

11-1993

# The Revised Uniform Partnership Act: The Reporters' Overview

Donald J. Weidner

*Florida State University College of Law*

John W. Larson

Follow this and additional works at: <http://ir.law.fsu.edu/articles>



Part of the [Business Organizations Law Commons](#)

---

## Recommended Citation

Donald J. Weidner and John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 *BUS. LAW.* 1 (1993),  
Available at: <http://ir.law.fsu.edu/articles/143>

This Article is brought to you for free and open access by Scholarship Repository. It has been accepted for inclusion in Scholarly Publications by an authorized administrator of Scholarship Repository. For more information, please contact [bkaplan@law.fsu.edu](mailto:bkaplan@law.fsu.edu).

# HEINONLINE

Citation: 49 Bus. Law. 1 1993-1994



Content downloaded/printed from  
HeinOnline (<http://heinonline.org>)  
Wed May 20 12:48:36 2015

- Your use of this HeinOnline PDF indicates your acceptance of HeinOnline's Terms and Conditions of the license agreement available at <http://heinonline.org/HOL/License>
- The search text of this PDF is generated from uncorrected OCR text.
- To obtain permission to use this article beyond the scope of your HeinOnline license, please use:

[https://www.copyright.com/cc/basicSearch.do?  
&operation=go&searchType=0  
&lastSearch=simple&all=on&titleOrStdNo=0007-6899](https://www.copyright.com/cc/basicSearch.do?&operation=go&searchType=0&lastSearch=simple&all=on&titleOrStdNo=0007-6899)

# The Revised Uniform Partnership Act: The Reporters' Overview

By Donald J. Weidner and John W. Larson\*

## INTRODUCTION

This Article is a brief overview of what the Reporters believe to be the four basic contributions of the Revised Uniform Partnership Act (RUPA or Act).<sup>1</sup> First, RUPA changes the law of partnership breakups and gives greater stability to partnerships by abandoning the traditional rule that a partnership is dissolved every time a member leaves. Second, RUPA makes clear that partners are not fiduciaries among themselves in the same sense as disinterested trustees. Specifically, RUPA states that partners legitimately may pursue self-interest without automatically running afoul of their fiduciary duties. On the other hand, RUPA provides an irreducible core of fiduciary duties among partners. Third, RUPA rewrites the rules on the nature and transfer of partnership property. It adopts an entity approach for the sake of simplicity and provides for the filing of partnership statements, including statements of partnership authority, dissociation, and dissolution. Fourth, RUPA for the first time expressly au-

\*Donald J. Weidner is Dean and a Professor and John W. Larson is an Associate Professor at the Florida State University College of Law. Dean Weidner and Professor Larson are the Reporters for the Revised Uniform Partnership Act. The authors wish to express their appreciation to Allan Donn and Edward "Doc" Merrill for their helpful comments on a draft of this Article. The views expressed are their own, however, and do not necessarily represent the views of the National Conference of Commissioners on Uniform State Laws. A copy of the Act may be obtained from: National Conference of Commissioners on Uniform State Laws, 676 North St. Claire St., Chicago, IL 60611, (312) 915-0195.

1. The Revised Unif. Partnership Act (1993) [hereinafter RUPA] was adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL or Conference) in August 1992. The RUPA Drafting Committee thereafter proposed a number of revisions, all of which were approved formally by the Conference at its annual meeting in August 1993. This Article is based on the Act, as amended, which is entitled Uniform Partnership Act (1993) by the Conference. Unless stated otherwise, all cites to RUPA are to the October 14, 1993 draft of the 1993 Act.

RUPA already has been adopted in two states. *See* Mont. S.B. 46 (to be codified at 1993 MONT. LAWS 238); 1993 Wyo. Sess. Laws 17-21. Texas also adopted a revised partnership act heavily influenced by an earlier draft of RUPA. *See* 1993 Tex. Sess. Laws Serv. 917 (Vernon).

thorizes the conversion and merger of partnerships and provides "safe-harbor" rules for those transactions.

### *DEFAULT AND MANDATORY RULES*

Across all substantive areas, RUPA reflects the policy judgment that, with rare exceptions, partners are permitted to govern relations among themselves by agreement. Almost all of RUPA's rules governing the relations among partners are merely default rules rather than mandatory rules.<sup>2</sup> That is, the statutory rules apply only in the absence of a partnership agreement to the contrary.<sup>3</sup> Under the present Uniform Partnership Act (UPA),<sup>4</sup> it is not clear which rules are merely default rules and which rules are mandatory rules.<sup>5</sup> Under RUPA, every rule governing the relations among partners is a default rule unless it is separately listed as a mandatory rule.<sup>6</sup>

RUPA reflects an attempt to craft default rules that are efficient and fair. The basic idea is that default rules should reflect what most partners would regard as implicit in their partnership agreements. A default rule that accurately reflects implicit agreements generally saves people the cost of drafting detailed agreements and also tends to avoid unexpected results.

2. See RUPA § 103.

3. Section 103(a) provides that the partnership agreement governs relations among the partners and between the partners and the partnership. To the extent the agreement does not provide otherwise, RUPA governs.

