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With Limited Liability For All: Why Not a Partnership Corporation?

Cover Page Footnote

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WITH LIMITED LIABILITY FOR ALL: WHY NOT A PARTNERSHIP CORPORATION?

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I. INTRODUCTION

ANIMISM, which is the ascription of human personality to subhuman or even inanimate objects, is, like nose-piercing, a common characteristic of primitive peoples. Hypostatization of groups of humans into entities conceived of as possessing an existence separate and apart from them can, with equal reason, be considered a form of animism, and, accordingly, a sign of a primitive stage of cultural development. Yet, as every lawyer and businessman knows, it is exactly such reification, under the name "corporation," which is the foundation of the economic systems of all non-socialist countries.

Other forms of business are, of course, possible in the United States as well as abroad.¹ However, figures at least in the United States show that in terms of total assets and importance to the over-all economy by way of contribution to the gross national product, corporations outweigh by far all other legal business molds.² The corporation is popular not only with large enterprises; but it appears to be the most popular business form for all new ventures, large and small.³ The reason for this popularity is simple: the corporation is universally associated in the popular mind with limited liability, that is, the principle that the participants need not place all of their resources at the risk of the business. The connection is widely regarded as representing a logical equivalence,⁴ that is, that limited liability

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1. As to forms available in the United States see, e.g., H. Henn, *Corporations*, ch. 2 (1961). See also IV Martindale-Hubbell, *Law Directory, Digests of the Laws of Foreign Countries*, pt. IV at 2677 (1967) which shows the wide variety of forms available in foreign countries.

2. Of the total businesses filing tax returns in 1961-62, 10.4% were active corporations. 81.3% were sole proprietorships, and 8.3% were active partnerships. However, corporations accounted for 77.1% of the total receipts, sole proprietorships for 16.0%, and partnerships for 6.9%. Data from Preliminary Report, *Statistics of Income-U.S. Business Tax Returns-1961-62*, Treasury Department, Internal Revenue Service (1963) as reproduced in R. Stevens & H. Henn, *Statutes, Cases and Materials on the Law of Corporations* 30 (1965). "More than one-half of the nation's income is generated by corporations." *Id.* at 31. Three-quarters of the corporations filing returns were formed after World War II. *Id.*

3. See note 2 *supra*. If sole proprietorships devoted to agriculture, retail trade and services (not even including "finance, insurance and real estate") are subtracted, the total number of corporations and partnerships exceeds the number of sole proprietorships. Judging by the number of new corporations, and the fact that most are not one man ventures, it is also fair to say that even the small businessman is choosing the corporation rather than the sole proprietorship. It is also clear that the corporation is more popular than the partnership.

4. As to logical equivalence, see A. Tarski, *Introduction to Logic* 32 (1941). As to the

is only available through the corporate device. Primitive or not, then, this particular hypostatization is of vital importance not only to American lawyers and businessmen, but to the entire society.

Although sometimes criticized,⁵ the "fiction" theory, which regards a business conducted under the corporate form as a separate entity, is firmly entrenched in American business law. Chief Justice Marshall's famous definition of a corporation as "an artificial being, invisible, intangible, and existing only in contemplation of law"⁶ is still the predominant conception of the statute-created relationship which is the bulwark of our economy. This definition has been cited by many later courts, and an even greater number of decisions recognize the same separate entity aspect as an essential characteristic of corporate business.⁷ Decisions recognizing a corporation as a person within the meaning of the fifth and fourteenth amendments to the Constitution,⁸ and the 1958 amendments to the federal diversity statute, which expressly recognize corporate citizenship in the corporation's state of incorporation and principal place of business,⁹ all tend to reinforce the separate entity concept. This would pose no problem were it not for the association of limited liability exclusively with corporateness. Nor would it pose so great a problem were it not for the fact that not only laymen but even judges make the same association. Neither association would pose any problem whatsoever were it not for the further association of the limited liability entity with a requirement of an unflinching adherence to a rigid statutory norm of corporate structure and behavior.

The infamous *Benintendi* case¹⁰ sums up all three associations in one sentence: "The State, granting to individuals the privilege of limiting their individual liabilities for business debts by forming themselves into an

popular equivalence of corporation and limited liability, see R. Stevens, *Corporations* 12 (1949): "The business man is apt to think that his new business must be incorporated even though he and his family, or he and a handful of outsiders will be the only shareholders. He is probably following business custom, and thinking only of the security of limitation upon individual liability. But his lawyer should think more closely for him."

5. R. Stevens, *supra* note 4, at 46-48. Stevens recommends a "realist" theory, under which the incorporated businessmen are viewed as having a dual legal personality. He says: "Furthermore, a realistic approach toward law is tending to substitute for the ancient theory that a fictitious person exists apart from the members, the theory that the members themselves have a dual legal personality." *Id.* at 49. See also R. Stevens & H. Henn, *Statutes, Cases and Materials on the Law of Corporations* 37 (1965). There are, of course, other theories. See 1 G. Hornstein, *Corporation Law and Practice* 22-24 (1959).

6. *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518, 636 (1819).

7. See, e.g., 13 Am. Jur. *Corporations*, § 2 (1938).

8. See H. Henn, *supra* note 1, at 90-91.

9. 28 U.S.C. § 1332 (1964). See H. Henn, *supra* note 1, at 91-95.

10. *Benintendi v. Kenton Hotel, Inc.*, 294 N.Y. 112, 60 N.E.2d 829 (1945).

entity separate and distinct from the persons who own it, demands in turn that the entity take a prescribed form and conduct itself, procedurally, according to fixed rules."¹¹

As a result of the widespread association of limited liability with corporateness, the forms of business relationships have tended to dichotomize between entity-limited liability on the one hand, and non-corporate, unlimited liability on the other. This taxonomy has, unfortunately, been aided by such diverse factors as the curricula of American law schools,¹² the concentration occasioned by the flurry of legislative revisions of outmoded corporation laws,¹³ and even law review articles (some of which the author must admit to having contributed). Suggestions that corporation statutes be revised to accommodate the needs of so-called "incorporated partnerships" have usually resulted in achieving the desires of the participants through circumvention of these corporation laws, rather than through use of other devices.¹⁴

It is the purpose of this article to demonstrate again that corporateness and limited liability are not necessarily logically coterminous, and, therefore, that a more flexible extension of limited liability to other business modes is not a break with tradition. It is further submitted that such an extension is a positive business desideratum, which could easily be accomplished by legislative action.

II. LIMITED LIABILITY AND CORPORATENESS

Is the one-to-one relationship of limited liability to corporation, characteristic of the popular conception, a necessary one? Or, to put it another way, is limited liability a "natural right" of the corporation and of no other

11. *Id.* at 118, 60 N.E.2d at 831.

12. Ordinarily, the course in Corporations is taught completely separately from Partnerships. The casebooks reflect (and perhaps partly cause) this dichotomy. Thus, although R. Stevens & H. Henn, *supra* note 2, devote a chapter to "Selection of Form of Business Enterprise" in which the other forms are discussed, the overwhelming bulk of the 1400 pages of this casebook are devoted exclusively to corporate law problems. H. Baker & W. Cary, *Cases and Materials on Corporations* 19 (3d ed. 1959) flatly admits: "No effort will be made here to discuss the variety of ways of doing business . . . This book starts with the decision made. We are concerned only with the corporation." The leading casebook which sought to combine corporations and partnerships, A. Frey, *Cases and Materials on Corporations and Partnerships* (1951), has been revised as a purely corporate law book, A. Frey, C. Morris and J. Choper, *Cases and Materials on Corporations* (1966).

13. For the past 15 years, the rate has been in excess of one a year. See R. Stevens and H. Henn, *supra* note 2, at 19-20.

14. Practically every article on "close corporations" has this as its purpose. As such articles succeed in the accomplishment of their objective, moulding the corporation to suit the needs of small businessmen who are basically partners *inter se*, the use of the corporate device increases at the expense of other forms.

business form? The term "natural right" is used advisedly since it implies a necessary endowment, which can nonetheless be denied. Whatever the relation of limited liability to incorporation, it is equally clear that it has been,¹⁵ and still is, denied to a greater or lesser extent.¹⁶

Unfortunately, the authorities differ on whether corporations are by nature endowed with limited liability. Thus, Holdsworth considers limited liability necessarily associated with corporateness. He states:

The recognition of the existence of an incorporate person necessarily involves the recognition of the three following principles: (i) A corporation is a person distinct from its members; (ii) the property of the corporation is distinct from the property of its members; (iii) the property of its members cannot be taken in execution for the debt of the corporation, and *vice versa*. We shall now see that these principles gradually gained recognition during the fifteenth century; that, in consequence, the lawyers began to acquire some ideas as to the nature of corporate personality; and that difficult questions were arising as to the effect which matters affecting the natural men composing the corporation could be allowed to have upon the corporation.¹⁷

According to Holdsworth, limited liability was recognized as early as 1440,¹⁸ so early as to suggest a natural connection with the business corporation as we know it. He sums up: "As early as the fifteenth century it was clear that an individual corporator was not personally liable for the debts of the corporation; and, after some hesitation, this conclusion was ultimately accepted in the latter part of the seventeenth century."¹⁹ Hold-

15. See Dodd, *The Evolution of Limited Liability in American Industry: Massachusetts*, 61 Harv. L. Rev. 1351, at 1361 (1948): "As soon as manufacturing companies began to be formed in substantial numbers, the Massachusetts legislature did adopt an unlimited-liability policy, a policy to which it adhered, with relatively minor modifications, for twenty-one years [1809-1830]."

16. H. Henn, *Corporations* 257 (1961): "Six states—Massachusetts, Michigan, New York, Pennsylvania, Tennessee, Wisconsin—have constitutional or statutory provisions subjecting shareholders to personal liability for wages due employees. Such liability exists even though the shares are otherwise full paid and non-assessable. Statutes of this type were once far more common than they now are." (Footnotes omitted.)

17. 3 W. Holdsworth, *A History of English Law*, 482 (1927). Holdsworth firmly adhered to the entity theory. He says "This idea that the corporation is to be treated as far as possible like a natural man is the only theory about the personality of corporations that the common law has ever possessed. It is a large and a vague idea; but, on that very account, it is a flexible idea. It has made it possible to develop the law as to the powers and capacities of corporations according to the needs and public policy of the day. It has made it possible to discipline them, and render them liable criminally or civilly for their wrongful acts, in ways which are appropriate to the artificial character of their personality. And the fact that it has thus been possible to make them liable for their wrongful acts, has enabled the law to adhere firmly to the central theory of corporation law, that the corporation is an artificial entity quite distinct from its members." 9 W. Holdsworth, *supra* at 70-71 (footnote omitted).

18. 3 *id.* at 484.

19. 8 *id.* at 203 (footnotes omitted).

worth concedes, however, in the following sentences that assessments or "leviations" could be made on the individual members to make them pay to the corporation, for its creditors, amounts owed, and that the House of Lords ordered such leviations in a case decided in 1671.²⁰

Dodd suggests that limited liability was a later addition:

An important phase of the early development of American manufacturing enterprise was the yielding on the part of one legislature after another to the demands of American manufacturers for limited liability. In England, the country from which our corporation law was originally derived, the struggle for limited liability was, for the most part, a contest between those who believed that that privilege should be open to businesses of all kinds and those who were opposed to the grant of the privilege to any group of businessmen unless their enterprise was of a semi-public character, such as a canal or railroad. A few English business associations other than those of a semi-public character did, indeed, attain individual grants of limited liability by royal charter or special legislative act. But, generally speaking, English company law applied to all types of business and did not grant limited liability to any type until Parliament was ready to grant it to all.²¹

He elaborates in a footnote:

In the eighteenth century, the English law of joint-stock companies consisted of the common law (which denied limited liability to shareholders in such companies) and the Bubble Act of 1720, 6 Geo. I, c. 18 (1719), which made it a criminal offense for an unincorporated company to presume to act as a corporation. An act of 1825, 6 Geo. IV, c. 91, repealed the Bubble Act and gave the king the power, which it was thought that he did not previously possess, to charter a corporation and at the same time deny it the privilege of limited liability. The Joint-Stock Companies Registration and Regulation Act of 1844, 7 & 8 Vict., c. 110 required registration of all partnerships which had transferable shares and more than 25 members and conferred on them, when registered, all the usual corporate privileges except limited liability. The latter privilege was granted to registered companies by the Companies Acts of 1855, 18 & 19 Vict., c. 133; of 1856, 19 & 20 Vict., c. 47, and of 1862, 25 & 26 Vict., c. 89.²²

He later seems to equivocate:

It has sometimes been suggested that the correct eighteenth-century answer to the question of the existence of shareholder liability for corporate debts was that such liability did exist but that it was indirect rather than direct and resulted from the corporate power to make assessments. That suggestion is based on the fact that in the seventeenth-century case of *Salmon v. Hamborough Co.*, the House of Lords instructed the Chancellor to order a corporation to levy an assessment on its members in order to provide funds with which to pay the plaintiff's claim and to issue process against any member who failed to pay the assessment. It was admitted by the demurrer in that case that the company, which had no joint stock, had made a practice of levying such assessments. That decision did not, therefore, necessarily establish a general principle of indirect shareholder liability to corporate creditors unless it was true that seventeenth- and eighteenth-century joint-stock corporations had broad power to make

20. Id. at 204. The case was *Salmon v. Hamborough Co.*, 22 Eng. Rep. 763 (Ch. 1671).

21. Dodd, supra note 15, at 1351.

22. Id. n.1.

assessments and to enforce payment by action and not merely by forfeiture of a delinquent's shares. The question whether such powers were normally possessed by such companies was never judicially answered in seventeenth- and eighteenth-century England, and there is reason to believe that serious doubts existed as to the extent of the corporate power to assess.²³

Commenting on the same case, Williston, writing in 1888, stated:

The case of *Dr. Salmon v. The Hamborough Company* was criticised by Fonblanque in 1793. It was, however, followed to its fullest extent in South Carolina so late as 1826 in a very carefully considered case, and on appeal the decision was affirmed. Even after 1840 the doctrine for which the case stands found support.²⁴

The omission of limited liability from the list of things of the essence of a corporation,²⁵ and those tacitly annexed,²⁶ in the first major corporation case, is another weight on the scale against limited liability as a natural corporate right.

The fact that limited liability was only generally granted in England in 1855,²⁷ and occasioned a good deal of opposition even then,²⁸ is also some indication of the accidental connection between limited liability and corporateness.

Stevens, too, is against limited liability. He puts it succinctly:

Limited liability is unquestionably the one incident which above all others gave popularity to the corporate device. It has been said that "the personal responsibility of the stockholders is inconsistent with the nature of a body corporate." However, the limitation of the individual liability of the shareholders is by no means an inseparable incident of incorporation. Immunity from individual liability has not always been the rule, and until recently there were statutes under which full liability of shareholders was either optional or compulsory.²⁹

It would appear that there were two independent corporate developments in England, one deriving from the formally chartered true corporations, the other from the joint-stock company, a common law contractual device which was a simple mutation from the enlarged partnership. Because the joint stock companies were informal and, after the Bubble Act, illegal,³⁰ it would be easy to draw the distinction as to limited liability along these lines, since it would appear clear that "corporations" in this category were not entitled to the privilege.³¹ Unfortunately, this simple

23. *Id.* at 1356-57 (footnotes omitted).

24. Williston, *History of the Law of Business Corporations Before 1800*, 2 *Harv. L. Rev.* 105, 149, at 162 (1888) (footnotes omitted).

25. *In re Sutton's Hosp.*, 77 *Eng. Rep.* 937, 968-69 (K.B. 1613).

26. *Id.* at 970.

27. See R. Formoy, *The Historical Foundations of Modern Company Law* 114 (1923).

28. *Id.* at 120-21 n.27.

29. R. Stevens, *supra* note 2, at 18-19 (footnotes omitted).

30. H. Henn, *supra* note 1, at 13-14.

31. *Id.* at 15. It is interesting to note that *de facto* limited liability was often achieved due to the difficulty of suing all the members to enforce their individual liability. *Id.*

answer is insufficient since the corporation in the *Hamborough* case was a chartered corporation.³² If shareholders of a properly incorporated corporation are not accorded personal immunity, it seems clear that such limited liability is not a necessary incident of a corporation—or at least was not in England.

Our American type of business corporation, which appears to be a joint stock company with limited liability superadded,³³ derives from English sources. But what about the corporation from which the vacillating³⁴ English experience itself derived?

Unfortunately, the origins of the corporation are lost in the obscurity of speculation. It was known to the Romans,³⁵ although it was apparently subject to the same deviations as in English law.³⁶ Perhaps the origin was with the Greeks,³⁷ or much earlier, with Hammurabi³⁸ or the peoples of his area.³⁹ It can be pushed back much further if, as perhaps it should be, it is regarded as merely the ability to view a group of individuals as an "it."⁴⁰ Obviously, at this point in time past, limited liability becomes meaningless.

One thing is clear: natural right or not, complete immunity from liability is not universally available even in the modern corporation. One of the most recent of modern corporation laws continues to deny it.⁴¹ Clearly,

32. Williston, *supra* note 24, at 162 n.3.

33. See Dodd, *supra* note 15, at 1370-71, 1374.

34. See H. Henn, *supra* note 16, at 14; H. Ballantine, *Corporations* 31-35 (rev. ed. 1946).

35. Williston, *supra* note 24, at 106-07. See also Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism*, 27 U. Chi. L. Rev. 696, 712 n.76 (1960).

36. Williston, *supra* note 24, at 107.

37. *Id.* at 106, citing Angel & Ames, *Corporations*, an early American text.

38. H. Henn, *supra* note 16, at 10.

39. 2 O. Spengler, *The Decline of the West* 67-68 (1928).

40. Raymond, *The Genesis of the Corporation*, 19 Harv. L. Rev. 350 (1906). See also Williston, *supra* note 24, at 106, citing Sir Henry Maine, *Ancient Law* 183 (4th ed.).

41. Under N.Y. Bus. Corp. Law § 630, the ten largest shareholders of close corporations, "the shares of which are not listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or an affiliated securities association, shall jointly and severally be personally liable for all debts, wages or salaries due and owing to any of its laborers, servants or employees other than contractors, for services performed by them for such corporation." This liability is an amelioration of previous law (N.Y. Stock Corp. Law § 71) which imposed a similar liability on all shareholders of all corporations.

The present form of liability is not necessarily bad, although it may come as a shock to some small businessmen, since the interests of workers for the small businessman deserve protection as well. Of course, if the corporation law imposes such a personal liability, any alternate business form should have a corresponding provision.

Probably, also, the reconciliation of the apparent conflict is that under the entity (*persona ficta*) theory, the liability should be limited to the assets of the enterprise, just as any real person's normally is. It took our English law quite a while to approach this ideal—Holdsworth's account itself indicates this gradualism, which, as shown, has not even now been

the joint stock company, the still feebly surviving progenitor of the modern American corporation, continues to deny its members the "essential" privilege.⁴²

What of the opposite extreme of the corporation, the individual proprietorship? This does not involve limited liability, except in the sense that one man can achieve it by using the corporation.⁴³ The partnership can also be regarded as polar to the modern corporation. And the undisputed recognition of limited liability in it, oddly enough, goes back further in time than its recognition in the corporation. As Rowley puts it:

The origin of limited partnerships is not found in English or American common law. Limited partnerships were first known and recognized in the Italian commercial centers of Pisa and Florence in the twelfth century, as a means for the owners of wealth, primarily the nobles and clergy, to invest their capital without being known or named. The system was carried to France at an early date and has always been there a major form of business organization. Such form of business association was known in Florence as "La Societ  en Commodit ," or, perhaps more colloquially, as "accomenda;" in France it was similarly termed, "La Societ  en Commandit ."

* The system of limited partnership was first brought to America by the French in Louisiana and Florida. In Louisiana it has been known as "partnership in commendam." Beginning in 1822 in New York, various statutes were enacted by different states providing for limited partnerships, and patterned after the French Code.⁴⁴

Historically, therefore, it is clear that the corporation, or separate entity, does not have a monopoly on the valuable business privilege of limited liability.

III. BASIC UNITY OF THE FORMS OF BUSINESS ORGANIZATION

Even today, the category of limited liability is not coterminous with the fictitious entity category. Limited liability has been conferred even where the separate entity has been lacking. The standard example is the limited partnership. Forty-two states⁴⁵ have enacted the Uniform Limited Partnership Act which expressly recognizes that the liability of non-active partners will be restricted to the amount of their capital contributions,

fully attained in all jurisdictions. Of course, this ideal, like Plato's bed (or his philosophy, for that matter), is something we can either take or leave.

42. H. Henn, *supra* note 16, at 67.

43. It is interesting to note that the corporation sole is older than the modern business corporation. 3 W. Holdsworth, *supra* note 17, at 480. They are, of course, not to be confused with today's one-man business corporations. See H. Ballantine, *supra* note 34, at 30; H. Henn, *supra* note 16, at 10.

44. 2 R. Rowley, *Partnership* 550 (2d ed. 1960) (footnotes omitted). See also H. Henn, *supra* note 16, at 54; 8 W. Holdsworth, *supra* note 17, at 193-99, discussing the Continental "commenda" and "societas." The "commenda" offered limited liability to the "commendatores." *Id.* at 196-97. This is another indication of the non-exclusive character of limited liability.

45. For a listing, see 8 U.L.A. 9 (Supp. 1966).

just as in a corporation. The limited partnership is not fully a separate entity, but more of an aggregate, a mixture rather than a compound. The reason is that, although the limited partnership has its own name⁴⁶ like a person, may hold property in that name⁴⁷ and must keep separate accounts,⁴⁸ it lacks the power, except where conferred by special statute, to sue and be sued in that name, and is not treated as a separate taxpayer under the federal income tax laws.⁴⁹

The limited partnership is exactly like the ordinary partnership under the Uniform Partnership Act,⁵⁰ except for its limited liability. This similarity suggests not only the non-exclusive nature of limited liability, but the vague boundaries of the entity concept. The draftsmen of the Uniform Partnership Act, moreover, must have recognized that they were conferring on the partnership a number of the characteristics of an entity.⁵¹

Thus entity is not a "discrete concept," as the logicians would say, but instead a continuum, a spectrum of greater or less concreteness. If the partnership is at one end of the spectrum and the corporation at the other, there is between them a business organization, an "agglomerate," which is well-nigh indistinguishable from the corporation in its entity aspect. It is the limited partnership association, currently recognized in three states,⁵²

46. Uniform Limited Partnership Act §§ 2(1)(a)(I) [hereinafter ULPA].

47. This is even permitted in an ordinary partnership. (Uniform Partnership Act § 8(3)) [hereinafter UPA], and a limited partnership is a partnership. ULPA § 1.

48. ULPA § 10(1)(a).

49. Int. Rev. Code of 1954, § 701 provides for non-taxation of a partnership, as defined in § 761. Information returns are required under § 6031. Under Treas. Reg. §§ 1.761-1 (1956) & 1.7701-3(b) (1960), not only ordinary partnerships, but the typical limited partnership as well qualify for such non-taxability (as an entity). Subchapter R (Int. Rev. Code of 1954, § 1361) which allowed certain partnerships to elect to be taxed as corporations has been repealed effective Jan. 1, 1969. 80 Stat. 111 (1966).

