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LIMITED PARTNER CONTROL AND LIABILITY UNDER THE REVISED UNIFORM LIMITED PARTNERSHIP ACT

by Michael K. Pierce

Both the limited and general partnership share many of the same attributes.¹ The primary characteristic differentiating the two is the fact that limited partners, unlike general partners, are liable for partnership obligations only to the extent of their capital contributions.² Under statutes modeled after the Uniform Limited Partnership Act, however, this limitation of liability may be lost if a limited partner takes part in the "control" of the business.³ Thus, to attorneys with the responsibility of organizing a limited partnership, and to the limited partners themselves, it is a matter of prime importance that a control threshold be identified. Unfortunately, neither the Uniform Act nor the decisions construing it provide a clear guide as to what constitutes control, creating much uncertainty as to what a permissible amount of participation in the affairs of a partnership might be. One commentator has called this resulting uncertainty "the greatest drawback of the limited partnership form."⁴

In 1976 the uniform law was revised for the first time since its inception in 1916. The drafters of the Revised Uniform Limited Partnership Act,⁵ among other things, attempted to provide a clearer definition of control. This Comment examines this new provision and attempts to ascertain whether it is, in fact, a more workable standard.

I. "CONTROL" UNDER THE ULPA

A. Background

At common law the general rule was that whoever enjoyed a right to share in the profits of a noncorporate enterprise must also share in its losses;⁶ thus, limited partnerships were unknown.⁷ In 1822 New York became the first state to pass a limited partnership act, modeling its statute

1. A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP § 26(c), at 150 (1968).

2. 2 Z. CAVITCH, BUSINESS ORGANIZATIONS WITH TAX PLANNING § 39.07(2)(a) (rev. ed. 1978).

3. See UNIFORM LIMITED PARTNERSHIP ACT § 7 [hereinafter referred to and cited as ULPA].

4. See A. BROMBERG, *supra* note 1, § 26(c), at 147.

5. REVISED UNIFORM LIMITED PARTNERSHIP ACT (adopted by the National Conference of Commissioners on Uniform State Laws, subject to revision by the Style Committee) [hereinafter referred to as RULPA or revised Act and cited as RULPA].

6. A. BROMBERG, *supra* note 1, § 26(a); Basye, *A Survey of the Limited-Partnership Form of Business Organization*, 42 ORE. L. REV. 35, 36 (1962); Note, 36 HARV. L. REV. 1016, 1016-17 (1923).

7. See *Hoefler v. Hall*, 75 N.M. 751, 411 P.2d 230, 232 (1965); *Ruzicka v. Rager*, 305 N.Y. 191, 111 N.E.2d 878, 881 (1953); *Lanier v. Bowdoin*, 282 N.Y. 32, 38, 24 N.E.2d 732, 735 (1939); H. HENN, LAW OF CORPORATIONS § 29 (2d ed. 1970).

after the *Société en Commendite* of the French Commercial Code, a form of limited partnership that had existed in France since the Middle Ages.⁸ Other states soon followed New York's example with similar laws designed to counteract the common law doctrine.⁹ The legislative intent in passing such legislation was to develop new sources of capital and foster greater business and trade.¹⁰

Despite passage of the limited partnership acts, judicial thinking persisted that anyone with an interest in a partnership should be responsible for the obligations of the partnership regardless of his contribution.¹¹ As a result, many courts regarded the limited partnership form as providing a special privilege to the limited partner, and therefore they construed the statutes strictly, allowing the privilege of operating as a limited partner only after absolute compliance with all statutory requirements.¹² Any minor deviation from the statutory requirements rendered the limited partner liable as a general partner, despite the lack of any actual intent to deceive or reliance by a creditor.¹³ Furthermore, the fact that the acts were in derogation of the common law compelled some courts to require rigid adherence to the statutory provisions.¹⁴ The danger of incurring unlimited liability from relatively minor infractions of the law naturally discouraged the use of limited partnerships by investors.¹⁵

B. *The ULPA*

The ULPA was drafted in large part to remedy the strict interpretation given its predecessors.¹⁶ Thus, the ULPA abrogates the rule that legislation in derogation of the common law shall be strictly construed.¹⁷ Additionally, the drafters of the Act, intending to encourage the use of limited partnerships as an alternative business form, removed the imposition of unlimited liability on a limited partner as a result of inconsequential departures from the statutory provisions.¹⁸ The Act instead specifically re-

8. ULPA § 1, Official Comment; Lewis, *The Uniform Limited Partnership Act*, 65 U. PA. L. REV. 715, 716 (1917). For a discussion of the earlier forms of limited partnerships, see *Ames v. Downing*, 1 Bradf. 321 (N.Y. 1850).

9. ULPA § 1, Official Comment.

10. See 2 Z. CAVITCH, *supra* note 2, § 39.03(1).

11. ULPA § 1, Official Comment.

12. See *Holliday v. Union Bag & Paper Co.*, 3 Colo. 342 (1877); *Pierce v. Bryant*, 87 Mass. 91 (1862); *Maloney v. Bruce*, 94 Pa. 249 (1880); ULPA § 1, Official Comment; 48 MICH. L. REV. 347, 348 (1950).

13. *Basye*, *supra* note 6, at 37. See *Haggerty v. Foster*, 103 Mass. 17 (1869).

14. 2 Z. CAVITCH, *supra* note 2, § 39.03(1); Note, *supra* note 6, at 1016; see *In re Allen's Estate*, 41 Minn. 430, 43 N.W. 382 (1889); *Spencer Optical Mfg. Co. v. Johnson*, 53 S.C. 533, 31 S.E. 392 (1898).

15. *Basye*, *supra* note 6, at 37; Note, *supra* note 6, at 1017.

16. *Henningsen v. Barnard*, 117 Cal. App. 2d 352, 255 P.2d 837, 841 (1953); *Stowe v. Merrilees*, 6 Cal. App. 2d 217, 44 P.2d 368 (1935); *Rathke v. Griffith*, 36 Wash. 2d 394, 218 P.2d 757 (1950); *Brown*, *The Limited Partnership in Indiana*, 5 IND. L.J. 421, 423 (1930); 45 YALE L.J. 895, 899 (1936).

17. ULPA § 28(1).

18. *Giles v. Vette*, 263 U.S. 553, 562-63 (1924); *Plasteel Prod. Corp. v. Helman*, 271 F.2d 354, 356 (1st Cir. 1959); 2 Z. CAVITCH, *supra* note 2, § 39.03(2)(a). An important figure in the drafting of the ULPA commented:

quires that there be substantial good faith compliance with the statutory requirements;¹⁹ as a result, mere technical defects will no longer cause a limited partner to incur general partner liability.²⁰

The ULPA defines a limited partnership as a partnership formed by two or more persons having at least one or more general partners and one or more limited partners.²¹ The decision to structure limited partnerships in this manner may well have been a compromise between two conflicting policy arguments: on the one hand, creditors and third parties dealing with the partnership should be able to expect repayment of money loaned to the partnership or to have contracts performed by the partnership; parties in the partnership, however, should be able to agree to limit their liability to no more than the amount they have invested.²² The conflict was resolved by requiring the presence of at least one partner with unlimited personal liability for partnership obligations, who had control over the investments of those partners whose liability was limited.²³ As the general partner is endowed with all the rights, powers, and liabilities of a partner in a normal partnership,²⁴ management and control of the business is vested in his hands.²⁵ Regardless of the amount of his capital contribution, the general partner can be held personally liable for the debts and obligations of the partnership.²⁶ By requiring at least one general partner, the Act attempts to insure the existence of one party in the partnership with unlimited liability.²⁷

In contrast, the limited partner is granted only limited rights under the

Practically all the differences between the new Uniform Act and the existing statutes are due to the desire of the Conference to present to the legislatures of the several states an act, under which a person willing to invest his money in a business for a share in the profits, may become a limited partner, with the same sense of security from any possibility of unlimited liability as the subscribers to the shares of a corporation.

Lewis, *supra* note 8, at 723.

19. *Tiburon Nat'l Bank v. Wagner*, 263 Cal. App. 2d 868, 71 Cal. Rptr. 832, 837 (1968); *Henningsen v. Barnard*, 117 Cal. App. 2d 352, 255 P.2d 837, 841 (1953); ULPA § 2(2).

20. *Basye*, *supra* note 6, at 37.

21. ULPA § 1. A limited partnership formed under the Act is permitted to carry on any business that a general partnership can carry on, subject to any state-imposed restrictions. ULPA § 3. Just less than half of the states do not permit limited partnerships to engage in banking and insurance. The remaining states have no restrictions whatsoever. As of this writing, 49 states, plus the District of Columbia and the Virgin Islands, have adopted versions of the ULPA. 6 UNIFORM LAWS ANN. 93 (Supp. 1979).

22. *Coleman & Weatherbie*, *Special Problems in Limited Partnership Planning*, 30 Sw. L.J. 887, 897 (1976). The authors of this article state that in finding a resolution to the above-mentioned conflict, the drafters disregarded one other important policy consideration: investor supervision of his investment. *Id.* at 897-98.

23. *Id.*

24. *Kitchell Corp. v. Hermansen*, 8 Ariz. App. 424, 446 P.2d 934, 936 (1968); *Cummings v. Nordmark*, 73 Wash. 2d 322, 438 P.2d 605, 606 (1968); ULPA § 9.

25. *Kitchell Corp. v. Hermansen*, 8 Ariz. App. 424, 446 P.2d 934, 936 (1968); *Merrick v. New York Subways Advertising Co.*, 14 Misc. 2d 456, 178 N.Y.S.2d 814 (1958); 2 Z. CAVITCH, *supra* note 2, § 39.07(1); Comment, "Control" in the Limited Partnership, 7 J. MAR. J. PRAC. & PROC. 416, 418 (1974).

