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SEC V. SHIELDS: FOR INVESTORS, A BAD PRESUMPTION YIELDS BAD RESULTS

ABSTRACT

Everyone knows the old saying about what happens when you assume. But when you presume, and the presumption is bad, the results are even worse. Currently, there is a presumption that general partnerships and joint ventures are not securities. Therefore, if the difficult burden of rebutting that presumption is not met, an investor who purchases a general partnership or joint venture is not protected by federal securities laws.

This Comment argues the presumption goes against the entire reason federal securities laws were created: to protect inexperienced investors from fraud in the securities industry. The presumption creates a potential loophole to federal securities laws. A promoter can create a product, structure and describe it as a general partnership or joint venture, and the product is presumably not a security and not subject to federal securities laws. If something goes wrong, the burden falls on the investor to rebut the presumption and prove the product is a security. This burden ranges from extremely difficult to meet to impossible, depending on the circuit.

A better presumption, and one more consistent with the securities industry as a whole, is to focus not only on the product being sold, but also on who is purchasing the product. If the purchaser is an inexperienced investor, the individual should be protected by federal securities laws. They were specifically designed to protect the inexperienced investor, so no presumption should take that protection away. The only benefit of the current presumption is a savvy promoter can get around federal securities laws simply by naming a product a general partnership or joint venture. No promoter should have that power.

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INTRODUCTION

In *SEC v. Shields*,[1] the United States Court of Appeals for the Tenth Circuit addressed the issue of whether particular Joint Venture Agreements (JVAs) soliciting investments in oil and gas exploration and drilling were investment contracts subject to federal securities regulations as defined by the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act) (collectively, the Securities Acts).[2] If not, the JVAs were not securities over which the SEC could exercise jurisdiction.

The Securities Acts were designed to protect inexperienced investors from fraud. Currently, a presumption exists that general partnerships and joint ventures are not securities subject to the Securities Acts.[3] This presumption creates an extremely difficult burden, which, unless overcome, denies inexperienced investors the very protection the Securities Acts were designed to provide, simply because the promoter was savvy enough to call the product a general partnership or joint venture.

Part I of this Comment summarizes the Securities Acts and two significant cases the court relied on in reaching its decision: *SEC v. W.J.*

1. 744 F.3d 633 (10th Cir. 2014).
2. *Id.* at 636.
3. *See, e.g.*, Banghart v. Hollywood Gen. P'ship, 902 F.2d 805, 807 (10th Cir. 1990) (per curiam).

Howey Co.,[4] and *Williamson v. Tucker*.[5] Part II presents the facts of *Shields*, the procedural history, and the majority opinion. Part III discusses the circuit court split regarding if and how the *Williamson* test is applied, as well as the power of the name and structure of an investment in determining whether the Securities Acts apply, and also examines how the district court might decide the case on remand.

I. BACKGROUND

A. Securities Acts

After the stock market crash of 1929, which led to the Great Depression, two important pieces of federal legislation were passed to regulate the securities markets[6]: the Securities Act of 1933[7] and the Securities Exchange Act of 1934.[8] The Securities Act, often called the "truth in securities" law, "has two basic objectives: [1] requir[ing] that investors receive financial and other significant information concerning securities being offered for public sale; and [2] prohibit[ing] deceit, misrepresentations, and other fraud in the sale of securities."[9]

Requiring securities to be registered with the Securities and Exchange Commission (SEC) accomplishes the goal of disclosing important financial information about a security.[10] Although there are certain exceptions and exemptions, generally securities sold in the United States must be registered.[11] Registration statements and prospectuses are filed with the SEC and made publically available on the EDGAR.[12] These documents contain "a description of the company's . . . business; a description of the security to be offered for sale; information about the management of the company; and financial statements certified by independent accountants."[13]

The Exchange Act created the SEC and gave the agency "broad authority over all aspects of the [U.S.] securities industry."[14] The Exchange

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4. 328 U.S. 293 (1946).
5. 645 F.2d 404 (5th Cir. 1981).
6. W. Taylor Marshall, Note, *Securities Law—The Securities Exchange Act of 1934—'Round and 'Round We Go: The Supreme Court Again Limits the Circumstances in which Federal Courts May Hold Secondary Actors Liable Under Section 10(b) and SEC Rule 10b-5.* Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., *128 S. Ct. 761 (2008).*, 31 U. ARK. LITTLE ROCK L. REV. 197, 200 (2008).
7. 15 U.S.C. § 77a–aa (2012).
8. 15 U.S.C. § 78a–pp (2012).
9. *The Laws That Govern the Securities Industry*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/laws.shtml#secexact1934 (last visited Nov. 18, 2014) (internal quotation marks omitted).
10. *Id.*
11. *Id.*
12. *Id.* (explaining that the EDGAR database allows users to search for companies and view any registration documents and periodic company reports filed with the SEC at www.sec.gov).
13. *Id.*
14. *Id.*

Act gives the SEC the power "to require periodic reporting . . . by companies with publically traded securities," to "identif[y] and prohibit[] certain types of conduct," and gives the SEC "disciplinary power[] over regulated entities and [individuals] associated with [those entities]."[15] These entities include brokerage firms, transfer agents, clearing agencies, and securities agencies such as the New York Stock Exchange, the NASDAQ Stock Market, and the Chicago Board of Options.[16]