50. See notes 46 & 47 supra.

51. According to the Commissioners' Prefatory Note to the UPA, the earlier action of the Conference tended to limit consideration to the entity theory. Ultimately, the Conference decided in favor of the aggregate theory, but with a special tenancy for partnership property, to be known as tenancy in partnership. 7 U.L.A. 2. The cases have split on the degree to which even an ordinary partnership is an entity separate from the individuals comprising it. Compare *Mazzuchelli v. Silberberg*, 29 N.J. 15, 148 A.2d 8 (1959), with *Tax Review Bd. of Philadelphia v. D. H. Shapiro Co.*, 409 Pa. 253, 185 A.2d 529 (1962).

52. Until recently, Pennsylvania also authorized such a statutory partnership association. See Pa. Stat. tit. 59, §§ 341-461 (1936). The origin of this statute was in an 1874 Act, which makes it appear that Pennsylvania was the first state to provide for such associations. In their broad outlines all of the statutes are similar, indicating that probably they were all patterned after the first one. See generally H. Ballantine, *Corporations* 17 (rev. ed. 1946). The Pennsylvania Act was repealed by the 1965 session of the legislature, act 519, § 50(g)(1)-(5) [1966] Pa. Laws, indicating its lack of popularity. A very complete description of the provisions of all of the Limited Partnership Association statutes is given in Schwartz, *The*

Michigan,⁵³ Ohio⁵⁴ and New Jersey.⁵⁵ The very existence of this strange creature is proof of the non-exclusive nature of both the limited liability and entity concepts.

The nature and history of the limited partnership association is well set forth in the New Jersey case of *Carle v. Carle Tool & Engineering Co.*,⁵⁶ which held that such an association was an entity sufficiently separate from its members that one member, the vice-chairman, could be considered an employee within the coverage of the Workmen's Compensation Act. The court described the New Jersey statute, which it characterized as "substantially similar" to those of Pennsylvania and Michigan, as follows:

Under our act (*R.S. 42:3-1 et seq.*) any three or more persons may form a partnership association designated as a limited partnership association "for the purpose of conducting any lawful business or occupation * * * by subscribing and contributing capital thereto, either in money or in real or personal property * * *, at a valuation to be approved by all the members subscribing to the capital * * * which capital shall *alone* be liable for the debts of such association." *Section 1.*

Persons forming such an association are required to file a certificate very much like that of a corporate charter in the office of the clerk of the county where its principal place of business is to be located. The certificate must set forth the names of the members; the amount of capital subscribed by each; the character of the subscription; the total amount of capital and when and how it is to be paid; the character of the business; the name of the association with the word "limited" added as part thereof; the duration of the association, not to be in excess of 20 years; and the names of the officers selected as required by section 4 of the act. *Section 2.*

It is mandatory that the word "limited" appear as the last word of the name. Failure in this respect renders any person who participates or acquiesces in such omission liable for any indebtedness arising therefrom. *Section 3.*

The affairs of the association are conducted by not less than three nor more than

Limited Partnership Association—An Alternative to the Corporation for the Small Business with "Control" Problems?, 20 Rutgers L. Rev. 29 (1965). The author concludes: "On balance, the limited partnership association affords a promising vehicle for the small, relatively localized business having few active participants, each of whom desires the type of control usually available only through the partnership form." *Id.* at 88.

The author suggests that, despite the requirement as to government by a minimum of 3 and a maximum of 5 "managers", and designated officers, and the lack of statutory or judicial authority for any such extra-parametric arrangements, side agreements among the participants as to the management of the business (e.g., requiring unanimous membership approval and subjecting management decisions to such unanimous membership consent) will be upheld. *Id.* at 43-49. Such confidence in the courts' willingness to allow this unusual creature, the partnership association, to behave like a true partnership seems overly sanguine in view of the widespread judicial disdain for such arrangements in even the less exotic, corporate form.

53. Mich. Comp. Laws §§ 449.301-16 (1948).

54. Ohio Rev. Code Ann. §§ 1783.01-12 (Baldwin 1959).

55. N.J. Rev. Stat. §§ 42:3-1-30 (1937), as amended, ch. 40, §§ 1-19 [1953], N.J. Acts 756-65.

56. 36 N.J. Super. 36, 114 A.2d 738 (App. Div. 1955).

five managers who must be elected annually. *Section 4*. Debts cannot be contracted or liability incurred except by one or more of the managers and no liability in excess of \$500 can be incurred unless in writing and signed by at least two managers. *Section 5*. It may purchase, hold and sell real estate in the firm name (*Section 6*), and shall sue or be sued in that name. *Section 8*. The individual members are not liable for any association judgment or debt, subject to the qualification that if its assets are not sufficient to satisfy an execution thereon, they shall be liable to the extent of their unpaid subscriptions to capital. *Section 9*.

The respective interests of the members of the association are personal estate, and may be transferred as its rules provide. Neither transfer, nor death, nor insolvency of a member causes termination; but no transferee or representative of a deceased or insolvent member can participate in the subsequent business of the association unless elected thereto by a vote of the majority of the members in number and value of their interests. If not elected, such person can demand only his monetary interest as mutually agreed upon, or if not agreed upon, at a price fixed by an appraiser appointed by the County Court and approved by such court. *Section 11*.

This analysis of the statute plainly indicates that an association formed thereunder attains corporateness; it becomes an entity separate and apart from its members. *Staver & Abbott Mfg. Co. v. Blake, supra* (111 Mich. 282, 69 N.W. 508, 38 L.R.A., at page 803). It takes on practically every substantial attribute of a corporation. As an artificial being it is endowed with the capacity of suing and of being sued, of acquiring, holding and conveying property in that character; the members do not act as individuals or as partners but through and in the name of the corporate body; disposal of a member's interest or his death or insolvency does not bring about dissolution. The members do not conduct its affairs as individual partners who in ordinary partnerships have equal rights in the management and conduct thereof (*R.S. 42:1-18(e)*). The operations are placed in the hands of three to five managers, and an individual member not a manager cannot bind the association.⁵⁷

As a result, the court concluded: "Such a company is a hybrid creature; it might be called a *quasi*-corporation."⁵⁸ Both "hybrid" and "quasi-corporation" are appropriate names for this business form and for that equally strange phenomenon, the Pennsylvania "Registered Partnership."⁵⁹

That entity and limited liability are not synonymous is further shown by that oddity of business organizations, the joint stock company, a common law device recognized by statute in some states, which is practically indistinguishable structurally from a corporation except in its most important practical aspect: the shareholders in a joint stock company are personally liable for the business debts.⁶⁰ Needless to say, the joint stock

57. *Id.* at 38-40, 114 A.2d 739-40.

58. *Id.* at 40, 114 A.2d at 740.

59. Pa. Stat. tit. 59, §§ 241-321 (1936). This Act too was repealed by the 1965 session of the Pennsylvania legislature, Act 519 § 50(e)(3) [1967] Pa. Laws, with the provision that "said act shall continue in effect until January 1, 1971, insofar as it relates to registered partnerships existing on January 1, 1966 which neither accept this act [Corporation Act] nor reorganize under the Uniform Limited Partnership Act." The repeal is, of course, an indication of the limited utilization by businessmen of its provisions.

60. H. Ballantine, *Corporations* 13 (rev. ed. 1946).

company is not a very popular business organization. It is, however, an entity closer to the corporation than a partnership, perhaps even closer than a partnership association.

One thing is clear: entity and limited liability are no longer coterminous, since either can be found without the other.

IV. INADEQUACY OF THE PRESENT FORM OF BUSINESS ORGANIZATIONS

It is the purpose of this article to suggest that the limited liability concept need not and should not be restricted to the corporation. The present day corporation is not suited to present business needs, and the substitutes available are even less adequate.⁶¹ From a functional examination of the corporation and other business forms, it is hoped that a new concept of business organization may emerge, and find statutory acceptance.

The corporation offers limited liability to every businessman, even the sole proprietor.⁶² "Piercing the corporate veil"⁶³ to subject the owner to personal liability is almost the joke it sounds like. Although the traditional grounds for disregard of the entity—fraud, illegality or evasion of a statute—are still recognized,⁶⁴ and an obvious undercapitalization, if coupled with other factors such as disregard of the entity by the participants themselves, has been held even recently to justify imposing personal liability,⁶⁵ the owners of a business in the corporate form are ordinarily safe if they observe the required formalities.⁶⁶ In this area of the law, at least, form is more important than substance. If they observe the amenities, notably treating their enterprise as a separate person, the owners may even be preferred creditors of their own business.⁶⁷ But this boon of personal im-

61. The following statement from the Commissioners' Note to the ULP, promulgated over 50 years ago (1916) is interesting in this connection: "One of the causes forcing business into the corporate form, in spite of the fact that the corporate form is ill suited to many business conditions, is the failure of the existing limited partnership acts to meet the desire of the owners of a business to secure necessary capital under the existing limited partnership form of business association." 8 U.L.A. 3 (1922).

62. See, as to the general recognition of one man corporations, H. Henn, *Corporations* 205-06 (1961); H. Ballantine, *Corporations* 298-301 (rev. ed. 1946).

63. H. Henn, *Corporations* 203 (1961).

64. R. Baker & W. Cary, *Cases and Materials on Corporations* 402 (3d unabr. ed. 1958); H. Ballantine, *Corporations* 292, 303, 305 (rev. ed. 1946).

65. See Annot., 63 A.L.R.2d 1051 (1959).

66. N. Lattin, *Corporations* 94 (1959).

67. The leading case is, of course, *Salomon v. Salomon & Co.*, [1897] A.C. 22. Such claims of controlling shareholders may, however, be subordinated to those of general creditors, under the famous "Deep Rock" doctrine. See R. Baker & W. Cary, *supra* note 64, at 396-400; H. Ballantine, *supra* note 64, at 301-302; H. Henn, *supra* note 63, at 212-13. This is especially likely where the initial capitalization of the corporation is inadequate. *Costello v. Fazio*, 256 F.2d 903 (9th Cir. 1958).

munity is not without its strings. The technicalities that must be observed are monumental. The corporation must conform to "statutory norms."⁶⁸ It must have not only separate books of account,⁶⁹ but a special three-tiered structure of shareholders, directors and officers—ordinarily more than one director and officer even if there is only one shareholder.⁷⁰ Each of these functionaries has his own prescribed powers and duties, even though perhaps incarnated in the same person. Although there are amelioratives to protect innocent outsiders, many cases demonstrate the rigid adherence to corporate etiquette required as the *quid pro quo* for the freedom from personal liability granted to businessmen operating under this shield.⁷¹

The participants in a small corporation ordinarily desire to operate with the informality of partners.⁷² Their freedom to do so has been curtailed by the courts, which have often failed to enforce extra-corporate partnership agreements;⁷³ the same protocol has been required in the conduct of "meetings" of a two or three man corporation as would be expected of a meeting of the board of directors of U.S. Steel or A.T. & T.⁷⁴ Even statutes which have made a conscious attempt to accommodate the desires of small business ventures⁷⁵ have not succeeded in cutting through the red

68. See *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.*, 297 N.Y. 174, 77 N.E.2d 633 (1948); *Benintendi v. Kenton Hotel, Inc.*, 294 N.Y. 112, 60 N.E.2d 829 (1945).

69. See, e.g., ABA-ALI Model Business Corporation Act § 46 [hereinafter cited as Model Act].

70. This rule has been ameliorated in some states. See, e.g., Del. Code Ann. tit. 8, § 141 (Supp. 1967), and N.Y. Bus. Corp. Law § 702, allowing less than three directors where there are less than three shareholders. See also N.Y. Bus. Corp. Law § 620(b), which presumably allows shareholder management in supersession of the board where certain conditions are met; see also Fla. Stat. § 608.0103 (1965).

71. See, e.g., cases cited, note 68, *supra*.

72. See, e.g., 1 F. O'Neal, *Close Corporations* § 1.12 (1958).

73. These agreements fall into two general categories: (1) to operate a joint venture using a corporation (or corporations) as the instrument—a typical example is a real estate "syndicate," i.e., a group of businessmen who enter into a partnership agreement to purchase and manage a number of apartment houses, and incorporate each apartment separately; (2) the typical shareholder's agreement under which the businessmen set up a management financial arrangement, separate from and often in conflict with that contemplated by the corporation law. Both types have been upset. See, e.g., *Jackson v. Hooper*, 76 N.J. Eq. 592, 75 Atl. 568 (E. & A. 1910), *Weisman v. Awnair Corp. of America*, 3 N.Y.2d 444, 144 N.E.2d 415, 165 N.Y.S.2d 745 (1957), *Manson v. Curtis*, 223 N.Y. 313, 119 N.E. 559 (1918), *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934).

74. 2 F. O'Neal, *Close Corporations* § 8.03 (1958). The cases fortunately recognize exceptions in order to protect the rights of innocent third parties dealing with the corporation. See also the recent, and unsympathetic, N.Y. Bus. Corp. Law § 708.

75. E.g., Model Act §§ 30, 37, 39A, 138; N.Y. Bus. Corp. Law § 620(b); Fla. Stat. § 608.0100-07 (Supp. 1966).

tape to an extent sufficient to give the small businessman what he wants, limited liability with flexibility of operation.⁷⁶

76. See, e.g., The Model Act's requirement for at least 3 directors for all corporations, Model Act § 34; New York's implied requirement for formal board actions, N.Y. Bus. Corp. Law § 708; and the requirement in the Florida statute as originally enacted for at least three shareholders before the board of directors can be dispensed with. Fla. Stat. § 608.0102 (1965).

Although certain of the provisions of the North Carolina statutes are worthy of note (see N.C. Gen. Stat. § 55-73 (1965)), New York (notably N.Y. Bus. Corp. Law § 620), Puerto Rico (P.R. Laws Ann. tit. 14, § 1102(a) (1962)) and South Carolina (S.C. Code Ann., § 12-16.22 (Supp. 1966)), the two most important attempts to mold the corporation to fit the needs of the small businessman have been the statute proposed by Winer in his article, *Proposing a New York "Close Corporation Law,"* 28 Cornell L.Q. 313 (1943), which has been widely discussed but nowhere enacted, and the recent Florida Close Corporation Statute which was enacted, but has not been so widely hailed.

Winer's proposed statute for close corporations is, basically, a corporation statute. Like the Florida statute, its provisions were tied in with those of the ordinary corporation statute (in Winer's case, the old New York Stock and General Corporation Laws).

Significant features were the limitation to five persons (Section 3); prohibition on increase of stock, and grant of preemptive rights even in authorized stock (Section 34); all powers in shareholders unless delegated to directors (Section 35, 36); arbitration of intra-corporate disputes (Section 39); express designation of stockholders as fiduciaries not only to the corporation but inter se (Section 50); absolute rights to examine books (Section 51); partnership rule as to the authority of officers (Section 60); right of remaining stockholders to repurchase stock passing to an estate or other transferee at appraised value (Section 62); right of any shareholders to dissolve unless he is bought out at the appraised value of his stock (Section 70, 71).

Emphasis is placed on the agreement of the parties. (See Sections 35, 36, 37, 38, 39, 40, 41, 43, 51, 73.)

It is interesting that only a unanimous agreement would be binding. (Section 42.)

The Florida Close Corporation Statute (Fla. Stat. § 608.0100-07 (Supp. 1966)) is not limited to any number of participants. Instead, it uses the North Carolina and New York criteria. A close corporation is one "whose shares are not generally traded in the markets maintained by securities dealers or brokers." Fla. Stat. § 608.0100(2). Again, the statute is basically a corporation statute, and contains cross references to the general corporation statute. Fla. Stat. § 608.0100(1), (2), (3).

Significant features are the implied permission to abolish the board (Fla. Stat. § 608.0103); provision for written consent in lieu of shareholder or director meetings (Fla. Stat. § 608.0103-04); and express authorization for a shareholder agreement, even though not embodied in the articles of incorporation, governing corporate management, dividends, who will be officers and directors, voting requirements, employment of shareholders, and arbitration (Fla. Stat. § 608.0105). Unanimous approval of the deviant mode of operation is not required, but such an arrangement by less than all would seem to bind only assentors. Fla. Stat. § 608.0105(2)-(3). But cf. Fla. Stat. § 608.0100(1), which allows a majority to elect to bring the corporation within the provisions of the act.

Although the statute is still not completely without ambiguity (see, e.g., Fla. Stat. § 608.0102), the original anomaly of a required three man board for a one man (i.e., one shareholder) corporation has recently been corrected. (L. 1967, c. ———).

The basic objection to both statutes is, however, their attempt to enter into the partner-

ship through the corporate door. They are basically corporation statutes, or, more precisely, limited modifications of these ordinary statutes: corporation laws with partnership "gingerbread." Since the partnership, at least the limited partnership, already has most of the desirable features of a corporation, without its elaborate superfluous superstructure, it would seem better to start with the partnership and add on the one really important corporate aspect not completely available in any but the amorphous hybrids, limited liability.

Some mention should be made of the new Maryland revision. The new Maryland statute is revolutionary in forbidding stock transfers in a close corporation except with the consent of all of the stockholders or pursuant to a stockholder agreement requiring the purchase by or offer to the corporation, one or more stockholders or security holders, or persons named in the agreement (§ 101(a)).

If the stockholders refuse the consent, or another party to a stockholder agreement defaults on an obligation to repurchase, the stockholder who wants to sell out can require dissolution of the corporation (§ 101(b)). Dissolution can be avoided by one or more of the stockholders' buying out the stockholder who wants to sell at the judicially determined fair value of his stock (§ 109(c)).

The board of directors may be abolished, if desired (§ 105), voting rights of stockholders denied or restricted (§ 103), consolidation, merger or sale of all assets automatically require unanimous consent (§ 110), and plenary authorization is given to stockholder agreements as to management, stock transfer restrictions, dividends, voting, etc. (§ 104).

Although it is impossible to say exactly how well the statute will work out in practice, it is certainly highly commendable in its purpose and the quality of its draftsmanship.

The revision is still subject to the objection that it is a rather complex overlay on a corporation statute, an attempt to crossbreed incompatibles. More important, it may well make dissolution too easy (see §§ 101(b) & 109(a)), and hence oppression of a financially embarrassed minority, unable to raise the cash to buy out the business, also too easy. The absolute right given to the shareholders to inspect the books (§ 108) is dangerous. See *Slay v. Polonia Publishing Co.*, 249 Mich. 609, 229 N.W. 434 (1930).

The new Delaware statute (§ 202) allows share transfer restrictions of the first offer, buy-sell and consent varieties for any corporation. Close corporations must (as, of course, they will want to) have one or more of them (§ 342(a)(2)). Although there are, of course, a number of other special provisions (e.g., dissolution (§ 355), provisional director to break deadlock (§ 353)), probably the other two most significant sections are the following:

§ 350. Agreements restricting discretion of directors.—

A written agreement among the stockholders of a close corporation holding a majority of the outstanding stock entitled to vote, whether solely among themselves or with a party not a stockholder, is not invalid, as between the parties to the agreement, on the ground that it so relates to the conduct of the business and affairs of the corporation as to restrict or interfere with the discretion or powers of the board of directors. The effect of any such agreement shall be to relieve the directors and impose upon the stockholders who are parties to the agreement the liability for managerial acts or omissions which is imposed on directors to the extent and so long as the discretion or powers of the board in its management of corporate affairs is controlled by such agreement.

§ 351. Management by stockholders.—

The certificate of incorporation of a close corporation may provide that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors. So long as this provision continues in effect,

- (1) No meeting of stockholders need be called to elect directors;
- (2) Unless the context clearly requires otherwise, the stockholders of the corporation shall be deemed to be directors for purposes of applying provisions of this chapter; and
- (3) The stockholders of the corporation shall be subject to all liabilities of directors. Such a provision may be inserted in the certificate of incorporation by amendment if all incorporators and subscribers or all holders of record of all of the outstanding stock, whether or not having voting power, authorize such a provision. An amendment to the certificate of

The result, of course, is money for the lawyers, either in litigation where the parties have deviated from the accepted corporate etiquette, or for the drafting of complicated papers (certificates of incorporation, by-laws, shareholder agreements, etc.) designed to circumvent the law and give the participants the mode of operation they desire while still affording them the benefits of limited liability. Because of the rigidity of the corporation laws, these carefully contrived circumventions are frequently challenged, and then as upholders or challengers of the extra-modal arrangements, the lawyers get additional fees in litigation which often must go up to the highest state court. Yet clients are willing to play the game, simply because they feel that the separate entity is the only way they can avoid personally staking their entire fortunes in any business they undertake. When a business client comes into his office, the lawyer's first task should be to determine whether or not the corporate form fits the needs of that client.⁷⁷ Often, however, this determination is already foreclosed: the client *says*, "I want you to form a corporation for me." Generally, the client is right, especially since enactment of Subchapter S of the Internal Revenue Code,⁷⁸ with its more favorable tax treatment for small corporations. The corporate entity is, with all its defects, the best practical alternative available to the average small businessman, even though the most accommodating of corporation statutes is clearly unsuited to his needs.

This is a shame. Is it a historical necessity? The intermingling of entity and limited liability, limited liability without entity, and entity without limited liability clearly shows it is not. If limited liability is not confined to corporations, why don't businessmen choose one of the other business forms, if it's limited liability they want without the rigidity of corporate-ness? The reason is simple and practical. The Uniform Partnership Act places emphasis on the basic contractual nature of the business relationship. It allows the parties to mold their own business arrangement as they desire. This flexibility is achieved through the technique of making the

incorporation to delete such a provision shall be adopted by a vote of the holders of a majority of all outstanding stock of the corporation, whether or not otherwise entitled to vote. If the certificate of incorporation contains a provision authorized by this section, the existence of such provision shall be noted conspicuously on the face or back of every stock certificate issued by such corporation.

These sections manifestly allow for the flexible operation desired by all close corporations. They seem to pose a possible danger of majority imposition on the minority, however, in allowing control of the corporation under a shareholder agreement entered into by less than all of its shareholders, and also in providing for repeal of shareholder management by a majority rather than all of the shareholders.

Nonetheless, despite the defects of the Maryland and Delaware statutes, it must be conceded that if other legislatures are as solicitous for the problems of the small business man operating in the corporate form, such experiments as those suggested in this article may well be unnecessary.

78. Int. Rev. Code of 1954, §§ 1371-78, as amended, 72 Stat. 1676 (1958).

77. See G. Seward, Basic Corporate Practice 8 (1966).

statute a "default" law. It provides certain rules unless the parties otherwise agree. Most of its management provisions will only be brought into play through the silence of the parties. In the partnership, the parties agree; with a corporation the state must agree first. The ordinary partnership, therefore, possesses the flexibility which the small businessman desires. Unfortunately, it lacks that attribute of the corporation which is the principal reason for its desirability: limited liability. The limited partnership purports to offer such personal protection, but in one important respect the limited partnership is even more rigid than the corporation: the partners who want limited liability are not permitted to take any active part in the operation of the business. If they do, they automatically lose their shield.⁷⁹

More significant than the statutory limitations⁸⁰ and the trouble of organizing out-of-state for all but residents of New Jersey, Michigan, and Ohio, the principal practical reason for not choosing the limited partnership association is the dubious treatment accorded to such ventures outside their state of authorization. Foreign corporations are universally recognized outside their state of incorporation, and the individuals involved are protected from personal liability where they qualify to do business locally. Exotic organizations are not ordinarily covered by such qualification statutes, and xenophobically have been denied the limited liability they enjoy in their state of authorization.⁸¹ Few lawyers, therefore, would go to the trouble of forming one of these organizations out-of-state when the risk of losing limited liability is so great.