26. A. BROMBERG, *supra* note 1, § 26(c).

27. *Id.*

ULPA to participate in the affairs of the business.²⁸ The Act specifically permits the limited partner to: (1) have the partnership books kept at the principal place of business and to inspect and copy them at all times; (2) demand information of all things affecting the partnership and an accounting of partnership affairs when just and reasonable; (3) seek a judicial dissolution and winding up of the partnership; and (4) share in the profits and other compensation earned by the business, as well as a return of his contribution.²⁹ In addition, the limited partner may make loans to³⁰ and assign his interest in³¹ the limited partnership. Section 9 of the ULPA sets out activities in which a general partner may not engage without the approval or ratification of the limited partners.³² The Act also provides that no limited partner's contribution can be returned nor his liabilities to the partnership waived until permission of all members in the partnership is given, including that of the limited partners.³³ Consent must also be gained before the remaining general partners may continue the business of the partnership upon the retirement, death, or insanity of a general partner.³⁴

As the limited partnership is structured under the Act, the most important difference between a limited partner and a general partner is the limitation of liability of the limited partner to the amount of his contribution to the partnership.³⁵ This right to limited liability under the ULPA is con-

28. Feld, *The "Control" Test for Limited Partnerships*, 82 HARV. L. REV. 1471, 1472 (1969).

29. ULPA § 10.

30. *Id.* § 13.

31. *Id.* § 19.

32. *Id.* § 9 provides that a general partner has authority to do the following acts only upon the written consent or ratification by the limited partners:

- (a) Do any act in contravention of the certificate,
- (b) Do any act which would make it impossible to carry on the ordinary business of the partnership,
- (c) Confess a judgment against the partnership,
- (d) Possess partnership property, or assign their rights in specific property, for other than a partnership purpose,
- (e) Admit a person as a general partner,
- (f) Admit a person as a limited partner, unless the right so to do is given in the certificate,
- (g) Continue the business with partnership property on the death, retirement or insanity of a general partner, unless the right so to do is given in the certificate.

33. *Id.* § 16(1)(b).

34. *Id.* § 20.

35. *Id.* § 1. Limited liability, however, is not the only desirable characteristic of the limited partnership form. Until recently the limited partnership form provided the opportunity for substantial tax savings over the corporate form of investment vehicle, and, in many cases, still does so. If properly structured, a limited partnership will qualify for treatment as a partnership rather than a corporation for federal income tax purposes. *See* Treas. Reg. § 301.7701-2 (1960). Consequently, the partners of the limited partnership, like those of a general partnership, are taxable on their distributive share of partnership income, gain, loss, deduction, and credit. I.R.C. § 702. Partners may offset partnership losses, passing through the partnership to them, against income from other sources for determination of their federal tax liability. The attractiveness of this "tax shelter" characteristic was further enhanced by the increase in a partner's taxable basis in his partnership interest by his allocable share of nonrecourse indebtedness of the partnership. *See* Treas. Reg. § 1.752-1(e) (1956). In

ditional, however, and may be lost in several ways. For instance, if a limited partner's name appears in the partnership's name, he becomes liable as a general partner to those creditors of the partnership who have extended credit to the partnership without actual knowledge that he is not a general partner.³⁶ The limited partner may also become liable to any party who relies to his detriment upon any false statement contained in the partnership certificate, if the limited partner was aware of the falsity at the time the certificate was signed by all the partners, or if it subsequently became known to him within a sufficient time for him to cancel or amend the certificate.³⁷ Finally, a limited partner loses his limited liability pursuant to section 7 of the Act if "in addition to the exercise of his rights and powers . . . he takes part in the control of the business."³⁸

Section 7, while easily stated, has not been susceptible to easy interpretation. This is due in large part to what appears to be an inability to determine the purpose of section 7. In one respect, it can be said that section 7 attempts on grounds of public policy to match partnership involvement with liability. As one writer has stated: "[p]ublic policy is violated when a partner retains his privileged status of limited liability while possessing the ability to 'control.'"³⁹ On the other hand, there is the idea that section 7 was designed to protect those who deal with the partnership; if section 7 was intended to protect the reasonable expectations of creditors, it only should be applied in situations in which a creditor has relied on acts of control in dealings with the limited partnership.⁴⁰ Added to this confusion is the further fact that the comment to section 1 of the ULPA indicates that

effect, this allowed the partner to deduct amounts in excess of his actual economic investment in the partnership. The Tax Reform Act of 1978, however, extends the at-risk rules of I.R.C. § 465 to all activities other than real estate and equipment leasing by a closely-held corporation. Section 465 limits the amount of a taxpayer's loss deductions to the amount that the taxpayer has at risk and could actually lose in the activity undertaken. Thus, a limited partner would be precluded from flow-through of losses to the extent of the nonrecourse liabilities of the partnership. I.R.C. § 465(b)(2). This restriction on the flow-through of losses will inhibit the use of limited partnerships as an investment vehicle except in the two areas where § 465 does not apply. Despite the above, the limited partnership still provides one possible advantage over a corporate entity: the avoidance of double taxation. Generally, income earned by a corporation is taxed twice—once at the corporate level and again when received in the form of dividends by a shareholder. As noted above, income earned by a limited partnership is taxed only once—at the partner level. See Hurd & Mayer, *Ohio Limited Partnerships—Business Use and Effect*, 27 OHIO ST. L.J. 373, 391 (1966).

36. ULPA § 5.

37. *Id.* § 6. Unlike a general partnership, which can be formed by a mere informal agreement, a limited partnership can only be validly created by complying with certain statutory requirements. *Id.* § 2 stipulates that persons desiring to form a limited partnership must sign a certificate setting forth among other things: (1) the name, character, location, and duration of the business; (2) names and addresses of both the general and limited partners; (3) the contributions of the limited partners and their share of the profits; and (4) provisions for the substitution of other partners and the continuance of the business. In addition, the certificate must be filed with an office designated by the state.

38. *Id.* § 7.

39. Note, *Liability of Limited Partners Participating in the Management of the Sole Corporate General Partner—Delaney v. Fidelity Ltd.*, 29 Sw. L.J. 791, 796 (1975).

40. Feldman, *The Limited Partner's Participation in the Control of the Partnership Business*, 50 CONN. B.J. 168, 173-74 (1976).

a limited partner under the ULPA should be able to exercise "some degree of control over the conduct of the business."⁴¹ Thus, in spite of the fact that limited partnerships are intended to be viable business alternatives, much of the effect of the ULPA is lost because of the uncertainty of the application of section 7 and the definition of control.

C. Case Law Construing Section 7

The case law construing section 7 has failed to provide a clear, definite interpretation of what constitutes control. This failure stems from two factors. First, there has been a relatively small amount of litigation in this area, which several commentators attribute to a cautious attitude amongst lawyers in advising limited partners as to the extent of permissible participation in a partnership.⁴² Secondly, in dealing with such problems when they do arise most courts have approached each situation on an ad hoc basis and thereby have avoided enunciating any general guiding principles applicable to other situations.⁴³ Analysis of the relevant case law reveals the evolution of two variant tests for purposes of ascertaining violations of statutes modeled after section 7: the "power" or "control" test and the "reliance" test.⁴⁴

The Power Test. The "power" or "control" test involves a quantitative analysis by the court of the powers exercised by a limited partner in the affairs of the partnership.⁴⁵ Normally, if the limited partners have the power to "initiate matters and to decide them entirely within the group of limited partners," control within section 7 is present.⁴⁶ One of the earliest and foremost cases decided clearly under the power test approach is *Holzman v. De Escamilla*.⁴⁷ In *Holzman* the limited partnership was involved in a farming operation. Testimony indicated that the two limited partners had visited the farm on a regular basis, and had not only conferred with the general partner as to what crops should be grown, but also on several occasions had overruled the general partner's choice. The general partner was ultimately required to resign and the limited partners selected a successor. Of particular importance to the court was the fact that the limited partners had ultimate power over the disposition of partnership funds, as both could write checks on the firm's bank account without the knowledge or consent of the general partner. In addition, the general partner had no authority to withdraw funds without first obtaining the countersignature of one of the limited partners.⁴⁸ Together, these factors led the court to con-

41. ULPA § 1, Official Comment.

42. See Feld, *supra* note 28, at 1484; Feldman, *supra* note 40, at 213.

43. See *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, 323 A.2d 371, 375 (1974); 2 Z. CAVITCH, *supra* note 2, § 39.07(2)(c)(i).

44. Coleman & Weatherbie, *supra* note 22, at 899.

45. Note, *Foreign Limited Partnerships: A Proposed Amendment to the Uniform Limited Partnership Act*, 47 S. CAL. L. REV. 1174, 1193 (1974).

46. Coleman & Weatherbie, *supra* note 22, at 899.

47. 86 Cal. App. 2d 858, 195 P.2d 833 (1948).