B. SEC v. W.J. Howey Co.

In *W.J. Howey Co.*, the United States Supreme Court granted certiorari to determine if a particular investment involving a citrus grove was an investment contract subject to the Securities Acts.[17] The Howey Company owned large tracts of citrus groves in Florida and planted approximately 500 acres of citrus groves per year.[18] Half of the acreage the Howey Company kept for itself and the other half was offered to the public in an effort to finance further development.[19] In the offering, each potential customer was given a land sales contract and a service contract to tend to the land.[20] The Howey Company said it was not feasible to invest in a grove unless service arrangements were made.[21] Although the service contracts allowed a purchaser to make arrangements with any service company, the Howey Company stressed the superiority of Howey-in-the-Hills Service, Inc., a corporation under the same direct control and management as the Howey Company.[22]

The land sales contract provided a price per acre and conveyed the land by warranty deed to the purchaser.[23] Each purchaser received a tract of land not separately fenced from the adjacent land owned by other purchasers.[24] In fact, "the sole indication of several ownership [was] found in small land marks intelligible only through a plat book record."[25]

The service contract gave Howey-in-the-Hills Service, Inc. a lease interest on each tract of land and "full and complete" possession.[26] This gave the company full discretion to use its skilled personnel and full inventory of equipment to cultivate, harvest, and market the crops.[27] The purchaser had no right to market the crops because there was no right to

15. *Id.*
16. *Id.*
17. 328 U.S. 293, 294 (1946).
18. *Id.* at 295.
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.* at 296 (internal quotation marks omitted).
27. *Id.*

specific fruit.[28] Instead, all fruit was pooled together for sale and each purchaser was entitled to a portion of the profit.[29] Most purchasers were not residents of Florida, and did not possess the "knowledge, skill and equipment necessary for the care and cultivation of citrus trees."[30] Instead, they were attracted by the potential for significant profits from their investments.[31]

There are many different types of investment interests included in the definition of a security subject to registration with the SEC.[32] In an alleged violation of the Securities Acts, the SEC sought to restrain the Howey Company "from using the mails and instrumentalities of interstate commerce in the offer and sale of unregistered and nonexempt securities."[33] The district court denied the injunction and the Fifth Circuit affirmed on the basis that "an investment contract is necessarily missing where the enterprise is not speculative or promotional in character and where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole."[34]

The Supreme Court held that the land sales contracts were securities, rejecting the Fifth Circuit's reasoning, and stated:

> The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.[35]

The Court recognized the need for a broad definition of the term investment contract to encompass the many different types of instruments that needed to fall within the scope of a security under the Securities Acts. That definition, "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."[36]

The Supreme Court ultimately held the transactions were investment contracts and reversed the decision of the lower courts.[37] The lower courts had treated the land sales contract and the service contract "as

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28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.*
32. 15 U.S.C. § 77b(a)(1) (2012).
33. *Howey*, 328 U.S. at 294.
34. *Id.* at 301.
35. *Id.*
36. *Id.* at 299.
37. *Id.* at 301.

separate transactions involving no more than an ordinary real estate sale and an agreement by the seller to manage the property for the buyer."[38]

The Supreme Court disagreed, stating they were investment contracts because the Howey Company was offering more than an interest in land or a farm coupled with management services.[39] Rather, it was offering, to persons who lived in different parts of the country and lacked the equipment and expertise to successfully operate a citrus farm, an opportunity to invest in and share the profits of a professionally managed citrus fruit enterprise.[40] These persons had no interest in developing the land themselves, or even occupying it.[41] They were "attracted solely by the prospects of a return on their investment."[42]

The Court called it a "profit-seeking business venture . . . . The investors provide[d] the capital and share[d] in the earnings and profits; the promoters manage[d], control[led] and operate[d] the enterprise."[43] Finally, the Court made it clear the structure of an offering, not the name, would determine whether it is an investment contract, and that an investment contract can take on many forms:

> It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed. The investment contracts in this instance take the form of land sales contracts, warranty deeds and service contracts which respondents offer to prospective investors.[44]

C. Williamson v. Tucker

In *Williamson v. Tucker*, the issue before the United States Court of Appeals for the Fifth Circuit was whether certain real estate joint venture interests were securities within the definition of the Securities Acts.[45] Between 1969 and 1971, through a series of different transactions, the land interests were sold to the defendants in three separate but similar joint ventures.[46] Here, the defendants owned a tract of land in Texas near the site of the newly announced Dallas/Fort Worth airport.[47] The transactions were all arranged by Godwin Investments, and the defendants invested in each separate joint venture.[48] Each joint venture had approxi-

38. *Id.* at 298.
39. *Id.* at 299.
40. *Id.* at 299–300.
41. *Id.* at 300.
42. *Id.*
43. *Id.*
44. *Id.*
45. 645 F.2d 404, 416 (5th Cir. 1981).
46. *Id.* at 407–08.
47. *Id.* at 407.
48. *Id.* at 408.

mately fifteen investors, including the defendants.[49] The purchases were each financed by a promissory note issued by the respective joint venture.[50]

Godwin Investments created marketing materials that analyzed the development of other major airport areas and suggested this was a similar opportunity, "[o]f course, an international airport of this immense size will undoubtedly have a tremendous effect on the values and development of nearby land, and its eventual economic contribution might be far greater than the public's ability to presently comprehend!"[51]

