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# Sale of Limited Partnership Interests: Rivlin v. Levine

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# NOTES

## SALE OF LIMITED PARTNERSHIP INTERESTS: *RIVLIN v. LEVINE*[1]

When is the sale of a purported limited partnership interest actually a sale of a security and therefore within the scope of the Corporate Securities Act?

A security, as defined in California Corporations Code section 25008, includes "any stock, including treasury stock; any certificate of interest or participation; any certificate of interest in a profit sharing agreement; . . . any transferable share, investment contract, or beneficial interest in title to property, profits, or earnings . . . ." The section purposely defines the word "security" broadly to protect the public against "spurious schemes, however ingeniously devised."[2] Thus, to effectuate the purpose of section 25008 the courts must examine the substance of any given transaction rather than its form.[3]

The broad scope of this definition is further extended by the interpretation of "company," as used in the Corporations Code, to include "all domestic and foreign corporations, associations, syndicates, joint stock companies, and partnerships of every kind."[4] The word "association," as used in this definition, has been defined as "a body of persons acting together without a charter, but upon methods and forms used by incorporated bodies, for the prosecution of some common enterprise."[5] It has even been held that the term "company," in addition to including partnerships, also includes an individual when he sells or negotiates for the sale of a security of his own issue.[6]

The broad and vague definitions found in the Corporations Code, coupled with "an unmistakable trend in the California decisions to interpret the Corporate Securities Act liberally and to sweep almost every conceivable sort of interest within the definition,"[7] have created many problems in attempts to enforce the Corporate Securities Act. One of the most troublesome within this vague area was the controlling issue in the present case, *Rivlin v. Levine*.[8] What is the differentiation between the sale of a limited partnership interest and the sale of a security?

Defendants Levine and the Laurelvale Construction Corporation had entered into an agreement for the purchase of land in Fresno county to be developed as a housing tract. Having neither funds to consummate the land purchase nor working capital to construct single family dwellings on the land, Levine

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[1] 195 Cal. App. 2d 13, 15 Cal. Rptr. 587 (1961).

[2] Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 814, 361 P.2d 906, 907 (1961).

[3] People v. Syde, 37 Cal. 2d 765, 235 P.2d 601 (1951); Farnsworth v. Nevada-Cal Management Ltd., 188 Cal. App. 2d 382, 10 Cal. Rptr. 531 (1961); People v. Woodson, 78 Cal. App. 2d 132, 177 P.2d 586 (1947).

[4] CAL. CORP. CODE § 25003.

[5] *In re* Lamb, 61 Cal. App. 321, 330, 215 Pac. 109, 113 (1923).

[6] People v. Woodson, 78 Cal. App. 2d 132, 136, 177 P.2d 586, 588 (1947).

[7] Dahlquist, *Regulation and Civil Liability Under the California Corporate Securities Act*, 33 CALIF. L. REV. 343, 357 (1947).

[8] 195 Cal. App. 2d 13, 15 Cal. Rptr. 587 (1961).

approached the plaintiff, Fred Rivlin of Rivlin Investment Ventures, with the proposal that Rivlin invest $22,000 in the venture, with other limited partners investing the remainder of the necessary $75,000. Subsequently, six other purported limited partners contributed $33,000 which, along with plaintiff's $22,000, was deposited in escrow.

A Certificate of Limited Partnership was executed and recorded, but only one of the signatures to it had been acknowledged in compliance with the provisions of the Corporations Code.[9] No statement of partnership was executed or recorded as required by the Code,[10] and the defendant corporation never executed a Limited Partnership Agreement. Rivlin's investment was lost when a first deed of trust on the property in question was foreclosed, and in an action against the seller of the property Levine and Laurelvale Construction sued on their own behalf without disclosing the purported limited partnership. They obtained a judgment for $59,500. Rivlin then brought the action of the principal case to recover the amount he had paid for the purported limited partnership interest, proceeding on the theory that the transaction was the sale of a security within the purview of the Corporate Securities Act; that a permit was necessary for the sale; and that the security thus issued was void, entitling him to restitution. The trial court gave judgment for the plaintiff, finding that "the preparation of and purported execution of the Limited Partnership Certificate was a subterfuge to evade the requirements of the Corporate Securities Law."[11]

The appellate court affirmed the decision, relying heavily on the criterion of partner selection as a means of distinguishing a limited partnership from a security.[12] It cited Dahlquist, *Regulation and Civil Liability Under the California Corporate Securities Act*,[13] who uses three tests to determine the existence of a security. The first test is that of investment with an expectation of profit. "The investor gives money into the hands of another with the expectation of profit."[14] But, on the other hand, so does a limited partner; i.e., he contributes cash or other property[15] although he cannot take part in the control of the business and still retain all his rights and immunities as a limited partner.[16] Nor can his contribution be merely services.[17]

Notwithstanding the similarity between the investment aspect of a limited partnership interest and that same aspect of a security, the case law overwhelmingly supports the contention that investment, as defined by Dahlquist, is a distinguishing characteristic of a security. An early decision, *People v. Oliver*,[18] laid down such a sweeping rule that it was questionable whether limited partnership interests still existed *except* as securities: "If the instrument of sale

[9] CAL. CORP. CODE § 15502.

