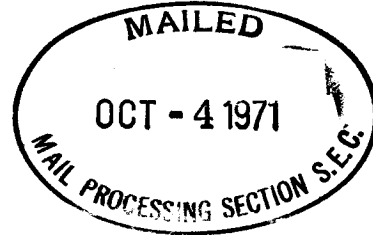


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DIVISION OF CORPORATE REGULATION

SEC 1103 (2-69)

LETTER ACKNOWLEDGED

DATE 6/9/71 (#1)

AP
3(a)

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Division of Corporate Regulation
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D. C. 20549
DIVISION OF CORPORATE REGULATION
REC'D-S.E.C.
ICA-40 JUN 7 1971

Attention: Sidney L. Cimmet, Esq. 3(a)

1940 Act/3(a)

Dear Sirs:

11/4/71

Pursuant to recent telephone conversations with members of the Staff, we are writing on behalf of Urban Land Investments, Inc. ("ULI" or the "Company") to obtain Staff views concerning the possible applicability of the Investment Company Act of 1940 (the "1940 Act") to a proposed financing plan involving the offer and sale to the public of "participation interests" in a limited partnership interest of a real estate partnership.

ULI, whose principal office address is 7850 Metro Parkway, Minneapolis, Minnesota 55420, is engaged in the business of syndicating real estate investments. In the fall of 1970 through its Minnesota counsel, Haverstock, Gray, Plant, Moody and Anderson, ULI asked our opinion concerning a proposal to offer publicly limited partnership interests in a newly organized partnership ("Partnership A") which would acquire limited partnerships interests in an operational partnership ("Partnership B") engaged in the business of owning and operating office buildings. At that time, we indicated that if 90% or more of the value of Partnership A's investment securities were represented by securities of Partnership B, it would appear that the former would be excepted from the definition of "investment company" by virtue of Section 3(c)(8) read together with 3(c)(6). We indicated, however, that the Investment Company Amendments Act of 1970 then pending called for the elimination of Section 3(c)(8) and the proposed program was abandoned.

The Company is now considering offering participation interests pursuant to arrangements similar to those of Investment Properties Associates ("Associates"), which in December 1969 offered to the public units consisting of junior mortgage bonds and limited partnership participation interests pursuant to an effective registration statement (File No. 2-33132) under the Securities Act of 1933 ("1933 Act"). ULI has asked our opinion regarding the applicability of the 1940 Act to such arrangements, particularly in view of the repeal of Section 3(c)(8).

We are advised by ULI that financing real estate syndications through the sale of participation interests along the lines of Associates offers a number of advantages over the sale of limited partnership interests as such. As a practical matter, sales of the latter must be restricted to well-to-do investors who can afford to purchase relatively illiquid partnership interests costing from \$5,000 to \$10,000. Such sales require substantial selling efforts and considerable time must be spent with each prospect or with his attorney, accountant or financial adviser. By contrast, participation interests which may be sold in small denominations and which may become freely transferrable open the way to a much broader market. In addition to having wider investor appeal, participation interests because of their small denomination and ultimate prospect for over-the-counter trading may be marketed through the use of small brokerage firms.

The unique features of this form of financing have been stressed in professional publications. See: The November 27, 1970 Bulletin published by the Institute for Business Planning ("IBP Bulletin"). The IBP Bulletin notes that this form of doing business has revolutionary implications for real estate investments and that it represents a great new breakthrough which opens the door to mass marketing of real estate investment interests. It emphasizes that this form of financing offers investors substantially all the advantages of investments in a corporate enterprise without the disadvantage of double taxation and, in addition, provides reasonable assurance of continuity of life, limited liability for investors and free transferability of their interests.

We understand that there are indications that this financing approach is being widely adopted and ULI has called our attention to at least one instance involving the distribution of participation interests in the State of Minnesota in reliance on the so-called "intrastate exemption" provided by Section 3(a)(11) of the 1933 Act.

Proposed Financing

Briefly stated, the proposed ULI program contemplates the formation of a Minnesota limited partnership (the "Partnership") pursuant to the provisions of the Minnesota Uniform Limited Partnership Act. A named individual who is a resident of Minnesota doing business therein will acquire the initial limited partnership interest therein (the "Limited Partner"). The general partnership interests will be acquired by one or more general partners (the "General Partners"). The Partnership will be primarily engaged in the business of acquiring and owning interests in real estate.