In addition to marketing, Godwin Investments represented it would "perform all management duties, including efforts to have the land rezoned from single-family residential to its best uses."[52] Although Godwin Investments performed these activities, the participants in each of the joint ventures retained substantial control and could vote to remove Godwin Investments as the property manager.[53] Despite maintaining these joint venture rights, all plaintiffs claimed to have relied entirely on Godwin Investments until late 1975 when they began to hold joint venture meetings.[54]

The court recognized the proper starting point for analysis of investment contracts is the *Howey* test and broke it into "three distinct elements: (1) an investment of money; (2) in a common enterprise; and (3) on an expectation of profits to be derived solely from the efforts of individuals other than the investor."[55] The third element, specifically the word "solely," was the focus of the court's analysis.[56] Relying on a decision from the Ninth Circuit, the court said a broad definition of "solely" was appropriate.[57] The Ninth Circuit held that, "the word 'solely' should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities."[58] The rationale was that too strict an interpretation of the word "solely" would provide a loophole to avoid federal securities laws: by requiring investors to contribute some minimal effort, investors would not be relying "solely" on the efforts of others, and therefore an investment contract finding would be automatically precluded.[59]

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49. *Id.*
50. *Id.*
51. *Id.* (internal quotation mark omitted).
52. *Id.*
53. *Id.* at 408–09.
54. *Id.* at 409.
55. *Id.* at 417.
56. *See id.* at 418 (internal quotation marks omitted).
57. *Id.* (citing SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476 (9th Cir. 1973)).
58. *Glenn W. Turner Enters.*, 474 F.2d at 482.
59. *Id.*

Williamson further pointed out "the Supreme Court has altogether omitted the word 'solely' in its most recent formulation of the investment contract definition."[60] The court referenced *United Housing Foundation, Inc. v. Forman*,[61] which summarized the *Howey* test as "the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."[62]

The issue in *Williamson* became whether the powers possessed by the investors in the joint venture agreements were enough to preclude a finding that the joint ventures were securities.[63] There is a circuit court split on this issue—discussed in detail below—and this issue was a matter of first impression for the Fifth Circuit.[64] After analyzing a plethora of cases over various circuits,[65] the court found the Eighth[66] and Tenth Circuits'[67] approach to be most appropriate:

> [T]he actual control exercised by the purchaser is irrelevant. So long as the investor has the right to control the asset he has purchased, he is not dependent on the promoter or on a third party for "those essential managerial efforts which affect the failure or success of the enterprise."[68]

Accordingly, general partnerships and joint partnerships generally cannot be investment contracts under the Securities Acts.[69] However, "the mere fact that an investment takes the form of a general partnership or joint venture does not inevitably insulate it from the reach of the federal securities laws."[70] There is a presumption "that the investor-partner is not in fact dependent on the promoter or manager for the effective exercise of his partnership powers."[71] In order to rebut that presumption, the investor-partner must show the partnership powers were "inadequate to protect him from the dependence on others which is implicit in an investment contract."[72]

An investor who lacks the necessary experience to intelligently exercise partnership power may be dependent on the manager.[73] Reliance

60. *Williamson*, 645 F.2d at 418.
61. 421 U.S. 837 (1975).
62. *Id.* at 852.
63. *Williamson*, 645 F.2d at 419.
64. *Id.*
65. *Id.* at 419–21.
66. *Id.* at 420–21 (analyzing *Schultz v. Dain Corp.*, 568 F.2d 612 (8th Cir. 1978), and *Fargo Partners v. Dain Corp.*, 540 F.2d 912 (8th Cir. 1976)).
67. *Id.* at 421 (analyzing Mr. Steak, Inc. v. River City Steak, Inc., 460 F.2d 666 (10th Cir. 1972)).
68. *Id.* at 421.
69. *Id.*
70. *Id.* at 422.
71. *Id.*
72. *Id.* at 423.
73. *Id.*

on irreplaceable expertise on the part of the manager may force dependence on the part of the investor.[74] Inexperienced members of the general public who had partnership powers but were led to expect profits derived from the efforts of others may be able to show dependence.[75] In essence, "a legal right of control would have little value if the partners were forced to rely on the manager's unique abilities."[76]

However, hiring someone else to manage an investment does not fulfill the reliance requirement.[77] "It is not enough, therefore, that partners in fact rely on others for the management of their investment; a partnership can be an investment contract only when the partners are so dependent on a particular manager that they cannot replace him or otherwise exercise ultimate control."[78] This makes fulfilling the reliance requirement very difficult.

The court recognized how difficult this was, saying "an investor who claims his . . . joint venture interest is an investment contract has a difficult burden to overcome."[79] In order to overcome the presumption that dependence does not exist because investors in partnership agreements retain control:

> An investor must demonstrate that, in spite of the partnership form which the investment took, he was so dependent on the promoter or on a third party that he was in fact unable to exercise meaningful partnership powers. A . . . joint venture interest can be designated a security if the investor can establish, for example, that (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.[80]

None of those factors were present.[81] First, the partnership agreements gave the plaintiffs ultimate control over the joint venture.[82] Second, the plaintiffs were all high level executives at Frito-Lay and had participated in other joint ventures, so they had the necessary experience and

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74. *Id.*
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.* at 424.
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.*

knowledge to adequately exercise those powers.[83] Finally, the plaintiffs did not allege Godwin Investments was uniquely qualified to manage the property or that their dependence on Godwin Investments made them incapable of finding a replacement.[84] Without one of those three factors, "meaningful powers possessed by joint venturers under a joint venture agreement do indeed preclude a finding that joint venture interests are securities."[85]

