

ADMINISTRATIVE PROCEEDING

BEFORE THE

SECURITIES COMMISSIONER OF SOUTH CAROLINA

IN THE MATTER OF:) **File No: 12059**
)
John M. McIntyre and)
Silver Oak Land Management, LLC,) **ORDER**
)
Respondents.)
_____)

BACKGROUND

On April 19, 2013, the Securities Division of the Office of the Attorney General of the State of South Carolina (the “Division”) issued an Order to Cease and Desist naming John M. McIntyre and Silver Oak Land Management, LLC (“SOLM”) as Respondents.¹ The Order to Cease and Desist alleged that on at least 39 occasions, the Respondents, jointly and severally, committed violations of section 501 of the South Carolina Uniform Securities Act (the “Act”), S.C. Code Ann. § 35-1-501. Order ¶ 43 at p. 7. The Division contended that the Respondent LLC managers had violated state law in their dealings with persons who invested in the manager-managed LLCs they controlled. The Respondents filed a timely Answer and Request for Hearing on June 3, 2013.

I appointed a Hearing Officer, and a four-day hearing was held where witnesses were heard and evidence was presented. The hearing concluded on October 3, 2013. On May 6,

¹ SOLM is the manager for each of the manager-managed LLCs; Dave Jeff, LLC and John M. McIntyre are the members of SOLM. Dave Jeff, LLC is a single-member LLC whose member is Susan Vitek. [7/30/13 Transcript, pp. 47-48].

2014, the Hearing Officer issued his Report and Recommendations. He recommended that I “find that the limited liability company interests which constitute the investments at issue in this matter are not securities” and accordingly dismiss the Cease and Desist Order. *Report and Recommendations* p. 1.

SUMMARY OF FINDINGS

Having independently reviewed the underlying facts and pertinent legal authorities, I disagree with and decline to follow the Hearing Officer’s recommendation. For reasons discussed below, I conclude that the Hearing Officer erred in holding that the investments at issue in this matter are not securities. In so holding, the Hearing Officer analyzed the investments in question as if they had been issued by an entity doing business as a general partnership. I conclude this analysis was incorrect.

The investment units in question were LLC membership interests issued by manager-managed LLCs. As discussed below, a manager-managed LLC is an entity that is, in key respects, very different from a general partnership. Among the major differentiating attributes are limited liability protection for the owners and decision-making by use of a centralized management structure. Hence, in terms of its key attributes, a manager-managed LLC is set up much like a corporation or a limited partnership. The non-manager members of a manager-managed LLC are closely akin to corporate shareholders or limited partners in a limited partnership.

Investments offered and sold to corporate shareholders or limited partners traditionally have been viewed as securities, whereas investments offered and sold to partners in a general partnership have not. Thus, while investment offerings to limited partners have been presumptively viewed as covered by the securities laws, the opposite presumption has applied

to partners is a general partnership. When the appropriate presumption is applied to the investments offered and sold in this case, which were issued by entities that are limited partnership-like in nature, it is clear that the investments at issue are most appropriately classified and regulated as securities. A review of the facts discussed below confirms the validity of this conclusion.

Accordingly, I conclude that dismissal of this matter at this juncture is inappropriate. The Hearing Officer is directed to make a Report and Recommendation as to whether any violation of S.C. Code Ann. § 35-1-501 has occurred.

ANALYSIS OF MANAGER-MANAGED LLC UNITS

INTRODUCTION

There is nothing novel in the view articulated here that investment units issued to members of manager-managed LLCs should presumptively be viewed as falling within the purview of the securities laws. “For LLC memberships, the generally held presumption is that memberships in member-managed LLCs are not securities (by analogy to general partnerships) but those in manager-managed LLCs are.” Scott Y. Barnes *et al.*, *South Carolina Limited Liability Companies and Limited Partnerships* 97 (South Carolina Bar Cont. Legal Education eds., 4th ed. 2012). Indeed, it has long been the position of the South Carolina Securities Commissioner that interests in manager-managed limited liability companies constitute securities absent strong evidence demonstrating the investment purchaser’s retention of rights of control. *See Limited Liability Company Membership Interests as Securities*, Office of the South Carolina Secretary of State Statement of Policy 95-2 dated June 16, 1995.

The 1995 Policy Statement put forward two rebuttable presumptions, each of which accords with the weight of authority: (1) for member-managed LLCs, the Policy Statement presumed that membership interests are not securities; (2) for manager-managed LLCs, the Policy Statement presumed the opposite, that the interests are securities. Under the Policy Statement, to be classified as a member-managed LLC, each member must have “practical and meaningful participation in and control over the managerial decisions” of the LLC. The Policy Statement also envisioned member-managed LLCs as entities where neither the articles of organization nor the operating agreement appoint managers or limit the ability of members to manage the LLC. I conclude the reasoning and analysis in the Policy Statement was sound. In the case of the instant LLCs, it is undisputed that each of the LLCs’ operating agreements specified they were manager-managed. As discussed below, facts in the record confirm that the LLCs actually were managed in that fashion by Respondents. Thus, presumptively, the memberships sold by the manager-managed LLCs were securities.

THE SUBJECT LLCs WERE RUN LIKE LIMITED PARTNERSHIPS

“Unlike general partnership interests, the interest of a limited partner will almost always be a security.” Mary Ann Frantz, 1 ADVISING SMALL BUSINESSES § 16:24 (2014). In general partnerships, the partners must shoulder the risk of open-ended personal liability for any wrong committed by their partnership or by a partner engaged in conduct that was either authorized or at least was for “apparently carrying on in the usual way the business of the partnership.”² This risk of personal liability exposure gives the partners in a general partnership a strong incentive, for their own protection, to participate in management and to

² See S.C. Code Ann. § 33-41-310(1).

monitor business activities on an ongoing basis. In contrast, limited partners are more entitled to be passive investors because they do not face unlimited personal liability for entity-related misconduct in which they are not personally involved.