4. UNIF. PARTNERSHIP ACT (1914) [hereinafter UPA].

5. For example, UPA § 18 is clearly a default rule. It provides rules for determining the rights and duties of the partners, "subject to any agreement between them." It is unclear, on the other hand, whether the UPA § 20 duty to render information on demand is mandatory or may be varied by agreement of the partners. The incomplete and inconsistent provisions of the UPA were noted in the thoughtful report of an American Bar Association subcommittee appointed in 1986 to study partnerships. See UPA Revision Subcommittee on Partnerships and Unincorporated Business Organizations, *Should the Uniform Partnership Act Be Revised?*, 43 BUS. LAW. 121, 124 (1987) [hereinafter *ABA Report*].

6. See RUPA § 103. Section 103(b) lists eight mandatory rules that govern the relations among partners. It provides that the partnership agreement may not:

(1) vary the rights and duties of partners in connection with the requirements for filing statements under the Act;

(2) "unreasonably restrict" a partner or former partner's right of access to books and records;

(3) eliminate the duty of loyalty, although the partners may identify specific types or categories of activities that do not violate the duty, if not manifestly unreasonable;

(4) "unreasonably reduce" a partner's duty of care;

(5) eliminate the obligation of good faith and fair dealing, although the partners may determine standards by which the performance of the obligation is measured, if not manifestly unreasonable;

(6) vary the power of a partner to dissociate at any time from the partnership;

(7) vary the right of a court to expel of a partner in certain situations; or

(8) vary the requirement to wind up the business in certain situations.

But for these eight rules, partners are free to order their affairs as they see fit.

Unpopular default rules add unnecessary cost to the extent they put people to the expense of drafting around them. Stated differently, the short-form contract contained in RUPA is more useful because partners are not required to incur costs to modify it. RUPA attempts to avoid burdening partners who fail to incur the modification costs with rules to which they would not have agreed.

Section 103(a) states the general rule that RUPA “governs the relations among the partners and between the partners and the partnership,” but only “[t]o the extent the partnership agreement does not otherwise provide.”<sup>7</sup> Although stated somewhat indirectly, the basic principle is that the agreement of the partners is supreme—unless the rights of third parties are involved. Section 103(b)(9) states that the partnership agreement may not “restrict the rights of third parties.”<sup>8</sup>

### *THE ENTITY THEORY*

The Drafting Committee began its work with no ideological or theoretical mandate concerning whether a partnership should be viewed as an entity or as an aggregate. Instead, the Committee proceeded to answer a series of pragmatic questions that arise in the formation, capitalization, operation, and breakup of partnerships. Before the drafting was complete, it became clear that the entity approach was adopted in virtually every situation. That approach provides simpler rules and is consistent with RUPA’s attempt to give partnerships greater stability.<sup>9</sup> Accordingly, as the project drew to a close, RUPA was amended to include a statement that partnerships are entities.<sup>10</sup>

### *NEW RULES ON PARTNERSHIP BREAKUPS*

#### *CONFUSION CONCERNING DISSOLUTION UNDER THE UNIFORM PARTNERSHIP ACT (UPA)*

At the beginning of this century, the law of partnership breakups was couched in terms of dissolution and was quite confusing. Dean William Draper Lewis, the Reporter who saw the UPA to completion, thought that the concept of dissolution was perfectly logical but sadly misunderstood. According to Lewis, “The subject of the dissolution and winding up of a

7. *Id.* § 103(a).

8. *Id.* § 103(b)(9).

9. See MELVIN A. EISENBERG, AN INTRODUCTION TO AGENCY AND PARTNERSHIP 36 (1987) (“Generally speaking, the entity theory of a partnership is much more functional than the aggregate theory.”). The *ABA Report*, *supra* note 5, at 124, also noted the advantages of the entity theory. *But see* Gary S. Rosin, *The Entity-Aggregate Dispute: Conceptualism and Functionalism in Partnership Law*, 42 *ARK. L. REV.* 395 (1989).

10. RUPA § 201. Nebraska already defines partnerships as entities: “A partnership is an association of persons organized as a separate entity to carry on a business for profit.” *NEB. REV. STAT.* § 67-306(1) (1986).

partnership is involved in considerable confusion principally because of the various ways in which the word 'dissolution' is employed."<sup>11</sup> His solution to the confusion, which became part of the UPA, was to continue to use the term dissolution but define in the statute both what is and what is not dissolution. UPA section 29 states what dissolution is: "the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business."<sup>12</sup> UPA section 30 states what dissolution is not: "[o]n dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed."<sup>13</sup> All the UPA provisions on partnership breakups then are activated by, and only by, a dissolution.<sup>14</sup>

Seventy-five years later, the law of partnership breakups still is confused. Some cases found a dissolution and applied the strict logic of dissolution even though justice seemed to require otherwise.<sup>15</sup> Other cases struggled to reach a proper result by refusing to find a dissolution even though the statute seemed to require it.<sup>16</sup> More basically, there are cases that appear to reflect a complete misunderstanding of the concept of dissolution as it is used in the UPA.<sup>17</sup>

The UPA section 29 definition of dissolution embodies the concept that a partnership is a unique aggregation of individuals, a specific cast of characters.<sup>18</sup> The unique cast is "dissolved" whenever a partner leaves. Consider the simple example of a firm of four partners. Assume all the partners, including the departing partner, happily and harmoniously agree the departing partner will leave and the remaining partners will continue with the business. Assume they also agree that the withdrawing partner will neither be required to make any additional contributions nor be entitled to receive any additional distributions. Federal income tax law says that the partnership continues.<sup>19</sup> The UPA, on the other hand, states that

11. William Draper Lewis, *The Uniform Partnership Act*, 24 YALE L.J. 617, 626-27 (1915).

12. UPA § 29.

13. *Id.* § 30.