[10] CAL. CORP. CODE § 15010.5.

[11] 195 Cal. App. 2d 13, 19, 15 Cal. Rptr. 587, 591 (1961).

[12] Citing Dahlquist, *supra* note 7, at 363: "[O]ne of the chief criteria for determining whether an interest in a partnership is a security under the Act is the element of selection of partners."

[13] Dahlquist, *supra*, note 7.

[14] *Id.* at 358.

[15] CAL. CORP. CODE § 15504.

[16] CAL. CORP. CODE § 15507.

[17] CAL. CORP. CODE § 15504.

[18] 102 Cal. App. 29, 282 Pac. 813 (1929).

creates a present right to a present or future participation in either the income, profits or assets of a business carried on for profit, it is a security as defined in the Corporate Securities Act."[19] Later cases have explored this definition and somewhat delineated it. *People v. Walther*[20] held that a certificate of interest in a profit sharing agreement was specifically designated a security in Corporations Code section 25008, while *People v. Woodson*[21] specifically singled out limited partnerships in holding that "certificates of interest in a profit sharing agreement, whereby a limited partner is to receive a percentage of the profits realized from a common venture are securities within the meaning of the Corporate Securities Act."[22]

The second factor distinguishing a sale of a security from the sale of other investment interests is the element of control. If the enterprise is to be conducted by persons other than the investor, then it is a security,[23] while the sale of an interest in an enterprise which is to be conducted by the investor himself cannot be, as to that party, considered the sale of a security.[24] "Where the investor actually participates in an enterprise from which he may receive a profit, the instrument is not a security within the Corporations Code, and neither the number of participants, nor possible fraud in its creation may transmute the instrument into a security."[25] This element of control is lacking in a limited partnership. Although a limited partner is not barred by his limited liability from having a voice in the management and disposition of the property,[26] nevertheless if he takes part in the control of the partnership business he may become liable as a general partner.[27] The degree of participation necessary to take the arrangement from the purview of the Corporate Securities Act is high. Unless the partner's active participation is necessary for the operation, the sale of the interest is not removed from the purview of the Act, and if the association could operate just as well without the services of the purchaser of the interest the requirements of the Corporate Securities Act must be met.[28] This degree of participation is considerably above that allowed a limited partner who wishes to retain his favored status, so the element of control cannot really be considered as a distinguishing factor.

Such lack of control is an important element in the policy behind the Corporate Securities Act. As stated in *People v. Rankin:* "The policy of the state is to subject to regulation all schemes for investment, regardless of forms of procedure employed, that are designed to lead investors into enter-

[19] *Id.* at 36, 282 Pac. at 817.

[20] 27 Cal. App. 2d 583, 81 P.2d 452 (1938).

[21] 78 Cal. App. 2d 132, 177 P.2d 586 (1947).

[22] *Id.* at 135, 177 P.2d at 588.

[23] People v. Woolson, 181 Cal. App. 2d 657, 5 Cal. Rptr. 766 (1960); People v. Hoshor, 92 Cal. App. 2d 250, 206 P.2d 882 (1949).

[24] People v. Steele, 2 Cal. App. 2d 370, 36 P.2d 40 (1934).

[25] People v. Syde, 37 Cal. 2d 765, 769, 235 P.2d 601, 603 (1951).

[26] Toor v. Westover, 94 F. Supp. 860 (S.D. Cal. 1950); *aff'd*, 200 F.2d 713 (9th Cir. 1952).

[27] Refinite Sales Co. v. Bright Co., 119 Cal. App. 2d 56, 258 P.2d 1116 (1953).

[28] People v. Jacques, 137 Cal. App. 2d 823, 291 P.2d 124 (1955), citing State v. Gopher Tire & Rubber Co., 146 Minn. 52, 177 N.W. 937 (1920).

prises where earnings and profits from business or speculative ventures must come through management, control and operations of others."[29]

A third factor enumerated by Dahlquist in distinguishing a security from a limited partnership interest is the extent to which the interest is offered to the public. This has a limited evidentiary value as to the good faith of the offeror and his lack of intent to evade the Act, since it has been held that a single transaction can be a public sale so as to come within the purview of the Corporate Securities Act, it not being necessary that there be a general sale or offer to the public.[30] Even the good faith of the parties in thinking that they are entering into a limited partnership is not binding. Said the court in *Rivlin:* "The understanding or misunderstanding of the parties as to the nature of the transaction is not determinative of its legal effect."[31] However, according to Dahlquist, the Corporations Commission itself has consistently ruled that bona fide general and limited partnerships are not securities requiring a permit, "despite the literal wording of the Act."[32]

Dahlquist uses one other criterion to distinguish a security from an interest in a limited partnership which was used by the court in Rivlin, *viz:* the element of mutual selection on the part of the members of the partnership. In general partnerships and in bona fide limited partnerships:[33]

> [T]here is the right of *delectus personarum,* the right to determine membership. No partner is admitted without the unanimous approval of every other partner. A true Partnership is a relationship of personal confidence and is a select closed group. Its memberships are never indiscriminately offered at random to the public at large. Even in the case of a limited partnership the certificate [of limited partnership] must expressly state the right, if given, of a limited partner to substitute an assignee as contributor in his place, and the terms and conditions of the substitution, and the right, if given, of the partners to admit additional partners.