The Limited Partner proposes to offer to the public participation interests representing undivided economic interests in his limited partnership interest, ("Participation Interests"). Participation Interests will be sold in relatively small denominations, probably in the range of \$10 to \$25. The offering will be made exclusively to Minnesota residents with restrictions on resale for a specified period of time following completion of the offering. Accordingly, a market for Participation Interests will not be established until after the securities have come to rest in the hands of the ultimate purchasers. The offering will be made without registration of the securities under the 1933 Act in reliance on the exemption provided by Section 3(a)(11) thereof. The proceeds of the offering received by the Limited Partner will be contributed by him to the capital of the Partnership.

Description of Participation Interests

Purchasers of Participation Interests will not be limited partners or members of the Partnership. They will be entitled, however, to rateable portions of any distributions by the Partnership in respect of the limited partnership interest of the Limited Partner. Purchasers of Participation Interests will not have voting rights but the Limited Partner will be restricted under certain circumstances from taking action without approval of the holders of Participation Interests. For instance, no amendment to the Limited Partnership Agreement relating to the crediting of income or gain or payment of net revenues which may adversely affect the rights of the Limited Partner may be made unless the Limited Partner obtains the affirmative vote or consent of a specified percentage of the outstanding Participation Interests. In addition, the Limited Partner will not create additional Participation Interests without prior approval of a specified percentage of the holders of the outstanding Participation Interests. Each Participation

Interest will have equal distribution and other rights and no Participation Interest will be subject to assessment, call or redemption. In addition, the certificates evidencing Participation Interests will provide that no holder thereof shall be subject as such to any liability, obligation or duty of any kind to the Limited Partner, the Partnership, its Partners or their respective creditors.

The Limited Partner (or his successor) will be required to maintain at all times an agreement with a natural person who will agree to become the successor Limited Partner upon the resignation, bankruptcy, incapacity or death of the Limited Partner and to assume all the obligations of the Limited Partner as provided in the certificates. For further information concerning the rights of holders of Participation Interests and the respective rights, duties and obligations of Limited Partners and General Partners, reference is made to the registration statement of Associates and the exhibits thereto.

The legal issue presented is whether, if the proposed financing plan is adopted, the Limited Partner may be deemed to be an investment company, or whether he and others associated with him in the enterprise may be deemed to have created an investment company within the meaning of the 1940 Act.

Definition of Investment Company

For purposes here pertinent, the 1940 Act contains the following definition of investment company:

Sec. 3. (a) When used in this title, "investment company" means any issuer which --

(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, re-investing, or trading in securities;

. . . .

or

(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

As used in this section, "investment securities" includes all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which are not investment companies.

Legal Discussion

The Limited Partner would appear to be an issuer within the meaning of the 1940 Act. The issuer definition contained in Section 2(a)(33) includes "every person who issues or proposes to issue any security, or has outstanding any security which it has issued." Despite the use of the impersonal pronoun in the last clause, any doubt as to the issuer status of the Limited Partner would appear to be removed by Section 2(a)(28) which defines "Person" to mean "a natural person or a company." In this connection, a recent "no-action" request to permit James D. Landauer, the sole Limited Partner of Associates, to dispense with the filing of periodic reports under the Securities Exchange Act of 1934 ("1934 Act") is of interest. The request acknowledges that Mr. Landauer is an "issuer" within the technical meaning of the 1933 Act and as such signed the registration statement in that capacity. CCH. Fed. Sec. L. Rep. ¶78,060 (Feb. 22, 1971).

It is equally clear that the Participation Interests constitute securities within the meaning of Section 2(a)(36), which includes within the security definition any "certificate of interest or participation in any profit-sharing agreement. . . investment contract. . . or in general, any interest or instrument commonly known as a 'security' or any certificate of interest or participation in . . . any of the foregoing."

The inquiry then is whether the Limited Partner can be regarded as being or holding himself out as being engaged primarily, or proposing to engage primarily, in the business of investing, reinvesting, or trading in securities. A threshold question is whether in the circumstances here presented the limited partnership interest itself which is to be acquired by the Limited Partner is to be deemed a security within the meaning of Section 2(a)(36).