14. *See id.* §§ 33-38, 40-43.

15. *See, e.g.*, *Fairway Dev. Co. v. Title Ins. Co.*, 621 F. Supp. 120 (N.D. Ohio 1985).

16. *See, e.g.*, *Zeibak v. Nasser*, 82 P.2d 375, 383 (Cal. 1938), where the court stated that the death of a partner does not necessarily dissolve the partnership, especially if the partner who dies is a passive investor. The court's discussion is difficult to reconcile with UPA § 31(4), which states that dissolution is caused "[b]y the death of any partner."

17. *See, e.g.*, *Great Hawaiian Fin. Corp. v. Aiu*, 863 F.2d 617, 620 (9th Cir. 1988), where the court stated that the withdrawal of three managing partners "indicates that the original partnership including those partners was dissolved as to those partners," but did not necessarily indicate that the partnership was dissolved as to the remaining partners. *See also* *Cowan v. Maddin*, 786 S.W.2d 647 (Tenn. Ct. App. 1989); *Adams v. Jarvis*, 127 N.W.2d 400 (Wis. 1964). The UPA does not support the argument that the partnership is dissolved as to some partners but not as to others. *See* UPA § 30.

18. UPA § 29.

19. I.R.C. § 708 (1992).

the “old” partnership is dissolved and a “new” partnership is created, not withstanding the contrary intent of all of the partners.<sup>20</sup>

The UPA’s dissolution logic has led many to conclude that, whenever a partner leaves, the property of the old partnership should be conveyed to the new partnership.<sup>21</sup> It also has led to the conclusion that contracts of the old partnership lapse because the old partnership, the party to the contract, no longer exists, leaving only a new partnership that is a stranger to the bargain.<sup>22</sup> One widely-cited recent case held that a partnership could not recover on a title insurance policy after the departure of one of its members because the new partnership had no “standing” to assert the contract rights of the old partnership.<sup>23</sup>

The problem with the UPA’s use of the term *dissolution* is therefore much more fundamental than the absence of a clear definition of the concept. The UPA’s definition and use of the concept of dissolution is a bad idea because it reflects an aggregate concept of partnerships that fails to recognize the stability of many partnerships. The UPA unnecessarily destabilizes many partnerships, particularly those that have continuation agreements, and actually undercuts the attempts of partners to contract for stability. The UPA suggests that the partnership business is coming to a close when all that may be coming to a close is one partner’s participation. In short, the UPA does not distinguish adequately a departure that triggers a winding up of the business from a departure that is governed by a buyout or continuation agreement.

20. UPA § 29.

21. See, e.g., VA. CODE ANN. § 50-37.1 (Michie 1989), which supplements the UPA. It provides that if the partnership is dissolved but its business is continued “without liquidation of the partnership affairs, the title to any real estate or any interest therein vested in the dissolved or former partnership shall be deemed to be transferred to and vested in such new partnership as may be created by the remaining partners without further act or deed.” *Id.*

22. See *Frederick C. Smith Clinic v. Lastrapes*, 170 N.E.2d 497 (Ohio Ct. App. 1959), which held that the withdrawal of a partner terminated an employment agreement that provided it would automatically end on dissolution of the partnership. Even though the assets of the partnership were transferred to a successor partnership that continued the business, the successor partnership was not permitted to enforce a covenant not to compete against an employee who resigned almost two years after the dissolution. *Id.* at 502. Dissenting. Judge Younger asked rhetorically:

A contract is a two-way street. Would the defendant admit that if the partnership with which he had contracted would have found the contract onerous it could have relieved itself of the burden of paying him . . . by the simple process of adding or withdrawing one member of the partnership? Can the defendant—and he alone—take from the contract what he wants and leave what he doesn’t?

*Id.* at 503 (Younger, J., dissenting).

23. *Fairway Dev. Co. v. Title Ins. Co.*, 621 F. Supp. 120, 125 (N.D. Ohio 1985).

## *BREAKUPS UNDER RUPA PROCEED DOWN ONE OF TWO TRACKS*

The departure of a partner can result in a winding up of the partnership business or in a buyout of the departing partner. RUPA attempts to identify and clearly define these two tracks. It has three separate articles on partnership breakups that distinguish departures that cause a winding up of the business from those which cause only a buyout of the departing partner.<sup>24</sup> RUPA gives stability to partnerships that have contracted for stability by providing that, in a buyout situation, the partnership entity continues without dissolution.