Limited partnerships feature centralization of control in the hands of a manager, the general partner, with the limited partners playing the role of generally passive investors. Under the limited partnership statute, however, even in a limited partnership the limited partners are entitled to exercise a measure of control in numerous ways without participating in the “control of the business” and thereby sacrificing their status as limited partners.³

³ Thus, under S.C. Code Ann. § 33-42-430(b), limited partners are given the right to take numerous actions to protect their interests or further the partnership’s interests, including advising the general partner about business matters, proposing and voting for the general partner’s removal, and many other actions. The full test of §33-42-430(b) follows:

(b) A limited partner does not participate in the control of the business within the meaning of subsection (a) solely by doing one or more of the following:

(1) being a contractor for or an agent or employee of the limited partnership or of a general partner or being an officer, director, or shareholder of a general partner that is a corporation;

(2) consulting with and advising a general partner with respect to the business of the limited partnership;

(3) acting as surety for the limited partnership or guaranteeing or assuming one or more specific obligations of the limited partnership;

(4) taking any action required or permitted by law to bring or pursue a derivative action in the right of the limited partnership;

(5) requesting or attending a meeting of partners;

(6) proposing, approving, or disapproving, by voting or otherwise, one or more of the following matters:

(i) the dissolution and winding up of the limited partnership;

(ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership;

(iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business;

(iv) a change in the nature of the business;

(v) the admission or removal of a general partner;

(vi) the admission or removal of a limited partner;

(vii) a transaction involving an actual or potential conflict of interest between a general partner and the limited partnership or the limited partners;

(viii) an amendment to the partnership agreement or certificate of limited partnership;

(7) winding up the limited partnership pursuant to Section 33 42 1430; or

The management scheme used by the LLCs managed by Respondents fits the limited partnership mold. The investor-members tended to be passive investors, and control was claimed and exercised by the designated managers, as it would be a general partner in a limited partnership. One of the Respondents, Mr. McIntyre, served as the promoter for the subject LLCs. The management company he operated, SOLM, was the appointed manager of each manager-managed limited liability company involved in this matter. In other words, SOLM, under Mr. McIntyre's leadership, performed basically the same management functions for the LLCs as a general partner would perform for a general partnership.

As discussed above, in a member-managed limited liability company each member has equal rights in the management and conduct of the company's business, whereas in a manager-managed company it is only the managers (in this case, the Respondents) with equal rights in the management and conduct of the business. S.C. Code Ann. § 33-44-404(a) & (b). Furthermore, except for conduct falling in a narrow band of exceptions set forth in S.C. Code Ann. 33-44-404(c), the statute decrees that "any matter relating to the business of the company may be exclusively decided by the manager." S.C. Code Ann. § 33-44-404(b)(2) (emphasis added). The Reporter's Comment to South Carolina's LLC law provides that the members of a manager-managed limited liability company "have no rights in the management and conduct of the company's business unless otherwise provided in an operating agreement." S.C. Code Ann. § 33-44-404 cmt.

(8) exercising any right or power permitted to limited partners under this chapter and not specifically enumerated in this subsection (b).

(c) The enumeration in subsection (b) does not mean that the possession or exercise of any other powers by a limited partner constitutes participation by him in the control of the business of the limited partnership.

The LLC Documentation Vests the Respondents with Control

For the limited liability companies at issue in this case, the non-manager members are given no appointment of managerial authority to act on behalf entities under their operating agreements. On the contrary, the LLC operating agreements uniformly state at paragraph 6.1, “[e]xcept as otherwise set forth herein, all decisions effecting [sic] the operations of the Company shall be decided by consent of the Manager.” *See, e.g.*, State’s Exhibit 4, p. 5, (Silver Oak Land Trust IV, LLC Operating Agreement); State’s Exhibit 10, p. 4 (Silver Oak Land Trust LLC, a/k/a SOLT I, Operating Agreement) (emphasis added). The Respondent-managers’ authority was very broad. Under the operating agreements, the manager had the authority to “[e]ngage in any kind of activity and to perform and carry out such contracts of any kind necessary to operate the business and purposes of the” LLCs. *See, e.g.*, State’s Exhibit 4, p. 5; State’s Exhibit 10, p. 4.

The term “Manager” is defined in each operating agreement as being one of the Respondents. *See, e.g.*, State’s Exhibit 4, p. 1, State’s Exhibit 10, p. 1. The LLC’s operating agreement explicitly curbs the ability of members to participate meaningfully in the management of the company. Through the documentation they originated, the manager(s) in this case had the sole ability to manage each company. It is reasonable to conclude that under the management scheme Respondents established and used, the Respondent-managers’ efforts were perforce the “undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.” *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9th Cir. 1973). Respondents’ control power was all-encompassing.

The LLCs Were Managed Consistent with the Operating Agreements

Respondents, through Mr. McIntyre, exercised control in forming and operating the LLCs. In setting up the LLCs, Respondents functioned as promoters for the LLCs. When inviting investment subscriptions, Mr. McIntyre reserved the right in his “sole discretion” to decide whether “to accept or reject any offer [or ‘membership’], in whole or in part.” *See, e.g.,* State’s Exhibit 3, p. 2; Exhibit 5, p. 4; Exhibit 7, p. 8. From day one, one of the Respondents was the appointed manager of each manager-managed limited liability company involved in this matter. By definition, from each one of the LLCs’ inception, Respondents furnished the essential managerial efforts which affect and determine the failure or success of the enterprise.