48. 195 P.2d at 834. The court stated: "Either Russell or Andrews [the limited partners]

clude that the limited partners had, contrary to the statute, participated in the control of the business.⁴⁹

In *Bergeson v. Life Insurance Corp. of America*⁵⁰ a limited partnership was formed and caused the organization of a life insurance company. The limited partners acted as the officers and directors of the insurance company. A shareholder of the insurance company brought a derivative action alleging that the company issued stock to the directors, at their own behest, in return for which the company received nothing of value. In response to this contention, the officers and directors claimed a limitation on their liability based on their status as limited partners.⁵¹ While not examining the activities of the limited partners in detail, the court stated that since the only business of the partnership was the operation of the company, the limited partners by their activities in the company as officers and directors had participated in the control of the partnership business.⁵²

In *Plasteel Products v. Helman*⁵³ an allegation was made by a creditor that since the limited partners possessed and had exercised the right to pick the general sales manager, they had control over the partnership steel business. In addition, the partnership agreement provided that the general partner was allowed to make certain financial decisions only in conjunction with the general sales manager.⁵⁴ An analysis of the limited partners' powers resulted in no imposition of unlimited liability. The court stressed the fact that the general partner possessed the discretionary authority to discharge the general manager at any time. Based on this factor, the court concluded that the limited partners did not possess control within the meaning of the statute.⁵⁵

While the above cases differ factually, the common thread running through all the decisions appears to be an attempt to determine who has the ultimate control over the ongoing operations of the partnership. If a limited partner actually performs the normal activities associated with ongoing management or has sufficient power to control the day-to-day functions of the business, he will be found liable as a general partner. In *Holzman*, since the limited partners had authority over the finances of the partnership, the general partner could not have the final say as to the regular conduct of business. On the other hand, in *Plasteel* the general partner possessed the authority to terminate any apparent control the limited part-

could take control of the business from de Escamilla by refusing to sign checks for bills contracted by him and thus limit his activities in the management of the business." *Id.*

49. *Id.*

50. 170 F. Supp. 150 (C.D. Utah 1958), *rev'd on other grounds*, 265 F.2d 227 (10th Cir.), *cert. denied*, 360 U.S. 932 (1959).

51. 170 F. Supp. at 158.

52. *Id.* at 159. The actual basis for denying the limited liability was that in fact the limited partnership had not been formed since there was a lack of substantial compliance with the partnership statute. Citing *Holzman*, the court stated that even had there been substantial compliance, it would have ruled against the limited partners on the control factor. *Id.* at 158-59.

53. 271 F.2d 354 (1st Cir. 1959).

54. *Id.* at 356.

55. *Id.*

ners may have had by firing the general sales manager who was appointed by the limited partners. Interestingly, none of the courts in the above decisions discussed whether the third parties involved relied on or were even aware of the various activities in question prior to filing suit. Under the power approach, therefore, there need be no actual showing of harmful or detrimental reliance. All that is required in order to impose general partner liability is to show "control" on the part of the limited partner.⁵⁶

The Reliance Test. The reliance test, in contrast to the power test, emphasizes whether the activities of a limited partner would reasonably lead a third party to believe that the limited partner has the liability of a general partner.⁵⁷ Thus, the reliance approach focuses not on the powers permitted or exerted by a limited partner, but rather on the activities of the limited partner and whether a third party has been led to the mistaken assumption that a limited partner has general liability for partnership obligations. The notion that a third party must have reasonably relied on some activity of a limited partner before liability will be imposed was first put forth in *Rathke v. Griffith*.⁵⁸ In *Rathke* the defendant limited partner had been selected to the board of directors of the firm that was to conduct the affairs of the partnership. Additionally, his name appeared as a "co-partner" in the granting clauses of two warranty deeds, and he had signed several instruments along with the general partners without specifying his status as a limited partner.⁵⁹ The court refused to impose liability, stating:

We call attention once more to the fact that it is not alleged that respondent ever relied on Mr. Griffith's [the limited partner] position as a general partner, or in fact ever understood that Mr. Griffith was anything other than a limited partner. Under these circumstances, we see no reason for holding Mr. Griffith liable to respondent as a general partner.⁶⁰

In *J.C. Wattenbarger & Sons v. Sanders*⁶¹ an attempt was made to impose personal liability on a limited partner because, in the publishing of a notice that the partnership was operating under a fictitious name, he had allegedly held himself out to the world to be a general partner.⁶² The court, however, held that because the certificate had not come to the respondent's attention until after the transaction in question was almost completed, the limited partner retained his limited liability.⁶³

Use of the reliance test was also evident in the case of *Silvola v.*

56. As a consequence, the power test approach has been criticized as unfairly giving a creditor of the limited partnership a "windfall" since he need not even demonstrate that he had a reasonable expectation that the limited partner was liable to him. See Feldman, *supra* note 40, at 179-82.

57. Feld, *supra* note 28, at 1479; Note, *supra* note 45, at 1195.

58. 36 Wash. 2d 394, 218 P.2d 757 (1950).

59. 218 P.2d at 764.

60. *Id.*

61. 216 Cal. App. 2d 495, 30 Cal. Rptr. 910 (1963).

62. 30 Cal. Rptr. at 913.

63. *Id.* at 914. The court stated: "The question to be answered when it is contended that a defendant is an ostensible partner is whether the acts and conduct of an individual

Rowlett,⁶⁴ which involved a contention that a limited partner was liable as a general partner since he had worked in the partnership business. The court noted that the plaintiff, as the partnership's accountant, was aware of the limited partner's status at all times and therefore could not have been reasonably led to believe that the limited partner had unlimited liability.⁶⁵

Finally, in *Filesi v. United States*⁶⁶ the court assessed a limited partner general partner liability for a federal excise tax, noting that the limited partner "openly and publicly took an active role in the management and control of the business."⁶⁷ The implication was that the limited partner's behavior would lead others to a reasonable belief that the limited partner was a general partner.⁶⁸

The reliance test decisions as a whole seem to reflect a judicial determination that it is unfair to impose unlimited liability on a limited partner for performing certain acts of "control" absent a showing that the plaintiff has suffered a detriment as a result.⁶⁹ In effect, they represent a judgment that acts of control on the part of a limited partner are not inherently contrary to public policy. Rather, such acts only become objectionable if some innocent third party is injured as a consequence.

Choice of Tests: Delaney and Frigidaire. Support for both the power approach and the reliance approach can be garnered from the ULPA. It can be argued that had the drafters of the Act intended that reliance be present in order for liability to be imposed, they would have expressly mentioned it in section 7. This is especially relevant since under section 6 of the Act, reliance was specifically mentioned before the limited partner could incur the liability of a general partner.⁷⁰ The official comment of the ULPA, however, states that there is no justification for imposing unlimited liability on a limited partner as long as "creditors have no reason to believe at the times their credits were extended that such person was so bound."⁷¹ This statement implies that a reliance factor is necessary in order to show control.⁷²

The question of which test should apply was directly considered in two

were factually and legally sufficient to lead another person to believe he was a copartner and assumed responsibility as such." *Id.*

64. 129 Colo. 522, 272 P.2d 287 (1954).

65. 272 P.2d at 289.

66. 352 F.2d 339 (4th Cir. 1965).

67. *Id.*

68. The decision in *Filesi* differs somewhat from the other decisions mentioned under the "reliance" test. Though not explicitly stated, the other cases would seem to require that there be actual reliance on the part of the plaintiff before liability will be imposed. In *Filesi*, however, the court did not say whether there had been any such reliance on the part of the Government. It simply intimated that the acts would be sufficient to cause such reliance.

69. The reliance approach can perhaps be viewed as accepting the notion that allowing a plaintiff to treat a limited partner as a general partner where the plaintiff was not misled by any of the limited partner's acts is an unfair windfall. *See* note 56 *supra*.

70. *See* text accompanying note 37 *supra*.

71. ULPA § 1, Official Comment.

72. Most commentators on the subject have supported the reliance approach. *See* Feldman, *supra* note 40, at 182; Feld, *supra* note 28, at 1479.

recent and factually similar cases, *Delaney v. Fidelity Lease Limited*⁷³ and *Frigidaire Sales Corp. v. Union Properties, Inc.*⁷⁴ Both cases involved a limited partnership with a corporation as the sole general partner. In addition, several of the limited partners held stock in and served as officers and directors of the corporate general partners. The plaintiffs alleged that because of their positions in the corporations the limited partners were exercising control over the partnership business and therefore should have unlimited liability for its obligations. In resolving this issue, however, the two courts reached different conclusions.

In *Delaney* the Texas Supreme Court overruled a lower court holding⁷⁵ and held that the limited partners would lose their limited liability upon a showing that the limited partners exercised control over the general partner. The court expressly held that for the purpose of imposing personal liability upon a limited partner, a demonstration of reliance on the part of a third party is unnecessary.⁷⁶ This result was reached by a strict interpretation of the Texas counterpart of section 7.⁷⁷ The court reasoned that since no mention was made of reliance in the statutory provisions,⁷⁸ there was no need for proof as to its existence in order to impose liability.⁷⁹

73. 526 S.W.2d 543 (Tex. 1975).

74. 88 Wash. 2d 400, 562 P.2d 244 (1977).

75. 517 S.W.2d 420 (Tex. Civ. App.—El Paso 1974), *rev'd*, 526 S.W.2d 543 (Tex. 1975), *noted in* 7 TEX. TECH L. REV. 745 (1976). The civil appeals court in El Paso had adopted the reliance test: "The logical reason to hold a limited partner to general liability under the control prohibition of the Statute is to prevent third parties from mistakenly assuming that the limited partner is a general partner and to rely on his general liability." 517 S.W.2d at 425.

76. 526 S.W.2d at 545.

77. Note, *supra* note 39, at 795.

78. TEX. REV. CIV. STAT. ANN. art. 6132a, § 8 (Vernon 1970).

79. In its opinion, the court also expressed concern that the statutory requirement of having at least one general partner with unlimited liability for partnership obligations would be circumvented by allowing the limited partners to operate the partnership through a corporation that was only minimally capitalized. 526 S.W.2d at 546; *see* note 27 *supra* and accompanying text. In effect, the court was fearful that sanctioning the use of corporations as general partners would result in the abuse of the rights of creditors dealing with limited partnerships. *Coleman & Weatherbie, supra* note 22, at 901. Also implicit in the decision is the idea that it is contrary to public policy for a limited partner to retain his special liability status while at the same time exercising control over partnership affairs. Note, *supra* note 39, at 796.