Article 6 applies to all "dissociations," whether they result in a buyout or a winding up.<sup>25</sup> Section 601 lists all the events that cause a partner's dissociation, and the remaining rules in Article 6 apply to all dissociations. Finally, Article 6 provides that Article 7 applies if a partner's dissociation results in a buyout and that Article 8 applies if there is a dissolution and winding up of the business.<sup>26</sup>

Article 7 applies to all dissociations that result in the buyout of a partner.<sup>27</sup> Section 701(a) states that if a partner is dissociated from a partnership without causing a dissolution and winding up, the dissociated partner's interest must be bought out. Other provisions in Article 7 are default rules to govern the valuation of and payout for the dissociating partner's interest.<sup>28</sup> Finally, Article 7 ends the ability of the departing and continuing partners to bind each other and limits the liability of the departing partner to firm creditors.<sup>29</sup>

Article 8 applies if there is a dissolution and winding up of the partnership business.<sup>30</sup> Section 801 identifies the dissociations and other events that cause a dissolution and winding up of the partnership business, which means that the partnership business must be liquidated. Other provisions in Article 8 contract the agency authority among partners and explain how the business is to be liquidated.<sup>31</sup> Finally, Article 8 provides simple default rules to guide the settlement of accounts among partners.<sup>32</sup>

### *"DISSOCIATION" OF A PARTNER*

Section 601 provides that a "partner is dissociated from a partnership" upon any one of ten listed events. Of those ten, withdrawal, death, and

24. See generally RUPA arts. 6-8.

25. *Id.* § 601.

26. *Id.* § 603(a).

27. *Id.* § 701.

28. *Id.* § 701(b)-(i).

29. *Id.* §§ 702, 703-705.

30. *Id.* § 801.

31. *Id.* §§ 802-806.

32. *Id.* § 807.



expulsion are the most common. Although the term *dissociation* is new to the statute, the concept is not. A partnership is formed by an “association of two or more persons to carry on as co-owners of a business for profit;”<sup>33</sup> a “dissociation” is the beginning of the end of an association. A partnership, like a marriage, often is far easier to start than it is to end. Unlike a shareholder in a public corporation, a partner cannot simply sell his interest and be done with the relationship. The process of dissociation is more complicated than in the case of a corporation because every partner has agency power and personal liability that must be wound down. Whether there is a buyout of the dissociating partner or a liquidation of the partnership, the disengagement almost invariably takes time.

RUPA's list of the events that cause a dissociation answers the policy question of whether enough has happened to trigger the contraction of a partner's association with the business. Stated somewhat differently, to say that a partner is dissociated is to say that the partner no longer continues as a co-owner of an on-going business.

RUPA section 601 lists all the events that cause a partner's dissociation. RUPA section 601 parallels section 402 of the Revised Uniform Limited Partnership Act (RULPA).<sup>34</sup> That section, entitled “Events of Withdrawal,” lists the ways one “ceases to be a general partner of a limited partnership.”<sup>35</sup> RUPA's basic terminology is different from RULPA's in two respects. First, the RUPA term *dissociation* is broader than the RULPA term *withdrawal* and more appropriately includes dissociations other than withdrawals, such as expulsions.<sup>36</sup> Second, RUPA rejects the RULPA language that refers to a single moment when one “ceases” to be a partner<sup>37</sup>—disengagement from the partnership relationship is a process that takes time to accomplish.

Upon a dissociation, other provisions of RUPA implement the various aspects of the process of disengagement from the relationship.<sup>38</sup> RUPA's rules contract the dissociating partner's agency power, limit the dissociating partner's liability for the acts of other partners, provide for the completion of unfinished business, and pay the dissociating partner for his or her equity in the partnership.<sup>39</sup> That process is described in Article 7 if it is accomplished through a buyout, and in Article 8 if it is accomplished through a winding up of the business.<sup>40</sup>

33. *Id.* § 202(a).

34. REVISED UNIF. LIMITED PARTNERSHIP ACT (1985) [hereinafter RULPA].

35. *Id.* § 402.

36. RUPA § 601.

37. *Id.*

38. *Id.* arts. 7-8.

39. *Id.*

40. *Id.* § 603(a).

## WINDING UP THE PARTNERSHIP BUSINESS

### *New Meaning to the Term "Dissolution"*

RUPA eliminates the UPA rule that a partnership dissolves every time a partner leaves.<sup>41</sup> Under RUPA, there is no dissolution of the partnership if a dissociating partner is bought out—dissolution only results if the business of the partnership must be liquidated.<sup>42</sup> RUPA section 801 lists the events that trigger a winding up, or liquidation, of the partnership business. It provides that "a partnership is dissolved, and its business must be wound up, only upon" one of the listed events.<sup>43</sup>

The term *dissolution* has no independent operative significance under RUPA. Stated somewhat differently, RUPA's provisions are redundant when they state that "a partnership is dissolved, and its business must be wound up."<sup>44</sup> Section 801 simply is a list of those situations in which the business of the partnership must begin to be wound up. The word *dissolution* is nothing more than a shorthand term for the occurrence of one of those situations.<sup>45</sup>

Because dissolution merely marks the beginning of the winding up process and not the termination of the partnership, the partners subsequently may agree to continue the partnership. Section 802(b) states that, at any time after the dissolution of a partnership and before the winding up of its business is completed, the remaining partners may continue the business if the right to have the business wound up is waived by all the partners. In that event, the partnership entity continues as if dissolution never occurred, notwithstanding the temporary contraction in the scope of its business.<sup>46</sup>

RUPA's use of the term *dissolution* is consistent with RULPA section 801, which provides that a limited partnership "is dissolved and its affairs shall be wound up upon the happening" of certain events.<sup>47</sup> It also is consistent with modern corporation law, where a dissolution is the beginning of the liquidation of the corporation.<sup>48</sup>

41. See UPA § 29.

42. RUPA § 801.

43. *Id.*

44. *Id.*

45. The Committee was told that there might be strong opposition to RUPA if it did not include the word *dissolution*. RULPA uses the term, and the Committee was continually urged to follow RULPA on this point.