The record reflects that the LLCs actually were managed in accordance with the documentation, i.e., by the designated manager, SOLM, which was headed by Mr. McIntyre. Mr. McIntyre promoted the LLCs and controlled SOLM, the LLCs’ manager. He testified that he was the one who would negotiate purchase price on the properties that he, himself, researched and identified. [7/30/13 Transcript, pp. 63, 65, 81]. Further, he testified that he was the only one with use of debit cards associated with the company accounts. [7/30/13 Transcript, pp. 82, 103]. Under the applicable operating agreements, the crucial management decision-making that determined the financial viability and profitability of the LLCs was plainly delegated to SOLM, which operated under Mr. McIntyre’s guidance.

It is evident that the reality of the LLC’s management structure and procedures followed the limited partnership model where control is concentrated in the hands of a

manager who plays the key role in making policy and operating decisions. Copies of the membership unit offering documents that the Respondents sent out while attempting to raise money from investors were introduced into the record. [State's Exhibits 3, 5, 6, 7]. None of those offering documents indicate that any member-investors being solicited were expected to shoulder any managerial duties after investing. [State's Exhibits 3, 5, 6, 7]. Any potential investors having questions about the offerings were told to call Mr. McIntyre for answers—no one else. [State's Exhibits 3, 5, 6, 7].

None of the offering documents mention or even suggest the requirement or need for any member-investor other than the manager-member to supply management services to the LLC. In fact, the offering documents either state or suggest the contrary. For example, Silver Oak Land Trust ("SOLT") V's offering materials explicitly state that "Silver Oak Land Management, LLC [the managing member], will generate income for Silver Oak Land Trust V, LLC." [State's Exhibit 6]. Respondent McIntyre further testified that when "soliciting interest in participation" in the LLCs he did not vary from the assertions found in the membership unit offering documents and that it was the standard offering. [7/30/13 Transcript, pp. 144-45].

At the Hearing, the Respondents offered James Russell Paris to show that the members played a role in the management of the company. [10/01/13 Transcript, Testimony of James Russell Paris]. However, Mr. Paris's testimony was not helpful in this regard. Mr. Paris testified that McIntyre had carte blanche with his money, as was consistent with prior financial transactions they had entered into together. [10/01/13 Transcript, p. 430]. Further, Mr. Paris testified that he had zero knowledge of the tree farming business and played no

role in making any managerial decisions dealing with SOLT I tree farming or land improvement. [10/01/13 Transcript, p. 430]. He testified he did not “participate directly in the management of the other SOLT entities in which [he] had an ownership interest. [10/01/13 Transcript, p. 424].

In describing his dealings with the Respondents, Mr. Paris did testify that he listed property for sale. The listing “was in the scope of [his] employment as a real estate broker . . . as opposed to anything relevant to SOLT I.” [10/01/13 Transcript, p. 431]. Mr. Paris’s role in such a brokerage transaction was to be in his capacity as a licensed real estate broker, and he would have received a commission if property had been successfully sold. [10/01/13 Transcript, p. 430-31]. As of the Hearing date, the property had not been sold. [10/01/13 Transcript, p. 418]. There is no proof that Mr. Paris offered any unique or essential managerial skills to SOLM or the LLC as a real estate broker that could not have been provided by some other licensed broker. In fact, Mr. Paris testified he was the third or fourth broker who listed the property. [10/01/13 Transcript, p. 418]. The record simply establishes that Mr. Paris acted as an agent of the company for the purposes of listing property for sale.

Mr. Paris denied participating directly in the management of SOLT entities. [10/01/13 Transcript, p. 424]. He denied being involved in any decisions about tree farming or improving the land. [10/01/13 Transcript, p. 430]. If Mr. Paris had been a limited partner his actions would not have disqualified him from limited partner status on the ground that he participated in control. This is because by law limited partners properly may participate in the conduct of the limited partnership’s affairs by being an agent or employee or contractor for the limited partnership or by advising or consulting with the general partner-manager. S.C. Code Ann. § 33-42-430(b)(1) & (2). Accordingly, I find that through his real estate brokerage

activities Mr. Paris did not act as a manager or participate in the control of any LLC. I further find that his limited efforts were not essential managerial efforts which affected the failure or success of any of the subject LLC enterprises.

Phil Hartman, an investor in SOLT IV, likewise had little or no involvement of a managerial nature. He testified that at the time he invested he did not contemplate having an active role in the company. Further, while he offered Mr. McIntyre assistance related to possibly obtaining grants through the Department of Agriculture, his offer was never accepted and he never did participate in the management or business of the company. [10/01/13 Transcript, pp. 13-14, 28]. So far as Mr. Hartman was initially aware, Jack McIntyre was solely responsible for the management of SOLT IV. [10/01/13 Transcript, p. 13, 14].

As a non-manager, Mr. Hartman was an outsider, and he was treated as such. When he became concerned about Mr. McIntyre's management behavior, Mr. Hartman sought and was denied access to information concerning his investment. He testified, "When we started hearing that there may be problems with the SOLT IV I called Jack [McIntyre] asking him for a list of all the financial records, including contracts for selling timber cuttings, as well as information on rentals for hunting land. He said he would give that to me. It did not come. I ended up writing a letter, sending him an email asking for it again, and I still have not received that information." [10/01/13 Transcript, p. 28].