II. *SEC v. SHIELDS*

Williamson focused on the reliance element of *Howey* specifically with respect to joint ventures, but courts continue to look to *Howey* as the starting point when examining whether an investment is an investment contract within the purview of the Securities Acts. *Howey* is regarded as "the seminal U.S. Supreme Court case that defined and gave life to the term 'investment contract.'"[86] In *SEC v. Shields*, the Tenth Circuit adopted the *Williamson* approach and applied its three-factor test to rebut the presumption that a general partnership is not a security.[87]

A. Facts

In September 2009, Mr. Shields formed GeoDynamics, a Colorado corporation.[88] The SEC alleged Mr. Shields sold over five million dollars of interests in oil and gas joint ventures between January 2010 and May 2011.[89] Marketing the interests involved making thousands of cold calls to the general public.[90] Potential investors were enticed by promises of annual returns between 256% and 548%.[91] At the height of the operation, Mr. Shields supervised dozens of salespersons who each made over 400 cold calls per day.[92] As a result, the joint ventures were made up of investors who had never met, never had contact with one another, and were spread out across the country.[93]

Members of the general public with little or no experience in the oil and gas industry were specifically targeted, and "Mr. Shields and his staff would specifically emphasize 'the capabilities and unique qualifications of GeoDynamics as an experienced oil and gas driller and operator.'"[94] Anyone who seemed interested was sent offering documents in-

83. *Id.* at 424–25.
84. *Id.* at 425.
85. *Id.*
86. S. Scott Lasher & Eric B. Liebman, *The Application of* SEC v. W.J. Howey Co. *in Colorado and Other Jurisdictions*, 31 COLO. LAW. 73, 73 (2002).
87. 744 F.3d 633, 644–45 (10th Cir. 2014).
88. *Id.* at 637.
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.* at 638.

cluding a memo explaining how the venture would operate, a joint venture agreement, and a document that outlined the expected profits.[95]

> The offering documents state[d] "the Venturers will have all of the rights and will be subject to all of the liabilities of a General Partner under" Texas law, and also note[d] that GeoDynamics, as managing venturer, "takes the position that the joint venture interest[s] are not securities." Under the agreements, investors "expressly delegate[d] management of the day-to-day Operations of the Joint Venture[s]" to GeoDynamics as managing venturer.[96]

Under the agreements, GeoDynamics had broad powers and no investor had any binding power.[97] Investors had the right to vote, the right to terminate the partnership or amend the partnership agreement, the right to inspect accounting records and company reports, and the right to call partnership meetings.[98] The SEC alleged that Mr. Shields denied report requests and lied to investors to "keep them misinformed, raise more money, and prevent them from challenging his actions."[99]

According to the offering documents, each venture was to have its own separate account where each investor's money was deposited to cover the costs of the oil and gas exploration and drilling associated with each respective venture.[100] Instead, according to the SEC, all investments were comingled and deposited into accounts controlled by Mr. Shields.[101] Of the five million dollars, Mr. Shields spent two million on general business expenses, which was much more than the offering documents allowed, and spent over two million more on personal expenses.[102]

> These expenditures included: $747,685 on a private Learjet; $236,444 on luxury automobiles; $31,537 on limousine and helicopter rentals; $200,206 on rent for multiple residences; $104,734 on sporting events; $26,434 on clothing and lingerie; $2,062 on jewelry; $68,223 on home furnishings; $14,987 on electronics; $39,205 on travel; and $467,129 to Mr. Shields via "cash withdrawals, checks, or transfers to his personal bank accounts."[103]

Of the five million dollars raised, only $613,494 went to actual oil and gas exploration.[104] GeoDynamics never finished drilling, never produced

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95. *Id.*
96. *Id.* (fourth and fifth alterations in original) (citations omitted).
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.* at 638–39.
101. *Id.* at 639.
102. *Id.*
103. *Id.* at 639 n.5.
104. *Id.* at 639.

any commercial quantities of oil or gas, and did not make a single payment to any investor in any of the four joint ventures.[105]

B. Procedural History

In September 2011, the SEC filed suit alleging violations under several provisions of the Securities Acts.[106] The SEC sought injunctions, disgorgement plus interest, an asset freeze, and recovery of assets transferred to relieve defendants.[107] The defendants filed a Rule 12(b)(6) motion to dismiss, which the district court granted without prejudice.[108] The district court held that "the SEC's allegations were 'insufficient to state a plausible claim that the joint venture interests at issue' were securities."[109] The SEC filed an appeal, which argued the district court erred in granting the motion to dismiss, claiming the joint ventures were investment contracts, and therefore securities subject to the Securities Acts.[110]

C. Majority Opinion

Judge Seymour authored the opinion of the Tenth Circuit, reversing the district court "[b]ecause it cannot be said as a matter of law that the investments at issue are not 'investment contracts.'"[111] A motion to dismiss is not appropriate if a complaint stated a plausible claim for relief.[112] The SEC's allegations were sufficient to defeat a motion to dismiss.[113] On appeal, the issue was whether the oil interests sold by Mr. Shields and GeoDynamics were investment contracts subject to federal securities laws.[114]

To provide background to the decision, the court described why the Securities Acts were created:

> Congress enacted the Securities Acts in response to "serious abuses in a largely unregulated securities market," and for the purpose of regulating "investments, in whatever form they are made and by whatever name they are called." Congress "painted with a broad brush" in defining a "security" in recognition of the "virtually limitless scope of human ingenuity, especially in the creation of 'count-

105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.* at 639–40.
109. *Id.* at 640 (quoting SEC v. Shields, No. 11-CV-02121-REB, 2012 WL 3886883 (D. Colo. Sept. 6, 2012)).
110. *Id.*
111. *Id.* at 636.
112. *See* Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007)) (internal quotation mark omitted).
113. *Shields*, 744 F.3d at 647.
114. *Id.* at 641.