46. Unless the partners agree otherwise, any liability incurred by the partnership after the dissolution is determined as if dissolution never occurred. RUPA § 802(b). That validates post-dissolution transactions that were appropriate for a continuation of the business, but not for winding up. The rights of third parties accruing before they knew (or received a notification) of the waiver, however, may not be affected adversely. *Id.*

47. RULPA § 801.

48. The MODEL BUSINESS CORP. ACT (1984) [hereinafter Model Act] provides that a dissolved corporation "continues its corporate existence but may not carry on any business except that appropriate to wind up and liquidate its business and affairs." Model Act § 14.05(a).

Events that cause a dissolution and winding up include a partnership at will having notice of a partner's express will<sup>49</sup> to withdraw, the expiration of the term in a term partnership,<sup>50</sup> events agreed to as resulting in liquidation,<sup>51</sup> and judicial dissolutions.<sup>52</sup> Most dissolution events are dissociations. On the other hand, it is not necessary to have a dissociation to cause a dissolution and winding up. The partnership simply can refrain from taking on new business with all partners remaining active for the sole purpose of completing unfinished business.<sup>53</sup>

### ***What Happens Upon Dissolution***

Section 802(a) provides that a partnership continues after dissolution "only for the purpose of winding up its business" and is terminated when the winding up is completed.<sup>54</sup> Section 807(a) states what must be done to wind up a partnership's business: "the assets of the partnership must be applied to discharge its obligations to creditors, including partners who are creditors. Any surplus must be applied to pay in cash the net amount distributable to partners in accordance with their right to distributions. . . ."<sup>55</sup> RUPA thus continues the "in cash" rule of UPA section 38(1) as opposed to in-kind distributions. The result is that a partner cannot be forced to accept a liquidation in kind on the winding up of partnership business.<sup>56</sup>

In-kind distributions were avoided as a default rule for several reasons. First, they present difficult valuation problems. The partner being forced to accept property in satisfaction of his or her claim seldom values it as highly as those who would have him or her accept it. RUPA reflects the conclusion that the safest way to value the assets is to sell them.<sup>57</sup> If the partners can negotiate another solution, they are free to do so. Second, the "in cash" rule is intended to give needed bargaining power to minority partners. Finally, to the extent undivided interests in the same asset might

49. RUPA § 801(1). The "express will" concept is continued from UPA §§ 31(1)(b)-(c) & 31(2) (causes of dissolution).

50. RUPA § 801(2).

51. *Id.* § 801(3).

52. *Id.* § 801(5), (6).

53. Section 801 provides that a term partnership "is dissolved, and its business must be wound up" upon "the express will of all of the partners." *Id.* § 801(2)(ii). *See also id.* § 801(3) (dissolution upon "an event agreed to in the partnership agreement resulting in the winding up of the partnership business").

54. *Id.* § 802(a).

55. *Id.* § 807(a).

56. *See Dreifuert v. Dreifuert*, 280 N.W.2d 335 (Wis. Ct. App. 1979), which stated that a "sale is the best means of determining the true fair market value of the assets. . . . While judicial sales in some instances may cause economic hardships, these hardships can be avoided by the use of partnership agreements." *Id.* at 339. *But see Rinke v. Rinke*, 48 N.W.2d 201 (Mich. 1951).

57. RUPA § 807.

be involved in an in-kind distribution, it does not make sense to force people trying to disengage as partners into another form of concurrent ownership they might find all too familiar.

Although RUPA requires that the business be sold whenever there is an event of dissolution,<sup>58</sup> it also attempts to avoid compelling a precipitous sale. Section 803(c) authorizes the partners who are winding up the business to "preserve the partnership business or property as a going concern for a reasonable time."<sup>59</sup>

Neither the UPA nor the case law gives partners any clear concept of how they are to settle accounts among themselves as they liquidate. There is remarkably little case law on point, and even recent cases are hopelessly confused.<sup>60</sup> RUPA section 807(b) contains a simple statement to guide the settlement of partnership accounts:

In settling accounts among the partners, the profits and losses that result from the liquidation of the partnership assets must be credited and charged to the partners' accounts. The partnership shall make a distribution to a partner in an amount equal to any excess of the credits over the charges in the partner's account. A partner shall contribute to the partnership an amount equal to any excess of the charges over the credits in the partner's account.<sup>61</sup>

With this statement and related language, RUPA brings the statutory law of partnerships into conformity with modern accounting concepts.<sup>62</sup> In particular, it directly states the current default rule that a negative capital account is a debt to the partnership.<sup>63</sup>

## ***BUYOUT OF DISSOCIATED PARTNER'S INTEREST***

### ***Little Guidance Under the UPA***

The UPA says little about the buyout of a partner. UPA section 38(2) provides that, if there is a wrongful dissolution, the partners who have not dissolved wrongfully may continue the business "during the agreed term" if they unanimously agree to do so.<sup>64</sup> To do so, they must "secure the

58. *Id.* § 803.