Rich Silver is another investor in the SOLT LLCs who appeared at the Hearing. Mr. Silver testified that in connection with each of his investments related to this matter, namely investments in SOLT IV, V, VII, Silver Oak Energy, and SOLT I, that he had no intention to play an active role in the company and never did. [10/01/13 Transcript, p. 93-94, p. 102-03, p. 107-108, 113-114, 121]. Mr. McIntyre was identified by Mr. Silver as the man who provided

the essential services needed by the LLCs.⁴ Based on how the SOLT offering had been sold to him, Mr. Silver's impression was that Mr. McIntyre was the key and in fact sole service provider. "He was going to do all the work. I didn't want to do any of the work." [10/01/13 Transcript, p. 101]. Further, Mr. Silver did not know anyone else who played a major management role in any company except for Susan Vitek. [10/01/13 Transcript, p. 93-94, 102-103, 108]. Ms. Vitek was associated with SOLM through another limited liability company. [07/30/13 Transcript, p. 47-48].

As was the case with Mr. Hartman, Mr. Silver recounted at the hearing having trouble getting information concerning his investment from Mr. McIntyre. "[T]he investors in Silver Oak Energy ("SOE") uncovered some financial irregularities that have occurred since SOE's creation. When the first of these irregularities came to light, information and documentation was requested of JM. These requests were initially ignored, but instead various and conflicting explanations were provided by JM as to what actually had transpired, much of which were later proven false." [10/01/13 Transcript, p. 141].

Another investor, Paul Finn, testified that in connection with his investments in SOLT IV and VII, he had no intention to play an active role in the company and never did. [10/01/13 Transcript, p. 196, 200]. In regards to Silver Oak Energy, Mr. Finn testified that he did contribute some services, but he had no access to information about the company, did

⁴ "In learning about how these timber LLCs worked that Jack had put together, my understanding was that he created these. He researched and found property and that each LLC, as he formed each one, would own a single tract of timberland. And that the purpose would be to manage the timber over time for cutting and harvesting and that that would produce a current return. . . . The only name that appeared on the offering document for SOLT IV, to my knowledge, was Jack McIntyre's. There was no reference to Silver Oak Land Management in the SOLT IV offering. I never knew of or heard of Silver Oak Land Management at the time. And so in my understanding from conversations with Jack, is these were his companies that he created and that he managed by himself." [10/01/13 Transcript, p. 92-93].

not have access to the financial records of the company, and visited the farm only once. [10/01/13 Transcript, p. 204-206]. Further, he was located in Massachusetts working as a mediator. Finn was not located near the farm. [10/01/13 Transcript, p. 205]. When it came to whose efforts were essential to realizing a profit, Mr. Finn testified that he was dependent on the Respondents to grow, cultivate, and sell for profit Miscanthus grass. [10/01/13 Transcript, p. 277]. He testified that SOLM and Mr. McIntyre received thirty-five percent of the Silver Oak Energy business for “professional services,” whereas he received no share for any services he contributed. [10/01/13 Transcript, p. 207-08]. Obviously the services contributed to Silver Oak Energy by Respondents were the essential managerial efforts which affect the failure or success of the enterprise.

With the lone exceptions of SOLM, McIntyre, and Susan Vitek, who functioned as a manager through her ownership of Dave Jeff LLC,⁵ none of the members of the companies intended to play an essential control or management role in the companies in which they invested. Nor is there evidence they were invited to play such a role when they were offered or sold their investments. Nor does the record disclose competent, credible evidence that they invested having had the inclination, desire, and ability to play a lead role in the management decision-making of the LLCs in which they invested. Likewise missing from the record is evidence proving that they ever took part in rendering any crucial services as part of the LLCs’ management; on the contrary, the record reflects by a clear preponderance of the evidence that they looked to Respondents for such services. In the case of each LLC, it is evident that the

⁵ Dave Jeff, LLC was solely owned by Ms. Vitek and was a co-manager or SOLM with Respondent McIntyre. Thus, through Dave Jeff, Ms. Vitek had control power over the LLCs in question.

investors' profits, which they expected to gain from the LLCs in which they invested, were to be derived primarily from the efforts of persons other than the investor, namely Respondents.

Respondents Had and Exercised the Dominant Control Power

Central to the Hearing Officer's recommendation that I find the LLC members units not to be securities was a list of nine factors which, he concluded, "show that the members have retained enough powers to protect their interests, to replace the management should they so elect, and to confer with each other to do so should they so elect." *Hearing Officer's Report and Recommendations*, p. 18. I decline to accept the Hearing Officer's analysis. I find that those factors provide an inadequate foundation for holding that the non-manager LLC members of the manager-managed LLCs in this case were not offered and sold securities.

Most of the factors cited by the Hearing Officer consist of rights or powers that limited partners in limited partnerships may exercise under the South Carolina Uniform Partnership Act, or which are expressly granted to members of South Carolina LLCs by statute. These facts are important. Nobody can seriously contend that limited partnership interests are not presumptively securities. Thus, the fact that a member of one of the LLCs had the same rights that a limited partner can lawfully exercise is not a valid reason for finding the securities laws should not apply. Stated differently, if the existence of a specific right in the hands of a limited partner does not disqualify the limited partnership interest held from being a security, it should not be disqualifying if the same right is in the hands of an LLC member.

The first factor cited by the Hearing Officer was the requirement of a majority vote to replace the manager. South Carolina law allows limited partners to vote on the removal of a general partners, *see* S.C. Code Ann. § 33-42-430(b)(6)(v), and members in every South

Carolina LLC can remove managers by majority vote. S.C. Code Ann. § 33-44-404(3). That the LLC members held a right held by every South Carolina limited partner (who is presumed to have purchased a security) does not furnish any justification for holding that the LLC members were not offered and sold securities.