The opinion is subject to criticism in several respects. First, the plaintiff in *Delaney* knew that it was dealing with a corporation functioning in the capacity of general partner. Assuming that it was aware of the limited liability nature of such a business entity, the plaintiff, if truly concerned about the ability of the corporation to meet its financial obligations, could have sought personal guarantees from those limited partners serving in the corporation. Since the plaintiff did not, it is hard to understand why it should be able to collect from the limited partners on the ground that the limited partners were exercising control over the partnership. Secondly, for all of its discussion on the evils of allowing a minimally-capitalized corporation to serve as a general partner, the court made no inquiry on whether the corporate general partner in *Delaney* was undercapitalized. If the corporation was not, it is difficult to envision how the plaintiff's rights against the limited partnership were hampered in any way. *See Coleman & Weatherbie, supra* note 22, at 902. Finally, singling out the use of a corporation in the capacity as a general partner as a means of defrauding creditors dealing with a limited partnership seems unreasonable. From a practical standpoint, it is just as likely that a limited partnership could be formed with an individual who possesses little or no assets serving as general partner.

Conversely, in *Frigidaire* the Supreme Court of Washington refused to find personal liability on the part of the limited partners since no element of reliance was present.⁸⁰ Unlike the court in *Delaney*, the *Frigidaire* court

The *Delaney* case has recently helped spark considerable controversy in Texas. In its opinion, the El Paso court of civil appeals said that it was permissible in Texas to form a limited partnership with a corporation as its sole general partner. With regard to this statement, the Texas Supreme Court commented:

The court had no point of error before it requiring such statement to be made. Its accuracy depends upon the scope of the corporate charter, *Luling Oil & Gas Co. v. Humble Oil & Refining Co.*, 144 Tex. 475, 191 S.W.2d 716 (1945), and upon whether we should extend our holding in *Port Arthur Trust Co. v. Muldrow*, 155 Tex. 612, 291 S.W.2d 312 (1956), to sanction corporations acting as general partners in a statutory limited partnership. We reserve any decision on these questions until they are properly presented for our determination.

526 S.W.2d at 546.

On Aug. 16, 1978, the Attorney General of Texas issued an opinion, in large part based on a substantial portion of the above-quoted language, which stated that a corporation could not serve as the sole general partner in a limited partnership. TEX. ATT'Y GEN. OP. NO. H-1229 (1978). In explaining the rationale for this conclusion, the opinion cited to all of the above-quoted language from *Delaney*, except for the last sentence in that passage. Moreover, the opinion went on to state: "On the basis of the court's language in *Delaney*, we do not believe that a corporation may, in Texas at this time, serve as the sole general partner of a limited partnership."

The soundness of the opinion is suspect for several reasons. First, at most the supreme court's language in *Delaney*, relied on by the attorney general to such a great extent, was a mere dictum. It clearly was not germane to the central holding in the case, which related to the potential liability of the limited partners to the plaintiff-creditor. To accord the language such weight seems questionable. Secondly, the statement can hardly be said to represent an affirmative indication of the court's position on the matter. This is particularly true in light of the language of the court that was not included in the attorney general's opinion: "We reserve any decision on these questions until they are properly presented for our determination." Thirdly, the conclusion reached is clearly contrary to statutory law in Texas. Since 1973, pursuant to the Texas Business Corporation Act, corporations in the state have been specifically empowered "[t]o be . . . partners . . . of any partnership, joint venture, or other enterprise." TEX. BUS. CORP. ACT ANN. art. 2.02(A)(18) (Vernon Supp. 1978-79). In addition, the Texas Uniform Partnership Act defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit." TEX. REV. CIV. STAT. ANN. art. 6132b, § 6(1) (Vernon 1970) (emphasis added). "Person" is defined in the same Act as including "individual, partnerships, corporations, and other associations." TEX. REV. CIV. STAT. ANN. art. 6132b, § 2 (Vernon 1970) (emphasis added). Furthermore, a limited partnership is defined in part as "a partnership formed by two (2) or more persons . . . and having as members one (1) or more general partners and one (1) or more limited partners." TEX. REV. CIV. STAT. ANN. art. 6132a, § 2 (Vernon 1970) (emphasis added). Moreover, it is provided that the Texas Uniform Partnership Act is to apply to limited partnerships in this state except to the extent inconsistent with the limited partnership act. TEX. REV. CIV. STAT. ANN. art. 6132 b, § 6(2) (Vernon 1970). Based on the above, there is a strong statutory argument that corporations can in fact serve as general partners in a limited partnership. See Bromberg, Bateman, Hamilton, Lebowitz & Winship, *Corporate General Partners* 16 TEX. ST. B. BULL. SECTION CORP., BANKING & BUS. L., No. 1, Sept. 1978, at 24; Hamilton, *Corporations, Annual Survey of Texas Law*, 30 SW. L.J. 153 (1976).

On Aug. 23, 1978, the portion of H-1229 relating to the authority of a corporation to be the sole general partner in a limited partnership was withdrawn pending consideration. TEX. ATT'Y GEN. OP. NO. H-1229a (1978).

80. The *Frigidaire* court attempted to distinguish the *Delaney* decision from the action before it. First, the court noted that in *Delaney* the corporate general partner and the limited partnership were formed at the same time, the purpose of the corporation being to operate the limited partnership. The acts of the corporation, therefore, were to benefit the partnership rather than to further the aims of the corporation itself. Conversely, in *Frigidaire* the corporation was involved in investigating real estate investment opportunities; when such

refused to restrict itself to a literal interpretation of the statutory language.⁸¹ The court acknowledged that the limited partners in their corporate capacities exercised day-to-day control and management of the limited partnership.⁸² Yet, it noted that the third party creditor involved was aware that he was dealing with a corporate general partner and did not rely on the limited partners' control of the corporate general partner by assuming that the limited partners were in fact general partners.⁸³

D. *Problems Caused by Lack of a Clear Standard*

The absence of a clear definition of control has created several problems. Most obviously, it has led to varying interpretations of control, which, in turn, have resulted in inconsistent holdings in factually similar cases,⁸⁴ contrary to the express purpose of the ULPA to make uniform the laws of states adopting the Act.⁸⁵ Additionally, such an inconsistency makes it extremely difficult for an attorney to know, either in structuring a limited partnership or in advising an existing one, how much power can be exercised by a limited partner.⁸⁶ As indicated by the decision in *Frigidaire*, in jurisdictions employing a reliance test a limited partner could assume a

opportunities were discovered, limited partnerships were then formed with the corporation as general partner. Thus, the court reasoned that, unlike in *Delaney*, the acts of the corporate entity were not solely for the benefit of the limited partnership. 562 P.2d at 246. Secondly, the court noted the Texas Supreme Court's indecision over the propriety of allowing a corporation even to function as a sole general partner. *Id.* The Washington court earlier in its opinion had acknowledged that it was permissible under Washington law for a corporation to serve in such a capacity. *Id.* at 245.

81. *Id.* at 247. For purposes of clarification, it should be noted that at present Washington is among a small number of states that have adopted a definition of control that varies from that contained in § 7. See note 90 *infra*. At the time of this action, however, limited partnerships in that state were operating under a provision, WASH. REV. CODE ANN. § 25.08.070 (1969), identical to the ULPA version.

82. 562 P.2d at 245.

83. The court stated:

[B]ecause respondents scrupulously separated their actions on behalf of the corporation from their personal actions, petitioner never mistakenly assumed that respondents were general partners with general liability. . . . Petitioner knew Union Properties [the corporation in question] was the sole general partner and did not rely on respondents' control by assuming that they were also general partners.

Id. at 247 (citations omitted).

The *Frigidaire* court also failed to share in the *Delaney* court's concern over the potential for abuse of creditors' rights by the formation of limited partnerships containing a corporation as sole general partner. *Id.* at 246; see note 79 *supra*. It stated that any time a creditor deals with a corporation it faces the risk that the corporation will lack sufficient funds to meet its obligations. *Id.* at 246. The court reasoned that if the creditor in *Frigidaire* was truly concerned about the solvency of the corporate general partner, it could have sought personal guarantees from the defendant limited partners. *Id.* at 247. Moreover, the court indicated that the fact a corporate general partner may be inadequately capitalized is not in and of itself justification for imposing unlimited liability on the limited partners because of their control of the corporation. *Id.* at 246. Rather, the court said that the rights of creditors in such a situation can be protected pursuant to the corporate law doctrine of "piercing the corporate veil." *Id.* at 247.

84. See notes 73-83 *supra* and accompanying text.

85. See ULPA § 28(2).

86. Two commentators state with regard to this point: "Probably the most serious problem encountered in drafting and carrying out a limited partnership agreement is that of

much more expansive role in the business, while in jurisdictions using a power test the limited partner's participation in the business is restricted. Thus, in jurisdictions that have yet to decide how the control problem will be handled, advising attorneys are faced with a considerable dilemma. The resulting uncertainty over the permissible level of control may actually discourage the use of limited partnerships as investment vehicles.⁸⁷ At the very least, those who do become limited partners may be so overly cautious in their actions that they fail to retain adequate supervision over their investment. The uncertainty also presents problems for those limited partnerships transacting business in more than one state.⁸⁸ Conflicting holdings such as *Delaney* and *Frigidaire* illustrate that activities permissible in one jurisdiction may not be permissible in another, creating problems not only in planning, but also in the area of conflict of laws should litigation arise.⁸⁹ Finally, the situation is further aggravated by states that have recognized the existing deficiencies in the ULPA's standard of control and have altered their statutes in an attempt to clarify the extent to which a limited partner may participate.⁹⁰ While their desire to

determining what constitutes taking part 'in the control of the business' of a limited partnership." Coleman & Weatherbie, *supra* note 22, at 897.