59. *Id.* § 803(c). *See* Paciaroni v. Crane, 408 A.2d 946, 956 (Del. Ch. 1979).

60. *See, e.g.*, Hamilton Airport Advertising v. Hamilton, 462 N.E.2d 228 (Ind. Ct. App. 1984); Park Cities Corp. v. Byrd, 534 S.W.2d 668 (Tex. 1976).

61. RUPA § 807(b).

62. Under RUPA § 401(a), each partner is deemed to have an account that is (i) credited with the partner's contributions to the partnership and his or her share of the profits, and (ii) charged with the partner's share of the losses and any distributions to the partner. RUPA § 807(b) instructs how to close out the accounts after dissolution. Accountants and tax lawyers call them "capital accounts." The partnership, however, may adopt a different accounting system if it chooses. RUPA § 103.

63. *Id.* § 807(b).

64. UPA § 38(2).

payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any damages recoverable . . . and in like manner indemnify him against all present or future partnership liabilities.”<sup>65</sup> There is no further definition of the buyout in the statute and the case law leaves many uncertainties about how the UPA rules apply.

### ***RUPA Provides Clear Default Rules***

RUPA has an extensive and clear statement of a core set of buyout rules that apply to both wrongful and non-wrongful dissociations. Section 701(a) provides that, if a partner’s dissociation does not result in a dissolution and winding up under Article 8, “the partnership shall cause the dissociated partner’s interest in the partnership to be purchased for a buyout price” determined pursuant to the Act.<sup>66</sup> RUPA thus declares that the partnership is obligated to buy out the dissociating partner.

A major qualification to the mandatory buyout is that a partner who wrongfully dissociates before the completion of an agreed term or undertaking has no right to immediate payment for his or her interest.<sup>67</sup> Section 701(h) provides that such a partner “is not entitled to payment of any portion of the buyout price until the expiration of the term or completion of the undertaking, unless the partner establishes to the satisfaction of the court that the earlier payment will not cause undue hardship to the business of the partnership.”<sup>68</sup> That rule is designed to protect the non-breaching partners from an unexpected loss of capital.

Section 701(b) is the default rule to determine the buyout price:

The buyout price of a dissociated partner’s interest is the amount that would have been distributable to the dissociating partner under Section 807(b) if, on the date of the dissociation, the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on a sale of the entire business as a going concern without the dissociated partner and the partnership were wound up as of that date. Interest must be paid from the date of dissociation to the date of payment.<sup>69</sup>

The basic policy judgment is that the departing partner should get the same amount through the buyout that he or she would get if the business were wound up. Theoretically, the amount paid to the dissociating partner should be the same whether there is a buyout by the continuing partnership

65. *Id.* § 38(2)(b). In “ascertaining the value of the partner’s interest the value of the good-will of the business shall not be considered.” *Id.* § 38(2)(c)II. *See also id.* § 42.

66. RUPA § 701(a).

67. *Id.* § 701(h).

68. *Id.*

69. *Id.* § 701(b).

or a liquidation of the business. As a consequence, there is no minority discount.

Valuing the assets at "the greater of liquidation value or value based on sale of the entire business as a going concern without the dissociating partner"<sup>70</sup> serves two purposes. First, it cuts through some of the confusion in the cases concerning the term *going concern value*. To many, *going concern value* is a term used to explain that assets that are part of a going concern have greater value than the sum of the values of the individual assets.<sup>71</sup> On the other hand, recent partnership cases in the estate tax context state that going concern value is lower than liquidation value if the assets cannot be liquidated because they are committed to a going concern.<sup>72</sup> In effect, dedication to a going concern is considered an encumbrance. Section 701 is intended to indicate that, however value is perceived, the higher of the two values is to be used. Second, valuation of the going concern "without the dissociating partner" is intended to emphasize that the partner being bought out need not be paid for his or her human capital.<sup>73</sup>

In computing the buyout price, the amount the dissociating partner receives is reduced by his or her share of partnership liabilities.<sup>74</sup> Accordingly, it is important that the dissociating partner not be called upon to satisfy liabilities that already reduced the amount he or she received. To avoid this double liability, section 701(d) provides:

A partnership shall indemnify a dissociated partner against all partnership liabilities incurred before the dissociation, except liabilities then unknown to the partnership, and against all partnership liabilities incurred after the dissociation. . . . [A] liability not known to a partner other than the dissociated partner is not known to the partnership.<sup>75</sup>

This provision improves the UPA rule in two respects. First, unlike the UPA, it is not internally inconsistent.<sup>76</sup> Second, it articulates a concept behind the liabilities that are the object of indemnification. RUPA's default rule on indemnification reflects the solution partners would likely negotiate, namely, an indemnification against all liabilities that are taken into

70. *Id.*

71. "Going-concern value is, in essence, the additional element of value which attaches to property by reason of its existence as an integral part of a going concern." VGS Corp. v. Commissioner, 68 T.C. 563, 591 (1977), *acq.*, 1979-2 C.B. 2. United States v. Cornish, 348 F.2d 175 (9th Cir. 1965), *rev'g and remanding* 221 F. Supp. 658 (D. Or. 1963), is the classic case attempting to identify and value the assets "behind" the purchase of a partnership interest. *Cornish* stated that the cost new partners paid for going concern value was incurred for "a true nondepreciable intangible asset of the partnership." *Id.* at 185.