Nor does the fact that the LLC members enjoyed rights held by every other member or a South Carolina LLC furnish grounds for holding that the subject LLC members' investments should not be classified as securities. After all, the South Carolina Securities Act specifies that LLC memberships may be classified as securities. *See* S.C. Code Ann. § 35-1-102(29)(E) (stating that securities in the form of an “[i]nvestment contract’ may include, among other contracts, an interest in a limited partnership and a limited liability company”). Thus, the existence of a right held by all South Carolina LLC members cannot provide a valid justification for picking and choosing between those LLC offerings that involve securities and those that do not.

The Hearing Officer also cited as a basis for his decision “the small number of votes required to replace the manager due to sizes of the memberships and the per capital [sic] majority rule.” Yet per capita voting in manager-removal decisions is the rule in every South Carolina LLC. *See* S.C. Code Ann. § 33-44-40(3). (“[A] manager . . . must be . . . removed, or replaced by a vote, approval, or consent of a majority of the members.”) Again, a right held by all South Carolina LLC members cannot provide a valid justification for picking and choosing between those LLC offerings that involve securities and those that do not.

The Hearing Officer’s suggestion that the existence of a relatively small number of members is an important factor influencing whether the securities laws should apply is noted

but is not accepted as a valid consideration. The Uniform Securities Act exists to provide protection to investors in need of the Act's protections. Therefore, the focus must be on the investors' need for protection, and that crucial central issue is not addressed or resolved by counting how many units are being offered or sold. Stated differently, if an LLC is manager-managed, the investments it issues presumptively are securities whether the number of member-buyers is few or many. I note that one of South Carolina's leading securities cases is *McGaha v. Moseley*, 283 S.C. 268, 322 S.E.2d 461 (Ct. App. 1984). That case involved a successful suit by a single investor in the face of a claim that the investment sold her was not a security. She recovered although she worked for the issuer and apparently was the only offeree and purchaser of the security in question. In *McGaha*, our Court of Appeals declared, "Since the securities laws are remedial in nature, courts have uniformly held they should be liberally construed to protect investors." *McGaha*, 283 S.C. at 273, 322 S.E.2d at 464.

Among the other factors cited by the Hearing Officer in support of his view that the LLC members had not purchased securities were the inability to amend the operating agreements without unanimous consent and the requirement that new members be admitted only upon unanimous consent. Yet again, both of those factors stem from statutory requirements applicable to every single South Carolina LLC. *See* S.C. Code Ann. § 33-44-404(c)(1) & (7). Because they are universal, they cannot properly provide a basis for distinguishing between LLCs when it comes to applying the securities laws. The same can be said of the Hearing Officer's reliance on the LLC Act's provisions guaranteeing LLC members access to information. *See* S.C. Code Ann. § 33-44-408. Limited partners also have

broad information rights, *see* S.C. Code Ann. § 33-42-60, but that does not provide a basis for disqualifying the partnership units from being classified as securities.

Also cited by the Hearing Officer as factors supporting a finding that the LLC members could protect their own interests were “the requirement that a majority approve any additional capital contributions [and] the protections afforded the members by requiring unanimous consent for any member to make loans to the entities.” It is not clear why these rights are significant. To the extent they protect against self-dealing transactions, they are not very important because breaches of fiduciary duty are expressly policed under the LLC statute. *See* S. C. Code Ann. § 33-44-409(b). In any event, the existence of a right to vote against the LLC raising capital or receiving a loan from a member are not considerations weighty enough to tip the scale in favor or depriving LLC members of the protections of the securities laws.

In further support of his position that the securities laws should not apply, the Hearing Officer also referred to “the interrelatedness of the various entities, and . . . the relationships between the members.” These factors are entitled to little weight as evidence in favor of the Hearing Officer’s conclusion. Indeed, the first factor actually cuts in the opposite direction, in that “the interrelatedness of the various entities” suggests the need for investors to receive full and fair disclosure about the consequences of that “interrelatedness” which could be subject to abuse and overreaching. In this case, it is clear Respondents controlled various interrelated LLCs. Because the entities were interrelated, the chances for conflicts of interest, self-dealing transactions, confusion of financial records, commingling of funds, misapplication of funds, and wrongful diversion of assets were increased, not decreased. Mr. McIntyre’s testimony

indicated that his disclosures when offering LLC unites to investors did not fully describe potential problems that might arise due to conflicts and self-dealing opportunities. For example:

Q When you were raising money for Silver Oak IV, did you tell investors that you would pay yourself consulting or management fees?

A IV. I don't – Well, let me just – I don't believe that ever came up.

Q When you were raising money for Silver Oak IV, did you . . . tell investors that you would use the money . . . to loan to yourself?

A I don't believe that ever came up.

Q When you were raising money for Silver Oak IV, did you . . . tell investors that you would use the money for other entities?

A I don't believe that came up. [7/30/13 Transcript, p. 71.]