> less and variable schemes devised by those who seek the use of the money of others on the promise of profits . . . ."'[115]

The court made it clear Congress did not intend for the Securities Acts to cover all fraud, and it was up to the SEC and the courts to decide which transactions are covered.[116]

Neither side disputed that the first two elements of the *Howey* test were satisfied because investors gave money directly to Mr. Shields as a part of a common investment scheme.[117] The focus of the case was the third element of the *Howey* test: "whether the investment was 'premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.'"[118]

The court noted the JVAs were labeled as general partnerships, and in the Tenth Circuit there is a strong presumption that a general partnership is not a security because investors retain significant control.[119] The SEC argued the court should apply the *Williamson* factors to the third element of the *Howey* test to rebut that presumption.[120] The court agreed and noted that the three factors in *Williamson* were a non-exhaustive list.[121] "[W]e view the *Williamson* approach as a supplement to controlling Supreme Court and circuit precedent in determining if allegations are sufficient to raise a fact question regarding whether a particular investment is a security."[122]

The Tenth Circuit held that the district court erred in granting the motion to dismiss[123] because the SEC's allegations were "clearly sufficient to rebut the presumption that the purported general partnerships here are not securities, and to raise a fact issue concerning whether investors were relying on the efforts of Mr. Shields and GeoDynamics to significantly affect the success or failure of the ventures."[124]

The issue became "whether the investors actually had the type of control reserved under the agreements to obtain access to information necessary to protect, manage, and control their investments at the time they purchased their interests."[125] From there, each of the three factors

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115. *Id.* (emphasis omitted) (citation omitted) (quoting Reves v. Ernst & Young, 494 U.S. 56, 60–61 (1990) (quoting SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946))).
116. *Id.* at 642.
117. *Id.* at 643.
118. *Id.* (quoting United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852 (1975)).
119. *Id.*
120. *Id.*
121. *Id.* at 644–45.
122. *Id.* at 645.
123. *Id.* at 641, 648.
124. *Id.* at 645.
125. *Id.*

from *Williamson* were analyzed to see if they were sufficiently pleaded.[126]

First, a joint venture could be a security if the agreement gave the investor so little power that the agreement operates as a limited partnership.[127] The SEC alleged the investors lacked the control of general partners and actually had the rights of limited partners.[128] The JVAs locked investors into turnkey contracts solely with GeoDynamics as the contractor.[129] Although the JVAs gave investors voting rights, including the right to remove GeoDynamics as the managing partner, investors still had to rely on GeoDynamics as the contractor per the turnkey contracts.[130] Therefore, the "turnkey contracts were key to the success of the enterprise and profits for the investors, regardless of the venturers' power, because they were the only way these oil and gas investments could generate money."[131]

The SEC also alleged Mr. Shields marketed the investments to individuals "with little or no experience in the oil and gas industry," and he served as their only source of information.[132] Accordingly, the SEC's allegations were enough to defeat a motion to dismiss on the issue of whether the investors here meaningful control.[133]

Second, the court considered "whether 'the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers.'"[134] Again, the court focused on the allegations of marketing to inexperienced investors: "The allegations that Mr. Shields marketed these oil and gas interests nationwide to investors with little, if any, experience in the oil and gas industry by means of over 400 cold calls a day clearly supports this conclusion."[135]

Third, the court considered "whether 'the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.'"[136] The SEC alleged that during his sales pitches Mr. Shields specifically emphasized GeoDynamics' unique expertise in the oil and gas industry.[137] He claimed that GeoDynamics' experience was "so unique that he was able

126. *Id.* at 645–47.
127. *Id.* at 646.
128. *Id.*
129. *Id.*
130. *Id.*
131. *Id.* at 646–47.
132. *Id.* at 647.
133. *Id.*
134. *Id.* (quoting Williamson v. Tucker, 645 F.2d 404, 424 (5th Cir. 1981)).
135. *Id.*
136. *Id.* (quoting *Williamson*, 645 F.2d at 424).
137. *Id.*

to offer—and investors depended on him for—estimated annualized profits between 256% and 548%."[138] These allegations, combined with the fact investors had no experience in the industry and relied solely on GeoDynamics per the turnkey contracts, sufficiently "raise[d] a fact issue as to whether the investors had any practical alternative to GeoDynamics."[139] The court stated:

> The district court focused only on the form of the JVAs themselves without considering the economic realities of the transactions and the investors' lack of access to information needed in order to actually use the powers reserved to them under the JVAs. When the allegations here are instead viewed in their totality, they state a plausible claim that the powers were illusory, which is sufficient to rebut the presumption that a general partnership is not a security.[140]

The court reversed the district court and remanded for further proceedings because it could not be proved that the oil interests are not investment contracts.[141]

III. ANALYSIS

The *Shields* decision answered one question, but several remain. The Tenth Circuit adopted the full *Williamson* three-factor test, which may rebut the presumption that general partnerships and joint ventures are not securities. However, a circuit court split remains as to whether and to what extent the *Williamson* test is applied. Remaining questions involve the implications of naming and structuring an investment as a general partnership or joint venture, the effect of the presumption and the standard that must be met to rebut the presumption, and how the district court will handle the decision on remand.