72. See Estate of Watts v. Commissioner, 823 F.2d 483 (11th Cir. 1987), *aff'g* 51 T.C.M. (CCH) 60 (1985).

73. RUPA § 701.

74. See *id.* §§ 701(b), 807(a).

75. *Id.* § 701(d).

76. Compare UPA § 38(2)(b) with *id.* § 38(2)(c)II.

account in computing the buyout price, which would not include liabilities that are completely unanticipated or that are known only to the dissociating partner.

If negotiations break down, RUPA requires the partnership to pay the estimated amount due to the departing partner, pending final determination of the buyout price.<sup>77</sup> Section 701(e) provides: "If no agreement for the purchase of a dissociated partner's interest is reached within 120 days after a written demand for payment, the partnership shall pay . . . in cash to the dissociated partner the amount the partnership estimates to be the buyout price and accrued interest."<sup>78</sup> The payment (or offer to pay) must be accompanied by supporting financial statements and by "written notice that the payment is in full satisfaction of the obligation to purchase unless, within 120 days after the written notice, the dissociated partner commences an action to determine the buyout price."<sup>79</sup> Those provisions, unprecedented in the UPA, are based on dissenters' rights provisions in corporate statutes.<sup>80</sup>

## *WINDING DOWN OTHER ASPECTS OF THE RELATIONSHIP*

### *The UPA Approach*

Whether there is a buyout or a liquidation, the agency power and liability among partners must be wound down, unfinished business must be completed, and liabilities must be apportioned. The UPA addresses those issues with a single set of provisions that apply whether there is a buyout or a liquidation.<sup>81</sup> Because any departure triggers a dissolution under the UPA, its provisions are triggered by, and only by, a dissolution.

Many people fail to understand that partners remain partners even after one says "I quit" or "You're out!" The logic of the UPA is clear, but its significance continues to be elusive. Under UPA section 29, a dissolution is merely a "change in the relation" of the partners, not an end to the relationship. UPA section 30 attempts to clarify that the relationship continues, but with a contraction in scope, by providing that the partnership "continues until the winding up of partnership affairs is completed."<sup>82</sup>

On dissolution, therefore, little happens to the partnership relationship except that the scope of the partnership business narrows, perhaps only

77. See RUPA § 701(e).

78. *Id.* If deferred payment is permitted because the dissociating partner prematurely withdrew, the partnership may make an offer to pay rather than a present payment. *Id.* § 701(f).

79. *Id.* § 701(g)(4).

80. See Model Act § 13.25(b).

81. UPA §§ 29-43.

82. *Id.* § 30. Winding up is not complete simply because the partners declare it completed; winding up is not complete until partnership obligations are satisfied. See *Sitchenko v. DiResta*, 512 F. Supp. 758, 762 (E.D.N.Y. 1981).

slightly.<sup>83</sup> Under the UPA, the continuing exposure to unlimited personal liability is open-ended. UPA section 36(1) provides that dissolution “does not of itself discharge the existing liability of any partner.”<sup>84</sup> UPA section 35(1)(a) adds that, after dissolution, partners can bind each other “by any act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution.”<sup>85</sup> Indeed, they can bind the partnership “by any transaction which would bind the partnership if dissolution had not taken place,” if the other party has no notice of the dissolution.<sup>86</sup>

### *RUPA Has Separate Rules for Buyouts and Dissolutions*

Under RUPA, the rules for disengaging from the partnership differ depending on whether there is a buyout of a dissociating partner or a dissolution and winding up of the business. In both situations, a partner’s lingering agency power can be cut off more quickly and easily than under the UPA.

#### *Winding Down If There Is a Buyout*

If there is a buyout, the scope of the partnership business continues unaltered for those partners who remain with the partnership.<sup>87</sup> Their agency power and personal liability for both old and new liabilities is unaffected by another partner’s dissociation and buyout.<sup>88</sup> Nor is the dissociating partner automatically discharged from partnership obligations incurred before the dissociation.<sup>89</sup> On the other hand, the management rights of a partner who is being bought out end immediately upon his or

83. See *Levy v. Disharoon*, 749 P.2d 84 (N.M. 1988), involving a partnership formed to purchase and operate an airplane. Relying on UPA § 35(1)(a), the court held that a partner was liable for the operation of the airplane even after giving written notice of his intent to “terminate” his relationship. *Id.* at 88. Liability extends through the winding-up period, which in this case required steps to preserve partnership assets: “A liquidating partner can act on behalf of his former associates in matters in which they still have a common interest and are under a common liability. Sometimes the period between dissolution and termination requires that the partnership business be conducted for the preservation of its assets.” *Id.* (citations omitted).

84. UPA § 36(1).

85. *Id.* § 35(1)(a). In *Redman v. Walters*, 152 Cal. Rptr. 42 (Cal. Ct. App. 1979), the court held a partner liable for an oversight that took place four years after he left the law firm. The obligation to the client was undertaken by the firm while he still was a member. *Id.* at 46.