Due to the conflicts of interest that were lurking within the LLCs Respondents managed, the need for careful and complete factual disclosure via detailed offering documents was increased, not lessened. Likewise increased was the justification for providing greater fraud protection for investors, which is a key benefit the securities laws offer to the public. In truth, the interrelatedness of the various SOLT LLCs was more an invitation to mischief than a blessing. This is confirmed by a report in the record sent by one LLC member to others in October of 2012:

From the startup of SOE through this year there were many intercompany loans to and from the various SOLT entities. These are all improper and unexplained. In addition there were intercompany loans between and among the various SOLT entities, and probably many more - so far I have some records for SOLT I and no records for any of the other SOLTs. But, as of the end of 2011, per SOLT I's tax return, SOLT I has receivables from SOLT II of \$15,098, from SOLT IV of \$5,240, from SOLT V of \$1,850, and from SOLT VI (which doesn't even exist) of \$6,661. Also, SOLT I as of the same date has payables to SOLT III of \$407, SOLT VII of \$3,606 and SOE of \$37,500.

. . . . In the meantime, each SOLT entity is apparently totally out of money, and, in fact, each apparently owes the CPA firm that does the annual tax work the payment for last year-end's tax return preparation. Also, as

indicated above, several of the SOLT entities owe money to SOLT I, and SOLT I and SOLT V owe money to SOE. [Exhibit 18, p. 2]

As for the “relationships between the members,” the Hearing Officer suggests that all of the members of the LLCs were in contact on a regular basis and that this furthered their ability to protect their interests. In fact, the members were geographically dispersed and communications between them were not easy. Email communication to Mr. McIntyre exists in the record showing that members had to demand other LLC members’ contact information from the Respondents. [State’s Exhibit 16]. Requests for information were met with stonewalling. [State’s Exhibit 17, p. 2]. Further reflecting the investors’ distant relationships, once the Respondents provided the contact information, an email was sent starting with, “My name is Rich Silver - most of you do not know me, but we are all investors (Members) in one or more of the Silver Oak Land Trust (SOLT) entities” [State’s Exhibit 17] (emphasis added).

It appears that even the ability to communicate with the other investors was dependent on the cooperation of the manager in supplying contact information. [State’s Exhibit 16]. There was substantial evidence that the members had little personal acquaintance with each other. *See* [State’s Exhibit 18] (consisting of an email written to various LLC investors by Mr. Silver stating, “most of you know nothing about me.”). In any event, the record reflects overwhelming evidence that the LLC members such as Mr. Silver relied on the manager-members to produce the profit-making efforts that were the “undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.” *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9th Cir. 1973).

In summary, I decline to accept the Hearing Officer's analysis at p. 18 of his *Report and Recommendations*. I find that the LLC members were offered investments by Respondents in entities controlled by Respondents, that the entities were intended to be managed by Respondents, and that, upon investing, the non-manager LLC members tended to acquiesce in control over the operation of the LLCs being in the hands of the Respondent manager-members. Thus, I find that the LLC memberships were offered and sold securities within the coverage of the South Carolina Uniform Securities Act.

Below I consider some additional specific areas in which my analysis differs from that of the Hearing Officer.

THE WILLIAMSON CASE IS NOT CONTROLLING

In making his determination, the Hearing Officer basically got the applicable legal presumption reversed, treating the investments at issue as if they had been issued by a general partnership instead of by an entity much more akin to a limited partnership. He thus incorrectly relied primarily on *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981), *cert. denied*, 454 U.S. 897 (1981). The *Williamson* test, as stated by the Hearing Officer, holds that for an investment in a general partnership to qualify as an investment contract one of three factors must be met:

- (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,
- (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.

Hearing Officer's Report and Recommendations, pp. 11-12 (quoting *Securities and Exchange Commission v. Merchant Capital, LLC*, 483 F.3d 747, 755 (11th Cir. 2007)).

In my opinion, *Williamson* offers little usable guidance when analyzing a manger-managed LLC. The case and its demanding three-part test apply to factual settings where investments have been sold to buyers who are general partners or joint venturers and who consequently have: (1) no limited liability protection,⁶ (2) a right to a say-so over management decisions,⁷ and (3) inherent power to bind the entity in the course of normal business dealings.⁸ As has been discussed, investments sold to buyers who are general partners or joint venturers presumptively are not securities. The investments in this case are different.

Specifically, like corporate shareholders and limited partners, members of a manger-managed LLC are different from general partners and joint venturers in each of these three key respects, in that they: (1) enjoy limited liability protection, (2) cede control over management decision-making to a central manager, and (3) typically have no authority by virtue of their ownership interest to conduct business on behalf of the entity. The Hearing Officer's reliance on *Williamson* accordingly was misplaced.

The *Williamson* test arguably provides some guidance in helping determine whether investments that facially would not be viewed as securities (like general partnerships or joint venture investments) might nevertheless qualify due to special circumstances. But it is of no

⁶ General partners are liable for the debts of the partnership. S.C. Code Ann. 33-41-370(A).

⁷ General partners all have equal rights in the management and conduct of the partnership business. S.C. Code Ann. § 33-41-510(5).

⁸ Each general partner has the authority to bind the partnership in the normal course of business S.C. Code Ann. 33-41-310(1).

use in evaluating whether investments that presumptively qualify as securities should be so treated. In truth, *Williamson* imposes an “extremely difficult factual burden” on claims that general partnerships are securities. *Williamson*, 645 F.2d. at 425. The Fourth Circuit stated that *Williamson* “identified a narrow exception to the strong presumption that a general partnership is not a security.” *Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236, 240 (1988) (emphasis added). This case does not involve general partnerships or entities resembling general partnerships. There is no justification for placing an “extremely difficult factual burden” on the Division in a case such as this.