87. This too is contrary to the intention of the drafters of the ULPA. See note 18 *supra* and accompanying text.

88. See Coleman & Weatherbie, *supra* note 22, at 904-06; Note, *supra* note 45, at 1192-97.

89. See Note, *supra* note 45, at 1200-07.

90. Eight states at the present time have enacted legislation that varies from § 7. Five of these states have passed laws specifically granting the right of limited partners to vote on certain matters affecting the partnership. For example, NEV. REV. STAT. § 88.080 (1973) provides:

1. A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business.

2. A limited partner shall not be deemed to take part in the control of the business by virtue of his possessing or exercising a power, specified in the certificate, to vote upon matters affecting the basic structure of the partnership, including the following matters or others of a similar nature:

- (a) Election or removal of general partners.
- (b) Termination of partnership.
- (c) Amendment of the partnership agreement.
- (d) Sale of all or substantially all of the assets of the partnership.

3. The statement of powers set forth in subsection 2 is not exclusive and does not indicate that any other powers possessed or exercised by a limited partner are sufficient to cause such limited partner to be deemed to take part in the control of the business within the meaning of subsection 1.

Other state statutes specifically granting voting privileges include: CAL. CORP. CODE § 15507 (West 1977); DEL. CODE ANN. tit. 6, § 1707 (1975); ORE. REV. STAT. § 69.280 (1975); and WASH. REV. CODE ANN. § 25.08.070 (Supp. 1977).

Alabama and Delaware, on the other hand, have adopted a test based on reliance. For example, ALA. CODE tit. 10, § 10-9-41 (1977), provides:

A limited partner may from time to time examine into the state and progress of the partnership business, advise as to its management and act as attorney-at-law, but he must not act as agent for the partnership for any purpose; and if he acts contrary to this subsection, he is liable as a general partner to any partnership creditor who extends credit to the partnership in the good faith belief that he was dealing with a general partner.

Nebraska is the final state at present with a section that differs from § 7. NEB. REV. STAT.

provide a more workable standard is understandable, the effect is to decrease even more the uniformity amongst the states and exacerbate the conflict of laws problem.⁹¹

II. SECTION 303 OF THE REVISED UNIFORM LIMITED PARTNERSHIP ACT

Section 303⁹² of the Revised Uniform Limited Partnership Act sets out a new standard for determining whether unauthorized control has been ex-

§ 67-210(3) (1976) provides that when a limited partnership qualifies as an investment company within the terms of the Investment Company Act of 1940, the limited partners shall have the right to vote: (1) to elect directors or trustees of the investment company; (2) to approve or terminate investment advisory or underwriting contracts; (3) to approve auditors; and (4) to approve any matters that the Investment Company Act of 1940 requires to be considered by the holders of beneficial interests in the investment company.

91. There has also been considerable concern among those dealing with limited partnerships in states that allow limited partners to vote on matters affecting the partnership's business that the possession and exercise of these voting rights by the limited partners may render them liable in states that have yet to permit such voting. See generally Augustine, Fass, Lester & Robinson, *The Liability of Limited Partners Having Certain Statutory Voting Rights Affecting the Basic Structure of the Partnership*, 31 BUS. LAW. 2087 (1976); Comment, *Partnership: Can Rights Required to be Given under New Tax Shelter Investment Regulations be Reconciled with Section 7 of the Uniform Limited Partnership Act?*, 26 OKLA. L. REV. 289 (1973).

92. RULPA § 303 provides:

(a) Except as provided in subsection (d), a limited partner is not liable for the obligations of a limited partnership unless he is also a general partner or, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business. However, if the limited partner's participation in the control of the business is not substantially the same as the exercise of the powers of a general partner, he is liable only to persons who transact business with the limited partnership with actual knowledge of his participation in control.

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

- (1) being a contractor for or an agent or employee of the limited partnership or of a general partner;
- (2) consulting with and advising a general partner with respect to the business of the limited partnership;
- (3) acting as surety for the limited partnership;
- (4) approving or disapproving an amendment to the partnership agreement; or
- (5) voting on one or more of the following matters:
 - (i) the dissolution and winding up of the limited partnership;
 - (ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership other than in the ordinary course of its business;
 - (iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business;
 - (iv) a change in the nature of the business; or
 - (v) the removal of a general partner.

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

(d) A limited partner who knowingly permits his name to be used in the name of the limited partnership, except under circumstances permitted by Section 102(2)(i), is liable to creditors who extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner.

exercised.⁹³ It also provides certain "safe harbor" activities in which the limited partner may engage without fear of incurring unlimited liability, such as allowing limited partners the right to vote on specified matters related to the affairs of the partnership.⁹⁴ Section 303 additionally modifies the liability of a limited partner in a situation in which his name appears in the name of the limited partnership by requiring that the limited partner must have knowingly permitted such a use of his name.⁹⁵

A. *Liability Under Section 303(a)*

Section 303(a) begins with essentially the same language as was used in section 7 of the ULPA.⁹⁶ Under this subsection, however, a limited partner may incur unlimited liability in two ways: first, when his participation in control of the partnership is substantially the same as that of a general partner, and second, when his participation in the control of the partnership is not substantially the same as that of a general partner,⁹⁷ but the party dealing with the business has actual knowledge of such participation.⁹⁸ If a limited partner's participation in the control of the corporation is substantially the same as that of a general partner, liability may be fixed regardless of whether the third party relied on or knew of the participation.⁹⁹ This approach should resemble in its operation the power test; a challenge under this part of section 303(a) will involve an examination on

93. The revised Act also makes other additions and changes in the prior uniform law. Without attempting to provide an exhaustive list, some of the modifications are as follows: (1) article 9 provides for the regulation and registration of foreign limited partnerships; (2) article 10 gives a limited partner the right to bring a derivative action on behalf of the limited partnership; (3) sections 101 and 501 provide that a limited partner's contribution may take the form of services; (4) section 103 permits the right by registration to an exclusive use of a limited partnership name; and (5) section 503 stipulates that profits and losses will be allocated among the partners on the basis of the value of their contributions as stated in the limited partnership certificate, unless otherwise provided in the partnership agreement. Section 504 is a similar provision relating to the distribution of partnership cash or other assets. See Gregory, *The Financial Provisions of the Revised Uniform Limited Partnership Act: Articles 5 and 6, Symposium: Limited Partnership Act*, 9 ST. MARY'S L.J. 479 (1978); Reuschlein, *Limited Partnership Derivative Suits, Symposium: Limited Partnership Act*, 9 ST. MARY'S L.J. 443 (1978); Sell, *An Examination of Articles 3, 4 and 9 of the Revised Uniform Limited Partnership Act, Symposium: Limited Partnership Act*, 9 ST. MARY'S L.J. 459 (1978).

94. In allowing voting privileges, the revised Act is following the example of several states that already provide for them. See note 90 *supra*.

95. RULPA § 303(d); see note 36 *supra* and accompanying text.

96. Section 7 was incorporated by the drafters in order to guarantee that court decisions made under the earlier act remain applicable to the extent not expressly modified by the new version. RULPA § 303, Commissioners' Comment.

97. The approach selected by the drafters based on whether a limited partner's participation is "substantially the same as" or "not substantially the same as" is entirely different from any used by the small groups of states that have already modified § 7 of the ULPA. See note 90 *supra*.

98. RULPA § 303(a).

99. The Commissioners' Comment on this section states in part:

Because of the difficulty of determining when the 'control' line has been overstepped, it was thought it unfair to impose general partner's liability on a limited partner except to the extent that a third party had knowledge of his participation in control of the business. On the other hand, in order to avoid permitting a limited partner to exercise all of the powers of a general partner

the part of the court of the various powers and activities of the limited partner to determine whether his participation is substantially the same as that of a general partner.¹⁰⁰ On the other hand, a limited partner may incur liability beyond his contribution, even though his acts of control are not substantially the same as that of a general partner, if some control is exercised and a third party who transacts business with the limited partnership has actual knowledge of that participation in control.

Extent of Liability. Under section 7 of the ULPA, once "control" is found to have been exercised by the limited partner, it is necessary to determine the extent of the limited partner's liability. The initial issue is, since the limited partner becomes liable "as a general partner," is he liable for all past, present, and future obligations of the partnership, for those partnership obligations that arose during the time of control and all obligations arising thereafter, or only for those obligations that arose during the time that the limited partner exercised control.¹⁰¹ The second issue is, under a reliance approach, if the limited partner becomes liable as a general partner, is he so liable only to those creditors that relied on his participation or is the reliance of one creditor sufficient to impose general liability as to all creditors. Of these two issues, only the latter is clearly resolved by section 303.

Section 303 does not delineate the time span for which the limited partner who has violated the section is liable. Although there is similar uncertainty under section 7 of the ULPA, one commentator suggests that liability under that section be determined according to the Uniform Partnership Act.¹⁰² This is also the logical approach under section 303. If the limited partner's participation is substantially the same as that of a general partner, then presumably the limited partner is liable as a general partner would be pursuant to the liability provisions of the Uniform Partnership

while avoiding any direct dealings with third parties, the 'is not substantially the same as' test was introduced.

Id. While the wording of this part of the Commissioners' Comment is confusing, its apparent thrust is that by introducing the "not substantially the same as" test, a section has been added that requires knowledge as a prerequisite to liability; in all other situations, by direct inference, no knowledge is required to impose liability. Thus, it is not necessary to prove that the creditor was aware of the limited partner's participation when that participation is substantially the same as that of a general partner.

The Commissioners' Comment also indicates that the first sentence of § 303(a) "carries over the basic test [of] former Section 7 . . . in order to insure that judicial decisions under the prior uniform law remain applicable to the extent not expressly changed." *Id.* (emphasis added). It can be persuasively argued that the language of § 303(a), particularly that pertaining to "actual knowledge" in a "not substantially the same as" situation, "expressly" makes inapplicable the case law establishing reliance as the determinative element of § 7 of the ULPA.