Dahlquist points out that as long as the element of mutual selection and the requirement of unanimous agreement on the part of the members are preserved the partnership is not the issuer of a security.

Mutual selection was lacking in the *Rivlin* transaction. Instead, "Levine went about among his relatives, friends, and acquaintances seeking those who would invest in his enterprise for a share of the contemplated profits. Those who were called limited partners never met together."[34]

The requirement of mutual selection, then, would seem to be one method of distinguishing between the sale of a limited partnership interest and the sale of a security. It follows that the Uniform Limited Partnership Act[35] should be strictly complied with, particularly the execution and acknowledgement by each partner of the Certificate of Limited Partnership. Such acknowledgement on the part of each partner would appear to supply the needed unanimous approval.

[29] People v. Rankin, 160 Cal. App. 2d 93, 96-7, 325 P.2d 10, 12 (1958).

[30] DeMille Productions v. Woolery, 61 F.2d 45 (9th Cir. 1932).

[31] 195 Cal. App. 2d at 23, 15 Cal. Rptr. at 594 (1961), citing People v. Sidwell, 27 Cal. 2d 121, 162 P.2d 913 (1945).

[32] Dahlquist, *supra,* note 7, at 361.

[33] *Id.* at 363.

[34] 195 Cal. App. 2d at 23, 15 Cal. Rptr. at 594 (1961).

[35] CAL. CORP. CODE §§ 15501-31.

Although the principal case, and Mr. Dahlquist's research, seem to support the proposition that an interest in a bona fide limited partnership can be sold without a permit under the Corporate Securities Act, Mr. Herbert A. Smith, Executive Deputy Commissioner of Corporations in 1944, has gathered case law which, at that time, supported his contention that even the sale of a bona fide limited partnership interest would come within the restrictions of the Act.[36]

There is much weight in Mr. Smith's conclusion that even a bona fide interest in a limited partnership comes within the purview of the Act since case law seems to be purely negative in character as opposed to presenting positive principles for guidance in attempting to ascertain, prior to litigation, exactly where a particular transaction stands in regard to the Corporate Securities Act. *Rivlin* is an example; i.e., the case does not say that if the partnership *had* had mutual selection it *would* be a bona fide limited partnership, but it does say that because the partnership did *not* have a mutual selection it was *not* a bona fide partnership.

Smith, on the other hand, has positive case law supporting his contention. He cites *People v. Simonsen*[37] in which it was held that the partnership interests which were offered required a permit for their sale and that it was constitutional to require a permit for the sale of partnership securities. He also quotes from *Barret v. Gore*:[38] "It is not material whether at the time of the sale the vendor's organization constituted a partnership, voluntary trust, or association. All alike are prohibited from selling such securities . . . ." *People v. Clagget*[39] says, in a similar situation, that "the fact that a partnership existed among the several interested parties is immaterial." In both *People v. Dutton*[40] and *People v. Dysart*[41] the court held that the sale of a limited partnership interest required a permit.

Dahlquist points out that in the cases cited by Smith there was either a finding of gross fraud or that there was only a purported partnership.[42] He distinguishes the case of *People v. Simonsen*[43] on the grounds that there was apparently a public solicitation and offering of the purported partnership interest. Whether the criterion of mutual selection was met does not appear in the last mentioned opinion.

The problem of predicting whether or not the court will rule that the sale of a limited partnership interest is the sale of a security still remains. Examination of all of the so-called "distinguishing criteria" indicates that a bona fide limited partnership which meets the procedural qualification set up by the Uniform Limited Partnership Act may be sold without a permit unless the sale is to that number of people (only one person in *DeMille Productions v. Woolery*[44]) required for "public solicitation and issue," or unless the parties fail to agree

[36] Smith, *Limited Partnership Interests as Securities Under the Corporate Securities Act*, April L. A. BAR BULL. 257 (1944).

[37] 64 Cal. App. 97, 220 Pac. 442 (1923).

[38] 88 Cal. App. 372, 378, 263 Pac. 564, 566 (1928).

[39] 130 Cal. App. 141, 144, 19 P.2d 805, 806 (1933).

[40] 41 Cal. App. 2d 866, 107 P.2d 937 (1940).

[41] 39 Cal. App. 2d 287, 102 P.2d 1091 (1940).

[42] Dahlquist, *supra*, note 7, at 364.

[43] 64 Cal. App. 97, 220 Pac. 442 (1923).

[44] 61 F.2d 45 (9th Cir. 1932).