Even in the three states where these organizations are authorized, the number of reported cases involving them is so small as to indicate that they are not much used. If one of the advantages of incorporating in Delaware is the large body of stable case law precisely interpreting the statute,⁸² then one of the disadvantages of even local use of these hybrid devices is the paucity of decisions on their proper mode of operation.⁸³

79. ULPA § 7.

80. E.g., the requirement of a board of managers or trustees, analogous to the requirement of a board of directors in a corporation. Mich. Comp. Laws § 449.305 (Supp. 1961); N.J. Rev. Stat. § 42:3-4 (1937); Ohio Rev. Code Ann. § 1783.03 (Page 1954); Pa. Stat. tit. 59 §§ 401-02 (1936). Another example is limited duration. Mich. Comp. Laws § 449.301; N.J. Rev. Stat. § 43:3-2 (1937); Ohio Rev. Code Ann. § 1783.01 (Page 1954); Pa. Stat. tit. 59, § 444 (1936).

81. See, e.g., *Ing v. Liberty Nat'l Bank*, 216 Ky. 467, 287 S.W. 960 (1926); *Willey v. W. J. Hoggson Corp.*, 90 Fla. 343, 106 So. 408 (1925); *Edwards v. Warren Linoline & Gasoline Works*, 168 Mass. 564, 47 N.E. 502 (1897); *Thompson v. Schmidt*, 115 Tex. 53, 274 S.W. 554 (1925); *Means v. Limpia Royalties*, 115 S.W.2d 468 (Tex. Civ. App. 1938).

82. *R. Baker & W. Carey*, *supra* note 64, at 21.

83. Lattin's generally unfavorable conclusion on the use of this device cites this paucity of decisions as a factor.

"(b) Conclusions. Barring local reasons for the use of the partnership association, where

Of course, any new statute proposed as a substitute would initially be subject to the same criticism. This could be alleviated, however, as in the case of the Uniform Commercial Code, by appropriate Reviser's Comments, a technique not used when these statutes, which are all quite old,⁸⁴ were drafted.

V. TO A MORE ADEQUATE FORM

The discussion so far, it is hoped, has shown two things: first, that none of the forms of business organization meets the needs of the small businessman, who must choose between limited liability and flexibility of operation, neither of which he wants to give up; second, that all forms of business organization are essentially the same, mere variations on the same theme. The law must deal to a greater or lesser degree with all aspects of human life, including economics, which encompasses the organization of society to produce and distribute material goods among its members. The present forms of business organization available in this country are merely the imperfect means which have been so far devised to do the job. The lines between these devices blur. Entity is found with and without limited liability; there is limited liability without entity; and there are quasi-entities with and without limited liability. The constructs of business law are not immutable verities, ideal forms, but rather a rough patchwork partly the result of historical accident, partly the result of invention, and, as the comments of the draftsmen of the Uniform Partnership Act indicate,⁸⁵ partly the result of eclectic combination of forms. And each of the fifty states has its own patches on the patches. It all shows

these organizations exist, the right to select its own members seems to be the only argument in its favor. Actually, reasonable restrictions may be placed upon the transfer of shares in a corporation to reach much the same result, thus overcoming this seeming advantage. The comparatively small amount of case law on this type of association, as compared with the voluminous amount on corporations, should be thoroughly considered before recommending a partnership association instead of a corporation. The danger of incurring unlimited liability through the failure to comply substantially with the statutory provisions also looms large against their use. Such factors must be weighed well before recommendations are made to use the partnership association." N. Lattin, *Corporations* 46 (1959).

84. Both Ballantine (H. Ballantine, *Corporations* 10 n.27 (Rev. ed. 1946)) and Lattin (N. Lattin, *Corporations* 29 (1959)) state that the New York law (Laws 1822, ch. 244), which was the first in this country, was patterned after the French Civil Code. The origins are, of course, even earlier. Formoy states that limited partnerships were regulated in the time of Louis XIV. (R. Formoy, *Historical Foundations of Modern Company Law* 44 (1923)). Holdsworth traces the French limited partnership back to the Italian commenda, under which (in Florence) the commendatores, or limited partners, had limited liability as early as 1408. (8 W. Holdsworth, *A History of English Law* 196 (1926)). For a historical background of the Code, see A. Von Mehren, *The Civil Law System* 13-22 (1957).

85. 7 U.L.A., *Commissioners' Prefatory Note to Uniform Partnership Act*, 1-4; *Commissioners' Note to § 6*, *id.* at 11-12.

what a highly imperfect job has been done in trying to fit the needs of that very important social institution, American business.

The result should be to dispel a fear of experimentation. The Continentals are not so hesitant.⁸⁶ In addition to the limited partnership, they have invented a number of other varieties of business forms. A notable recent example of their experimentation is the West German integration of employees into corporate management.⁸⁷ Also worthy of mention is the Yugoslavian device of competition among socialized enterprises.⁸⁸ There have, of course, been experiments in this country, mainly in the area of public or quasi-public corporations, for example, to construct and operate new highway systems.⁸⁹

Very little has been done, however, for the small businessman. The only recent changes have been attempts to accommodate small business within the framework of the corporation laws. These have taken the form of allowing the participants to insist on unanimous consent for shareholder⁹⁰ and/or director⁹¹ decisions; allowing less than the normal three directors where the corporation has less than three owners;⁹² allowing informal written consent in place of a formal meeting, not only for shareholders,⁹³ but even for directors;⁹⁴ and the validation of certain shareholder agreements, even though they deprive the directors of some of their "inherent" powers.⁹⁵ Unfortunately, few states go as far as to make all of these accommodations, and most offer considerably less.⁹⁶

86. See the variety of devices available in France and Germany, as listed in Treillard, *The Close Corporation in French and Continental Law*, 18 *Law & Contemp. Prob.* 546 (1953).

87. BGBl I, No. 24, May 21, 1951, as to mining enterprises and steel mills.

88. They even have separate names like ordinary business corporations. See: Yugoslav Iron Steel and Nonferrous Metal Industry 29-30 (Yugoslav Federal Chamber of Foreign Trade, Beograd).

89. See, e.g., N.J. Rev. Stat. § 27:12b-4 (Supp. 1952): "There is hereby established in the State Highway Department a body corporate and politic, with corporate succession, to be known as the New Jersey Highway Authority." The Port of New York Authority and the Tennessee Valley Authority are other examples.

90. See, e.g., Model Act § 30; N.Y. Bus. Corp. Law § 616.

91. See, e.g., Model Act § 37; N.Y. Bus. Corp. Law § 709.

92. Wyo. Stat. Ann. § 17-36.34; Del. Code Ann. tit. 8, § 141 (1967); N.Y. Bus. Corp. Law § 702; S.C. Code Ann. § 12-18.3 (Supp. 1966); Ill. Rev. Stat. ch. 32, § 157.34 (1965); Neb. Rev. Stat. ch. 21, § 2036 (Supp. 1965). See also Rudolph, *Further Thoughts on the One and Two Director Statutes*, 20 *Bus. Law* 781 (1965).

93. Model Act § 138; N.Y. Bus. Corp. Law § 615.

94. Model Act § 39A (optional).

95. N.Y. Bus. Corp. Law § 620(b) (Supp. 1967); Fla. Stat. § 608.0105 (Supp. 1966).

96. It should be observed that under the New York Business Corporation Law's special close corporation section (§ 620 (b) (Supp. 1967)) which validates a "provision in the certificate of incorporation otherwise prohibited by law because it improperly restricts of the board in its management of the business of the corporation," as long as none of the

There have been pleas for separate statutes for close corporations,⁹⁷ and for engrafting partnership fiduciary principles on the relationship between shareholders in such close corporations.⁹⁸ The legislatures have, however, remained unmoved. Florida may be said to have a separate close corporation statute since it was enacted as a separate session law.⁹⁹ However, it refers to other sections of the corporation code¹⁰⁰ and has been integrated into that code.¹⁰¹ The problem is only a semantic one, however. The only relevant question is the adequacy of the devices available to fit the needs of businessmen and the public. The only advantage of a separate statute, which will only end up as a separate "title" or "chapter" or collection of sections, is convenience in locating the applicable provisions.

corporation's shares are "listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or affiliated securities association" (§ 620(c) (Supp. 1967)) and the corporation's shares are transferred or issued only to persons with "knowledge or notice thereof" (§ 620(b) (Supp. 1967)) or who consent in writing to such provisions, businessmen may presumably enact for themselves the management provisions of the ordinary partnership, by confining the directors' functions to the shareholders or officers, and giving them the powers, subject to the same limitations, with regard to unanimous approval of certain matters, required for the ordinary partnership. The partnership principle of *delectus personarum* can perhaps be achieved if the directorial powers are conferred upon the officers, and approval of all present officers is required for selection of a new officer. (Attempts to condition transfers of interest (shares of stock) upon approval of the remaining shareholders may fail, since this may go beyond a restriction on directors' powers.) The partnership dissolution provisions may be adopted under another special close corporation provision (N.Y. Bus. Corp. Law § 1002(a)) which states that the certificate of incorporation "may contain a provision that any shareholder, or the holders of any specified number or proportion of shares . . . , may require the dissolution of the corporation at will or upon occurrence of a specified event." Again, notice is required (N.Y. Bus. Corp. Law § 1002(c)), and for both provisions under N.Y. Bus. Corp. Law § 620(b) (Supp. 1967) and § 1002(b), the certificate of incorporation should expressly require unanimous approval of all shareholders for any certificate amendment regarding them in order to protect these special partnership features from excision (see N.Y. Bus. Corp. Law §§ 620(d), 1002(b)). An approximation of the partnership within the protective corporate shell can probably then be obtained under the New York corporation statute, which is more congenial than most. The word "probably" is used since no significant judicial interpretation of these sections of the New York Act has yet appeared. Even if the uncertainty is discarded, the result can only be achieved by elaborate and careful drafting, which should not be necessary if the legislature has no objection to allowing close corporations to mold their internal structures and operations as they choose. The real importance of the New York statute is in its demonstration that there is no basic objection to the type of statute here proposed.

97. See authorities cited in H. Henn, *Corporations* 406. n.21 (1961).

98. See Conway, *The New York Fiduciary Concept in Incorporated Partnership and Joint Ventures*, 30 *Fordham L. Rev.* 297 (1961).

99. Ch. 63-379 [1963] Fla. Laws 1030.

100. See Fla. Stat. § 608.0102 (Supp. 1966).

101. It has become Fla. Stat. Ann. § 608 Part II (Supp. 1966). Ordinary corporations are governed by § 608 Part I.

This is a positive value, but clearly secondary. It has already been argued that none of the devices is adequate. The only solution is to propose one which is, even if it means setting up a whole new concept of doing business. It would be preferable, however, for reasons to be stated below, to borrow what is best from present forms of doing business.

VI. "CLOSE CORPORATIONS"

There are two interrelated objections to a separate statute for small business in the corporate form, the separate "close corporation" statutes of the pleas. They will concern us regardless of the form which our organization takes. The first problem is that of defining a close corporation. There is no unanimity on the subject. Clearly, the statement that a close corporation is like a spiral staircase, hard to describe but recognizable when you see one, is not appropriate to a statutory definition, although it does point up the definitional problem. "Chartered partnership," a term sometimes used in the cases,¹⁰² is merely a synonym, not a definition. A corporation in which "the personnel of ownership and management are identical"¹⁰³ has been criticized as too restrictive, since corporations, too, may have the equivalent of "silent partners."¹⁰⁴ For certain purposes, Florida, North Carolina, South Carolina and New York have adopted a negative definition: a corporation none of whose shares is listed on an exchange or regularly traded over-the-counter.¹⁰⁵ This definition may well be too broad for general use since it might exempt very large corporations from regulatory provisions designed to protect a minority holder or the public, simply because the management carefully avoided large-scale trading. In foreign law the definition is usually in terms of num-

102. *Ripin v. United States Woven Label Co.*, 205 N.Y. 442, 447, 98 N.E. 855, 856 (1912); *Clark v. Dodge*, 269 N.Y. 410, 416, 199 N.E. 641, 643 (1936).

103. C. Israels, *Corporate Practice* 48 (1963).

104. 1 F. O'Neal, *Close Corporations* 4 (1958).

105. Fla. Stat. Ann. § 608.0100(2) (Supp. 1966); N.C. Gen. Stat. § 55-73 (1965); S.C. Code Ann. § 12-16.22 (Supp. 1966); N.Y. Bus. Corp. Law § 620(c) (Supp. 1967). The new Maryland amendments are interesting in this regard. There is no real definition of a close corporation. Section 100(a) merely states: "A corporation shall be a 'close corporation' for purposes of this Article so long as its charter shall contain a statement that the corporation is a close corporation authorized by this section, which statement was (i) contained in the articles of incorporation as originally filed with the Department, (ii) included in the charter by an amendment authorized by Section 11(a) of this Article, if at the time of the adoption of such amendment no stock of the corporation was either outstanding or subscribed for, or (iii) included in the charter by an amendment authorized by affirmative vote of the holders and subscribers for all stock of the corporation." The obvious philosophy is that no such definition is needed, since the requirements for, and consequences of electing status as a close corporation will make the special treatment only feasible for corporations of the desired size. See also note 118, *infra*.

bers of participants,¹⁰⁶ with an added requirement that the ownership interest *not* be freely transferable.¹⁰⁷ This is a typical desideratum for "close corporations," since the term means, in effect, the attempt to apply the partnership principle of *delectus personarum* to participation in a corporation. In the United States, this privilege of determining who will come into the enterprise has been only grudgingly conceded to corporations¹⁰⁸ because of the theory that participations should be freely negotiable¹⁰⁹—a theory carried over in the Uniform Commercial Code.¹¹⁰ As to limitations on the number of participants, the numbers under foreign law are usually high, 50 in England¹¹¹ and Japan, for example.¹¹²

In the United States, three new quasi-definitions of the "close corporation" have emerged. The first was that in Subchapter S of the Internal Revenue Code, added in 1958.¹¹³ With necessary qualifications to prevent evasions, it defines a close corporation ("Small Business Corporation")¹¹⁴ as one with no more than 10 shareholders¹¹⁵ (while it preserves the old common law unity of husband and wife).¹¹⁶ The Securities Act of 1964 supplies us with another possible definition: a corporation worth less than \$1,000,000 and having less than 500 shareholders.¹¹⁷ Again, like the

106. See Gower, *The English Private Company*, 18 *Law & Contemp. Prob.* 535 (1953); Treillard, *The Close Corporation in French and Continental Law*, 18 *Law & Contemp. Prob.* 546 (1953).

107. Law of March 7, 1925 instituting *société à responsabilité limitée*. Maryland's and Delaware's close corporation provisions borrow this aspect. See note 76 *supra*, and note 118, *infra*.

108. 2 F. O'Neal, *Close Corporations* 8 (1958).

109. See discussion in *Lawson v. Household Finance Corp.*, 17 Del. Ch. 343, 152 A. 723 (Sup. Ct. 1930); *Allen v. Biltmore Tissue Corp.*, 2 N.Y.2d 534, 141 N.E.2d 812, 161 N.Y.S.2d 418 (1957). See also H. Ballantine, *Corporations* 1 (rev. ed. 1946); C. Israels, *Corporate Practice* 7, 11 (1963), stating that the attribute of ease of transferability is an advantage.

110. See N.Y. U.C.C. § 8-101, N.Y. Annotations: "Article 8 attempts to provide for the ready and easy transfer of securities without excessive investigation of title questions."

111. Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 28(1)(b).

112. Special act authorizing the Yugen Kaisha.

113. Int. Rev. Code of 1954, §§ 1371-74. See also Kan. Gen. Stat. Ann. § 17-2701 (Supp. 1965), adopting special provisions for corporations with no more than 10 shareholders engaged in agricultural pursuits.

114. Int. Rev. Code of 1954, § 1371(a).

115. Int. Rev. Code of 1954, § 1371(a)(1).

116. Int. Rev. Code of 1954, § 1371(c) provides: "For purposes of subsection (a)(1) stock which—(1) is community property of a husband and wife (or the income from which is community income) under the applicable community property law of a State, or (2) is held by a husband and wife as joint tenants, tenants by the entirety, or tenants in common, shall be treated as owned by one shareholder."

Of course, separate ownership will cause the husband and wife to be counted as two shareholders.

117. Under the Securities Exchange Act of 1934, 15 U.S.C. § 78h, as amended, 15 U.S.C.

Florida, North Carolina, South Carolina and New York definitions, it seems to be too broad for general use, including too many corporations.

Obviously what is said here is not intended to be a criticism of any of the statutes noted, since for different purposes the needs are different, and none of the statutes has been enacted with the express purpose of definitively distinguishing between the two categories of corporations, "public issue" and "close," for all purposes.

The most recent definition is that in the new Delaware corporation statute.¹¹⁸ Unlike the few other American statutes which have attempted special provision for close corporations, it follows the European tradition and defines a close corporation in terms of numbers of shareholders (in this case, thirty).¹¹⁹ It also engrafts a variation of the "not-generally-traded" definition of the earlier statutes in forbidding any offering of its stock which would constitute a public offering within the meaning of the Securities Act of 1933.¹²⁰

It is impossible to assess the wisdom of the Delaware enactment at this early date. However, if for no other reason than that it is a *Delaware* statute, hence a part of the most important corporation law in the country, it is the most significant enactment since the initial Florida experiment in the area of accommodation of small business. If it succeeds and, as has happened with other Delaware enactments, becomes the pattern for simi-

§ 78I, corporations with 500 or more shareholders and assets exceeding \$1,000,000 must register, and are subject to other requirements of the 1934 Act formerly restricted generally to corporations listed on stock exchanges.

Int. Rev. Code of 1954, § 1244(c)(2) has its own definition of a "small business corporation" in financial terms including, under certain circumstances, corporations with as much as \$1,000,000 in equity capital.

118. The Delaware statute also adopts the European tradition of requiring restrictions on share transferability for close corporations. Del. Code Ann. tit. 8, § 342 (1967), provides:

(a) A close corporation is a corporation organized under this chapter whose certificate of incorporation contains the provisions required by section 102 of this title and, in addition, provides that:

(1) All of the corporation's issued stock of all classes, exclusive of treasury shares, shall be held of record by not more than a specified number of persons, not exceeding thirty; and

(2) All of the issued stock of all classes shall be subject to one or more of the restrictions on transfer permitted by section 202 of this title; and

(3) The corporation shall make no offering of any of its stock of any class which would constitute a "public offering" within the meaning of the United States Securities Act of 1933, as it may be amended from time to time.

(b) The certificate of incorporation of a close corporation may set forth the qualifications of stockholders, either by specifying classes of persons who shall be entitled to be holders of record of stock of any class, or by specifying classes of persons who shall not be entitled to be holders of stock of any class or both.

(c) For purposes of determining the number of holders of record of the stock of a close corporation, stock which is held in joint or common tenancy or by the entireties shall be treated as held by one stockholder.

119. Del. Code Ann. tit. 8, § 342(a)(1).

120. Del. Code Ann. tit. 8, § 342(a)(3).

lar laws throughout the country, the problem may be solved without a need for any further articles like this one. Nonetheless, the thirty shareholder maximum allows large corporations, which are technically non-public issue, to qualify for special treatment.

The second problem involved in giving special treatment to close corporations is based on the valid assumption that any statute designed to benefit close corporations would permit them to mold their mode of operation more or less as they chose, thus making them even more permissive than the ordinary corporation statute in allowing the "contrôleurs," as Father Bayne would call them,¹²¹ close to complete freedom in their running of the corporation. Clearly, it would be undesirable to allow the management of a public-issue corporation to plunder the shareholders by molding the corporate structure to give themselves an even stronger guarantee of self-perpetuation than they presently have,¹²² and by obtaining a complete immunity from liability for things like self-dealing, negligence, etc.¹²³ While prior to the DeAngelis, Birrell, and Gulf Sulphur scandals, the fear of adverse publicity was thought to be an effective deterrent, the public cannot take the chance of allowing large corporations to operate just as they want. There are, of course, dangers of imposition in a small business, but the greater proportional power of the minority, and the likelihood of greater information through the fact that the business will ordinarily represent their livelihood rather than a mere investment, combine to diminish these dangers. Also, the courts have shown a greater readiness to require a higher standard of conduct on the part of the participants to one another than they have in large corporations.¹²⁴ A legitimate fear with regard to any statute which allows a small business to mold its future completely according to its own will is that, unless properly limited to businesses where the rights of all parties can be guaranteed sufficient protection, it will be used by the wrong people for the wrong purposes.

VII. A NEW FORM OF BUSINESS ORGANIZATION

Before drawing any lines between businesses to be given and those to be excluded from special treatment, however, a basic policy decision must be made; or rather, the fact that it has already been made by the people

121. See Bayne, *The Sale of Corporate Control*, 33 *Fordham L. Rev.* 583, 586 (1965).

122. See A. Berle & C. Means, *The Modern Corporation and Private Property* 124-25 (1932).

123. If a fully contractual theory of organization is adopted, even wider recognition of the validity of exculpatory provisions can be anticipated. See, e.g., *Spiegel v. Beacon Participations, Inc.*, 297 *Mass.* 398, 8 *N.E.2d* 895 (1937). In a small enterprise the participants are, of course, unlikely to utilize them where the result may be to destroy the fiduciary obligations of the members to one another.

124. See H. Henn, *Corporations* 383 (1961).

should be made clear. The small businessman usually chooses the corporation for its limited liability feature. Every businessman should have the privilege of limited liability. This is not a radical proposal since even the sole proprietor today may have this privilege. The only difference is that it is conferred at a price, the strictures of conformity with the corporation law.

Once this is recognized and accepted, conferring the privilege becomes an easy matter. Language could be taken from almost any corporation statute,¹²⁵ or perhaps better, one of the Limited Partnership Association statutes,¹²⁶ or even, for a touch of tradition, the first general corporation statute.¹²⁷

A. *Partnership Advantages*

If the participants in a small business desire partnership operation, this, too, is simple of accomplishment. The Uniform Partnership Act could be reenacted, but with the limited liability language added. Perhaps better yet, the Uniform Limited Partnership Act could be reenacted, but with limited liability applicable to *all* partners.¹²⁸

125. See, e.g., Model Act § 23: "A holder of or subscriber to the shares of a corporation shall be under no obligation to the corporation or its creditors with respect to such shares other than the obligation to pay to the corporation the full consideration for which such shares were issued or to be issued."

126. E.g., Ohio Rev. Code Ann. § 1783.08 (Page 1964): "The members of a limited partnership association shall not be liable under any judgment, decree, or order obtained against the association, or for any debt or engagement of the association, further or otherwise than is provided in sections. . . ."

127. New York is generally credited with having the first general corporation law for business purposes. See H. Ballantine, *Corporations* 37 (rev. ed. 1946). Massachusetts or North Carolina (the latter's limited to corporations for the purpose of cutting canals), however, may dispute this. Connecticut's later statute (1837) was also before New York in allowing incorporation for any lawful purpose and hence may claim priority. (H. Henn, *Corporations* 17 (1961)). N.Y. Laws 1811, ch. 67 is, however, a pretty satisfactory corporation statute even today. Its section conferring limited liability is as follows:

VII. *And be it further enacted*, That the stock of such company shall be deemed personal estate, and be transferable in such manner as shall be prescribed by the laws of the company; and that for all debts which shall be due and owing by the company at the time of its dissolution, the persons then composing such company shall be individually responsible to the extent of their respective shares of stock in the said company and no further; and that it shall not be lawful for such company to use their funds, or any part thereof, in any banking transaction, or in the purchase of any stock of any bank, or in the purchase of any public stock whatever, or for any other purposes than those specified in such instrument as aforesaid.