Applying the test in SEC v. W.J. Howey Co., 328 U.S. 293 (1946), a distinction is usually drawn between general and limited partnership interests. Since general partners are viewed as active participants in the common enterprise who expect to derive profits through their own efforts, their interests are normally not deemed to be securities. By contrast, since limited partners are viewed as investing

in the common enterprise with the expectation of profits from the efforts of others, their interests have customarily been deemed to be securities. It has been said in fact that the use of the word "partner" in connection with a limited partner is really a misnomer; that he is merely a passive investor having no vote or active voice in the conduct of the firm's affairs and that the Uniform Limited Partnership Act provides that a limited partner is not liable to the firm's creditors beyond the amount of his investment unless he takes part in the control of the business. 11 Business Organizations, H. Sowards, The Federal Securities Act, § 2.01[12] (1970). Sowards concludes that the interest of a limited partner is an "investment contract" and a "certificate of interest or participation in any profit-sharing agreement", and, therefore, a security within the meaning of Section 2(1) of the 1933 Act. This is consistent with the definition of "equity security" contained in Rule 3a11-1 under the 1934 Act which includes any "limited partnership interest," and Securities Act Release No. 4877 (Aug. 8, 1967), issued jointly with the Maryland, Virginia and District of Columbia securities administrators. There the Commission stated: "Under the Federal Securities Laws, an offering of limited partnership interests. . . generally constitutes an offering of a 'profit sharing agreement' or an 'investment contract' which is a 'security' within the meaning of Section 2(1) of the Securities Act of 1933."

On the other hand, it has been said that it is at least arguable that one should be able to advertise publicly for a small number of limited partners without regard to the 1933 Act if the partnership certificate does not permit free substitution of limited partners. 1 L. Loss, Securities Regulation 504 (2d ed. 1961). Professor Loss states further that "it may be questioned whether in statutory context a private offering of limited partnership interests which is exempt from registration under § 4(1) of the Securities Act (that is to say, personal negotiation with prospective limited partners) involves a 'security' for purposes of the fraud provisions whether or not the certificate contains a provision on substitution without the consent of all the partners."

It is contemplated that purchasers of Participation Interests will be permitted to apply to the Partnership to be admitted as Limited Partners. Such admittance will be subject to the consent of the General Partners which may be withheld or granted by them in their sole discretion. (so-called "right of delectus personarum"), the execution of such documentation as may be required by the Partnership,

the payment of expenses of effecting such admission and to the surrender for cancellation of his certificate covering Participation Interests.

Since it is contemplated that the basis of the Limited Partner's participation in the common enterprise as represented by his limited partnership interest will be arrived at through personal negotiation, and in view of the General Partners' right of delectus personarum, a case can be made for the proposition that the limited partnership interest should not be regarded as a security for purposes of either the 1933 Act or the 1940 Act. However, it must be recognized that the Limited Partner will be acquiring his limited partnership interest with a view to dividing up such interest and distributing to the public participations therein. This raises the question whether the proposed transactions can be equated with the type of Section 4(1) transaction Professor Loss had in mind. We would appreciate being advised whether the Commission in the circumstances here presented would deem the limited partnership interest to constitute a security for the purposes of either the 1933 or 1940 Act.

If the limited partnership interest is to be viewed as a security within the meaning of Section 2(a)(36), the inquiry becomes whether the Limited Partner by acquiring and holding his limited partnership interest can be said to be engaged primarily in the business of investing, re-investing, or trading in securities. Two points should be stressed at this juncture. First, it is contemplated that the Limited Partner will acquire a single security, namely the limited partnership interest. But Section 3(a)(1) speaks of "securities" in the plural. It thus appears to presuppose transactions in more than one security.

The second point calls for a comparative analysis of Sections 3(a)(1) and 3(a)(3). The latter refers not only to investing, reinvesting or trading in securities, but also to "owning," or "holding" securities. Accordingly, it has been held that a company may be within Section 3(a)(3) even though its portfolio is not active if investment securities comprise 40% of its assets. It has been stated, on the other hand, that Section 3(a)(1) does not include an issuer who merely owns or holds securities but only one whose primary business is investments and whose portfolio is active. See Kerr, The Inadvertent Investment Company: Section 3(a)(3) of the Investment Company Act, 12 Stan. L. Rev. 29, 34 (1959).