Because a limited partner is held personally liable under the "substantially the same as" test regardless of whether the creditor relies or has knowledge of his participation, there exists a windfall element. This criticism, however, assumes that the purpose of § 303(a) is the protection of third party creditors.

100. For a discussion of the power test, see notes 45-56 *supra* and accompanying text.

101. Feldman, *supra* note 40, at 174-75.

102. *Id.* at 175.

Act. Thus, if a limited partner was in control from the inception of the partnership, he would be jointly and severally liable for all partnership obligations. Assuming the limited partner began participating at some point after the partnership began, he would be liable only to the extent of his contribution for prior partnership obligations, and would incur unlimited liability for debts incurred thereafter. Similarly, in the case of a limited partner who exercises some control, but not substantially the same as that of a general partner, the limitation of liability to those who transact business with the limited partnership with actual knowledge of the participation presumably excludes liability for obligations incurred prior to the participation. Thus, the limited partner would only incur personal liability to those persons with knowledge for obligations arising during the time of participation and thereafter.

Another potential problem unaddressed by section 303 is whether the limited partner's relinquishment of control would have any effect on the extent of his liability. For example, in the case of a limited partner whose participation in control is substantially that of a general partner, would relinquishing that control avoid unlimited liability for partnership obligations incurred thereafter? Likewise, in the situation where a limited partner participates in control, but not substantially the same as a general partner, could the limited partner avoid further liability by giving actual notice that he has relinquished participation in control to those creditors with knowledge of his past participation? Both approaches are consistent with the underlying policy bases and have been suggested in commentary on section 7 of the ULPA¹⁰³ and section 303 of the RULPA.¹⁰⁴

There is a potential interpretational problem under section 7 of the ULPA in those jurisdictions applying the reliance test. Section 7 provides that when a limited partner is found to be participating in the "control" of the business, he is liable "as a general partner." This could be interpreted as meaning that if one creditor relies on the participation of the limited partner, that partner becomes personally liable not only to the relying creditors, but to all partnership creditors. Such an interpretation is clearly extreme if the policy basis underlying the reliance test is the protection of the reasonable expectations of creditors.¹⁰⁵ Furthermore, if this is truly a problem under the ULPA, the case law does not reflect it. Nonetheless, section 303 resolves any doubts in this regard by providing that the limited partner's personal liability extends only to those persons with actual knowledge of his participation.

Definition of Control. As for when a limited partner's participation in control is substantially the same as that of a general partner, the implication is that the limited partner must be exercising power over the day-to-day operations of the partnership; however, the use of the word "substantially"

103. *Id.* at 179.

104. Sell, *supra* note 93, at 464.

105. *Id.* at 463.

also implies that the powers of a limited partner do not have to be identical to those a general partner normally has. The clearest instance of when participation will not be substantially the same as that of a general partner would probably be when a limited partner engages only in an isolated act of control over the partnership. Apart from situations in which a limited partner's control is either absolute or an isolated, single event, it is difficult to know how his participation will be categorized. Neither the revised Act nor the Commissioners' Comment to section 303(a) provide any guidance as to when a limited partner's participation crosses over the line from not substantially the same to substantially the same as that of a general partner. The distinction is an important one as it is determinative of whether the element of knowledge of the participation in control by a third party need be present, and consequently the extent of limited partner liability.

The Knowledge Test. As previously noted, in a situation where some control has been exercised by the limited partner, yet it is not substantially the same as that of a general partner, it must be shown that the third party has actual knowledge of the limited partner's participation in control before unlimited liability can be imposed. The revised Act does not state whether this information must be learned first hand by the third party or if the knowledge requirement is satisfied simply by hearsay. The use of the word actual would seem to imply, however, that a party transacting business with the partnership must learn of the participation directly himself.¹⁰⁶

A more troublesome question in this context is whether in addition to knowledge, the element of reliance on the part of the third party is necessary. A strong argument can be advanced that the revised Act does not require reliance. First, no specific mention of reliance is made in either the statutory language or in the Commissioners' Comment to section 303. Requiring that a third party have knowledge of a limited partner's participation in control does not necessarily mean that the person must also rely on that participation. Second, in light of the considerable confusion in recent years over whether reliance is essential in order to impose general partner liability, it would seem logical that had the drafters intended that reliance be present, they would have clearly and unequivocally so stated. Finally, an examination of the various drafts that this subsection went through before completion indicates that reliance is not intended as a prerequisite to imposition of unlimited liability. As originally drafted, the standard adopted to replace section 7 was entirely based on reliance.¹⁰⁷ It was sub-

106. This interpretation is supported by language in the Commissioners' Prefatory Note to the revised Act in which it is stated: "Moreover, [§ 303] goes on to confine the liability of a limited partner who merely steps over the line of participation in control to persons who actually know of that participation in control."

107. ULPA § 7 (Tent. Draft No. 1, 1974) provided:

A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business, and then only to persons who transact business with the limited partnership reasonably believing that the limited partner is a general partner.

sequently dropped, however, and did not reappear in any of the later versions.¹⁰⁸ The confusion on whether reliance is required is attributable to language contained in the Commissioners' Prefatory Note to the revised Act. The note states that with the exception of a situation where a limited partner's participation in control is substantially the same as a general partner, "the provisions of the new Act that impose liability on a limited partner who has somehow permitted third parties to be misled to their detriment as to the limited partner's true status confine that liability to those who have actually been misled."¹⁰⁹ Requiring that parties "be misled to their detriment" seems far different from requiring that those parties have only actual knowledge of a limited partner's control. Rather, use of language such as "misled to their detriment" and "actually . . . misled" suggests that reliance is a necessary factor.¹¹⁰

B. *Safe Harbor Provisions*

Unlike section 7 of the ULPA, section 303(b) lists certain activities that a limited partner may engage in without being deemed to have participated in the control of the business.¹¹¹ Such activities include allowing him to serve as a contractor for or an agent or employee of the limited partnership or the general partner.¹¹² A limited partner may also consult with and give advice to the general partner,¹¹³ as well as function as a surety for the partnership.¹¹⁴ In addition, he may approve or disapprove of any amendments to the partnership agreement¹¹⁵ and vote on matters affecting the business as specified in the revised Act.¹¹⁶ These voting rights for limited partners, however, are not mandatory; rather, section 302 makes it clear that the grant of such power is within the discretion of the partnership.¹¹⁷ More importantly, if voting rights are granted, they cannot exceed those

108. Note that the significance of this particular point is suspect. The various drafts of the revised Act contain a general disclaimer that any language in the drafts is not to be used to construe the legislative meaning of the final version adopted.

109. RULPA, Commissioners' Prefatory Note.

110. If reliance is required, the end result is that the drafters have in effect combined the control test and the reliance test for purposes of determining liability under section 303(a). As discussed, the determination of whether a limited partner's activities in control are substantially the same as that of a general partner's will probably involve much the same kind of analysis as that used under the power test, *i.e.*, an examination of the powers and activities of the limited partner. See notes 96-100 *supra* and accompanying text. If the limited partner's participation in control is not substantially the same, the focus will then turn to whether the activity was such as to mislead the third party with regard to the limited partner's liability for partnership obligations.

111. RULPA § 303. The Commissioners' Comment to § 303 states: "Paragraph (b) is intended to provide a 'safe harbor' by enumerating certain activities which a limited partner may carry on for the partnership without being deemed to have taken part in control of the business."

112. *Id.* § 303(b)(1).

113. *Id.* § 303(b)(2).

114. *Id.* § 303(b)(3).

115. *Id.* § 303(b)(4).

116. *Id.* § 303(b)(5).

117. RULPA § 302 provides: "Subject to section 303, the partnership agreement may grant to all or a specified group of the limited partners the right to vote (on a per capita or any other basis) upon any matter."

specified in the safe harbor provisions of section 303(b)(5).¹¹⁸ If they do, the Commissioners' Comment to section 302 warns that "a court may hold that . . . the limited partners have participated in 'control of the business' within the meaning of Section 303(a)."¹¹⁹

The list of safe harbor activities set forth in section 303(b) is not intended to be an exhaustive one. Section 303(c) provides that the possession or exercise of any powers outside of those enumerated in subsection (b) by a limited partner is not necessarily participation in the control of the business.¹²⁰ Thus, subsection (c) in effect permits the limited partner even greater latitude in performing partnership related activities.

It should be observed that even with the inclusion of the safe harbor provisions in section 303(b), uncertainty about permissible levels of control will still remain. An example will illustrate. Assume that under the terms of a partnership agreement, approval of a limited partner is needed before any purchases by the partnership above a specific dollar amount can be made, and in accordance with this procedure such approval has been given. The question arises as to whether the limited partner's participation is sufficient to subject him to unlimited liability for partnership obligations. Clearly the activity is not one included in the safe harbor list; moreover, it appears to be of a type that could be classified as participation in the control of the business pursuant to section 303(a), resulting in the possibility of unlimited liability. This power, however, is somewhat analogous to certain powers permitted under the safe harbor provisions. Unlimited liability could therefore be avoided if it is demonstrated that the activity is exempted by section 303(c). Thus, for many activities which are outside of the safe harbor provisions, legal disputes seem likely in order to determine whether the activities fall within either sections 303(a) or 303(c).

Although section 303(b) sets out certain activities in which a limited partner can participate, it does not specify the extent of control over the business that a limited partner may possess while engaged in any of the activities. This is particularly relevant with regard to the limited partner serving as an employee of the partnership or offering advice to the general partner, since both activities could offer an opportunity for a limited partner to exert considerable influence over partnership affairs. Along these lines, two questions likely to confront an attorney dealing with this part of the revised Act are: (1) Can a general partner hire a limited partner as an employee and turn over to him the complete control of the business? (2) Can a limited partner consult with or advise a general partner on a daily basis as to the ongoing operations of the partnership? In answering

118. This approach varies from the approach of those states with statutes already providing for voting rights. In four of the states, Nevada, California, Oregon, and Washington, the statutes provide that limited partners may vote on "matters affecting the basic structure of the partnership, including the following matters or others of similar nature." See note 90 *supra*. Delaware has the only statute granting voting rights that does not contain such language. Neither does it have language that expressly limits the voting rights to those specified in the statute.