VIII. *And be it further enacted*, That the copy of any certificate filed in pursuance of this act, and certified to be a true copy by the secretary of this state, or his deputy, shall together with this act, be received in all courts and places as legal evidence of the incorporation of such company.

128. Although a few states (Florida, Georgia, Hawaii, Iowa and New Hampshire) have the Uniform Limited Partnership Act but not the Uniform Partnership Act, the former, in effect, presupposes the existence of the latter—or at least some general partnership law—

Once the principle that all the forms of business organization are merely variations on the same theme is accepted, it is easy to create a new form simply by picking and choosing from those already existing. This makes drafting easier, and makes available the already existing mass of rights and obligations which cluster around recognized concepts, their connotations, in the fullest sense of that word. Thus, for example, if recognized standards of fiduciary obligation on the part of one participant vis-à-vis another are desired, the organization may simply be characterized as a partnership. This automatically brings to the organization a large body of case law on the rights and duties of the participants inter se. In New York, it engrafts *Meinhard v. Salmon*,¹²⁹ with its principle that the members "owe to one another, while the enterprise continues, the duty of the finest loyalty . . . Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."¹³⁰

B. *Entity Advantages*

Is the new organization to be merely a partnership, a quasi-entity? The full entity has certain advantages. For one thing, it allows a one-man organization, while a partnership presupposes at least two people; why should two be freer than one?

What are the other advantages of an entity? To find out it is necessary to look at its essence. Lord Coke sets out the elements.¹³¹ He states:

Now it is to be seen what things are of the essence of a corporation. 1. Lawful authority of incorporation: and that may be by (b) four means, *sc.* by the common law, as the King himself, &c. by authority of Parliament: by the King's charter (as in this case); and by prescription. The 2d, which is of the essence of the incorporation, are persons to be incorporated, and that in two manners, *sc.* persons natural, or bodies incorporate and political. 3. A name (c) by which they are incorporated; as in this case governors of the lands, &c. 4. Of a place, for without a place no incorporation can be made; here the place is the Charter-house in the county of Middlesex. *Vide* 3 H.

as regards the rights, powers and liabilities of the general partners in the limited partnership Uniform Limited Partnership Act § 9(1). Further, the Uniform Partnership Act is expressly made applicable to limited partnerships, except where the statutes relating to the latter are inconsistent therewith. Uniform Partnership Act § 6(2). This seems necessary, of course, since there are lacunae in the Limited Partnership Act. Accordingly, it will often be necessary to use Uniform Partnership Act provisions (or incorporate them by reference into the new Act). Provisions in the Uniform Limited Partnership Act which draw distinctions based on differences in treatment between limited and general partners also must be modified if all members are to be accorded the same limited liability status. Often it will be simpler to use the Uniform Partnership Act provision, instead, therefore, despite the general decision to use the Uniform Limited Partnership Act as the model.

129. 249 N.Y. 458, 164 N.E. 545 (1928).

130. *Id.* at 464, 164 N.E. at 546.

131. *In re Sutton's Hosp.*, 77 Eng. Rep. 937, 960 (K.B. 1613).

6 Det. 20. 17 E. 3. 59. b. & 45 E. 3. 17. 5. By words sufficient in law, but not restrained to any certain, legal, and prescript form of words.¹³²

He next sets forth ten attributes of a corporation, or rather of the type of charitable corporation under consideration, as demonstrated by granted charters. He states, however, that "divers clauses subsequent in the charters are not of necessity, but only declaratory, and might well have been left out."¹³³ The list follows:

1. By the same to have authority, ability, and capacity to purchase, but no clause is added that they may alien, &c. and it need not, for it is incident. 2. To sue and be sued, implead and be impleaded. 3. To have a seal, &c. that is also declaratory, for when they are incorporated, they may make or use what seal they will. 4. To restrain them from aliening or demising but in certain form; that is an ordinance testifying the King's desire, but it is but a precept, and doth not bind in law. 5. That the survivors shall be the corporation, that is a good clause to oust doubts and questions which might arise, the number being certain. 6. If the revenues increase, that they shall be employed to increase the number of poor, &c. that is but explanatory 7. To be visited by the governors, &c. that is also explanatory 8. To make ordinances (d); that is requisite for the good order and government of the poor, &c. but not to the essence of the incorporation. 9. The exemption from the Ordinary is but declaratory, for being a lay incorporation he neither can nor ought to visit. 10. The license to purchase in mortmain is necessary¹³⁴

As suggested by incident 5, perpetual duration is also a necessary attribute. This is made clear by the later "definition" of corporation: "[F]or a corporation aggregate of many is invisible, immortal, and rests only in intendment and consideration of the law"¹³⁵

The elements of a corporation are relatively few.¹³⁶ With the obvious exception of unlimited duration (an incident which it seems wise to include),¹³⁷ they boil down generally to the attributes of a human being—at least a human of Lord Coke's time:¹³⁸ name, address, power to sue and be

132. Id. at 968-69.

133. Id. at 970-71.

134. Id. See Williston, *History of the Law of Business Corporations Before 1800*, 2 Harv. L. Rev. 105, 116 (1888).

135. 77 Eng. Rep. at 973. If Coke is correct, this is another example of the denial of a "natural right" since perpetual duration has often been denied in the past (see N. Lattin, *Corporations* 154 (1959)), and still is today in some states. (See, e.g., La. Const. art. XIII, § 7; Miss. Const. art. VII, § 178; Okla. Const. art. 2, § 32.)

136. 1 Blackstone, *Commentaries* *475, agrees as to the necessity of a name. He states the incidents of a corporation to be (1) perpetual succession, (2) to sue and be sued, (3) to purchase lands, (4) to have a common seal, and (5) to make by-laws. The obvious omission from both lists, Coke's and Blackstone's, is limited liability.

137. See, e.g., *Leventhal v. Atlantic Rainbow Painting Co.*, 68 N.J. Super. 406, 172 A.2d 710 (App. Div. 1961), holding that a New Jersey Limited Partnership Association becomes a partnership after expiration of its fixed duration.

138. See 9 W. S. Holdsworth, *A History of English Law* 71 (1927).

sued, power to own and sell property, and, since the seal was merely the substitute for it in an age of illiteracy, the power to sign one's name, to make a valid legal commitment.¹³⁹ These are all such manifest advantages to the real persons composing the entity, and to those dealing with it, that many have been taken over by the partnership,¹⁴⁰ and more by the other forms of organization.¹⁴¹ The name is important for identification and simplicity. The business name could be required to include the names of all the participants. It would often be ridiculously long if it did. On the other hand, the name should not be designed to deceive, whence the typical register of corporate names with which a new corporation's name may not conflict.¹⁴² The "fictitious name" statutes which many states have,¹⁴³ and the filing requirements of the Limited Partnership Act (and the hybrids), also perform¹⁴⁴ the function (unlike many corporation statutes) of disclosing the true owners of the business. This not only prevents deception but requires affirmative disclosure. Today corporate names, and the names of the hybrids are required to have a distinctive "suffix."¹⁴⁵ This worthwhile requirement of disclosure of limited liability will be discussed below.

A fixed location is probably not as obsolete a requirement as it was once thought to be.¹⁴⁶ Although corporations and other organizations often desire to operate outside their state of creation, they should still have some fixed place at which those who wish to hold them to account will be able to find someone at least sufficiently important so that "our traditional

139. Williston, *History of the Law of Business Corporations Before 1800*, 2 Harv. L. Rev. 105, 117-121 (1888).

140. Under the ULPA § 2(1)(a)(I), a name is required. Although not expressly required under the UPA, a name is, in effect, required by separate name registration statutes (often called trade name or fictitious name statutes) in a number of states. See, e.g., N.Y. Gen. Bus. Law § 130; Va. Code Ann. §§ 50-74 to 50-78 (1967). An address is expressly required by ULPA § 2(1)(a)(III), and inferentially by UPA § 19. Neither the UPA nor the ULPA expressly grant the right to sue or be sued in the partnership name. A few states have conferred the right. See, e.g., Neb. Rev. Stat. § 25-313 (1943); N.Y. C.P.L.R. § 1025. The power to take and hold property in the partnership name is given by UPA §§ 8, 10, and accordingly carried over to the ULPA. Neither act expressly grants the right to have a seal.

141. All the Limited Partnership Association statutes, for example, expressly confer power to sue and be sued in the partnership association name. Ohio Rev. Code Ann. § 1783.06 (Page 1964); Mich. Comp. Laws §§ 449.310, 449.313 (1967); N.J. Rev. Stat. § 42:3-8 (1937).

142. See Model Act § 7.

143. See note 140 *supra*.

144. See ULPA § 2(1)(b); Mich. Comp. Laws § 449.101 (1967); Ohio Rev. Code Ann. § 1783.01 (Page 1964); N.J. Rev. Stat. § 42:3-1 (1937).

145. See, e.g., Model Act § 7(a).

146. Williston characterizes it as "apparently so fanciful," and the relaxation of the requirements as the result of lawyers becoming more "reasonable." Williston, *supra* note 134, at 115. In fairness to the criticism, it should be added, however, that originally the place had to be part of the name. *Id.*

notions of justice and fair play"¹⁴⁷ will not be offended by holding that notice to him binds all the businessmen involved. The "principal office" (in addition to affording a means for laying the venue in actions brought against the business, despite the different addresses of the members)¹⁴⁸ and the "registered agent"¹⁴⁹ perform this function for corporations, and it should be noted that the limited partnership¹⁵⁰ and the hybrids¹⁵¹ have adopted analogous requirements.

The power to sue in the business name is a valuable right. To see its importance, consider the almost impossible task of getting all the owners to join in a suit, where there are a large number of them. It was once considered to be more important to the corporation than limited liability.¹⁵² Naturally, the corporation is more easily suable in its "common name." Both the benefit and the burden seem worthy of preservation. As indicated above,¹⁵³ some states, recognizing the value of such ease of suit and suability, have conferred the privilege-liability on ordinary partnerships. This has required a special statute; it is not incorporated in the Uniform Act. The proposed business organization should have it.

For the same reasons, a power to take and sell property in the business name is a right which seems quite necessary, except perhaps where all, or almost all, of the corporate assets are being sold. It is manifestly simpler to have a deed signed by two than by five, six, ten or more. It is even more important to have minor transactions executed by fewer than all of the business associates.

Since we can now write, the seal is not so important except perhaps as a guaranty of authenticity, as it is still used on governmental documents. Although still recognized as valuable for this purpose even under modern statutes,¹⁵⁴ this prerequisite of corporations is not indispensable.

147. *McGee v. International Life Ins. Co.*, 355 U.S. 220 (1957), which cites *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

148. See, e.g., Ill. Rev. Stat. § 110-6 (1963); N.Y. C.P.L.R. § 503(c); Ohio Rev. Code Ann. § 2307.36 (Page 1953).

149. Model Act § 11.

150. ULPA § 2(1)(a)(III) requires setting forth the location of the principal place of business, and § 2(1)(a)(IV) the name and place of residence of each member, in the filed certificate.

151. See, e.g., Ohio Rev. Code § 1783.06, providing for service on the chairman, secretary or treasurer, and § 1783.01, requiring the naming of the officers in the filed certificate.

152. Note, e.g., the fact that Coke, *supra* note 131, includes it in his list of corporate incidents. Following him, Blackstone mentions it as one of the powers "necessarily and inseparably incident to every corporation." 1 Blackstone, Commentaries *475. It should be noted that both he and Coke omit limited liability completely.

153. See note 140 *supra*.

154. See, e.g., N.Y. Bus. Corp. Law § 107 which provides: "The presence of the corporate seal on a written instrument purporting to be executed by authority of a domestic or foreign corporation shall be prima facie evidence that the instrument was so executed."

Thus, the addition of at least five of the six entity aspects to the new business organization is indicated. Whether this makes the organization a corporation is only a semantic problem since the limited partnership has all but two of the five,¹⁵⁵ and the limited partnership association has all but one.¹⁵⁶ A definite characterization of the new form as a corporation would mean that the settled body of corporation law decisions would immediately attach to the new entity. Some of this law, as indicated above, would not be desirable from the point of view of the small businessman. There is, however, one significant advantage to a corporate designation, if out-of-state operation is to be allowed. It is the availability of the statutory mechanisms for authorization of foreign corporations to do business locally.¹⁵⁷ It will be remembered that the lack of a guarantee of the same treatment out-of-state as locally was one of the principal objections to the hybrid business forms.¹⁵⁸

C. *What's in a Name?*

How can the advantages of both the typical partnership and the corporation be obtained? Obviously, as suggested, we can pick and choose the various provisions, piecing them together to construct a new organization designed to secure the benefits desired. The desired provisions, with the exception of the financial provisions which will be considered shortly, are all pretty obvious. However, in this area of the law technicalities are important. The name given to this new form of business organization may well be vital since the law in this field is still compartmentalized. What is probably desired is an "incorporated partnership." By having the word "partnership" last, qualification as a foreign corporation is probably foreclosed since the statutes generally use the term "foreign corporation" and require a statement of the jurisdiction and date of "incorporation."¹⁵⁹

155. See note 140 *supra*. The limited partnership has name, address, power to hold property. It lacks perpetual duration, the power to sue and be sued in the partnership name (unless conferred by special statute), and the express authorization for a seal.

156. The limited partnership association has the additional prerequisite of suit in the association name, as well as those possessed by the limited partnership.

157. See, e.g., Model Act §§ 99-105.

158. See *Edwards v. Warren Linoline & Gasoline Works*, 168 Mass. 564, 47 N.E. 502 (1897), holding that a partnership association is really a partnership and not a corporation and hence the members must be sued individually. See also *H. Henn, Corporations* 61 (1961).

159. See, e.g., Model Act § 99. See also N.Y. Bus. Corp. Law § 1304(a): "A foreign corporation may apply for authority to do business in this state. An application, entitled 'Application for authority of . . . (name of corporation) under section 1304 of the Business Corporation Law,' shall be signed and verified by an officer of or attorney-in-fact for the corporation and delivered to the department of state. It shall set forth: (1) The name of the foreign corporation. (2) The jurisdiction and date of its incorporation."

“Small Business Corporation,” the name used in the Internal Revenue Code for a Subchapter S corporation, would seem appropriately descriptive if the availability of the device is to be limited to businesses the same size as those under that statute. However, it would tend to negative the desired partnership connotations in favor of exclusively corporate ones. The best way to protect the essential limited liability feature of our organization is to make the entity aspect the basic one and to superimpose the partnership element on it. This may appear to be coming full circle back to a separate close corporation statute. It is really immaterial whether it is or not. The entity, perhaps just because it is primitive, has the advantage of simplicity. It might also have an advantage with regard to the financial aspects of business organization. The only objection to the corporate entity is the rigidity of its internal structure, which will be corrected by adoption of a partnership as the innards of the entity. There is no objection to leaving a corporate shell as our protective exterior. Why not christen the new form simply a “partnership corporation?” Is such a name a contradiction in terms? Hardly more so than “limited partnership,” since, as indicated, limited liability, at least today, is peculiarly associated with the corporation, and “limited” even more so, as the distinctive mark of an English corporation.¹⁶⁰ Certainly a “partnership association” is an even more peculiar term. Strange though it may sound, the term “partnership corporation” is an accurate one. Internally, the organization will operate like a partnership; externally, if possession of the attributes of a corporation is the criterion, it is a corporation.

D. *Financial Limitations and the Scope of Coverage*

There remains the complicated subject of the finances of the organization. Unfortunately, this problem is interrelated with the problem of how widely this new organization will be allowed to be utilized and involves again the limited liability already conferred. Fundamental to the discussion is the public welfare.

The public interest is not injured by granting limited liability to businessmen. It must be conceded, however, that in addition to the formalistic requirements exacted as a condition of this insulation of the businessman's personal assets, certain other concessions, designed to protect creditors through insuring a degree of financial responsibility, are also a part of the quid pro quo demanded.

The protection of the public interest when limited liability is conferred on a business requires at least two things: notice, and separate fund and

160. “Limited” must be the last word of every corporate name of every company “limited by shares or by guarantee.” Companies Act of 1948, 11 & 12 Geo. 6, ch. 38, § 2, at 438.

record keeping. The first is the reason for the traditional requirement of the addition of some special word or abbreviation to the business name to give creditors warning that liability is limited. Whether they take this notice seriously or not is a matter for speculation, since many creditors, assuming that a corporation is a bigger financial operation than a partnership or sole proprietorship, are more willing to lend or sell on credit to them than to other businesses, where they can pursue the individuals and not be restricted to the corporation's separate funds.

Also, some of the notice words are ambiguous. "Company," permitted in some states, can connote either a corporation or a partnership.¹⁶¹ Many people, including some businessmen, consider "Ltd." as having only social appeal and not any legal significance. But understood or not, the notice words are held to be fair warning (like "constructive" notice).¹⁶²

The notice requirement can easily be met. A requirement for the addition of "corporation" or "incorporated," or an abbreviation, would seem to suffice. By avoiding the word limited, associated with the limited partnership and limited partnership association, any difficulties in the way of a corporate characterization for "external" legal purposes are avoided.¹⁶³

Our organization can easily be required to keep its own books. One of the reasons why businesses fail is the failure to keep accurate accounts: the participants don't realize they are losing money until it's too late. They often forget their "fixed" costs like rent, light, heat, telephone, etc., when they are taking in more than the cost of the items sold during the month.¹⁶⁴ Such a requirement of separate accounts performs a valuable educational function and is one of the advantages of the entity concept: if the business is regarded as a separate person, it is easier to convince the real people involved to keep their "child's" accounts separate from their own.

161. Compare *In re American Cigar Lighter Co.*, 77 Misc. 643, 138 N.Y.S. 455 (Sup. Ct. 1912), with *Lowell Woodward Hardware Co. v. Woods*, 104 Kan. 729, 180 P. 734 (1919). The latter stated that "company" implied a corporation.

162. This is the philosophy of recording statutes: although it is possible that people will not have actual notice of such filed documents, it is not considered unfair to treat all people as though they did, since careful persons have the opportunity for such knowledge.

163. "Corporation," "company," "incorporated," and "limited" (or abbreviations thereof) are the typical words to indicate corporateness. See Model Act § 7(a).

164. Dewing, a recognized authority on corporate finance, in discussing the causes of business failure concludes:

"Whether we deal with the business in its earlier stages, small in size, or in its mature and expanded stages, large in size, we reach the same fundamental truth—business success and business failure may be resolved into qualities of human management." 2 A. Dewing, *The Financial Policy of Corporations* 1216 (5th ed. 1953).

He adds: "After the most exhaustive and illuminating analysis of economic causes, there will stand out the fact that a business fails because the managers do not possess the necessary intuitive skill, foresight, initiative, perseverance and intellectual power to compel its success." *Id.* at 1217.

But books require some funds to keep track of. In the ordinary partnership, before the federal income tax, there was no imperative need to keep separate business accounts (although, of course, the Uniform Act requires them)¹⁶⁵ except to prevent disputes among the partners as to their respective shares of the profits or losses. Today, even in the partnership there is, through the requirement of the information return,¹⁶⁶ a built-in necessity for separate accounts.

But, in the new organization, what accounts will be kept? Every business requires a certain amount of "capital"¹⁶⁷ to launch it, the amount varying according to the particular business carried on. Obviously, a steel mill needs more available assets than a grocery store. In a partnership, the partners merely agree on the amount they will each contribute to the enterprise. There is no legal minimum. The same is true of the limited partnership and the general and limited partners' contributions. The only additional requirement is constructive notice, through the filing of a certificate stating the limited partners' contributions.¹⁶⁸

This would probably be sufficient for our organization, too, and the arrangement as to what moneys or other assets could be withdrawn, and under what circumstances, could be left to provisions like those of the Limited Partnership Act,¹⁶⁹ or to the agreement of the parties.

It can be cogently argued that this is not unfair to the outsiders if the same filing¹⁷⁰ and amendment¹⁷¹ requirements are imposed. Just as sophisticated creditors of a corporation may and often do exact an additional personal guaranty, so those dealing with the new organization can always protect themselves in a similar fashion.

On the other hand, a corporation is elaborately restricted with regard to its dealings with the capital invested;¹⁷² in many states, a corporation cannot begin business at all until a certain amount is "in the till."¹⁷³ "Legal capital," or "stated capital"¹⁷⁴ as modern statutes call it, is rela-

165. UPA § 19.

166. Int. Rev. Code of 1954, §§ 701, 6031; see H. Henn, *Corporations* 50 (1961).

167. In the sense of financial capital, i.e., cash or cash and property.

168. ULPA § 2(1)(a)(VI). Both acts presuppose contributions of capital to the business by the general partners. See the rules for distribution. UPA § 40(b)(III); ULPA § 23(1)(f).

169. ULPA § 16.

170. ULPA § 2.

171. ULPA § 24(2)(a).

172. See, e.g., Model Act §§ 5, 40 and 41. These rely on the provisions of §§ 2, 17, and 19 to determine the amounts distributable. See also the detailed provisions governing when changes in the distributable amounts are desired in §§ 53-55, and the penalty provisions for improper distributions in §§ 23 and 43. Many other sections of the Act are also relevant. It is fair to say that the great bulk of the Act is taken up with just such financial provisions.

173. See H. Henn, *Corporations* 173 (1961).

174. E.g., Model Act § 2(j).

tively sacred. The loopholes however, are legion. It was not always so. At one time "capital" meant what it sounds like to the layman: cash or the equivalent. At one time it could be distributed to the participants, freely, when they chose.¹⁷⁵ Today "capital" is best understood as merely an accounting concept¹⁷⁶ and therefore is well understood only by accountants. Because many states have no minimum capital requirements, and those which do never require more than \$1,000,¹⁷⁷ the protection offered to creditors by way of a fund of assets on which they can rely for satisfaction of their claims is of dubious value. In states which have no minimum capital requirements, there is nothing but the realistically discountable fear of a disregard of the corporate entity for such undercapitalization to prevent a corporation from starting off business with only 3 cents in the till. Even with a higher capitalization, distributions of the sacred capital through a simple "change of name proceeding" (reduction of stated capital to create "reduction surplus", a form of capital surplus, often as available for dividends as corporate profits)¹⁷⁸ are so easy to accomplish that the protection afforded by the statutory enactment of complicated accounting principles is negligible.

Although the small businessman should have an accountant, if only to figure out his tax properly, it would hardly seem worthwhile to the public interest to force him into this feature of the corporate mold.

On the other hand, it should be noted that if this new organization is ever given life, it will, at least as to ordinary businesses, probably put the ordinary partnership out of business. If businessmen can have partnership operation *plus* limited liability, why should they settle for less? It may then be justifiable to require the new organization to show some degree of financial responsibility in exchange for the privilege we have decided to confer.

A minimum financial capitalization could be required. As a practical matter, however, this would necessitate the borrowing of the corporate financial concepts. Although the typical partnership agreement states the

175. D. Kehl, *Corporate Dividends* 3-4 (1941); Williston, *History of the Law of Business Corporations Before 1800*, 2 *Harv. L. Rev.* 105, 109-110 (1888).

176. H. Ballantine, *Corporations* 478-79 (rev. ed. 1946); *Model Act* § 2(j), comment at 22 (1953).

177. *Model Act*, § 51, Annot. ¶ 2.02 (Supp. 1960).