A. Circuit Court Split

The *Shields* decision made one thing clear; the Tenth Circuit agreed with the Fifth Circuit's approach and adopted the three examples from *Williamson* that can be used to rebut the presumption that a general partnership is not a security.[142] *Shields* called the examples "non-exhaustive"[143] by pointing to language in *Williamson*,[144] but did not provide any other examples that may rebut the presumption.

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138. *Id.* at 647–48.
139. *Id.* at 648.
140. *Id.*
141. *Id.*
142. *Id.* at 644–45; *see supra* notes 68–69, 80 and accompanying text.
143. *Id.* at 644.
144. *Id.* at 645 ("[N]oting that other factors could 'also give rise to such a dependence on the promoter or manager that the exercise of partnership powers would be effectively precluded.'" (quoting Williamson v. Tucker, 645 F.2d 404, 424 n.15 (5th Cir. 1981))).

Perhaps the court neglected to expand that list because of the treatment of the *Williamson* approach in other circuits. The court cited cases from the Second, Sixth, Ninth, and Eleventh Circuits that followed the *Williamson* approach;[145] however, the Third and Fourth Circuits have followed different approaches.[146]

> [T]he Third Circuit took a legalistic approach, and established a bright-line rule (i.e., an irrebuttable presumption) that a general partner's interest cannot qualify as a security "because the role of a general partner, by law, extends well beyond the permitted role of a passive investor." Although the general partner alleged that the partnership agreement distributed control with respect to certain general partners as though they were limited partners, and therefore that the interests could be securities under *Williamson*, the court ruled that the Uniform Partnership Act "puts its own limitations on the extent to which a general partner can be so restricted" and that even "the most draconian restrictions on the rights of non-management partners" would not eliminate the "quantum of powers and responsibilities" which would preclude the interest from constituting a security.
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> . . . .
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> . . . [T]he Fourth Circuit embraced the *Williamson* presumption, but expressly rejected the second and third *Williamson* rebuttal factors. The court stated that a broad application of the *Williamson* factors "would undercut the strong presumption that an interest in a general partnership is not a security" and "would unduly broaden the scope of the Supreme Court's instruction that courts must examine the economic reality of partnership interests."[147]

Each circuit presumes a general partnership is not a security, but each takes a different approach to the question of how that presumption can be rebutted, if at all: the Second, Sixth, Ninth, Tenth, and Eleventh Circuits embracing the Fifth Circuit's full three-part *Williamson* approach;[148] the Fourth Circuit limiting the test to the first part of the *Williamson* three-part approach;[149] and the Third Circuit taking the position the presumption cannot be rebutted.[150]

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145. *Id.* at 644 n.9 (citing United States v. Leonard, 529 F.3d 83, 90–91 (2d Cir. 2008) (applying *Williamson* and finding investment contract notwithstanding documents gave investors powers of control similar to general partnership); SEC. v. Merch. Capital, LLC, 483 F.3d 747, 755–57 (11th Cir. 2007) (same); Stone v. Kirk, 8 F.3d 1079, 1086 (6th Cir. 1993) (same); Koch v. Hankins, 928 F.2d 1471, 1476–81 (9th Cir. 1991) (applying *Williamson* to analyze whether general partnerships were investment contracts)).

146. J. William Callison, *Changed Circumstances: Eliminating the* Williamson *Presumption that General Partnership Interests Are Not Securities*, 58 BUS. LAW. 1373, 1376–77 (2003).

147. *Id.* (emphasis omitted) (footnotes omitted) (first quoting Goodwin v. Elkins & Co., 730 F.2d 99, 103, 107 (3d Cir. 1984); and then quoting Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236, 241 n.7 (4th Cir. 1988)).

148. *Shields*, 744 F.3d at 644 n.9.

149. Callison, *supra* note 146, at 1377.

150. *Id.* at 1376–77.

The Third Circuit created a loophole around the Securities Acts by completely rejecting the *Williamson* approach holding "that a participant who holds a general partnership interest in an enterprise . . . does not possess a security within the meaning of federal securities law."[151] This interpretation gives future promoters the power to decide, depending on how they structure and what they name their investment, whether it will be subject to the Securities Acts. No promoter should have this power. Rather, it is up to the SEC and the federal courts to decide which types of transactions involve securities and, therefore, have the protection of the Securities Acts.[152]

> Unless the courts abandon the presumption, it is likely that unscrupulous promoters will create limited liability partnerships in which vulnerable and unsophisticated general partners (the so-called "widows and orphans" that the securities laws were designed to protect) invest their money in schemes in which they rely on the promoter's efforts to generate profits. These transactions will be undertaken without the benefits of securities disclosure rules or regulatory agency oversight. When the scheme fails, the promoter will argue that there is a strong presumption that the interest is not a security and that the investor has the burden of proving on an individual-by-individual basis that he acquired an investment contract, thereby skirting rescission requirements and securities fraud liability.[153]