119. RULPA § 302, Commissioners' Comment.

120. *Id.* § 303(c).

these questions a reading of section 303 and applicable case law indicates that there are boundaries to the degree in which a limited partner may be involved in the safe harbor activities.

Section 303(a) suggests that a limited partner cannot participate to the extent that he is exercising, much like that of a general partner, day-to-day control of the partnership. One of the apparent aims of section 303(a) is to prevent a limited partner from being involved in the control of the business to the same extent as a general partner.¹²¹ If the revised Act is to be construed as a whole, therefore, it is reasonable to assume that a limited partner, in performing the permitted safe harbor activities, should also be similarly restricted. To allow a partnership, for example, to hire a limited partner for the purpose of running the business would be entirely inconsistent with subsection (a).

In addition, granting a limited partner a great deal of control over the day-to-day operations of the partnership would be out of line with the remainder of the subsection (b) activities, particularly the voting privileges. For instance, section 303(b)(5)(ii) provides that while a limited partner can vote on whether an asset should be sold or whether future indebtedness can be incurred, he may only do so *other than* in the ordinary course of business. This implies that such decisions are generally to be left to the discretion of the general partners. Thus, an interpretation of this statute that would allow a partnership to hire one of its limited partners and permit him to make decisions on which he could not even vote under section 303(b) would be at odds with the general intent of the provisions. The same could also be said for permitting the limited partner to give advice on such questions.

Judicial decisions under section 7 of the ULPA, which remain applicable under the RULPA,¹²² are also relevant to determining whether a general partner can turn over the complete control of the business to a limited partner employee and whether a limited partner can consult or advise a general partner on a day-to-day basis as to the ongoing operations of the partnership. In *Gast v. Petsinger*¹²³ the court held that the key in determining liability of a limited partner employee is the degree of control exercised in the day-to-day functions of the business.¹²⁴ If too great a degree of control is found, the limited partner is liable as a general partner. Such an approach is also apparent in other cases in which the question has been presented. In *Grainger v. Antoyan*¹²⁵ it was alleged that the limited partner's position as a sales manager of the auto dealer partnership rendered

121. See note 99 *supra* and accompanying text.

122. See note 96 *supra* and accompanying text.

123. 228 Pa. Super. Ct. 394, 323 A.2d 371 (1974). In *Gast* a former project engineer of the limited partnership sued for back pay and expenses. The plaintiff claimed that certain limited partners were in fact general partners on the basis of their participation in the firm. Two of the limited partners had been employed by the partnership as independent engineering consultants on certain projects. 323 A.2d at 374.

124. *Id.* at 375.

125. 48 Cal. 2d 805, 313 P.2d 848 (1957).

him personally liable.¹²⁶ The court ruled for the limited partner, however, because the evidence established that he had little say in the actual ongoing operations of the business.¹²⁷ The implication is that had more control over the normal operations been exercised, he may have been found financially accountable. In *Silvola v. Rowlett*¹²⁸ the limited partner served as a foreman in an auto repair shop and had on several occasions purchased necessary parts and extended credit to people he knew. Unlimited liability was not imposed, however, as the management of the business was found to be still vested in the general partner.¹²⁹

The right of a limited partner to advise and consult seems similarly limited. In *Silvola* the advice sought by the general partner and given by the limited partner pertained only to certain major transactions.¹³⁰ In both *Weil v. Diversified Properties*¹³¹ and *Trans-Am Builders, Inc. v. Woods Mill, Ltd.*¹³² the limited partnerships involved were facing severe financial difficulties; thus, the advice and consultation permitted by the courts occurred in the context of an event out of the ordinary course of business.¹³³ None of these cases should therefore be read as permitting a limited partner to advise and consult with a general partner to a degree in which he has an active voice in the normal operations of the business.

As a final consideration, section 303(b) should not be read as granting exemption from liability to any limited partner who intentionally engages in any fraudulent conduct while performing a safe harbor activity. Neither section 303 nor the accompanying Commissioners' Comment expressly address this point. The Commissioners' Comment to section 208¹³⁴

126. The limited partner had the authority to sell cars and had other salesmen working under him. In addition, he was allowed to and did on several occasions co-sign checks. He did not, however, have any authority as to (1) hiring or discharging personnel, (2) purchasing new cars, (3) determining the selling price of cars and the trade-in allowances for customers buying new cars, and (4) evaluating the credit worthiness of prospective customers. 313 P.2d at 850.

127. *Id.* at 853.

128. 129 Colo. 522, 272 P.2d 287 (1954), noted in 27 ROCKY MT. L. REV. 98 (1954).

129. 272 P.2d at 289.

130. *Id.* at 289-90.

131. 319 F. Supp. 778 (D.D.C. 1976). In *Weil* a general partner was seeking an action to have the court declare the limited partners as general partners and for an appointment of a receiver and an accounting. The partnership had been in severe financial straits. The limited partners during this period had conferred amongst each other and with two individuals who had taken over from the general partner the ongoing operations of the business. *Id.* at 779-81.

132. 133 Ga. App. 411, 210 S.E.2d 866 (1974). The limited partnership was involved in the construction of an apartment complex. Due to financial problems that arose during the construction period, some of the limited partners consulted with the general partner. At least one visited the construction site and complained about the way the work was being done. 210 S.E.2d at 867.

133. As was stated by the court in *Trans-Am Builders, Inc.*: "It would be unreasonable to hold that a limited partner may not advise with the general partner and visit the partnership business, particularly when the project is confronted with a severe financial crisis." 210 S.E.2d at 869.

134. Section 208 provides: "The fact that a certificate of limited partnership is on file in the office of the Secretary of State is notice that the partnership is a limited partnership and the persons designated therein as limited partners are limited partners, but is not notice of any other fact."

of the revised Act, however, appears to have some bearing on this matter, although somewhat indirectly. It provides that while a limited partnership certificate is constructive notice to third parties of the status of the designated individuals, it is not intended to change any liability of a limited partner created by his action or inaction under estoppel, agency, or fraud. An example of this would be where a limited partner, in serving as an agent of the partnership, intentionally causes the party he was transacting business with reasonably to believe that the limited partner was in fact a general partner with unlimited liability for partnership obligations. While under section 303 the limited partner would be performing one of the safe harbor activities, the Commissioners' Comment on section 208 indicates that the limited partner would be held to have liability as a general partner.

C. *Evaluation and Alternative Proposals*

Section 303 of the revised Act does have certain desirable features. The inclusion of the safe harbor activities will allow attorneys to function with more certainty in setting up and advising limited partnerships.¹³⁵ In addition, by expressly granting limited partners the right to vote on certain major matters, the new section assures the limited partners of not only some input into the operations of the business, but also a better capacity to maintain control over their investment. Section 303 also is an improvement insofar as it specifies that a limited partner's liability under the "not substantially the same as" test is limited to those creditors with knowledge of his participation; however, many other questions concerning the extent of a limited partner's liability once that partner is ruled to have liability beyond his contribution are left unresolved.¹³⁶

A major deficiency of section 303 is its considerable indefiniteness. One such problem area is the question whether in a situation where a limited partner exercises control, but not substantially the same as a general partner, a third party creditor seeking to impose unlimited liability on the limited partner must demonstrate reliance.¹³⁷ The literal language of section 303(a) suggests that reliance is not required; rather, the section speaks specifically in terms of actual knowledge of the limited partner's actions. Certain remarks in the Commissioners' Prefatory Note pertaining to whether the third party has been misled to his detriment, however, indicate that reliance is a necessary element to be demonstrated before unlimited liability will be imposed. Another potential problem area is the difficulty of ascertaining what conduct outside of the safe harbor provisions will subject a limited partner to liability beyond his contribution. As evidenced by

135. An attorney would still be faced with problems in advising a partnership under the revised Act, particularly where a limited partner is an employee of or is giving advice to the partnership. As noted, a limited partner may be restricted in the extent to which he may participate while performing a safe harbor activity. See notes 121-33 *supra* and accompanying text.

136. See notes 101-05 *supra* and accompanying text.

137. See notes 107-10 *supra* and accompanying text.

the hypothetical stated earlier, imposition of general partner liability for partnership obligations may depend on whether a particular act or acts of a limited partner fall within the terms of section 303(a) or section 303(c). Finally, even if a limited partner's acts should be construed under section 303(a), the interpretational problem of whether the activity constitutes conduct substantially the same or not substantially the same as that of a general partner must be resolved. The revised Act provides no guidance as to what these phrases mean. Moreover, both phrases seem ultimately as ambiguous as control was under section 7 of the prior Act. As many of these questions will have to be resolved by litigation, there may be a substantial delay before the case law can develop to provide a more definite standard. Thus, the law in this area could continue to remain in doubt, creating the possibility that decisions under this section will be inconclusive and contradictory, giving rise to problems of the type that have made section 7 so troublesome.