178. Thus, e.g., under the *Model Act*, stated capital can be reduced by reducing the par value of shares. *Model Act* §§ 53(e) and 54(c). Under § 63 a mere majority may reduce the stated capital of no-par shares. The capital surplus thus created can be distributed either as dividends, through the use of §§ 14 and 40, or directly under § 41. Under the new § 40(a) "nimble" dividends, i.e., out of stated capital itself, will be permitted where current profits are present. Although a class vote of affected shares is required under § 55, it is obvious that stated capital can be molded to allow distributions when desired.

contributions of the parties, it is not important to require that these remain intact, that is, not be redistributed to the partners since creditors may go after not only these investments but also the personal resources of the individual partners. The ordinary partnership's protection of dissolution on the bankruptcy of a partner¹⁷⁹ is meaningless, if each partner's liability is limited solely to his financial contribution. Insolvency of the organization (in the bankruptcy or equity insolvency senses)¹⁸⁰ could be used as the sole protection for third parties. The bankruptcy-insolvency test would not afford much protection, but then it is not much less than that afforded by the non-impairment of stated capital requirements of modern corporation laws. Under the former, only assets in excess of liabilities may be distributed. Under the latter, only assets in excess of liabilities plus stated capital may be distributed. Obviously, if stated capital may start at, or be diminished to next to nothing, the difference in creditor protection is negligible. The loss of protection by electing only a bankruptcy test is, therefore, also negligible. It is perhaps for this very reason that modern corporation laws also superimpose the equity-insol-

179. UPA § 31(5).

180. Henn pointedly distinguishes the two: "The term 'insolvency' has two meanings: (a) inability of the corporation to pay its debts as they become due in the usual course of business—so-called 'equity sense', and (b) excess of liabilities over assets—so-called 'bankruptcy sense'." H. Henn, *Corporations* 487 (1961) (footnote omitted).

The bankruptcy-insolvency limitation on distributions is, in effect, built into the "compensation" and withdrawal provisions of the Limited Partnership Act. ULPA §§ 15-16. See also ULPA § 23; UPA §§ 18(a), 38(1) & 40(b).

The bankruptcy of the partnership causes dissolution, UPA § 31(5), and bankruptcy includes the Federal Act and "any state insolvent act." UPA § 2. Although these provisions may allow voiding distributions made when the partnership was unable to pay its debts as they matured, they do not expressly engraft the equity-insolvency limitation.

Similar (but not identical) protection may be afforded under the Uniform Fraudulent Conveyance Act's insolvency test. Uniform Fraudulent Conveyance Act § 2(1) defines insolvency as follows: "A person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured."

It should be observed that the special partnership insolvency provisions of the latter Act (§§ 2(2) and 8) will not apply to the business organization if it is characterized as a "corporation."

To add expressly the equity-insolvency limitation is a relatively simple drafting matter. The following language might be used: "In addition to the foregoing limitations, no payment or distribution whatsoever shall be made to a member when the partnership corporation is insolvent, or would thereby be made insolvent."

A definition of "insolvent" in the equity sense should be added to any relevant sections, or included in the definitions section.

Model Act, § 2(n) could be used: "'Insolvent' means inability of a corporation to pay its debts as they become due in the usual course of its business."

vency test as a further limitation on corporation distributions.¹⁸¹ A simple prohibition against distributions which render the organization unable to pay its debts as they mature, coupled with the bankruptcy limitation, would offer about the same protection as is offered by modern corporation laws to creditors of small corporations. A disadvantage to the organization from even such minimal limitations should be noted. It is basically the same danger that caused some criticism when New York decided expressly to adopt the equity-insolvency test in its new Business Corporation Law: the danger of unanticipated *ex post facto* liability against managers who consented to the distribution producing the insolvency. If the equity-insolvency test produces uncertainty as to liability in corporations, it is even more apt to do so in an organization where there are no minimum capital or stated capital requirements, since there is even more of a temptation to utilize wholly credit financing. The naïve businessman may find that merely through ignorance he has lost the limited liability with which he felt so secure, because the court holds that his withdrawal of "profits" was improper as rendering the business unable to pay its debts.

There is also a problem as to whether all participants in the organization will be equally liable, even though they did not all participate in the distribution, but appropriate provisions could easily be drafted, for example, to hold only those who consent, or receive the improper distributions with knowledge.¹⁸²

Another difficulty raised by adopting the simple insolvency tests is that, in addition to rendering the ordinary partnership obsolete, the organization, if available to businesses of every size, might render the ordinary corporation obsolete, too, since the financial limitations are less stringent (if for no other reason than their simplicity) than those of the ordinary corporation, hence more attractive. This returns us to the question of how widely available this new organization should be.

If the principle of the ordinary partnership limiting admission of new partners is adopted, the new organization can be limited to relatively small businesses, since free transferability of shares is one of the necessities for any business which is to have public participation.

The dissolution provisions of the ordinary partnership¹⁸³ would also

181. See, e.g., Model Act, §§ 40-41 forbidding distributions when the corporation is "insolvent," defined in § 2(n) in the equity sense.

182. See, e.g., N.Y. Bus. Corp. Law §§ 719(a)(1) and (d)(1).

183. Although the death or bankruptcy of a partner in an ordinary partnership causes its dissolution (UPA §§ 31(4)-(5)), an *inter vivos* transfer does not. UPA § 27(1). ULPA § 20 provides for an automatic dissolution on the retirement, death or insanity of a general partner, but allows the certificate to provide otherwise, or all members to consent to a continuation. Accordingly, under both acts, a transfer of interest is possible without dissolution of the partnership.

discourage use by other than small businesses, especially if the Uniform Act's permission to provide otherwise by agreement were eliminated.¹⁸⁴ This limitation would not seem advisable, however, since a "buy-out" arrangement is usually preferable to liquidation when one of the par-

Both acts provide for continuity of the existing partnership, or at least deny the status of complete newness to the partnership even when the transferee is admitted to membership. See ULPA § 24(2)(d) which merely requires an amendment of the certificate when a new general partner is admitted, and UPA §§ 17 and 41(1), which provide that the "new" partnership and partners will be liable for previous debts, but an incoming partner will not be personally liable for them.

But see the Commissioners' Note to UPA § 41(1): "The section as a whole deals primarily with the rights of creditors when a new partner is admitted or a partner retires, is expelled or dies, and the business is continued without liquidation of the debts of the partnership dissolved by the change in personnel.

"At present the whole subject is in doubt and confusion. It is universally admitted that any change in membership dissolves a partnership, and creates a new partnership. This section as drafted does not alter that rule. Neither does it alter the rule that on any change of personnel the property of the dissolved partnership becomes the property of the partnership continuing the business. At present, however, creditors of the dissolved partnership do not become creditors of the new partnership."

UPA § 41 also imposes liability for the "old" partnership's debts on the survivor partnership where the business is continued.

Manifestly, some provision must be made to protect creditors in a changeover situation. Although it could be provided that any change in membership worked an automatic dissolution necessitating a winding up, this would perhaps work more of a hardship than continuing the liability of what is substantially the same business unit. Retention of such provisions as those found in UPA § 41 would therefore seem advisable. UPA § 17 would seem unnecessary unless partial personal liability is to be imposed, since limited liability will protect the incoming member from personal responsibility for new as well as prior business debts.

In the case of transfers of partnership assets to third parties, presumably sufficient creditor protection will be given by the Bulk Sales Article (art. 6) of the Uniform Commercial Code, and the Uniform Fraudulent Conveyance Act.

If, as suggested, the new enterprise is characterized as a corporation, presumably the ordinary corporate merger and consolidation statutes will be available for fusions with another corporation. Probably the provisions of UPA §§ 9(2), 3(b)-(c) requiring unanimous consent of the members to do an act rendering it impossible to carry on the partnership business and to dispose of its good will, would be sufficient on the partnership corporation side to allow such mergers, even though the fusion is with an ordinary corporation. Additions to the ordinary corporate law provision dealing with mergers and consolidations (e.g., Model Act §§ 65-68, 70) would probably be necessary. This could, of course, be accomplished by a definition of stockholders, directors and officers in the corporate merger and consolidation provisions to include, where appropriate, the members or a member of the partnership corporation. Since such fusions can, however, be accomplished by the sale of assets route, it may be just as well to make merger and consolidation unavailable to our business form, either expressly or at least by implication through failure to make the corresponding changes in the statute for ordinary corporations.

Ordinary partnership provisions would seem adequate to fusions of one partnership corporation with another. If limitation on the utilization of the new mode is to take the form

ticipants retires or dies,¹⁸⁵ and restricted transferability of interest plus the other features of the ordinary partnership should be sufficient deterrents to attempted use by enterprises which are too large. Although the insanity of a partner¹⁸⁶ might be retained as a ground for dissolution, there would not seem sufficient reason for allowing his bankruptcy¹⁸⁷ to work a dissolution, unless, as will be discussed below, the members' limited liability is not to be complete. Suffice it to say here that in states which, like New York,¹⁸⁸ do not accord complete limited liability to shareholders

of a limitation on the number of members allowed, language limiting the number of members to no more than the optimum chosen under all circumstances could be added to prevent circumventions through the fusion route.

It is interesting to note that the business continuation provisions of UPA § 41 refer to "persons," a term which under § 2 includes corporations. The ramifications of this provision, and the general authorization to "persons," as so defined, to become partners (§ 6(1)) have not been fully realized because of the widespread omission of the mating authorization in the powers sections of most corporation statutes. See H. Ballantine, *Corporations* 234-36 (Rev. ed. 1946); N. Lattin, *Corporations* 182-83 (1959); R. Stevens, *Private Corporations* 261-65 (2d ed. 1949). But see N.Y. Bus. Corp. Law § 202(a)(15) which expressly authorizes a corporation to become a partner. In order to avoid questions as to possible personal liability of natural persons it is best to make the statute unambiguous. For the reasons suggested above, it is probably also best to deny ordinary corporations the power to participate in the continuation of the partnership corporation business.

184. Although the UPA does not expressly allow the agreement to provide otherwise as to the dissolution provisions of § 31, case law seems to recognize the right. See, e.g., *Associated Creditors' Agency v. Wong*, 216 Cal. App. 2d 61, 30 Cal. Rptr. 705 (1963); *Storer v. Ripley*, 12 Misc. 2d 662, 178 N.Y.S.2d 7 (Sup. Ct. 1958). See also ULPA § 20, set forth in note 187 *infra*. Some cases recognize the right to continue the business despite dissolution. E.g., *Abel v. O'Hearn*, 97 Cal. App. 2d 747, 218 P.2d 827 (1950). The latter is probably the more appropriate characterization of what occurs, and, of course, is clearly recognized by UPA § 41. In other words, "dissolution" may occur, but it need not be followed by "liquidation," under present partnership law.

185. See, e.g., *Mutual Life Ins. Co. of N.Y., Business Life Insurance Agreements* 3 (2d ed. 1967).

186. UPA § 32(1) provides: "On application by or for a partner the court shall decree a dissolution whenever: (a) A partner has been declared a lunatic in any judicial proceeding or is shown to be of unsound mind. . . ." ULPA § 20 provides: "The retirement, death or insanity of a general partner dissolves the partnership, unless the business is continued by the remaining general partners: (a) Under a right so to do stated in the certificate, or (b) With the consent of all members." Preserving the insanity ground is probably advisable to avoid problems as to the agency powers of the member.

187. UPA § 31 provides: "Dissolution is caused:

. . . .

(5) By the bankruptcy of any partner or the partnership . . ." An argument can be made, however, that if a member cannot successfully manage his own personal affairs, he should not be allowed to endanger the business by his improvidence. It should be observed that under the Ontario Corporation Act, Ont. Rev. Stat., c. 71, § 299(5) (1960), a company director may not be a bankrupt.

188. See N.Y. Bus. Corp. Law § 630 (Supp. 1967). See also 15 Pa. Stat. tit. 15, § 3136 (1967); Tenn. Code Ann. § 48-710 (1964); Wis. Stat. Ann. § 180.40(6) (1957).

of certain *corporations*, analogous provisions will probably be wanted in the new statute, and bankruptcy of the members then becomes relevant again.

The partnership's agency principles¹⁸⁹ alone would make the proposed organization unusable by all but very small enterprises. The Uniform Act's provisions on this subject, together with that Act's limitations, seem satisfactory.

These ordinary partnership provisions should be sufficient to limit the organization to small enterprises, and accordingly are, with necessary modifications, set forth in the proposed statute.

Since a small business will probably want to qualify for Subchapter S tax treatment, a clearer line could be drawn, however, by restricting the scope of the statute to ten or fewer persons.

If restricted by one or a combination of these methods to really small enterprises, the insolvency tests should be sufficient protection for outsiders, without the necessity for burdening the participants with more technical restrictions. There are two reasons for this. First, losses to creditors in the event of failure are likely to be less in amount because of the probable smaller scope of the business activities. Second, and more important, as to creditors of such small businesses, the additional protection offered by even the most complicated of corporate restrictions is likely to be so little more as not to be worth the burden imposed. Thus, as indicated above, even in those states which have the highest paid-in capital requirements, only \$1,000 must be paid in,¹⁹⁰ and even this ordinarily may be immediately paid *out* for incorporation fees and legal expenses, if the parties so choose.¹⁹¹ In larger undertakings, the elaborate provisions of present corporation laws may give more meaningful protection. If the new business form is utilized only by small enterprises, the less complex restrictions will offer hardly less protection.

No corporation is required to maintain liquid assets at a fixed level. This would impose an unnecessarily harsh burden for two reasons: first, the fact that a business is *supposed* to invest its funds to make a profit, and in many types of business, significant investment in fixed assets is necessary to accomplish this; second, unanticipated losses may always, even without any fault on the part of the businessmen involved, diminish the funds below the original investment. Yet such a requirement would be the only significant improvement over stated capital, already shown to be scarcely worth the trouble for small corporations.¹⁹² A simple requirement

189. UPA § 9, incorporated into ULPA § 9.

190. Model Act § 51, Annot. ¶ 2.02 (1960, Supp. 1966).

191. See H. Ballantine, *Corporations* 534 (rev. ed. 1946).

192. In states like New York, which have a simple balance sheet test for corporate distributions, assets in excess of liabilities and stated capital can be distributed to the share-

that distributions be restricted to "profits," the term used in the Uniform Partnership Act,¹⁹³ might not, offhand, seem too complex or too onerous. However, this is probably because the term has not been so frequently tested as the corresponding terms in corporation law, "earned surplus," "net profits," etc. for the simple reason stated above: the source of distributions is not of much significance when underlying any distribution is the personal liability of the members. A requirement analogous to the stated capital provisions of corporation laws might suggest itself as the only alternative, if greater protection is desired. Such a requirement posits the use of divisible interests, or "shares," in the enterprise, all or a portion of the consideration for which will be required to be retained or replenished before any distributions. If more protection for creditors is desired it should *not* take the form of shares with a certain nonimpaired face value, although this would seem to be the simplest method of guaranteeing retention of a certain amount of assets since in addition to introducing the complicated accounting of corporation statutes, even the word "shares" today implies negotiability¹⁹⁴ or free transferability, which is one of the corporate attributes a small business does *not* desire. The lack of such negotiability of participations is one of the most attractive features of a partnership.¹⁹⁵ As a result, a great deal has been written to show corporate participants how to avoid the customary ease of transferability associated with corporate shares and how to keep the corporation "close," to give it this attribute of a partnership.¹⁹⁶ The problem arises because, although "shares" once meant what the word sounds like to a layman, pieces of a pie or "portions," the word has now been so emasculated that it is almost completely identified with the piece of paper evidencing it; generally, the paper is treated as more important than the interest evidenced. Hence, under both the Uniform Commercial Code and the old Uniform Stock Transfer Act¹⁹⁷ attempts to prevent the passage of the paper are viewed with disfavor.

holders. "Stated capital" need be no more than the total of the par values of the issued par shares. If there are no limits on the minimum par value, the par can be, e.g., 1¢ per share, and if there are no limits on the number of shares which must be issued, as e.g., is also the case in New York, the stated capital can be practically nil. Under a bankruptcy insolvency test, assets in excess of liabilities are distributable. Where stated capital is next to nothing, a bankruptcy insolvency test obviously gives as good creditor protection, without the additional accounting burden stated capital requirements imposed.

193. See UPA §§ 26 and 27(1).

194. See definition of a "security" under the Uniform Commercial Code. N.Y. U.C.C. § 8-102(1)(a). "Securities" meeting the definition are negotiable. N.Y. U.C.C. § 8-105(1).

195. See UPA § 18(g). N. Lattin, *Corporations* 9 (1959). Of course, a partner's interest is assignable, but the assignee acquires no automatic right to participate in control. UPA § 27(1).

196. See 2 F. O'Neal, *Close Corporations* ch. 7 (1958), and authorities cited.

197. See N.Y. U.C.C. § 8-204; Uniform Stock Transfer Act § 15.

In the face of the accounting and transferability problems, and the valuation problems always associated with property contributions,¹⁹⁸ all requiring elaborate statutory provisions if abuses are to be prevented and the small businessman is not to be hamstrung, it would seem preferable, if it is decided that a higher price than the insolvency tests is to be exacted in exchange for the essential limited liability, to withdraw it to a certain extent. As indicated above, the author feels the insolvency limitations are enough. If further concessions are necessary, they could take the form of a limited personal liability. To use the language of present law, each "limited partner" could also become a "general partner" to the extent of, for example, a \$1,000 personal liability.

Such a proviso would give greater protection to creditors of the proposed organization than creditors of most small corporations now have. It has a precedent under older corporation statutes, notably those governing banks, whereunder shareholders could be held liable for double the par value of their stock.¹⁹⁹ Further, it is a concept simple enough of statutory expression so that creditors and small businessmen alike could understand it. This itself is a commendation recommending this alternative over other possibilities. Bentham's hope for a code of all laws simple enough for any layman to understand is an impossibility, not because we lawyers have a vested interest to protect, but simply because life and hence the law which must regulate it are so complex. It is, however, an ideal to which we should all still aspire.

VIII. RECAPITULATION

Although there is doubt about the historical necessity of the relationship between entity and limited liability, there is little doubt about the association between the two in the popular mind. We have seen, however, not only that entity is a flexible concept, found even to a degree in the partnership, but also that limited liability is a non-exclusive concept, being conferred not only on the corporation but, today, down the line of quasi-corporations or hybrids, to such antipodal organizations as the (limited) partnership. On the other hand, recognized entities sometimes lack it and, consequently, are not much utilized. Further, the size of the organization in terms of the number of persons involved is not conclusive on the issue of whether or not the benefits of limited liability will or will not be conferred since an ordinary partnership without the privilege must have at least two members, while a corporation need have only one. This overlapping of forms and treatment indicates the basic unity of all business organizations and demonstrates that there is nothing radical in deciding

198. See discussion in H. Henn, *Corporations* 250-55 (1961), H. Ballantine, *Corporations* 789-820 (rev. ed. 1946).

199. See H. Ballantine, *Corporations* at 820-23 (rev. ed. 1946).

to make limited liability available to small businesses in a new form combining the desirable attributes of existing forms, but without the unnecessary red-tape of the least unsatisfactory vehicle presently available for conferring it, the corporation.

The small businessman generally desires the flexibility of partnership operation combined with the protection of limited liability. There is no reason not to give both to him by picking and choosing from the existing forms those which will help him most and still protect the public interest. There is nothing contrary to the public interest in so doing, as the enactment of corporation statutes which allow almost any businessman, no matter how small his business, complete protection of his personal property from claims of his business creditors, has indicated. The proposed new organization, however, must be limited to enterprises of a size not requiring the additional regulation imposed by the statutes of businesses where there is a public participation. Various possible means of accomplishing this have been discussed.

It is now time to piece together the various provisions needed in order to mold this new form of business organization. A preliminary draft of a "Partnership Corporation" statute follows.²⁰⁰

200. The following statute is only the most tentative of suggestions. It is hoped that it will at least stimulate a discussion from which a really adequate new business modality will emerge. The form which follows is basically a partnership with the corporate dome of limited liability to protect it, i.e., a form of limited partnership. In this connection, it is probably worth noting that Crane, an acknowledged expert, considers the limited partnership generally an undesirable business form. J. Crane, *Partnership* 117-18 (2d ed. 1952). What do you think?

PARTNERSHIP CORPORATION ACT

§ 1. Partnership Corporation Defined.—A Partnership Corporation is a corporation with the internal structure of a partnership formed by one or more natural persons under the provisions of § 2. The members as such shall not be bound by the obligations of the partnership corporation.¹

1. This section, modified from Uniform Limited Partnership Act § 1 [hereinafter cited ULPA], which, although entitled a definition, also confers limited liability. Although a definition is probably unnecessary for our partnership corporation, some provision conferring limited liability must be included. Whether it is placed here or later is, of course, immaterial. The name of the Act could go here instead, as is done, for example, in the Uniform Partnership Act [hereinafter cited as UPA], or the ABA-ALI Model Business Corporation Act [hereinafter cited as Model Act]. Most modern statutes have definitions at the beginning, e.g., the Model Act, the New York Business Corporation Law, the Uniform Commercial Code, and even the old UPA. If a good index is drafted, it will not make any difference in any event. As indicated above, in the text, other language can be used to confer limited liability. The word "obligations" in the ULPA is somewhat vague. "Tortious or contractual" might be added for clarification since "obligations," having a contractual flavor, may imply a meaning more restricted than intended. Obviously, if the decision is made to require partial personal liability as the quid pro quo for the internal partnership operation, as opposed to an agreed capital contribution, some expression like "except that each member shall be personally liable to the extent of \$1,000 only" should be added at the end. The language used in the New Jersey Limited Partnership Association Statute would suffice. See N.J. Rev. Stat. § 42:3-9(19), as amended, ch. 40, § 6, [1953] N.J. Acts 760. Clearly, unless capital contributions are to be required, the words after "except" should be deleted, and if partial personal liability is to be required, an appropriate substitution could be made. Changing the words "association" and "limited partnership association" to "corporation" and "partnership corporation", respectively, the section would read:

"The members of a partnership corporation shall not be liable under any judgment or order obtained against the corporation, or for any debt or engagement of the corporation, except that, if any execution, sequestration or other process in the nature of execution be issued against the property or effects of the corporation, and if there cannot be found sufficient property or effects on which to levy or enforce such process, such execution, sequestration or other process may be issued against any of the members to the extent of the portions of their subscriptions respectively, in the capital of the corporation not then paid up."

The words "or liability of any kind" could be inserted after "engagement" to make the insulation from tort as well as contract liability airtight.

The words of the first general corporation statute would, of course, be equally adequate. See text supra note 127.

Where the ordinary corporation statute does not give complete personal insulation (e.g., N.Y. Bus. Corp. Law § 630 which imposes personal liability on the ten largest shareholders of a close corporation for "all debts, wages or salaries due and owing to any of its laborers, servants or employees other than contractors, for services performed by them for such corporation") conforming provisions should be added here or in a separate section, since if an ordinary corporation is not accorded complete limited liability, the partnership corporation would afford an obvious loophole by providing for corresponding liability.