B. What Is in a Name?

The *Williamson* presumption has been "categorized as the last investment contract battlefield, i.e., whether or when interests in what are held out to be a 'general partnership' or 'joint venture' are investment contract securities."[154] However, no cases have said what a general partnership or joint venture actually is.[155] Unlike other business entities, general partnerships and joint ventures do not have to file certificates with the government, and the relationship among the parties to the agreement can be anything they choose to stipulate in the contract.[156]

Surely, naming an investment a general partnership or joint venture should be able to have as much power as it seems: "A promoter cannot evade the securities law simply by calling his otherwise obvious investment contract a 'general partnership' or 'joint venture' interest."[157] Outside of the Third Circuit, as stated in *Shields*, this is not the case, but the truth is not too far removed. There is a "strong presumption that an inter-

151. Goodwin v. Elkins & Co., 730 F.2d 99, 108 (3d Cir. 1984).
152. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 847–48 (1975).
153. Callison, *supra* note 146, at 1384.
154. 12 JOSEPH C. LONG & PHILIP A. FEIGIN, BLUE SKY LAW § 3:58 (2014).
155. *See id.*
156. *Id.*
157. *Id.*

est in a general partnership is not a security."[158] The Fifth Circuit reiterated this principle: "To sum up: . . . . [an investor has] an extremely difficult factual burden if they are to establish that the joint venture interests they purchased are securities."[159] Therefore, "by simply characterizing an operation as a 'general partnership' or 'joint venture,' the promoter seemingly automatically interposes a presumption that investment contracts are not involved, so that anyone claiming they are faces some very difficult obstacles to overcome it."[160]

One argument for this presumption is that sophisticated investors and institutions are normally the parties in these types of agreements and have equal bargaining power in creating general partnerships and joint ventures.[161] They understand the risks involved, should be able to transact as they see fit, and should not later be able to claim the protections of the Securities Acts to recover their loss if the investment does not perform as expected.[162] It is not against the law to make risky or even bad investments, and as long as the investor understands the risks, the Securities Acts cannot be a fallback simply because an investor lost money. The Securities Acts do not, and should not, afford that type of protection.[163]

But the Securities Acts should, and were designed to, protect inexperienced investors from fraud.[164] The courts should not impose such an extremely difficult burden, which could deny inexperienced investors the protection of the Securities Acts simply because the investment had a promoter savvy enough to call it a general partnership or joint venture.

It would not be difficult for the courts to distinguish between a situation involving sophisticated investors or institutions and one involving salesmen making hundreds of daily cold calls to thousands of members of the general public whom they have never met.[165] Accordingly, based on the experience of the investor, it would not be difficult to decide whether the Securities Acts applied. A presumption should exist, but the presumption should also focus on the investor, not only the name and structure of the investment. When an inexperienced investor purchases something that looks and acts like a security, it should be presumed to be a security protected by the Securities Acts.

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158. SEC v. Shields, 744 F.3d 633, 643 (10th Cir. 2014) (quoting Banghart v. Hollywood Gen. P'ship, 902 F.2d 805, 807 (10th Cir. 1990) (per curiam)) (internal quotation marks omitted).

159. Williamson v. Tucker, 645 F.2d 404, 425 (5th Cir. 1981).

160. LONG & FEIGIN, *supra* note 154.

161. *Id.*

162. *Id.*

163. *See id.*

164. *The Laws That Govern the Securities Industry*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/laws.shtml#secexact1934 (last visited Nov. 18, 2014).

165. *See* LONG & FEIGIN, *supra* note 154.

The idea of subjecting different types of investors who invest in the same product to different rules, is not a new idea in the securities industry. The JOBS Act[166] recognized the difference between sophisticated investors and unsophisticated investors and created exemptions to certain rules if an issuer sells to an investor deemed wealthy and sophisticated enough to be "accredited."[167] Therefore, there is precedent to apply different rules to investors with different levels of wealth and sophistication.[168]

> The reasoning for the exemptions [for sophisticated investors] seems to be that offerings involving small amounts of money and/or small numbers of investors pose less of a threat to the investing public, and the investors involved are more likely to be sophisticated enough to understand the risks of investment and are better suited to protect themselves and bear the risk of loss.[169]

The JOBS Act places the burden on the issuer to prove investors are accredited and, therefore, sophisticated and wealthy enough to invest in a product not subject to the Securities Acts.[170] If an investor is not accredited, the issuer is liable if it sells that type of product to an unaccredited investor.[171]

Similarly, the difficult burden should be on the promoter to prove the investors, who bought a general partnership, were sophisticated enough that the Securities Acts need not apply. Reasonable persons would not argue that inexperienced investors deserve the protection of the Securities Acts. A presumption focused on the investor, as well as the investment being sold, would result in a more organic application of the Securities Acts to the type of persons the Acts were designed to protect.

This is not to suggest investors do not have a duty to protect themselves. If an investment sounds too good to be true, it probably is. It should be a gut feeling, almost instinctual. Similarly, if it feels like the Securities Acts should apply, they probably should.

C. How Will the United States District Court for the District of Colorado Decide the Case on Remand?

In *Shields*, the Tenth Circuit reversed the district court's decision granting the motion to dismiss and remanded for further proceedings consistent with its opinion.[172] But the question remains whether the oil

166. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

167. *See* Joseph E. Richotte & Jennifer E. Consiglio, *Benefits, Pitfalls, and Possibilities in the JOBS Act*, *in* RECENT DEVELOPMENTS IN SECURITIES LAW (2015 ed.), *available at* 2014 WL 5465772, at *9.