If this distinction has validity, it would appear that the Limited Partner would not come within the Section 3(a)(1) definition of investment company, since he will do no more

than invest in the limited partnership and thereafter own and hold such interest. We would appreciate knowing whether the Commission concurs in the foregoing interpretation of Section 3(a)(1). If it does not, the Limited Partner would appear to come within the definition of investment company contained therein.

If it accepts such interpretation, it becomes necessary to deal with Section 3(a)(3). The question then presented is whether the Limited Partner may be viewed as acquiring and owning "investment securities" having a value exceeding 40% of the value of his total assets (exclusive of Government securities and cash items). This in turn depends upon whether the limited partnership interest of the Limited Partner comes within the definition of "investment securities," the latter for present purposes being defined to include all securities except "(C) securities issued by majority-owned subsidiaries of the owner which are not investment companies." Section 2(a)(24) defines a "Majority-owned subsidiary" of a person to mean "a company 50 per centum or more of the outstanding voting securities of which are owned by such person, or by a company which, within the meaning of this paragraph is a 'majority-owned subsidiary' of such person." A strict reading of the statute leads to the conclusion that the Partnership cannot be viewed as a majority-owned subsidiary of the Limited Partner. Moreover, the proposed Articles of Limited Partnership will provide that the General Partners will have charge of the management, conduct and operation of the Partnership business and that neither the Limited Partners nor the holders of Participation Interests will take part in or interfere in any manner with the management, control or conduct of the Partnership business. In these circumstances, no grounds exist for treating the Partnership as a majority-owned subsidiary of the Limited Partner. Accordingly, if limited partnership interests constitute securities, they are also "investment securities." Even so, it would appear that the Limited Partner could escape the Section 3(a)(3) definition of investment company if it could be shown that the value of his limited partnership interest did not exceed 40% of the value of his total assets (exclusive of Government securities and cash items). We would appreciate confirmation of this view.

Assuming that the Limited Partner himself does not come within the Section 3(a)(1) definition of investment company for the reason that his portfolio is inactive and that he would not come within the Section 3(a)(3) definition on the grounds just stated, one further area of inquiry remains. In The Prudential Ins. Co. of America, 41 S.E.C. 335 (1963),

the Commission held that the variable annuity contracts there under consideration created a "relationship subject to the Act" and that although Prudential was not itself an investment company, it was the "creator of one." In its Findings and Opinion, the Commission pointed out that the Act's definition of "company" included ". . . a trust, a fund, or any organized group of persons whether incorporated or not. . . ." It stated that the variable annuity contracts created a "trust" in the hands of Prudential for the contract holders, and it also added (p. 345):

"The contracts also constitute the holders an 'organized group of persons.' Prudential states that the holders are 'merely scattered individuals and companies who happen to have purchased variable annuity contracts. They have formed no organization among themselves, they take part in no joint activity of any kind, and they have assumed no responsibility toward each other.' But this is to argue that a group is not a group because it was some other person who brought it together. It is a principal purpose of the Act to require that a group such as this have a certain role and take part in certain responsibilities; it does not leave these matters to contractual whim. [Footnotes omitted]

We seek assurance that the proposed relationships, by a parity of reasoning, will not be deemed to create an investment company. We are particularly interested in being assured that the proposed arrangements will not be construed to create a trust. We note that Section 4(1) of the 1940 Act defines a "Unit investment trust" to mean:

an investment company which (A) is organized under a trust indenture, contract of custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities; but does not include a voting trust.

The proposed Articles of Limited Partnership will acknowledge that the Limited Partner intends to assign substantially all of his economic interest in his limited partnership interest in the form of transferable Participation Interests, each representing a ratable undivided interest

in the limited partnership interest of the Limited Partner and will require the Limited Partner to maintain an agency satisfactory to the Partnership for the registration of the assignment and transfer of Participation Interests and to advise the Partnership from time to time of the identity of holders of record of Participation Interests. We note that in the no-action request on behalf of Mr. Landauer referred to above the statement is made that "Mr. Landauer was an issuer only in a nominal sense and functions essentially in a representative capacity for holders of Participation Interests."

It is arguable that under these circumstances there will be created an investment company which "(A) is organized under a . . . contract of custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues . . . securities each of which represents an undivided interest in a unit of specified securities. . . ."