§ 2. **Formation.**—(1) One or more natural persons desiring to form a partnership corporation shall:

(a) Sign and swear to a certificate which shall state:

I. The name of the partnership corporation, which shall contain the word "corporation," "incorporated," or an abbreviation of one of such words,

II. The character of the business,

III. The location of the principal place of business,

IV. The name and place of residence of each member,

V. The term for which the partnership corporation is to exist, which may be unlimited,

VI. The amount of cash and description of and the agreed value of the other property contributed by each member,

VII. The additional contributions, if any, agreed to be made by each member and the times at which or events on the happening of which they shall be made,

VIII. The time, if agreed upon, when the contribution of each member is to be returned,

IX. The share of the profits or the other compensation by way of income which each member shall receive by reason of his contribution,

X. The right, if given, of a member to substitute an assignee as contributor in his place, and the terms and conditions of the substitution,

XI. The right, if given, of the members to admit additional members,

XII. The right, if given, of one or more of the members to priority over other members, as to contributions or as to compensation by way of income, and the nature of such priority,

XIII. The right, if given, of the remaining member or members to continue the business on the death, retirement or insanity of a member,

XIV. The right, if given, of a member to demand and receive property other than cash in return for his contribution.

(b) File for record the certificate in the office

(2) A partnership corporation is formed if there has been substantial compliance in good faith with the requirements of paragraph (1).²

2. This is ULPA § 2, with only the following changes: (1) "Limited partnership" is changed to "partnership corporation." (2) All references to "partners" are changed (throughout the proposed Act) to "members" to avoid ambiguity (there is a precedent for characterizing "partners" as members in the ULPA itself, and for so characterizing a shareholder in the old New York General Corporation Law, § 3(15) and, of course, the distinction between limited and general partners is eliminated. (3) Permission is granted to one person, as in a normal corporation, rather than two, as in ULPA or UPA, to form the organization. If, as perhaps should be done, a separate statute is enacted for one-man corporations—mini-corporations—this change from UPA and ULPA will be unnecessary, and the language throughout the partnership corporation statute can even more closely parallel the correspond-

§ 3. **Business Which May Be Carried On.**—A partnership corporation may carry on any business which a partnership may carry on except³

ing UPA and ULPA provisions. (See, e.g., § 33). (4) There is a requirement that the name contain an unambiguous indication of corporateness. Model Act § 7(a), however, allows "company", a term which has been held not to imply corporateness, *In re American Cigar Lighter Co.*, 77 Misc. 643, 138 N.Y.S. 455 (Sup. Ct. 1912). (5) "Limited" has been omitted to negative any suggestion that the organization is merely a limited partnership association. Compare Model Act § 7(a), with N.Y. Bus. Corp. Law § 301(a)(1). The Act could, of course, use the same language as the ordinary corporation statute, or incorporate it by reference. A separate section on the subject, instead of the reference here, might be advisable, carrying over also the prohibitions of the corporation law of the state on names tending to deceive for one reason or another, e.g., because they indicate formation for a prohibited purpose, or because they are similar to one already in use. See, e.g., Model Act §§ 7(b)-(c), N.Y. Bus. Corp. Law §§ 301(a)(2), (3), (4), (5), (6), (7), Mass. Bus. Corp. Law § 11. (6) A clarification that the organization need not have a specific duration. The limited partnership associations are all limited to a maximum duration of 20 years. See also the language of Model Act § 48(b) which requires a statement of duration but provides that it may be "perpetual." Since the dissolution of a partnership corporation will be more akin to that of a partnership, "perpetual" would seem an inappropriate word. Language such as that in N.Y. Bus. Corp. Law § 402(a)(9) only requiring a statement of duration, when other than perpetual (i.e., only when limited), would be equally appropriate.

If the suggestion to avoid all talk of capital and capitalization is heeded, clauses VI, VII, VIII, IX, X, and XIV, and if desired, XII may be omitted. A provision expressly authorizing "any provision relating to the business of the partnership corporation, its affairs, its rights or powers, or the rights or powers of its members" (based on N.Y. Bus. Corp. Law § 402 (b)) could be added. However, such a provision might create an inference that the members were not otherwise free to mould their business life by separate agreement not embodied in the filed document.

If it is desired to insure that the partnership corporation will not be utilized by large enterprises, the words, "but less than eleven" might be added after "One or more" and before "natural persons" in the opening paragraph. This, it will be recalled, would limit the availability of the partnership corporation to the same number of persons who qualify to form a "small business corporation," under the Internal Revenue Code. Int. Rev. Code of 1954, § 1371. It will be noticed that the restriction to "natural" persons incorporates the Internal Revenue Code's prohibition against corporate shareholders and trusts. Int. Rev. Code of 1954, § 1371(a)(2). The code prohibition against nonresident alien participants seems unnecessary to insure smallness.

3. This section is derived from ULPA § 3. The new organization would seem appropriate to professional corporations (provided they are required to carry sufficient malpractice insurance to protect their clients and patients), and could be used instead of such Acts, should the Internal Revenue Service change its attitude with regard to their tax status. The permission to carry on any business appropriate to a partnership (with whatever exceptions are desired) was chosen to emphasize the partnership aspect of the organization, although the permission could be in terms of any business appropriate to a corporation organized under the ordinary corporation statute (which could be referred to by Code section numbers for convenience in drafting). This might be wise since, as indicated in the text, the most important corporate aspects are the ability to qualify and be accorded limited liability treatment outside the state of organization, which the corporation characterization alone should secure,

§ 4. **Character of Member's Contribution.**—The contributions of a member may be cash or other property, tangible or intangible, but not services, performed or to be performed.⁴

§ 5. **Liability for False Statements in Certificate.**—If the certificate contains a false statement, one who suffers loss by reliance on such statement may hold liable any party to the certificate who knew the statement to be false:

(a) At the time he signed the certificate, or

(b) Subsequently, but within a sufficient time before the statement was relied upon to enable him to cancel or amend the certificate, or to file a petition for its cancellation or amendment as provided in § 41.⁵

§ 6. **Partnership Corporation Property.**—(1) All property originally brought into the partnership corporation stock or subsequently acquired by purchase or otherwise on account of the partnership corporation is partnership corporation property.⁶

but which may be denied if the authorized purposes are more extensive than those allowed to domestic corporations. See Model Act § 99.

4. This section is taken from ULPA § 4, with the qualifiers "tangible or intangible" added to "property," and "performed or to be performed" added to "services." These additions are designed to clarify the ULPA provisions. It should be observed that, as stated in the text, "capital," and related requirements, are not as important in a limited partnership since there is always the personal liability of the general partners to fall back upon. Accordingly, the same precision as in a corporation statute is not so significant. Nonetheless, the words added should help to clarify the provisions, should it be decided to include capital requirements, despite the author's contrary advice in the text. The Model Act § 18, and the most recent corporation statutes such as those of Massachusetts (Mass. Bus. Corp. Law § 21) and New York (N.Y. Bus. Corp. Law § 504(a)), allow stock to be issued for performed services. This seems like an invitation to the reintroduction of watered stock, and hence the provisions of the ULPA preventing contributions to be made by way of services have been retained. (All of the corporation statutes mentioned, it should be noted, forbid future services as compensation.)

The Model Act's prohibition against promissory notes (Model Act § 18) might also be added. Language like: "nor may such contributions be in the form of obligations of the member for future payments," could be used. If, as recommended, interference in internal affairs is to be kept to a minimum, this section may be omitted in its entirety.

5. The philosophy of statutes allowing businessmen limited liability (corporation statutes, the ULPA, and the limited partnership association acts) is that creditors are at least entitled to constructive notice that they will not be able to rely on the personal credit of the businessmen involved, unless they secure a separate personal guaranty. The certificates (or "articles," or filed "charters") required are designed to give this notice. Naturally, in fairness to such creditors, such public notices must be accurate. This provision from ULPA § 6 is simply designed to insure this accuracy, which is certainly a reasonable quid pro quo for limited liability.

6. This section is derived from UPA § 8, with "corporation" added after "partnership" in that section. It will be noticed that it provides (as does the UPA itself, in one of its manifestations of the adoption of entity aspects) one of the principal advantages of a corporation, the power to hold and sell real property in the organization name. Subsection (2) might be

(2) Unless the contrary intention appears, property acquired with partnership corporation funds is partnership corporation property.

(3) Any estate in real property may be acquired in the partnership corporation name. Title so acquired can be conveyed only in the partnership corporation name.

(4) A conveyance to a partnership corporation in the partnership corporation name, though without words of inheritance, passes the entire estate of the grantor unless a contrary intent appears.

§ 7. **Suit by or Against Partnership Corporation.**—Suit by or against the partnership corporation shall be brought in the name of the partnership corporation, without joining the members thereof. Service of process on the partnership corporation may be made on any member thereof, or in any other manner provided for service upon a corporation.⁷

§ 8. **Member Agent of Partnership Corporation as to Partnership Corporation Business.**—(1) Every member is an agent of the partnership corporation for the purpose of its business, and the act of every member, including the execution in the partnership corporation's name of any instrument, for apparently carrying on in the usual way the business of the partnership corporation of which he is a member binds the partnership corporation unless the member so acting has in fact no authority to act for the partnership corporation in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

(2) An act of a member which is not apparently for the carrying on of the business of the partnership corporation in the usual way does not bind the partnership corporation unless authorized by the other members.

(3) Unless authorized by the other members or unless they have abandoned the business, one or more but less than all the members have no authority to:

(a) Assign the partnership corporation's property in trust for creditors

thought to present a danger of misappropriation of partnership corporation funds. This can be counteracted as adequately by the UPA's fiduciary provisions as by more elaborate corporate law sections. Consequently, the virtue of incorporating established precedents by taking the UPA provision in toto seems to outweigh the danger.

7. As indicated in the text, one of the principal advantages of entity status is the ability to sue in the name of the organization, i.e., without joining all the members as plaintiffs. Conversely, persons suing the entity are allowed to do so without making all the members defendants. See, e.g., Model Act § 4(b). If the state has a statute allowing suit against a partnership as an entity, as some do, see e.g., N.Y. C.P.L.R. § 1025, it may be copied, or referred to. The corporation statute or practice act may be referred to instead, at least as to mode of service. Although the partnership mode of service would seem simpler, a registered agent, such as for ordinary corporations could be required. See, e.g., Model Act §§ 11, 12, 13. See also note 22 *infra*.

or on the assignee's promise to pay the debts of the partnership corporation,

(b) Dispose of the good-will of the business,

(c) Do any other act which would make it impossible to carry on the ordinary business of a partnership corporation,

(d) Confess a judgment,

(e) Submit a partnership corporation claim or liability to arbitration or reference,

(f) Admit a person as a member, unless the right so to do is given in the certificate,

(g) Continue the business with the partnership corporation property on the death, retirement or insanity of a member, unless the right so to do is given in the certificate,

(h) Do any act in contravention of the certificate.

(4) No act of a member in contravention of a restriction on authority shall bind the partnership corporation to persons having knowledge of the restriction.⁸

8. UPA § 9 together with § 18, to be discussed below, provide the core of partnership operation. Section 9 gives the "default" law agency rules under which the partnership will operate, unless the partners agree to some other arrangement granting greater or lesser authority. Under this section partners can give equal authority to any co-partner, or require unanimity or any percentage approval which they desire. Although Model Act §§ 37, 136 are not cumbersome, corresponding provisions in other corporation statutes (e.g., N.Y. Bus. Corp. Law §§ 616, 709) are involved, and present a trap to the unwary. Furthermore, although a recent amendment to the Model Act (Optional § 39-A) allows informal action by directors (cf. N.Y. Bus. Corp. Law § 708), the Act still requires a board (Model Act § 33), of at least three directors (Model Act, § 34) for every business organized under it, and at least two officers (Model Act § 44). It is just such provisions which are typical of corporation laws throughout the country (see Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism*, 28 U. Chi. L. Rev. 641 (1961)), which make the corporation unsuited to the needs of the small businessman. Whence, the incorporation of the partnership provision with only the changes to "members" and the addition of "corporation" where necessary. To the limitations on authority of subsection (3) have been added three from the ULPA. Although the limitation on the right to admit a new partner is limited by a separate section in a genuine partnership (UPA § 18(g)), it was felt advisable by the draftsmen of the ULPA to require notice of the reservation of power to do so (ULPA § 9(f)). (See also ULPA § 8, as to limited partners.) And since the members of the partnership corporation possess an analogous status, it seems desirable here to give similar notice to creditors.

Similar considerations prompt the addition of § 3(g). This section is also taken from the ULPA § 9(g). Death will cause dissolution, as in an ordinary partnership (see UPA § 31(4)); but the business may, if desired, be continued, as in the ordinary partnership (see UPA § 42), if the certificate so provides. Since management incompetence is recognized as a principal cause of business failure (see 2 A. Dewing, *Financial Policy of Corporations* 1218-19 (5th ed. 1953); Dun and Bradstreet, *Causes of Business Failure* (19—)), prospective creditors should have notice, should they care to take the trouble to find out, that the business may be continued under the same name despite the death, etc., of perhaps the only member in whose ability

§ 9. Conveyance of Real Property of the Partnership Corporation.

—(1) Where title to real property is in the partnership corporation name, any member may convey title to such property by a conveyance executed in the partnership corporation name; but the partnership corporation may recover such property unless the member's act binds the partnership corporation under the provisions of paragraph (1) of § 8, or unless such property has been conveyed by the grantee, or a person claiming through such grantee, to a holder for value without knowledge that the member in making the conveyance has exceeded his authority.

(2) Where title to real property is in the name of the partnership corporation, a conveyance executed by a member, in his own name, passes the equitable interest of the partnership corporation provided the act is one within the authority of the member under the provisions of paragraph (1) of § 8.

(3) Where title to real property is in the name of one or more but not all the members and the record does not disclose the right of the partnership corporation, the members in whose name the title stands may convey title to such property, but the partnership corporation may recover such property if the member's act does not bind the partnership corporation under the provisions of paragraph (1) of § 8, unless the purchaser, or his assignee, is a holder for value without knowledge.

(4) Where the title to real property is in the name of one or more or all members, or in a third person in trust for the partnership corporation, a conveyance executed by a member in the partnership corporation name, or in his own name, passes the equitable interest of the partnership corporation provided the act is one within the authority of the member under the provisions of paragraph (1) of § 8.

(5) Where the title to real property is in the names of all the members, a conveyance executed by all the members passes all their rights in such property.⁹

they have any confidence. This provision, of course, is complementary to that in § 2 above. ULPA § 2(a)(V).

Subsection (3)(h) of this Act is taken from ULPA § 9(a). As § 5 (ULPA § 6), it is necessary to make the notice given by the filed certificate meaningful.

Use of UPA § 9 rather than ULPA §§ 9-10, with these three additional provisions from the latter Act, is justified on the ground that the ULPA draws a distinction between limited and general partners' rights (which distinction is abolished in the partnership corporation statute) and because ULPA § 9 itself incorporated by reference, as to general partners, the rights and liabilities of a general partnership.

9. This is UPA § 10, with the usual minor changes. While the section could be limited to only subsections (1) and (2), or perhaps omitted entirely, as in a typical corporation statute, which ordinarily gives the corporation the general power to hold and sell realty (see, e.g., Model Act § 4(d)), and, except where the sale amounts to a disposition of substantially all

§ 10. Partnership Corporation Bound By Admission of Member.

—An admission or representation made by any member concerning partnership corporation affairs within the scope of his authority as conferred by this Act is evidence against the partnership corporation.¹⁰

§ 11. Partnership Corporation Charged with Knowledge of or Notice to Member.—Notice to any member of any matter relating to partnership corporation affairs, and the knowledge of the member acting in the particular matter, acquired while a member or then present to his mind, and the knowledge of any other member who reasonably could and should have communicated it to the acting member, operate as notice to, or knowledge of the partnership corporation, except in the case of a fraud on the partnership corporation committed by or with the consent of that member.¹¹

§ 12. Partnership Corporation Bound by Member's Wrongful Act.

—Where, by any wrongful act or omission of any member acting in the ordinary course of the business of the partnership corporation or with the authority of his co-members, loss or injury is caused to any person not being a member in the partnership corporation, or any penalty is incurred, the partnership corporation is liable therefor to the same extent as the member so acting or omitting to act.¹²

§ 13. Partnership Corporation Bound by Member's Breach of Trust.—The partnership corporation is bound to make good the loss:

- (a) Where one member acting within the scope of his apparent authority receives money or property of a third person and misapplies it; and
- (b) Where the partnership corporation in the course of its business receives money or property of a third person and the money or property

of the corporate assets (see, e.g., Model Act § 71), leaves the power to sell to case law principles, and the formalities to the acknowledgment statute, there seems an advantage to permitting the greater flexibility of the partnership law. Also, the ordinary corporate deed by an officer, with corporate seal affixed by another officer, is inappropriate to the partnership corporation, one of the objects of which is to dispense with the unnecessary three tiered (shareholders-directors-officers) corporate structure. Whence the advisability of adopting existing partnership formalities in full, to make easy the tie-in with acknowledgment and recording statutes. See also note 22 *infra*.

10. Corporation laws, for some reason, are not specific on the subject of admissions against, and knowledge by, the corporation. As a result, there has been some confusion in the case law formulation of these principles. The addition of UPA § 11, incorporated here, and UPA § 12, which constitutes § 11 of the partnership corporation law, represent useful clarifications which might well be considered for all ordinary corporation statutes.

11. See note 10 *supra*.

12. This is UPA § 13. It makes clear the application of respondeat superior, and, although perhaps unnecessary, again emphasizes the internal partnership nature of the enterprise.

so received is misapplied by any member while it is in the custody of the partnership corporation.¹³

§ 14. **Rules Determining Rights and Duties of Members.**—The rights and duties of the members in relation to the partnership corporation shall be determined, subject to the certificate and any agreement between them, by the following rules:

(a) The partnership corporation must indemnify every member in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business or for the preservation of its business or property.

(b) A member, who in aid of the partnership corporation makes any payment or advance beyond the amount of capital which he agreed to contribute, shall be paid interest from the date of the payment or advance.

(c) A member shall receive interest on the capital contributed by him only from the date when repayment should be made.

(d) All members have equal rights in the management and conduct of the partnership corporation's business.

(e) No member is entitled to remuneration for acting in the partnership corporation's business, except that a surviving member is entitled to reasonable compensation for his services in winding up the partnership corporation affairs.

(f) No person can become a member of a partnership corporation without the consent of all the members.

(g) Any difference arising as to ordinary matters connected with the partnership corporation business may be decided by a majority of the members; but no act in contravention of any agreement between the members may be done rightfully without the consent of all the members.¹⁴

13. This is UPA § 14. Like the previous section it emphasizes the equal management authority of each member by making the organization liable for each member's breach of trust. It is useful in limiting the availability of the new form to businesses without public participation.

14. This is UPA § 18 with subsection (a) (as to equal sharing of profits and losses) omitted; and the usual changes of "partner(s)" to "member(s)" and "partnership" to "partnership corporation." Reference to the certificate has been added in the introductory paragraph. See § 2. See also § 44. UPA §§ 18 (b)-(d) could perhaps also be omitted if the advice to omit all provisions smacking of the complicated financial provisions of corporate law is accepted. Subsection (a) (UPA § 18(b)) although "financial" in a sense, uses none of the objectionable corporate law terms (like capital, surplus, profits), and, hence, should not pose too much difficulty. (The members are, after all, not directors or officers, and indemnification in the corporate law sense is not in issue.) Although the term "capital" as used in subsections (b) and (c) (UPA §§ 18(c)-(d)) should be interpreted in its simpler partnership meaning, there is always a danger in its use that corporate law problems may be introduced. To completely avoid this, the words "his agreed contribution," could be substituted for "capital which he agreed to contribute," in subsection (b) (UPA § 18(c)),

§ 15. **Compensation of Member.**—A member may receive from the partnership corporation the share of the profits or the compensation by way of income stipulated for in the certificate; provided that after such payment is made, the partnership corporation's assets are in excess of all liabilities of the partnership corporation except liabilities to members; and provided further that no such payment shall render the partnership corporation unable to pay its debts as they become due in the usual course of its business, nor be made while it is unable so to do.¹⁵

and "his contribution" for "the capital contributed by him" in subsection (c) (UPA § 18(d)). Explanation for the omission of UPA § 18(a) will be given in note 15 infra.

15. This is based on ULPA § 15. The provision of UPA § 18(a) as to sharing of losses is inappropriate to the partnership corporation, unless there is to be partial personal liability on the part of the members. If this is desired, a separate section requiring each member to "contribute towards the losses of the partnership corporation to the extent of \$1,000, but no more, in the absence of an express additional personal undertaking so to do," and providing that "such liability shall not be subject to contrary agreement by the members" could be added, to reiterate the extent of liability, already presumably set out in § 1. If such partial personal liability is to be imposed provisions such as those in UPA §§ 15, 16, 17, 36, 40 & 41, modified to limit personal liability to the figure chosen, should be added. The provision of UPA § 18(a) as to repayment of contributions after liabilities and the sharing of "profits and surplus," equally, in the absence of contrary agreement, could be used in the partnership corporation statute. It would then, with the usual modifications, read: "Each member shall be repaid his contributions, whether by way of capital or advances to the partnership corporation property and share equally in the profits and surplus remaining after all liabilities." Reinserted under § 14 above (as in UPA § 18) it would be subject to contrary agreement on the part of the members. Such a provision would be inappropriate unless the provisions of § 2 supra are modified to delete clauses VI, VII, VIII, IX, X, XII & XIV. See note 2 supra. Otherwise, the notice function of the certificate would be defeated. In fact, the certificate would prove a deception to any creditors cautious enough to examine it, unless an amendment were required when any returns of contributions were made. Therefore, provisions from the ULPA seem more appropriate. ULPA § 15 is the ULPA analogue to the UPA provision on distribution of profits, and ULPA § 16, to be discussed further in note 16 infra, guarantees constructive notice when any portion of a contribution is withdrawn. Also, "profits" (the ULPA § 15 term), although sometimes used in corporation laws (see, e.g., N.J. Rev. Stats. 14:8-19), is not as intimately associated with such statutes as "surplus" and is, therefore, preferable. The word "share" in this context would not seem ambiguous, either. However, if it is desired to avoid even these savors of present corporate law, "portion" may be substituted for "share," and language like "of any distribution of assets," for the references to profit and income. (Corresponding changes must, of course, be made in § 2 also.) As discussed in the text, the equity insolvency test is a pretty good insurance against improvident distributions detrimental to creditors. Accordingly, ULPA § 15's bankruptcy insolvency limitation has been supplemented by an equity insolvency limitation on distributions as well.

Even if all financial provisions are omitted from the new statute, i.e., the entire concept of transfer of assets by the members to a separate "person," the "partnership corporation," is discarded, whatever assets reach the partnership corporation's coffers should be committed to the business to the extent that their distribution back to the members will not prejudice business creditors. Accordingly, the theory of this section should be preserved, even if all requirements for a statement of contributions (§ 2 supra (ULPA § 2)), conditions of with-

§ 16. **Withdrawal or Reduction of Member's Contribution.**—(1)

A member shall not receive out of partnership corporation property any part of his contribution until:

(a) All liabilities of the partnership corporation, except liabilities to members on account of their contributions, have been paid or there remains property of the partnership corporation sufficient to pay them, as they become due in the usual course of its business,

(b) The consent of all members is had, unless the return of the contribution may be rightfully demanded under the provisions of paragraph (2), and

(c) The certificate is cancelled or so amended as to set forth the withdrawal or reduction.

(2) Subject to the provisions of paragraph (1) a member may rightfully demand the return of his contribution:

(a) On the dissolution of the partnership corporation, or

(b) When the date specified in the certificate for its return has arrived, or

(c) After he has given six months' notice in writing to all other members, if no time is specified in the certificate either for the return of the contribution or for the dissolution of the partnership corporation.

(3) In the absence of any statement in the certificate to the contrary or the consent of all members, a member, irrespective of the nature of his contribution, has only the right to demand and receive cash in return for his contribution.