Section 303 also can be criticized as unfairly providing a "windfall" to creditors of the business. When the limited partner's participation in control is substantially the same as a general partner's, unlimited liability can be imposed regardless of whether the third party even knew of the limited partner's existence at the time he transacted business with the partnership.¹³⁸ The possibility for a windfall may also exist in a situation where the limited partner's control over partnership affairs is not like that of a general partner. If in fact reliance on the part of a third party is not required to impose on a limited partner unlimited liability, a third party need only show that he had knowledge of the limited partner's activity. Thus, with this type of standard, the fact that the third party had or had not been misled would be irrelevant. For example, in the hypothetical stated earlier if a creditor knew the limited partner and was aware of his limited liability status, yet was also aware that all purchases of the partnership above a certain dollar limit had to have the assent of the limited partner, under section 303(a) the limited partner could still be held to personal liability for the debt owed the creditor. This would hold true despite the fact that the limited partner's exercise of some measure of control in no way confused the creditor as to the limited partner's status. Allowing such a recovery when a third party is not even misled with regard to the liability status of the limited partner appears to impose a rather harsh penalty, which may in fact discourage use of the limited partnership by investors.¹³⁹

The question also arises as to whether the safe harbor provisions really would provide a limited partner with any greater degree of security as to his participation in the business.¹⁴⁰ If the interpretation in this Comment

138. RULPA § 303(a). Note that this criticism is the same as that leveled at the power test. See note 56 *supra*.

139. The validity of this criticism of § 303(a) is grounded on the idea that the purpose of § 303(a) is to protect third party creditors. If this in fact is the policy aim of § 303(a), then as drafted, creditors can potentially reap a windfall.

140. See notes 121-33 *supra* and accompanying text.

of those activities is correct, there exist limits to the extent to which a limited partner can exercise control over the partnership even while engaged in any of the exempt activities. Thus, the limited partner must be constantly concerned with overstepping the line into impermissible participation.

As a final consideration, section 303, although an improvement, does not deal adequately with the extent of a limited partner's liability once he is found to have unlimited liability. As stated earlier, when a limited partner is found to have participated in control, but not to the extent of exercising control like that of a general partner, he has unlimited liability only to a party with knowledge of his participation. Thus, if the limited partnership had an obligation with a party who at the time of entering into the obligation had knowledge of a limited partner's control, presumably the limited partner could have liability beyond his contribution on that obligation to the party. Section 303, however, does not address the question whether this unlimited liability extends to any prior and future obligations owed to the party with knowledge. In addition, a similar criticism can be offered with regard to when a limited partner has control like that of a general partner over the affairs of the partnership. In this situation the limited partner, if he began to exercise such control sometime after the inception of the limited partnership, would have liability for all prior partnership debts up to the amount of his capital contribution, plus would have unlimited liability for all subsequent obligations. Suppose that a limited partner after assuming control of this type for a short while relinquishes the control. Does he still retain personal liability on those debts incurred while in control? Moreover, does he continue to remain personally liable on partnership obligations incurred after he relinquished control and returned to limited partner status? Answers to these questions are hard to discern from an examination of section 303. Clearly a more tightly drawn provision that addresses the above mentioned points is desirable.

In summary, analysis suggests that section 303 of the Revised Uniform Limited Partnership Act, instead of being an improvement over section 7, could turn out to be as deficient. Although the inclusion of the safe harbor provisions would allow a greater degree of certainty as to the type of activities that can be performed by a limited partner, a substantial amount of uncertainty would still exist as to the types of activities outside of the safe harbor that would subject a limited partner to unlimited liability. In addition, due to the vagueness of the "substantially the same as" language, the limited partner could never be sure when he had personal liability on all partnership obligations, except in a situation in which he is in total control of the day-to-day functions of the partnership. Moreover, assuming that reliance is not required in a "not substantially the same as" situation, the liability standard promulgated under section 303(a) will lead to the same result as was reached in *Delaney*. That is, unlimited liability will be incurred by a limited partner regardless of whether or not the third party involved was misled to his detriment on the limited partner's participation

in control. As in *Delaney*, such an outcome seems unfair to the limited partner and clearly inimical to the use of the limited partnership form as a practical business entity.

One alternative to the approach suggested in the RULPA would be to drop all restrictions on the amount of participation in control by the limited partner. Although allowing both limited liability and control appears inconsistent with what was felt appropriate some sixty years ago when the original Act was drafted,¹⁴¹ it would not seem contrary to public policy today. This is evidenced by the present use of closed corporations, which offer an investor an opportunity to engage in the exercise of the management of a corporate entity while at the same time enjoying limited liability.¹⁴² Additional evidence of this is the increasing use of nonrecourse financing, where liability is similarly limited. Nor would the rights of third parties transacting business with the partnership be necessarily imperiled by such a move. Many creditors have become aware of the use of limited partnerships and of their nature. As added protection, limited partnerships could be required to identify themselves as such by their names and in dealings with other parties.¹⁴³ One commentator has expressed the belief that this would be "the most effective way of communicating its status to third persons trading with it."¹⁴⁴ If a limited partner did anything to intentionally mislead a creditor into believing that he had general partner liability, however, such liability could still be imposed.¹⁴⁵

Another alternative, not quite such a substantial break with tradition, is to delete the language in section 303(a) pertaining to "actual knowledge" and substitute a reliance factor in its place.¹⁴⁶ In so doing, when a limited partner has not participated in the control of the business to the same degree as a general partner, and yet has performed some act of control that is

141. See notes 23 & 39 *supra* and accompanying text.

142. A close corporation is one whose voting shares are generally held by a single shareholder or a small group of shareholders. It differs from a publicly held corporation in several respects. First, there is no public issue of, or active trading in, the voting shares of a closed corporation. In addition, corporate procedures are often less formalized. Finally, the shareholders of a closed corporation are often active in the management of the business. This is unlike the publicly held corporation where there exists a separation of ownership and control, caused by a delegation of power by the stockholders to a board of directors. See H. HENN, *supra* note 7, § 257.

Both close corporation shareholders and limited partners are similar in that they enjoy the corporate characteristics of limited liability. They are different in the respect that close corporation shareholders also enjoy the right to participate actively in the control and management of their business.

143. At present, Florida is the only state that has such a requirement. See FLA. STAT. ANN. § 620.05(1) (West 1977).

144. A. BROMBERG, *supra* note 1, § 26(b), at 145.

145. *Id.* § 26(c).

146. With a reliance requirement, § 303(a) would read essentially as follows:

Except as provided in subsection (d), a limited partner is not liable for the obligations of a limited partnership unless he is also a general partner or, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business. However, if the limited partner's participation in the control of the business is not substantially the same as the exercise of the powers of a general partner, he is liable only to persons who reasonably believe that he is a general partner as a result of his participation in control.

not included within the safe harbor provisions, the focus of any litigation would center on whether a third party creditor had reasonably relied on the limited partner's participation. The main advantage to adding a reliance requirement is that it would partially eliminate the windfall element that is inherent in the revised Act's standard.¹⁴⁷ In addition, such a requirement would still help to clarify the extent of liability question, insofar as the limited partner would have personal liability only to a party who had relied to his detriment upon the acts in control.

A variation on the above alternative is to eliminate completely the "substantially the same as" language and simply combine a reliance test with the safe harbor provisions.¹⁴⁸ The merit of this standard is that it would avoid the confusion that could arise under the present section 303(a) as to whether a limited partner's participation is or is not substantially the same as that of a general partner; rather, attention would be directed to the question whether the limited partner's activities outside of the safe harbor were sufficient to cause reasonable reliance.¹⁴⁹ Moreover, such an approach would eradicate totally the possibility for any windfall by a third party creditor.¹⁵⁰ The standard would allow a limited partner to exercise control like a general partner over the partnership as long as there is no reliance as a consequence. The propriety of this result depends on whether it is felt that the enjoyment of such control in conjunction with limited liability is an inappropriate combination.¹⁵¹

147. A certain degree of windfall, however, would still be present insofar as when the limited partner's participation is substantially the same as that of a general partner he may be found to have unlimited liability for partnership obligations regardless of whether a third party relied on or even had knowledge of the participation. See note 99 *supra*.

148. Such a standard would read essentially as follows:

Except as provided in subsection (d), a limited partner is not liable for the obligations of a limited partnership unless he is also a general partner or, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business. However, if a limited partner takes part in the control of the business, he will have unlimited liability only to those persons who transact business with the limited partnership reasonably believing that he is a general partner as a result of his participation in control.

149. To reduce even further any confusion over a limited partner's participation, consideration should also be given to dropping § 303(c). As observed, whether under § 303 a limited partner may be liable as a general partner when he performs an act outside of the safe harbor list depends on if the activity is found to fall under § 303(a) or § 303(c). By eliminating subsection (c), while at the same time inserting the language pertaining to reliance, the focus would be entirely on whether the limited partner's action outside the safe harbor caused a third party to be misled to his detriment as to the true liability status of the limited partner.

150. See notes 99 & 147 *supra*.

151. The State Bar of Texas has recently proposed legislation along these lines to the 66th session of the Texas Legislature. The proposal would amend § 8 of the Texas Uniform Limited Partnership Act to provide that a limited partner will incur general partner liability only to persons who transact business believing that the limited partner is a general partner. The aim of the amendment is to eliminate by statute the strict construction given § 8 in *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543 (Tex. 1975). For a discussion of *Delaney*, see notes 73-83 *supra* and accompanying text. In addition, the state bar is proposing the inclusion of a nonexclusive list of safe harbor activities in which a limited partner may engage without being deemed to have participated in control. The list of activities is essentially the same as that included under the revised Act. Unlike the revised Act, however, the state bar's proposal also provides that a limited partner may serve as an officer or director of a corporate general partner; this too can be viewed as a reaction to the holding in *Delaney*. Cole-

III. CONCLUSION

The need to define the limited partner's role in the partnership business more accurately is obviously a necessity. As it now stands, section 7 of the ULPA and the judicial decisions construing it provide an inconclusive guide as to the extent to which a limited partner may participate. Although section 303 of the revised Act has certain desirable features, it fails to rectify the situation completely. Its enactment will only lead to continued uncertainty in this area and protracted litigation. Consideration should be given to its modification.

man, *Proposed Amendments Texas Uniform Limited Partnership Act*, 42 TEX. B.J. 14, 14-15 (1979); see note 79 *supra*.