The foregoing quotation omits the word "redeemable" which modifies "securities" in Clause C. It is not contemplated that the Participation Interests will be redeemable; on the contrary, by their terms they will not be subject to redemption. But the fact that the issuer does not intend to make the Participation Interests redeemable does not necessarily end the matter. Such securities may be required to be redeemable, or if appropriate they may be exempted, in whole or in part, from the Act's redeemability requirements. In the Prudential matter, supra, the Commission acknowledged that variable annuity contracts by their very nature could not be surrendered during the annuity payment or "pay-out" period. It nevertheless categorized them for legal purposes as redeemable securities. It dealt with their non-redeemability feature during the pay-out period by granting an exemption from Section 27(c)(1) of the Act during such period.

In a sense, the question whether a unit investment trust may be created is a secondary issue. It relates not to whether an investment company may be present, but rather to its proper classification assuming such a company is found to exist. The primary issue remains, namely, whether the proposed arrangements will be deemed to give rise to the creation of an investment company under either Section 3(a)(1) or 3(a)(3) of the 1940 Act.

Resolution of the interpretative questions under the 1940 Act raised herein is necessary not only to ascertain what, if any, steps must be taken to effect compliance with that Act but also to determine the status of any public offering of Participation Interests under the 1933 Act.

Section 24(d) of the 1940 Act makes the intrastate exemption provided by Section 3(a)(11) of the 1933 Act inapplicable to any security of which a registered investment company is the issuer. If the issuer of Participation Interests is an investment company, a public offering of such securities in purported reliance on Section 3(a)(11) of the 1933 Act would be misplaced and would result in a violation of such Act.

We would appreciate receiving guidance with respect to the interpretative questions raised herein at the earliest practicable date so that ULI may proceed promptly with its financing program. If it is concluded that the proposed arrangements will not give rise to the creation of an investment company within the meaning of the 1940 Act, we also request assurance that the Staff will not recommend any action to the Commission if ULI proceeds with its financing plan on the assumption that the provisions of the 1940 Act have no applicability to its operations.

Very truly yours,


E. Ladd Thurston

REC'D-S.D.C.

JUN - 7 1971

Based on the facts and representations in this letter, we are of the opinion that if the proposed financing plan is adopted the Limited Partner and others associated with him in the enterprise will have created an investment company within the meaning of the Investment Company Act of 1940 ("Act"). The Limited Partner would be the creator of a "company" within the meaning of Section 2(a)(8) of the Act consisting of a fund or an unincorporated organized group of persons ("Fund"), whose only investment would be the security of a single issuer, the Limited Partner. In our view, the Limited Partner's interest is a certificate of interest or participation in a profit-sharing agreement or in an investment contract and thus a security. (See Section 2(a)(36) of the Act.) In this instance, it is as well an investment security within the meaning of Section 3(a)(3) of the Act. The exclusion from the definition of investment company in Section 3(c)(5) of the Act, which may be available to the limited partnership, would be unavailable to the Fund since a company primarily engaged in purchasing or otherwise acquiring securities of companies engaged in the real estate business does not qualify for the exclusion. (See Investment Company Act Release No. 3140 (November 18, 1960)). Participation Interests in the Fund, which is invested solely in the interest of the Limited Partner, are of course themselves securities, being certificates of interest or participations in a security.

In this connection, comparison of Sections 3(c)(5) and 3(c)(9) of the Act is revealing. The latter Section specifically excludes from the definition of investment company any person substantially all of whose business consists of owning or holding certificates of interest or participation in or investment contracts relative to oil, gas, or other mineral royalties or leases. This is in contrast to the exclusion in Section 3(c)(5)(C), limited to any person who is primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.

As you know, Section 3(c)(8) of the Act was repealed by the Investment Company Amendments Act of 1970 (P.L. 91-547, December 14, 1970). Section 3(c)(8) had excluded from the statutory definition of an investment company, a company 90 per cent or more of the value of whose investment securities are those of any single financial institution including, among others, the type enumerated in what is now Section 3(c)(5)(C). The availability of that exclusion to companies which hold, solely as an investment, securities of certain types of financial institutions was deemed to be wholly inconsistent with the statutory policy of the coverage of the Act and was removed. (See Investment Company Act Release No. 6440, April 6, 1971, pp. 1-2)

For the foregoing reasons, we cannot give you the no-action assurance you request.

Alan Rosenblat

Alan Rosenblat, Chief Counsel
Division of Corporate Regulation
September 24, 1971 SLC:lam

as of 10/4/71 (mailed?)