In applying the *Williamson* line of cases, the Fourth Circuit has acknowledged that “[g]eneral partnerships ordinarily are not considered investment contracts because they grant partners – the investors – control over significant decisions of the enterprise.” *Rivanna Trawlers Unlimited*, 840 F.2d at 240. As the federal district court explained in *Ak’s Daks Communications Inc., v. Maryland Securities Division*, 138 Md. App. 314, 331, 771 A.2d 487, 496-97 (2001):

The rationale for the *Williamson* presumption is that general partners have a legal right to participate in the management and control of the partnership and can promote its success through their efforts, and that even if they delegate their actual authority, they retain the apparent authority to bind the partnership. In addition, general partners remain liable for the acts of the partnership; therefore, they cannot expect to be passive investors who derive profits solely from the efforts of others.

The rationale for applying *Williamson* disappears when the unique setting applicable to joint ventures or general partnerships is not present. And, as has been noted, the instant case at issue does not involve a general partnership. Instead, as the Hearing Officer found at p. 6 of his *Report and Recommendations*, each of the limited liability companies in question is manager-managed. This is an important distinction.

Unlike the case with general partnerships, under South Carolina statutory law, “in a manager-managed [limited liability] company, a member is not an agent of the company for the purpose of its business solely by reason of being a member.” S.C. Code Ann. § 33-44-301(b). Further, unlike the case with partnerships, neither the members nor the manager are personally liable for a debt or liability of the company solely by reason of being or acting as a member or manager. S.C. Code Ann. § 33-44-303(a). Moreover, where the default setting in a general partnership is shared control, in a manager-managed limited liability company, with only very limited exceptions, “any matter relating to the business of the company may be exclusively decided by the manager . . .” S.C. Code Ann. Ann. § 33-44-404(b)(2). Therefore, none of the reasons for applying the *Williamson* presumption against finding an investment contract apply to this matter.

Likewise, wide of the mark were the Hearing Officer’s repeated citation to and reliance on *SEC v. Merchant Capital, LLC*, 483 F.3d 747 (11th Cir. 2007). In that case, the SEC alleged and proved that the registered limited liability partnership interests involved were securities. Registered limited liability partnership interests are a special category of investment in a partnership-style entity falling between general partnership and limited partnership memberships. In fact, in *Merchant Capital*, the SEC argued that investment contracts existed in the case because the “RLLP interests are more akin to limited partnership interests, which are routinely treated as investment contracts.” *Id.* at 755. Indeed, in holding the investments to be securities the court in *Merchant Capital* found it “significant” that the RLLP’s manager represented to third parties that the investments actually *were* limited partnership interests. *Id.* at 762. Although no such representation was made in this case, the

record reflects that there are compelling similarities between the manager-managed LLCs run by Respondents and limited partnerships.

**THE LIMITED PARTNERSHIP ANALOGY IS VALID –
THE LLC MEMBERSHIPS WERE SOLD AS INVESTMENT CONTRACTS**

Interests in manager-managed limited liability companies are more closely related to limited partnership interests than to general partnership interests. Limited partnerships involve a general partner or a group of general partners that retain the rights and powers associated with a partner in a general partnership. S.C. Code Ann. § 33-42-630(a). Likewise, in a limited partnership, the general partner(s), not the limited partners, have open-ended liability for the partnerships debts and obligations. *Id.* §33-42-630(b).

In exchange for getting protection from devastating personal liability, a limited partner in a limited partnership gives up many incidents of control to the general partner, just as corporate shareholders typically relinquish control to the corporation’s board of directors. Similarly, in a manager-managed limited liability company, “any matter relating to the business of the company may be exclusively decided by the manager . . .” S.C. Code Ann. § 33-44-404(b)(2) (emphasis added). The members of a manager-managed limited liability company “have no rights in the management and conduct of the company’s business unless otherwise provided in an operating agreement.” S.C. Code Ann. § 34-44-404 cmt.

As we have seen, limited partnership interests generally are presumed to constitute securities and just as the threshold is high before general partnership interests are considered securities, the presumption that limited partnership interests are securities is equally high. *See Garrett v. Snedigar*, 293 S.C. 176, 181, 359 S.E.2d 283, 286 (Ct. App. 1987); *Williamson v. Tucker*, 645 F.2d 404, 423 (5th Cir. 1981).

In summary, I conclude it was error for the Hearing Officer to apply the *Williamson* test to analyze the manager-managed limited liability interests in the present case. The proper presumption to apply is that the manager-managed limited liability membership interests constitute securities. Absent strong evidence of legal and actual control by investors, this presumption governs. I find no compelling evidence of actual or intended control by the non-manager investors in the record. On the contrary, my review of the record reflects that in purchasing their LLC memberships the LLC investors made investments in a common enterprise with the expectation of profits to be derived primarily from the efforts of persons other than the investor, with those persons being Respondents.

I accordingly find the investment interests sold to them to be securities within the purview of S.C. Code Ann. § 35-1-102(29)(D) (defining a security to include “an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor.”). This conclusion is further amplified below.

THE LLC MEMBERSHIP INTERESTS SATISFY THE *HOWEY* TEST

Because this is a case of first impression before the Commission, I will explain why the LLC membership interests in this case qualify as investment contracts under the *Howey* line of cases and the South Carolina Uniform Securities Act.

When interpreting the Act, the courts may look for guidance in the interpretation of the federal securities laws. *Majors v. South Carolina Securities Commission*, 373 S.C. 153, 163, 644 S.E.2d 710, 716 (2007). The securities law must be applied flexibly. The need for flexibility is important because the securities laws were enacted to regulate the “countless and variable schemes devised by those who seek the use of the money of others on the promise

of profits.” *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946). The securities laws serve the purpose of regulating “investments, in whatever form they are made and by whatever name they are called” and thus they contain broad definitions designed “to encompass virtually any instrument that might be sold as an investment.” *S.E.C. v. Edwards*, 540 U.S. 389, 393 (2004) (citations omitted). When determining whether an instrument fits within the Act’s definition of a security, that definition “should be liberally construed to protect investors.” *Gordon v. Drews*, 358 S.C. 598, 606, 595 S.E.2d 864, 868 (Ct. App. 2004) (citing *McGaha v. Mosley*, *supra*).