(4) A member may have the partnership corporation dissolved and its affairs wound up when:

(a) He rightfully but unsuccessfully demands the return of his contribution, or

(b) The other liabilities of the partnership corporation have not been paid, or the partnership corporation property is insufficient for their payment as required by paragraph (1)(a) and the member would otherwise be entitled to the return of his contribution.¹⁶

drawal (§ 16 *infra* (ULPA § 16)), and liability of unpaid or underpaid contributions (§ 17 *infra* (ULPA § 17)) are omitted. The words "No distribution of partnership corporation assets shall be made to any of the members unless" should replace all the initial words through "provided, that," to accomplish this protection in the absence of other financial provisions.

16. This provision is taken from ULPA § 16. It has been amended to impose, in addition to other limitations, the equity insolvency test on removal of a member's (capital) contribution, and, in addition, requires an amendment of the certificate to show the reduced asset level available as creditor protection. It is complementary to ULPA §§ 15 & 17, and may be omitted if the decision is made to omit entity investment provisions.

§ 17. **Liability of Member to Partnership Corporation.**—(1) A member is liable to the partnership corporation:

(a) For the difference between his contribution as actually made and that stated in the certificate as having been made, and

(b) For any unpaid contribution which he agreed in the certificate to make in the future at the time and on the conditions stated in the certificate.

(2) A member holds as trustee for the partnership corporation:

(a) Specific property stated in the certificate as contributed by him, but which was not contributed or which has been wrongfully returned, and

(b) Money or other property wrongfully paid or conveyed to him on account of his contribution.

(3) The liabilities of a member as set forth in this section can be waived or compromised only by the consent of all members; but a waiver or compromise shall not affect the right of a creditor of the partnership corporation, who extended credit or whose claim arose after the filing and before a cancellation or amendment of the certificate, to enforce such liabilities.

(4) When a contributor has rightfully received the return in whole or in part of his contribution, he is nevertheless liable to the partnership corporation for any sum, not in excess of such return with interest, necessary to discharge its liabilities to all creditors who extended credit or whose claims arose before such return.¹⁷

§ 18. **Loans and Other Business Transactions with Member.**—

(1) A member may loan money to and transact other business with the partnership corporation and, receive on account of resulting claims against the partnership corporation with general creditors, a pro rata share of the assets. No member shall in respect to any such claim:

17. This is ULPA § 17. The unnecessary words "the capital of" have been omitted from before "his contribution" in subsection (4). The liability imposed on a member is analogous to that imposed under the "fraud theory" of watered stock liability in corporation law. This theory is the predominant one in the country as to shareholder liability. See H. Henn, *Corporations* §§ 169-171 (1961). The opposing "statutory liability" theory compels a shareholder to make up the water (i.e., pay the difference between the consideration—usually overvalued property—and the par of the stock exchanged for it), even though creditors may not have relied on the inflated corporate financial statement. Under the fraud theory reliance by subsequent creditors is presumed, but nonreliance is a defense. See *Bing Crosby Minute Maid Corp. v. Eaton*, 46 Cal. 2d 484, 297 P.2d 5 (1956); *Hospes v. Northwestern Mfg. & Car Co.*, 48 Minn. 1274, 50 N.W. 1117 (1892). The only difference under the ULPA is that the defense is removed. Although the statutory liability theory is preferable, the ULPA provision is probably a good compromise and an advance in creditor protection over that offered in the majority of states to corporate creditors. Of course, if the entire concept of separate entity investment is discarded, this provision can be discarded too.

(a) Receive or hold as collateral security any partnership corporation property, or

(b) Receive from the partnership corporation any payment, conveyance or release from liability, if at the time the assets of the partnership corporation are not sufficient to discharge partnership corporation liabilities to persons not claiming as members, nor when the partnership corporation is unable to pay its debts as they become due in the usual course of its business.

(2) The receiving of collateral security, or a payment, conveyance or release in violation of the provisions of paragraph (1) is a fraud on the creditors of the partnership corporation.¹⁸

§ 19. **Assignment of Corporation Member's Interest.**—(1) A member's interest is assignable.

(2) A substituted member is a person admitted to all the rights of a member who has died or has assigned his interest in a partnership corporation.

(3) An assignee, who does not become a substituted member, has no right to interfere in the management or administration of the partnership corporation business or affairs or to require any information or account of the partnership corporation transactions or to inspect the partnership corporation books; he is only entitled to receive the share of the profits or other compensation by way of income, or the return of his contribution, to which his assignor would otherwise be entitled.

(4) An assignee shall have the right to become a substituted member if all the members (except the assignor) consent thereto or if the assignor, being thereunto empowered by the certificate, gives the assignee that right.

18. This section is ULPA § 13, with the equity insolvency limitation engrafted, as in § 15 supra. See Model Act § 2(n). It can be utilized whether or not the concept of agreed contributions is to be utilized. It will accord for our partnership corporation the same privilege accorded to a one-man corporation. See *Salomon v. Salomon & Co.* [1897] A.C. 22 (the leading case). It should be noted that the treatment accorded by this section may be even more favorable than that ordinarily granted to corporate participants since it expressly allows them to share on an equal basis with ordinary creditors, while under corporation law the debt claims of such "creditors" are sometimes subordinated to those of outside creditors by virtue of the famous "Deep Rock doctrine." *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307 (1939). See also *Pepper v. Litton*, 308 U.S. 295 (1939); *In re Merrick Dairy Co.*, 249 Wisc. 295, 24 N.W.2d 679 (1946). There appear to be no cases as to such subordination in the case of limited partnerships. Presumably, in a bankruptcy proceeding subordination is still possible where "equity" so requires, despite the statute. See *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946); *Prudence Realization Corp. v. Geist*, 316 U.S. 89 (1942). If it is felt undesirable to allow the participants to share with ordinary trade creditors under any circumstances, provisions expressly subordinating all such loans could be added.

(5) An assignee becomes a substituted member when the certificate is appropriately amended in accordance with § 41.

(6) The substituted member has all the rights and powers, and is subject to all the restrictions and liabilities of his assignor, except those liabilities of which he was ignorant at the time he became a member and which could not be ascertained from the certificate.

(7) The substitution of the assignee as a member does not release the assignor from liability to the partnership corporation under §§ 5 and 17.¹⁹

§ 20. Rights of Creditors of Member.—(1) On due application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the interest of the indebted member with payment of the unsatisfied amount of the judgment debt; and may appoint a receiver, and make all other orders, directions and inquiries which the circumstances of the case may require.

(2) The interest may be redeemed with the separate property of any member, but may not be redeemed with partnership corporation property.

(3) The remedies conferred by paragraph (1) shall not be deemed exclusive of others which may exist.

(4) Nothing in this act shall be held to deprive a member of his statutory exemptions.²⁰

19. This is ULPA § 19. It and the next section, based on ULPA § 22, were chosen in preference to the UPA §§ 27 and 28. Since the new Act draws no distinction between members with, and members without limited liability, the univocal UPA provisions might seem preferable to the special ULPA sections on the ground of simplicity. The reason for choosing ULPA § 19 is, however, its tie in to the notice requirements of the certificate. Since, in addition, it engrafts the ordinary partnership's provision for *delectus personarum* (subsection (4)), in substitution for the free transferability of participations characteristic of the corporation, it supplies that essential of "close" businesses as well as the UPA does. Language from UPA § 27(1), denying the right of an assignee to participate in management unless he has been made a "substituted" member, has been added, however, to clarify the limitation. (Such language naturally is omitted from the ULPA since a limited partner unless also a general partner has no such participation rights.) See ULPA §§ 7, 12. If changes were made in § 15 above to avoid financial terminology, corresponding changes should be made in subsection (3).

20. This is ULPA § 22. The last word has been made plural to insure not only the complete or partial limited liability, but also any personal exemptions the local law may accord to the member individually. See UPA § 28(3). The ULPA section is similar to UPA § 28, except that the UPA section talks about "profits," while the ULPA section refers simply to the "interest" of the indebted member, a preferable term under the theory that complicated financial terminology should be avoided. Also, the UPA allows the redemption of the indebted member's interest out of partnership property where the other partners consent, while the ULPA forbids it. Creditors of the business are given greater protection by the latter provision. It would seem the preferable alternative since in the partnership corporation, as in the limited partnership, they will not have the additional protection of the personal liability of the partners to fall back on, as they do in the ordinary partnership. The word

§ 21. Nature of Member's Interest in Partnership Corporation.—A member's interest in the partnership corporation is personal property.²¹

§ 22. Extent of Property Rights of a Member.—The property rights of a member are:

- (1) His rights in specific partnership corporation property, and
- (2) His interest in the partnership corporation, and
- (3) His right to participate in the management.²²

"judgment" before "creditor" should be deleted, and the words "of such claim" substituted for "of the judgment debt" in subsection (1), in accordance with the Commissioner's suggestion as to the ULPA, in jurisdictions which allow attachment of debts due a defendant before judgment.

21. This is ULPA § 18. It seems as adequate to describe the nature of the member's interest as UPA § 26, which adds that the partner's interest in the partnership "is his share of the profits and surplus" and avoids these financial terms. Since other sections of the partnership corporation statute provide for distributions to the members, there would seem no necessity for repetition here. Characterization of the interest as personalty not only performs a useful function as to devolution on death, and for purposes of pledge and taxation, but tends, even in the ordinary partnership, to emphasize the entity aspect. See *In re Finkelstein's Estate*, 40 Misc. 2d 910, 245 N.Y.S.2d 225 (Sur. Ct. 1963). At the same time, the use of partnership terminology negatives the idea of negotiability preventing Article 8 of the Uniform Commercial Code, and the old Uniform Stock Transfer Act, from coming into play.

22. This is UPA § 24. The ULPA separates the rights and liabilities of general from limited partners. We have in the partnership corporation statute, in effect, made all of the "partners" ("members") limited partners. We must now face the problem of the exact nature of the relationship of the members to the property of the partnership corporation. All property could be held by the entity, with the "interests" of the members solely claims against the entity, as in the typical corporation. It has already been decided (see § 9 (UPA § 10)) to allow real property to be held in either the partnership corporation's, or the individual members' names, a departure from strict entity theory. The exact nature of all tenancies in property should be made explicit. This section and § 23, based on UPA § 25, do so for the partnership corporation. They adopt the partnership, rather than entity principle. The ULPA seems indefinite on the subject, although ULPA § 9(1) gives general partners "all the rights and powers" of a partner in a partnership without limited partners. The result has been the necessity for judicial interpretation. See, e.g., *Donroy, Ltd. v. United States*, 301 F.2d 200 (9th Cir. 1962). If at all possible, this should be avoided. There seems to be no objection to a "tenancy in partnership," as defined in the UPA, of the assets of the corporation. It also accords with the general theory of adopting entity aspects as a shell for protection of the members from individual liability while leaving all internal affairs to partnership modality. The significant effects should be to guarantee equal access to partnership corporation property (e.g., the business office) and to prevent attempts at removal from the grasp of creditors of property dedicated to the business, although "retained" in the name of a member.

It is possible that ownership of partnership corporation property in the name or names of the members will prove troublesome, should the business fail. Unless the property is unequivocally committed to the business, questions are bound to arise as to whether particular assets are partnership corporation or individual property. Creditors of the partnership corporation will naturally argue that property in such individual names is partnership corporation

§ 23. Nature of a Member's Right in Specific Partnership Corporation Property.—(1) A member is co-owner with his co-members of specific partnership corporation property holding as a tenant in partnership.

property; members will argue that it has not been dedicated to the business, and is hence immune from business creditor claims. (Obverse problems may, of course, arise with regard to creditors of the members.) These considerations argue for utilization of entity ownership concepts, instead of membership title.

The ownership determination problem is, however, alleviated by the requirement for stated contribution. (Section 2 of the partnership corporation statute, following ULPA § 2.) Clearly, each member is liable to dedicate to the business the amount agreed, and can be held for any difference between any lesser contribution and that agreed amount. See Partnership Corporation Act §§ 17(1)(a)-(b) (ULPA §§ 17(1)(a)-(b)); *Dunroy, Ltd. v. United States*, 196 F. Supp. 54 (N.D. Cal. 1961). It is not unfair to limit creditors to this agreed amount, plus only such additional assets as are unambiguously dedicated to the business. They generally get no more protection from a corporation. See *Salomon v. Salomon & Co.*, [1897] A.C. 22.

Whether a dedication of assets additional to those thus agreed upon has taken place should prove no more of a problem than it does with corporations. See, e.g., *Costello v. Fazio*, 256 F.2d 903 (9th Cir. 1958); *Obre v. Alban Tractor Co.*, 228 Md. 291, 179 A.2d 861 (1962).

In order to avoid a "tracing" problem, should the contributed assets (e.g., cash) be converted into another form (e.g., an automobile), it could be required that where any assets are purchased or otherwise acquired with partnership corporation assets contributed pursuant to § 2, such assets "shall be acquired only in the partnership corporation name."

Certainly, with this qualification, the partnership ownership provisions should pose no more of a difficulty than the problem of dedication in other businesses. See, as to analogous problems raised in the partnership association, Schwartz, *The Limited Partnership Association—An Alternative to the Corporation for the Small Business With "Control" Problems?*, 20 Rutgers L. Rev. 29, 35-40 (1965).

For flagrant intermingling of business and private assets, the usual corporate penalties of personal liability should also prove a sufficient deterrent. See H. Ballantine, *Corporations* § 123 (rev. ed. 1946).

It is, of course, possible to have all ownership of partnership corporation property vested in the partnership corporation "entity" itself. This could be accomplished by adopting the simple corporate law provision empowering ownership and sale of real and personal property. See, e.g., Model Act §§ 4(d) & (e). If this were done corresponding changes would be necessary in § 9 supra. The members would still have the same agency powers vis-à-vis such property as possessed under and limited by § 8 supra. Because of the express adoption of the assignment (as opposed to negotiability) concept of transferability of a member's share, and the express requirement for consent to admission of a new member (either after assignment or, in advance, in the certificate), entity terms should not result in undesirable consequences from the fact that a member's "property interest" in the business property will be the same as that of a shareholder in the ordinary corporation. The only disadvantage would seem to be the possible necessity, to avoid ambiguity and consequent litigation, of enumerating a full list of entity powers. The omission of such a list could result in their denial through judicial application of the maxim *expressio unius est exclusio alterius*. (The suability provision, § 7, found in many states as to ordinary partnerships, should not pose such a problem, simply because already associated with the ordinary partnership.) To solve this problem, if the tenancy in partnership is not to be utilized, § 7 supra should be replaced by Model Act § 4, modified as follows:

(2) The incidents of this tenancy are such that:

(a) A member, subject to the provisions of this Act and to any agreement between the members, has an equal right with his co-members to possess specific partnership corporation property for partnership corpora-

General Powers. Each partnership corporation shall have power:

(a) To have perpetual succession by its partnership corporation name unless a limited period of duration is stated in its certificate,

(b) To sue and be sued, complain and defend, in its partnership corporation name,

(c) To have a corporate seal which may be altered at pleasure, and to use the same by causing it, or a facsimile thereof, to be impressed or affixed or in any other manner reproduced,

(d) To purchase, take, receive, lease, or otherwise acquire, own, hold, improve, use and otherwise deal in and with, real or personal property, or any interest therein, wherever situated,

(e) To sell, convey, mortgage, pledge, lease, exchange, transfer and otherwise dispose of all or any part of its property and assets in accordance with the provisions of this Act,

(f) To lend money to its employees other than its members, and otherwise assist its employees and members,

(g) To purchase, take, receive, subscribe for or otherwise acquire, own, hold, vote, use, employ, sell, mortgage, lend, pledge, or otherwise dispose of, and otherwise use and deal in and with shares or other interests in, or obligations of, other domestic or foreign corporations, associations, partnerships or individuals, or direct or indirect obligations of the United States or of any other government, state, territory, governmental district or municipality or of any instrumentality thereof,

(h) To make contracts and guarantees and incur liabilities, borrow money at such rates of interest as the partnership corporation may determine, issue its notes, bonds, and other obligations, and secure any of its obligations by mortgage or pledge of all or any of its property, franchises and income,

(i) To lend money for partnership corporation purposes, invest and reinvest its funds, and take and hold real and personal property as security for the payment of funds so loaned or invested,

(j) To conduct its business, carry on its operations, and have offices and exercise the powers granted by this Act in any state, territory, district, or possession of the United States, or in any foreign country,

(k) To appoint agents, in addition to the members, of the partnership corporation and define their duties and fix their compensation,

(l) To make donations for the public welfare or for charitable scientific or educational purposes; and in time of war to make donations in aid of war activities,

(m) In time of war to transact any lawful business in aid of the United States in the prosecution of the war,

(n) To indemnify any member as hereinafter provided,

(o) To pay pensions and establish pension plans, pension trusts, profit-sharing plans and other incentive plans for any or all of its members and employees,

(p) To cease its partnership corporation activities and surrender its partnership corporation franchise,

(q) To have and exercise all powers necessary or convenient to effect any or all of the purposes for which the partnership corporation is organized,

Subsection (l) dealing with by-laws has been omitted. The indemnification provision has been modified simply to refer to the indemnification provisions of the Act. See § 14(a) supra.

tion purposes; but he has no right to possess such property for any other purpose without the consent of his co-members.

(b) A member's right in specific partnership corporation property is not assignable except in connection with the assignment of rights of all the members in the same property.

(c) A member's right in specific partnership corporation property is not subject to attachment or execution, except on a claim against the partnership corporation. When partnership corporation property is attached for a partnership corporation debt, the members, or any of them, or the representatives of a deceased member, cannot claim any right under the homestead or exemption laws.

(d) On the death of a member his right in specific partnership corporation property vests in the surviving member or members except where the deceased was the sole or last surviving member when his right in such property vests in his legal representative. Such surviving member or members, or the legal representative of the last surviving member, has no right to possess the partnership corporation property for any but a partnership corporation corpse.

(e) A member's right in specific partnership corporation property is not subject to dower, curtesy or allowances to widows, heirs, or next of kin.²³

§ 24. Effect of Retirement, Death or Insanity of a Member.—(1) The retirement, death or insanity of a member dissolves the partnership corporation unless the business is continued by the remaining members:

- (a) Under a right so to do stated in the certificate, or
- (b) With the consent of all the members.

(2) On the death of a member his executor or administrator shall have all the rights of a member for the purpose of settling his estate, and such power as the deceased had to constitute his assignee a substituted member.

(3) The estate of a deceased member shall be liable for all his liabilities as a member.²⁴

§ 25. Dissolution Defined.—The dissolution of a partnership corporation is the change in the relation of the members caused by any member

The authorization for pension and profit-sharing plans, § 4(o) (Model Act § 4(p)), has been modified to omit reference to stock bonus and stock option plans.

This section (§ 22) should then be omitted. Section 23 *infra* should also be omitted and the "entity" changes discussed under § 9 made.

23. See note 22 *supra*.

24. This section combines ULPA §§ 20 & 21. ULPA § 20 deals with the effect of the retirement, death or insanity of a general partner, while ULPA § 21 deals with the effect of the death of a limited partner. Since the distinction between the two types of members has been obliterated in the new statute, it seems only proper to combine the two sections.

ceasing to be associated in the carrying on, as distinguished from the winding up of the business.²⁵

§ 26. **Partnership Corporation Not Terminated by Dissolution.**—On dissolution the partnership corporation is not terminated, but continues until the winding up of partnership corporation affairs is completed.²⁶

§ 27. **Causes of Dissolution.**—Dissolution is caused:

- (1) Without violation of the agreement between the members:
 - (a) By the termination of the definite term specified in the certificate,
 - (b) By the express will of any member when no definite term is specified,
 - (c) By the express will of all the members who have not assigned their interests or suffered them to be charged for their separate debts, either before or after the termination of any specified term,
 - (d) By the expulsion of any member from the business bona fide in accordance with such a power conferred by any agreement between the members;
- (2) In contravention of the agreement between the members where the circumstances do not permit a dissolution under any other provision of this section, by the express will of any member at any time;
- (3) By any event which makes it unlawful for the business of the partnership corporation to be carried on or for the members to carry it on as a partnership corporation;
- (4) As provided in § 24;
- (5) By decree of the court under § 28.²⁷

25. This and the following three sections are taken from the UPA. The ULPA is silent on the causes of dissolution, except as to the death, retirement or insanity of a general partner. See note 24 supra. Following ULPA § 9 the powers of the general partners to cause a dissolution should be the same as in an ordinary partnership. It is wise, accordingly, to set out the details of such permissible powers, since the UPA will not be expressly incorporated by reference in our statute.

It is interesting to note that there is precedent for dissolution of a corporation when all of its members or "an essential member" disappears. 9 W. Holdsworth, *A History of English Law* 62 (1926).

26. This is UPA § 30. See note 25 supra.

27. This section is based on UPA § 31. See note 25 supra. Since the effect of death of a member is already covered (see § 24 of the partnership corporation act), subsection (4) of the UPA is omitted, and a cross-reference made. UPA § 31(5) provides that bankruptcy of a member will result in dissolution. Because of the limited liability of all members (unless partial personal liability is chosen) of the partnership corporation, this provision seems unnecessary. If desired, it may of course be retained, but, stylistically, would be more appropriate under § 24. Subsection (6) has accordingly been renumbered. Since the partnership corporation will have, if such a term is desired, a term specified in the certificate, references to dissolution on the termination of a "particular undertaking" have been deleted.

§ 28. **Dissolution by Decree of Court.**—(1) On application by or for a member the court shall decree a dissolution whenever:

- (a) A member is shown to be of unsound mind,
 - (b) A member becomes in any other way incapable of performing his part of the partnership corporation contract,
 - (c) A member has been guilty of such conduct as tends to affect prejudicially the carrying on of the business,
 - (d) A member willfully or persistently commits a breach of the partnership corporation agreement, or otherwise so conducts himself in matters relating to the partnership corporation business that it is not reasonably practicable to carry on the business with him,
 - (e) The business of the partnership corporation can only be carried on at a loss,
 - (f) Other circumstances render a dissolution equitable.
- (2) On the application of the purchaser of a member's interest under §§ 19 or 20, after the termination of the specified term.²⁸

UPA §§ 31(a)-(c). Permission for special agreements, apart from the certificate, has been retained from the UPA, consistent with the "contract" as opposed to the "concession" theory of the new statute. Although, as in the ordinary partnership, dissolution can be caused at any time, as with the ordinary partnership, damages for wrongful dissolution should be a sufficient deterrent. See Commissioner's note to UPA § 31; UPA § 38(2)(a)(II), and § 32 of the partnership corporation act.

28. This section is taken from UPA § 32. Again the reference to "particular undertaking" (UPA § 32(2)(a)) has been deleted, and since the new statute does not carry over "partnership at will" concepts, any more than does the ULPA, UPA § 32(2)(b) has been omitted.

ULPA § 20 differs from UPA §§ 31 and 32 in providing that insanity works an automatic dissolution. In the ordinary partnership, on the other hand, although insanity is a ground for dissolution, a court decree is required. (The court would appear to have no discretion once it is established that "[a] partner has been declared a lunatic in any judicial proceeding or is shown to be of unsound mind.") Although UPA §§ 41 and 42 (see §§ 33 & 34 of the partnership corporation act) deal with business continuation when a partner dies or retires, these sections are not express on the problems caused by continuation in the event of the insanity of a member. The ULPA is completely silent on the matter of continuation except to authorize it if the certificate allows (ULPA § 2(1)(a)(XIII)), or all members consent (ULPA § 20(b)), and to require a cancellation of the certificate on dissolution (ULPA § 24(1)) or permit continuation after the death, retirement or insanity of a general partner. ULPA § 24(2)(e).

