁵ See Rule 144(e) and 144(f).

⁶⁶ See Rule 144(g).

⁶⁷ See Rule 144(f).

⁶⁸ See Rule 144(h).

⁶⁹ See Rule 144(k).

⁷⁰ See Staff Leasing, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 910 (Oct. 1, 1997) (regarding tacking of limited partnership interests); The Petersen Cos., Inc., SEC No-Action Letter, 1998 SEC No-Act. LEXIS 892 (July 16, 1998) (regarding tacking of LLC interests); Cravath, Swaine & Moore, SEC No-Action Letter, 2000 SEC No-Act. LEXIS 141 (Feb. 11, 2000) (regarding tacking of LLC interests).

⁷¹ 15 U.S.C. §§80a-1, *et. seq.* (West 1997 and Cum. Supp. 2002).

⁷² A hyperlink to the Treasury Department's announcement can be found at <http://www.treas.gov/press/releases/po3034.htm>. A copy of the Regulation governing mutual funds is attached as Exhibit B.