The Act defines a security by listing various items which qualify as securities, including an “investment contract.” According to the Act, the term “security” includes:

an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor and a “common enterprise” means an enterprise in which the fortunes of the investor are interwoven with those of either the person offering the investment, a third party, or other investors.

S.C Code Ann. 35-1-102(29)(D). As was noted at p. 15, *supra*, the Securities Act goes on to state that an “investment contract may include, among other contracts, an interest in a limited partnership, and a limited liability company. . .” S.C. Code Ann. 35-1-102(29)(E).

An investment contract has been defined at the federal level as a “contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . .” *W.J Howey Co.*, 328 U.S. at 298-99. In fact, South Carolina’s Supreme Court has applied the “*Howey test*” in defining an investment contract. *Majors*, 373 S.C. at 162-67.

Since the *Howey* decision, federal decisions and the Act have eliminated the word “solely” or have lessened the requirement that the profits come “solely” from the efforts of others to “primarily” from the efforts of others or from the essential efforts of others. See *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (eliminating the word “solely” from the recitation of the *Howey* test); S.C. Code Ann. § 35-1-102(29)(D) (“primarily from the efforts of a person other than the investor.”); *Majors*, 373 S.C. at 167 (“The key determination is whether the promoters’ efforts, not that of the investors, form the ‘essential managerial efforts which affect the failure or success of the enterprise.’”); *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9th Cir. 1973). (“[W]e adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.”); *Bailey v. J.W.K. Properties, Inc.*, 904 F.2d 918, 920 (4th Cir. 1990) (“[T]he most essential functions or duties must be performed by others and not the investor.”).

As was shown above in discussing the factual record, there is no doubt that the profits, if any, generated by the investors’ LLCs in this case were destined to come “primarily” from the efforts of Respondents and not from the efforts of the investors. Applying the appropriate construction to the “investment contract” definition mandates that the investments in issue here be classified as securities.

The *Howey* test’s applicability in this matter turns on the last prong: “whether the promoters’ efforts, not that of the investors, form the essential managerial efforts which affect the failure or success of the enterprise.” *Majors*, 373 S.C. at 167, 644 S.E.2d at 718 (internal quotations omitted) (citing *Unique Financial Concepts*, 196 F.3d 1195, 1201 (1999))

(11th Cir. Fla.1999)). The higher factual burden of meeting one of the *Williamson* factors does not apply in this case. In my review of the Hearing Officer's *Report and Recommendation* and the accompanying record, it is clear that this test is satisfied.

Even using the *Williamson* test as guidance in determining whether the "efforts of others" prong of *Howey* is satisfied, the operating agreement, the facts in the record, and the inferences reasonably drawn all combine to prove that the manager-managed limited liability companies at issue distributed power as would a limited partnership. Thus, the first prong of *Williamson* is met with respect to each company.

As discussed above, the Hearing Officer listed nine factors that he viewed as supporting his finding that the first of the three *Williamson* tests had not been met. As has been noted, however, these factors listed by the Hearing Officer are either irrelevant or are entitled to little weight in a case such as this. The crucial question under *Howey* is whether the investors were induced to rely on a promoter or manager (which they unquestionably were) and whether the efforts extended by the party relied upon were the "undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9th Cir. 1973). In this case, the primary and undeniably significant efforts were being supplied by Respondents, particularly those coming from Mr. McIntyre. The crucial questions surrounding status of the investments as securities must therefore be answered, "Yes." Unquestionably, Respondents offered to provide and did provide the essential managerial efforts that the investors justifiably relied on to make a financial return on their investments.

Again, the members in the manager-managed limited liability companies at issue lack the authority to perform key management actions for the companies. In each of the companies at issue, the operating agreements provided the manager with the primary, if not the sole, authority and power to discharge the business of the company. The South Carolina Uniform Limited Liability Company Act and the language of the operating agreements neutered any ability of the members to play a major role in the management of the companies in which they invested. No grant of authority to act for the company exists in the operating agreements; therefore, according to the law, no authority exists. In this case, reality followed the form announced in the documents: the members never intended to play a role in the companies and never did play a leading role in the management of the companies. Plainly, the power distributed to the members was analogous to that found in a limited partnership.

SUMMARY

To summarize, I find and conclude that, (i) a membership interest in a manager-managed limited liability company is presumed to be an investment contract and that no competent, credible evidence sufficient to rebut the presumption has been presented; the membership interests are properly classified as investment contracts under S.C. Code Ann. § 35-1-102(29)(E), (ii) the *Howey* test is satisfied, and (iii) the record provides compelling evidence that at least one of the three *Williamson* factors is satisfied, which is sufficient to satisfy even the rigorous *Williamson* test. I thus hold that the manager-managed limited liability company interests at issue in this matter are securities.

ORDER

It is hereby ordered that the Hearing Officer is to make a Report and Recommendation to me within sixty (60) days of this Order consistent with this ruling regarding whether or not a violation or violations of S.C. Code Ann. § 35-1-501 occurred as it relates to an offer or sale of the securities at issue.

IT IS SO **ORDERED** this 12 day of September 2014.

By: Alan Wilson
The Honorable Alan M. Wilson
Securities Commissioner State of South Carolina