Accordingly, it appears to be of little moment, from considerations of proper intermeshing of provisions, whether the UPA or ULPA provision, as to the effect of insanity, is chosen. If the member is insane, even though not judicially declared such, his contracts are presumably voidable anyhow. 1 S. Rowley, *Law of Partnership*, § 32.1, at 612 (2d ed. 1960). Hence there would not appear to be much danger from the delay necessary for a judicial decree of dissolution, as is provided in the UPA. See also 1 S. Rowley, *supra* § 32.0, at 610: "Furthermore it is often necessary to resort to judicial decree to determine whether or not there has been a dissolution previously caused by termination, act or event which has so operated as to have caused dissolution." This implies the practical necessity for such a judicial determination, anyhow, whether or not the dissolution is absolute. The ULPA provision (see partnership corporation act § 24 *supra*) has been tentatively selected. Although UPA § 32's

§ 29. **Power of Member to Bind Partnership Corporation to Third Person After Dissolution.**—(1) After dissolution a member can bind the partnership corporation except as provided in paragraph (2):

(a) By any act appropriate for winding up partnership corporation affairs or completing transactions unfinished at dissolution;

(b) By any transaction which would bind the partnership corporation if dissolution had not taken place, provided the other party to the transaction:

I. Had extended credit to the partnership corporation prior to dissolution and had no knowledge or notice of the dissolution; or

II. Though he had not so extended credit, had nevertheless known of the partnership corporation prior to the dissolution, and, having no knowledge or notice of dissolution, the fact of dissolution had not been advertised in a newspaper of general circulation in the place (or in each place if more than one) at which the partnership corporation business was regularly carried on.

(2) The partnership corporation is in no case bound by any act of a member after dissolution:

(a) Where the partnership corporation is dissolved because it is unlawful to carry on the business, unless the act is appropriate for winding up partnership corporation affairs; or

(b) Where the member has no authority to wind up partnership corporation affairs; except by a transaction with one who:

I. Had extended credit to the partnership corporation prior to dissolution and had no knowledge or notice of his want of authority; or

II. Had not extended credit to the partnership corporation prior to dissolution, and, having no knowledge or notice of his want of authority, the fact of his want of authority has not been advertised in the manner provided for advertising the fact of dissolution in paragraph (1)(b)II.²⁹

authorization for judicial dissolution on the ground of insanity could also be retained, this might create ambiguities. Retaining the latter portion of UPA § 32(1)(a) as has been done, allowing judicial dissolution when a member is shown to be of unsound mind, justifies dissolution without the necessity for a formal adjudication of incompetence as a condition precedent. To clarify the respective scopes of the two provisions (§ 24(1) *supra*, and the provision of this section), the words "adjudication of" could be added before "insanity" in § 24(1), *supra*.

29. ULPA, as indicated above, carries over (ULPA § 9) as to general partners, the rights, powers and liabilities of the partners in an ordinary partnership. Accordingly, UPA agency and termination of agency provisions are carried over. Except for the reference to UPA § 35, UPA §§ 33 & 34 deal with the binding effect of a partner's acts on the co-partners individually, after dissolution. Unless partial personal liability is to be required, these provisions are unnecessary. Fortunately, UPA § 35 can stand alone without modification (except for the formal ones: "partner" = member, "partnership" = "partnership corporation"), and with the following deletions: UPA § 35(2) which deals with the liability of the partnership

§ 30. **Distribution of Assets.**—(1) In settling accounts after dissolution the liabilities of the partnership corporation shall be entitled to payment in the following order:

(a) Those to creditors, in the order of priority as provided by law, except those to members on account of their contributions,

(b) Those to members in respect to their share of the profits and other compensation by way of income on their contributions,

(c) Those to members in respect to the capital of their contributions.

(2) Subject to any statement in the certificate or to subsequent agreement, members share in the partnership corporation assets in respect to their claims for capital, and in respect to their claims for profits or for compensation by way of income on their contributions respectively, in proportion to the respective amounts of such claims.³⁰

§ 31. **Right to Wind Up.**—Unless otherwise agreed the members who have not wrongfully dissolved the partnership corporation or the legal representative of the last surviving member has the right to wind up the partnership corporation affairs; provided, however, that any member, his legal representative or his assignee, upon cause shown, may obtain a winding up by the court.³¹

§ 32. **Rights of Members to Application of Partnership Corporation Property.**—(1) When dissolution is caused in any way, except in contravention of any agreement, each member as against his co-member

as opposed to the partners, and hence can be omitted unless partial personal liability is to be required; § 35(4), which deals with the liability of a partner by estoppel; and § 35(3)(b) which provides for partnership nonliability where the partner binding the partnership has become bankrupt. The latter could perhaps be retained to protect the business from the possibly improvident commitments of a member, so improvident as to become personally bankrupt.

30. This is ULPA § 23, with the differences between treatment of general and limited partners' claims omitted. To avoid financial terminology, subsection (1)(b) may be changed to read: "those to members on, but not including, their contributions"; subsection (1)(c), to read: "Those to members as a return of their contributions"; and the phrase "under (1)(b) and (1)(c) above, respectively" may be substituted for the words "for capital . . . contributions respectively" in subsection (2). If it is desired expressly to subordinate claims on the part of members for loans, language from UPA § 40(b)(I) can be borrowed to bifurcate the two types of debt claims. Subsection (1)(a) would then be broken into two parts: (i) "Those to creditors other than members in the order of priority as provided by law. (ii) Those to members who are creditors of the partnership corporation by virtue of loans made thereto pursuant to § 18 hereof." UPA § 40 was not chosen as the general provision because of its elaborate provisions for enforcing personal liability. If partial personal liability is to be retained, these provisions are, of course, appropriate.

31. This is UPA § 37, with the requirement that the winding up member not be bankrupt omitted. Restoration of this requirement may, for reasons indicated above, note 29 *supra*, be desirable even where no partial personal liability is to be imposed. Where such partial personal liability is to be imposed, bankruptcy of a member, of course, becomes relevant.

and all persons claiming through them in respect of their interests in the partnership corporation, unless otherwise agreed, may have the partnership corporation property applied to discharge its liabilities, and the surplus applied to pay in cash the net amount owing to the respective members. But if dissolution is caused by expulsion of a member bona fide under any agreement, he shall receive in cash only the net amount due him from the partnership corporation.

(2) When dissolution is caused in contravention of any agreement the rights of the members shall be as follows:

(a) Each member who has not caused dissolution wrongfully shall have:

I. All the rights specified in paragraph (1) of this section, and

II. The right, as against each member who has caused the dissolution wrongfully, to damages for breach of the agreement.

(b) The members who have not caused the dissolution wrongfully, if they all desire to continue the business in the same name, either by themselves or jointly with others, may do so, during the agreed term for the partnership corporation and for that purpose may possess the partnership corporation property, provided they secure the payment by bond approved by the court or pay to any member who has caused the dissolution wrongfully, the value of his interest in the partnership corporation at the dissolution, less any damages recoverable under clause (2)(a)II of this section.

(c) A member who has caused the dissolution wrongfully shall have:

I. If the business is not continued under the provisions of paragraph (2)(b), all the rights of a member under paragraph (1), subject to clause (2)(a)II, of this section.

II. If the business is continued under paragraph (2)(b) of this section the right as against his co-members and all claiming through them in respect of their interests in the partnership corporation, to have the value of his interest in the partnership corporation, less any damages caused to his co-members by the dissolution, ascertained and paid him in cash, or the payment secured by bond approved by the court; but in ascertaining the value of the member's interest the value of the good-will of the business shall not be considered.³²

32. This is UPA § 38. It is designed to allow continuance of a partnership after wrongful dissolution by act of a partner, to deter such dissolution by requiring the payment of damages by the wrongdoer and to secure whatever payment is due him for his interest. These purposes all seem desirable in the partnership corporation, too. They provide a neat Benthamite solution (making dissolution a little unpleasant, but not impossible where a participant really wants out) to this crucial problem of intra-business conflict. For the complexities of the corporate law solutions, see J. Tingle, *The Stockholder's Remedy of Corporate Dissolution* (1959).

§ 33. **Liability of Persons Continuing the Business in Certain Cases.**—(1) When any new member is admitted into an existing partnership corporation or when any member retires and assigns (or the representative of the deceased member assigns) his rights in partnership corporation property to one or more of the members, or to one or more of the members and one or more third persons, if the business is continued without liquidation of the partnership corporation affairs, creditors of the first or dissolved partnership corporation are also creditors of the partnership corporation so continuing the business.

(2) When all but one member retire and assign (or the representative of a deceased member assigns) their rights in partnership corporation property to the remaining member, who continues the business without the liquidation of partnership corporation affairs, either alone or with others, creditors of the dissolved partnership corporation are also creditors of the partnership corporation so continuing the business.

(3) When any member retires or dies and the business of the dissolved partnership corporation is continued as set forth in paragraphs (1) and (2) of this section, with the consent of the retired members or the representative of the deceased member, but without any assignment of his right in partnership corporation property, rights of creditors of the dissolved partnership corporation and of the creditors of the partnership corporation continuing the business shall be as if such assignment had been made.

(4) When all the members or their representatives assign their rights in partnership corporation property to one or more third persons who promise to pay the debts and who continue the business of the dissolved partnership corporation, creditors of the dissolved partnership corporation are also creditors of the person or partnership corporation continuing the business.

(5) When any member wrongfully causes a dissolution and the remaining members continue the business under the provisions of § 32(2) either alone or with others, and without liquidation of the partnership corporation affairs, creditors of the dissolved partnership corporation are also creditors of the partnership corporation continuing the business.

(6) When a member is expelled and the remaining members continue the business either alone or with others, without liquidation of the partnership corporation affairs, creditors of the dissolved partnership corporation are also creditors of the partnership corporation continuing the business.

Reference to discharge from partnership liability is appropriate only if partial personal liability is imposed, and hence, has been deleted from the second sentence of subsection (1). Similarly, the release and indemnification against personal liability provisions have been omitted from subsection (2)(b), and subsection (2)(c)(II).

(7) The liability of a person becoming a member of the partnership corporation continuing the business, under this section, to the creditors of the dissolved partnership corporation shall be satisfied out of partnership corporation property only.

(8) When the business of a partnership corporation after dissolution is continued under any conditions set forth in this section the creditors of the dissolved partnership corporation as against the separate creditors of the retiring or deceased member, have a prior right to any claim of the retired member or the representative of the deceased member against the person or partnership corporation continuing the business, on account of the retired or deceased member's interest in the dissolved partnership corporation or on account of any consideration promised for such interest or for his right in partnership corporation property.

(9) Nothing in this section shall be held to modify any right of creditors to set aside any assignment on the ground of fraud.³³

§ 34. Rights of Retiring or Estate of Deceased Member When the Business is Continued.—When any member retires or dies, and the business is continued under any of the conditions set forth in § 33(1), (2), (3), (5), (6) or § 32(2)(b) without any settlement of accounts as between him or his estate and the person or partnership corporation continuing the business, unless otherwise agreed, he or his legal representative as against such persons or partnership corporation may have the value of his interest at the date of dissolution ascertained, and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership corporation with interest, or, at his option or at the option of his legal representative, in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership corporation provided that the creditors of the dissolved partnership corporation as against the separate creditors, or the representative of the retired or deceased member, shall have priority on any claim arising under this section, as provided by § 33(8) of this Act.³⁴

33. This is UPA § 41 with the provisions of subsection (1) modified slightly in accordance with the permission for formation of the partnership corporation by only one person. Subsection (10) which deals with individual liability (non-liability for allowing his or the original partnership name to continue to be used) of the estate of a deceased member has been omitted. Unless partial individual liability is retained, it would seem unnecessary. This section provides a substitute for the merger and consolidation provisions of corporation law, by providing for continuation of business liabilities of the old in the new business. It should be noted in this connection that "person" in the UPA provision includes corporations. See UPA § 2. These definitions are included as § 44 of this statute. The word "person" has been omitted, however, in subsections (2), (5) & (6) to avoid any suggestion of personal liability of the members.

34. This is UPA § 42. It is complementary to § 33 of the partnership corporation statute (UPA § 41), and provides a simple solution to the "buy-out" problem caused when a

§ 35. **Accrual of Actions.**—The right to an account of his interest shall accrue to any member or his legal representative, as against the winding up members or the surviving members or the person or partnership corporation continuing the business, at the date of dissolution in the absence of any agreement to the contrary.³⁵

§ 36. **Partnership Corporation Books.**—The partnership corporation books shall be kept, subject to any agreement between the members, at the principal place of business of the partnership corporation, and every member shall at all times have access to and may inspect and copy any of them.³⁶

§ 37. **Duty of Members to Render Information.**—Members shall render on demand true and full information of all things affecting the partnership corporation to any member or the legal representative of any deceased member or member under legal disability.³⁷

§ 38. **Member Accountable as a Fiduciary.**—(1) Every member must account to the partnership corporation for any benefit and hold

business participant dies or "wants out". The word "profit" does not seem particularly objectionable. See note 15 *supra*. Words like "increment in the net assets" could be substituted if desired, however. Although "assets" in § 15 should cause no problems, it should be observed that this term too may be subject to ambiguities when transmitted into a corporation law provision. See *Randall v. Bailey*, 23 N.Y.S.2d 173 (Sup. Ct. 1940), *aff'd mem.*, 262 App. Div. 844, 29 N.Y.S.2d 512 (1st Dep't 1941), *aff'd*, 288 N.Y. 280, 43 N.E.2d 43 (1942). In this section it might prove more troublesome. A requirement of "sound accounting practice" could be imposed in the definition section, but this would introduce problems of interpretation, and the probability of litigation. It would seem an unnecessary complication to introduce elaborate definitions for just one section, but this appears the only other alternative to leaving the word "profits" (which has been subject to some judicial construction under the UPA), if the absolute right of election is to be preserved. "Such return of his contribution as shall be provided for in the certificate, or agreed upon between said member or his legal representative and the remaining member or members for," which could be substituted for "the profits attributable to," may not give as much of a benefit to the retiring or deceased member as under the UPA. However, the amounts to be paid a retiring or deceased member should be fixed in advance anyhow, to avoid later dispute, and this change of verbiage accordingly might be preferable in even the ordinary partnership, where such agreements are often made and upheld. See *Devlin v. Rockey*, 295 F.2d 266 (7th Cir. 1961); *Wood v. Gunther*, 89 Cal. App. 2d 718, 201 P.2d 874 (1949); *Sorokach v. Trusewich*, 13 N.J. 363, 99 A.2d 790 (1953).

35. This is UPA § 43. It is, of course, necessary to have a limitation of the time within which an accounting can be sought where the departing or departed members allow a continuation of the business.

36. This is UPA § 19. It and the next three sections are integral to the partnership mode of operation. The unlimited inspection right given by this and the next, and § 39, is analogous to that accorded directors in a corporation under the majority rule. See H. Ballantine, *Corporations* 383-84 (rev. ed. 1946). It should guard against utilization of this business device by larger enterprises.

37. This is UPA § 20. See also note 36 *supra*.

as trustee for it any profits derived by him without the consent of the other members from any transaction connected with the formation, conduct or liquidation of the partnership corporation or from any use by him of its property.

(2) This section applies also to the representatives of a deceased member engaged in the liquidation of the affairs of the partnership corporation as the personal representatives of the last surviving member.³⁸

§ 39. **Right to an Account.**—Any member shall have the right to a formal account as to partnership corporation affairs:

- (a) If he is wrongfully excluded from the partnership corporation business or possession of its property by his co-members,
- (b) If the right exists under the terms of any agreement,
- (c) As provided by § 38,
- (d) Whenever other circumstances render it just and reasonable.³⁹

§ 40. **When Certificate Shall be Cancelled or Amended.**—(1) The certificate shall be cancelled when the partnership corporation is dissolved or all members cease to be such.

(2) A certificate shall be amended when:

- (a) There is a change in the name of the partnership corporation or in the amount or character of the contribution of any member,
- (b) A person is substituted as a member,
- (c) An additional member is admitted,
- (d) A member retires, dies or becomes insane, and the business is continued under § 24,
- (e) There is a change in the character of the business of the partnership corporation,
- (f) There is a false or erroneous statement in the certificate,
- (g) There is a change in the time as stated in the certificate for the dissolution of the partnership corporation or for the return of a contribution,
- (h) A time is fixed for the dissolution of the partnership corporation or the return of a contribution, no time having been specified in the certificate, or
- (i) The members desire to make a change in any other statement in

38. This is UPA § 21. There have been pleas for express imposition of fiduciary duties among the shareholders of corporations, a subject which in corporation law has been left to case law development; a development which, although accelerating, is still in an adolescent stage. The whole problem can be solved by enactment of this provision. Its enactment will also help to confine use of the new business form to smaller organizations where the participants will be willing to be as open towards one another as this section requires.

39. This is UPA § 22, and merely puts teeth into the full disclosure requirements of §§ 36 & 37 (UPA §§ 19 & 20) *supra*.

the certificate in order that it shall accurately represent the agreement between them.⁴⁰

§ 41. **Requirements for Amendment and for Cancellation of Certificate.**—(1) The writing to amend the certificate shall:

(a) Conform to the requirements of § 2(1)(a) as far as necessary to set forth clearly the change in the certificate which it is desired to make, and

(b) Be signed and sworn to by all members and an amendment substituting a member shall be signed also by the member to be substituted or added, and by the assigning member.

(2) The writing to cancel a certificate shall be signed by all members.

(3) A person desiring the cancellation or amendment of a certificate, if any person designated in paragraphs (1) and (2) as a person who must execute the writing refuses to do so, may petition the (here designate the proper court) to direct a cancellation or amendment thereof.

(4) If the court finds that the petitioner has a right to have the writing executed by a person who refuses to do so, it shall order the (here designate the responsible official in the office designated in § 2) in the office where the certificate is recorded to record the cancellation or amendment of the certificate; and where the certificate is to be amended, the court shall also cause to be filed for record in said office a certified copy of its decree setting forth the amendment.

(5) A certificate is amended or cancelled when there is filed for record in the office (here designate the office designated in § 2) where the certificate is recorded:

(a) A writing in accordance with the provisions of paragraph (1) or (2), or

(b) A certified copy of the order of the court in accordance with the provisions of paragraph (4).

(6) After the certificate is duly amended in accordance with this section, the amended certificate shall thereafter be for all purposes the certificate provided for by this Act.⁴¹

§ 42. **Foreign Partnership Corporations.**—Foreign partnership corporations shall qualify to do business in this State in the same manner as other foreign corporations, and shall be subject to the same liabilities and disqualifications for failure to do so as other foreign corporations. No foreign partnership corporation shall be entitled to procure a certificate of authority to transact in this State any business which a partnership corporation organized under this Act is not permitted to transact. Notwith-

40. This is ULPA § 24. In order to make effective the notice function of the certificate, provision must be made for its amendment and cancellation, which events may necessitate.

41. This is ULPA § 25. It merely sets forth the formal requirements for amending the certificate when, as the previous section provides, such an amendment is necessary.

standing any contrary provisions contained in (ordinary corporate law sections applicable to qualification of foreign corporation), any foreign partnership corporation shall comply with the requirement of § 2(a)I of this Act.⁴²

§ 43. **Reservation of Power.**—The legislature reserves the right, at pleasure, to alter, amend, suspend or repeal in whole or in part this chapter, or any certificate of incorporation or any authority to do business in this State, of any domestic or foreign partnership corporation, whether or not existing or authorized on the effective date of this chapter.⁴³

§ 44. **Definition of Terms.**—In this Act, “Court” includes every court and judge having jurisdiction in the case.

“Business” includes every trade, occupation or profession.

“Person”, except where otherwise indicated, includes individuals, partnerships, corporations and other associations.

“Conveyance” includes every assignment, lease, mortgage or encumbrance.

“Real property” includes land and any interest or estate in land.

“Agreement” includes, but is not limited to, the certificate referred to in §§ 2 and 41.⁴⁴

§ 45. **Interpretation of Knowledge and Notice.**—(1) A person has “knowledge” of a fact within the meaning of this Act not only when he has actual knowledge thereof, but also when he has knowledge of such other facts as in the circumstances shows bad faith.

42. This section is designed to guarantee limited liability locally to partnership corporations formed under the statutes of other states. If desired, the local recognition of such out-of-state partnership corporations can be made contingent on reciprocal treatment being accorded. The limitation to purposes possible for local partnership corporations is based on Model Act § 99.

43. This section is based on N.Y. Bus. Corp. Law § 110. Model Act § 142 could, of course, be used instead. Since this is a corporation statute, such a reservation of power is necessary to prevent any amendatory statute from being an unconstitutional impairment of “contract” as to corporations previously formed under the Act. *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

44. This is UPA § 2, with the definition of “bankrupt” omitted. The words “except where otherwise indicated,” have been added in the definition of person. This makes clear that only natural persons may form a partnership corporation. See § 2(1) of this statute. Otherwise, corporations could combine to form partnership corporations and thus defeat the intent to limit the availability of the new form to small businesses. In order to prevent evasions, e.g., through use of § 33, by ordinary corporations to acquire partnership corporations, “person” could be expressly defined to exclude ordinary corporations. Of course, if it desired to allow “joint-venture” corporations, the limitations can be completely removed. See *Abercrombie v. Davies*, 35 Del. Ch. 599, 123 A.2d 893 (Ch. 1956), rev'd 36 Del. Ch. 371, 130 A.2d 338 (Sup. Ct. 1957). A definition of agreement to include the certificate will make it clear that the participants may, but need not, include their management, dissolution, etc., agreement in the filed certificate, and avoid ambiguity in such provisions as § 32.

(2) A person has "notice" of a fact within the meaning of this Act when the person who claims the benefit of the notice:

(a) States the fact to such person, or

(b) Delivers through the mail, or by other means of communication, a written statement of the fact to such person or to a proper person at his place of business or residence.⁴⁵

§ 46. **Rules of Construction.**—(1) The rule that statutes in derogation of common law are to be strictly construed shall have no application to this Act.

(2) The law of estoppel shall apply under this Act.

(3) The law of agency shall apply under this Act.

(4) This Act shall be so interpreted and construed as to effect its general purpose to make uniform the law of those states which enact it.

(5) This Act shall not be so construed so as to impair the obligations of any contract existing when the Act goes into effect, nor to affect any action or proceedings begun or right accrued before this Act takes effect.⁴⁶

§ 47. **Rules for Cases not Provided for in this Act.**—In any case not provided for in this Act the rules of law and equity, including the law merchant, shall govern.⁴⁷

§ 48. **When Act Takes Effect.**—This Act shall take effect on the — day of ——— one thousand nine hundred and ———.⁴⁸

§ 49. **Name of Act.**—This Act may be cited as the (jurisdiction) Partnership Corporation Act.⁴⁹

45. This is UPA § 3. It clarifies an area of obscurity in corporation law.

46. This is UPA § 4, which is identical to ULPA § 28. Its effect should be to preclude judicial emasculatation of the agreed upon partnership mode of operation by interposition of the "statutory norms" of ordinary corporation law. See, e.g., *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.*, 297 N.Y. 174, 77 N.E.2d 633 (1948); *Benintendi v. Kenton Hotel, Inc.*, 294 N.Y. 112, 60 N.E.2d 829 (1945).

47. This is UPA § 5 or ULPA § 29.

48. An effective date is, of course, necessary. This is UPA § 44.

49. This section may be moved to § 1 if desired. See note 1 *supra*.

Certain minor changes in other statutes of the state, e.g., the Fraudulent Conveyance Act, receivership provisions of the Practice Act, provisions of the ordinary corporation statute, e.g., as to qualification of foreign partnership corporations, filing fees, taxation, may also be necessary, and are certainly advisable.