168. *See id.*

169. *Id.*

170. *Id.*

171. *Id.* at *4.

172. SEC v. Shields, 744 F.3d 633, 648 (10th Cir. 2014).

and gas interests sold by Mr. Shields and GeoDynamics were investment contracts, and therefore securities, subject to the Securities Acts.[173] The Tenth Circuit analyzed each part of the *Williamson* approach and found the SEC's allegations under each were sufficient to raise an issue of fact sufficient to defeat a motion to dismiss,[174] but the decision may have done more than that.

Through an in-depth analysis of each of the three-part *Williamson* test, the Tenth Circuit all but told the district court what its decision should be on remand. The court said the SEC's allegations were "clearly sufficient to rebut the presumption that the purported general partnerships here are not securities."[175] While the allegations were found sufficient to defeat the motion to dismiss, the claim that the oil and gas interests were investment contracts must still be proved in the district court. However, the court's in-depth analysis of each part suggests the interests were, at least in its opinion, conclusively investment contracts.

The first part of the *Williamson* test provides a joint venture may be a security if "an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership."[176] The court found that even if the investors had exercised their power to remove GeoDynamics as managing partner, they still had to rely on GeoDynamics for the success of the joint venture because "[t]he turnkey contracts were key to the success of the enterprise and profits for the investors . . . [and] they were the only way these oil and gas investments could generate money."[177] The court did not explain if this was enough to meet the first part of the *Williamson* test, but it is reasonable to so infer.

In regard to the first and third parts of the *Williamson* test, it held the SEC's allegations raised issues of fact sufficient to defeat a motion to dismiss.[178] The court was even more transparent in its analysis of part two of the *Williamson* test. However, the court's analysis of the second part was not phrased in terms of sufficiency but of legal conclusion..[179]

> Second, we consider whether "the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers." The allegations that Mr. Shields marketed these oil and gas interests nationwide to investors with little, if any, experience in the oil and gas

173. *Id.*
174. *Id.* at 645–48.
175. *Id.* at 645.
176. Williamson v. Tucker, 645 F.2d 404, 424 (5th Cir. 1981).
177. *Shields*, 744 F.3d at 646–47.
178. *Id.* at 647–48.
179. *Id.* at 647.

> industry by means of over 400 cold calls a day *clearly supports this conclusion.*[180]

By making this statement the court reached a conclusion of law, effectively finding that one of the *Williamson* factors had been met.[181] Importantly, the *Williamson* test is a factors test, not an elements test, so a joint venture interest can be designated a security if the investor can establish any one of the *Williamson* factors.[182] The court did not expressly state this was enough to meet the second part of the *Williamson* test, but saying that it *clearly* supported that conclusion rather than saying it was sufficient to defeat a motion to dismiss, as it did when discussing the other two parts of the *Williamson* test, is a powerful message to the district court.

The third part of the *Williamson* test provides a joint venture may be a security if "the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers."[183] The court focused on allegations that Mr. Shields emphasized expertise "so unique that he was able to offer—and investors depended on him for—estimated annualized profits between 256% and 548%."[184] Further, investors had no experience in the industry and were "totally reliant on GeoDynamics and the turnkey drilling contracts for a profitable investment."[185] The court did not say this was enough to meet the third part of the *Williamson* test, but, as in the analysis of the part one, it is a reasonable inference.

Shields all but wrote the district court's opinion. Only time will tell if the lower court follows the not-so-subtle guidance of this decision, but it is difficult to imagine how it could reach a conclusion that the oil and gas interests were not investment contracts. Likely, determining that the oil and gas interests were investments contracts subject to the Securities Acts will be the easy part of the district court's decision. The more difficult part will be determining which sections of the Securities Acts were violated. Hopefully, the district court delivers an opinion that punishes Mr. Shields for what clearly appears to be fraud, assuming the SEC's allegations are proved, and provides precedent that furthers Congress's intent behind enacting the Securities Acts in the first place: to protect inexperienced investors from serious abuses in the securities markets.

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180. *Id.* (emphasis added) (citation omitted) (quoting *Williamson*, 645 F.2d at 424).
181. *Id.*
182. *Williamson*, 645 F.2d at 424.
183. *Id.*
184. *Shields*, 744 F.3d at 647–48.
185. *Id.* at 648.

CONCLUSION

Currently, the presumption that general partnerships and joint ventures are not securities remains. The *Williamson* test gives investors a small chance to rebut that presumption if they can overcome, what even the Supreme Court called, an extremely difficult burden.[186] Even so, there is a circuit split on how to apply *Williamson*, if at all. Unfortunately, the circuit split is not a simple disagreement as to whether general partnerships and joint ventures are securities. Perhaps then the circuits would be divided enough that the Supreme Court would step in and provide a better presumption to protect inexperienced investors, or at least provide some certainty. The irrebuttable presumption in the Third Circuit is the biggest outlier, and likely the only reason the Supreme Court may address the issue. However, the lower courts, to some degree, agree on the current presumption. Right or wrong, the Securities Acts currently do not apply to most transactions involving general partnerships and joint ventures. For now, buyers beware.

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186. *Williamson*, 645 F.2d at 424.

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