86. UPA § 35(1)(b). The strongest notice requirement is for those who extended credit to the partnership prior to dissolution. *Id.* § 35(1)(b)I. With respect to those who previously had not extended credit, but nevertheless knew of the partnership before dissolution, partners’ apparent authority may be cut off by published notice of the dissolution. *Id.* § 35(1)(b)II.

87. There may be some alteration in scope if a significant amount of the firm capital is used to buy out the departing member.

88. RUPA § 702.

89. *Id.* § 703(a).



her dissociation.<sup>90</sup> So, too, does the partner's duty to refrain from competing with the partnership, although he or she has some continuing duty of loyalty and care with respect to matters arising before the dissociation.<sup>91</sup>

RUPA makes several changes to the rules that govern the winding down of the departing partner's lingering agency power and personal liability for post-dissociation obligations. First, RUPA minimizes the partnership's risk of being bound by the departing partner's lingering agency authority, and the departing partner's risk of liability for a new partnership debt, by imposing a reliance requirement on third parties.<sup>92</sup> In both cases, liability is limited to those who, at the time of entering into a transaction, "reasonably believed that the dissociated partner was then a partner . . . [and] did not have notice of the partner's dissociation."<sup>93</sup>

Second, and more importantly, third parties are deemed conclusively to have notice of a partner's dissociation ninety days after the filing of a statement of dissociation.<sup>94</sup> Thus, there is a strong incentive for both the partnership and a departing partner to make sure a statement is filed immediately after the partner's dissociation. Creditors also can be expected to consult the record more frequently when dealing with a partner.

Finally, RUPA limits a dissociating partner's agency power and personal liability to a maximum period of two years following dissociation, regardless of a third party's notice or reliance, even if no statement of dissociation is filed.<sup>95</sup> The policy judgment is that the continuing exposure of partners under the UPA is far too open-ended, particularly in an era of easy access to limited liability organizations.

### *Winding Down If There Is a Liquidation*

In the case of a dissolution and winding up, the scope of the partnership business narrows with respect to all partners. All partners have a right to participate in management during the liquidation, except a partner who wrongfully caused the liquidation.<sup>96</sup> All partners are bound by acts appropriate to the winding up.<sup>97</sup> In addition, partners are bound by acts that, before dissolution, would have bound the partnership, if the third party had no notice of the dissolution.<sup>98</sup> Third parties, however, are

90. *Id.* § 603(b)(1).

91. *Id.* § 603(b)(3).

92. *See id.* §§ 702(a) (dissociated partner's power to bind the partnership), 703(b) (dissociated partner's liability to third parties).

93. *Id.* § 702(a)(1), (2).

94. *Id.* § 704(c).

95. *Id.* §§ 702(a) (agency power), 703(b) (personal liability).

96. *Id.* § 803(a).

97. *Id.* § 804(1).

98. *Id.* § 804(2). As among the partners, a partner who knowingly incurs a partnership liability that is not appropriate for winding up is liable to the partnership for any damage caused to the partnership arising from the liability. *Id.* § 806(b).

deemed conclusively to have notice of the dissolution ninety days after the filing of a statement of dissolution.<sup>99</sup> That is analogous to the rule provided in the case of a buyout<sup>100</sup> and adds considerably to the protection of partners from liability for inappropriate acts following dissolution.

## **FIDUCIARY DUTIES**

### ***THE STATE OF THE LAW UNDER THE UPA***

Traditional legal analysis of fiduciary duties distinguishes the duty of care from the duty of loyalty. That is true in the general law of principal and agent<sup>101</sup> and in the law of corporations.<sup>102</sup> The UPA has no duty of care provision. Nor does the term *duty of loyalty* even appear in the UPA. The UPA does, however, contain a number of provisions that can be interpreted as a broad duty of loyalty.<sup>103</sup>

UPA section 21, entitled "Partner Accountable as a Fiduciary," is the core provision generally cited as the statutory authority for a duty of loyalty among partners. It states:

Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.<sup>104</sup>

Although a basic purpose of this language is to give excluded partners priority over the separate creditors of a disloyal partner as to traceable usurped assets,<sup>105</sup> it has been treated by courts as the statutory foundation for broad and powerful fiduciary duties among partners, particularly duties of loyalty.<sup>106</sup>

Other provisions of the UPA provide more specific rights and obligations that are often thought of as part of the duty of loyalty. Access to information is provided in UPA section 19, which states that "every partner shall at all times have access to and may inspect and copy" partnership books.<sup>107</sup> More broadly, UPA section 20 provides that "partners shall render on demand true and full information of all things affecting the part-

99. *Id.* § 805(d).

100. *See supra* text accompanying note 94.

101. *Compare* RESTATEMENT (SECOND) OF AGENCY § 379 (1958) ("Duty of Care and Skill") with *id.* § 387 ("General Principle").

102. The Model Act distinguishes the duty of care from the duty of loyalty by providing separate sections for each. *See* Model Act §§ 8.30(a)(2) (duty of care), 8.61 (duty of loyalty).

103. *See generally* UPA §§ 18-21.

104. *Id.* § 21(1).

105. *See id.* § 21(1) Official Comment.

106. *See* *Lipinski v. Lipinski*, 35 N.W.2d 708, 712 (Minn. 1949).

107. UPA § 19.

nership to any partner.”<sup>108</sup> The UPA section 18 rule of equal management rights has led some commentators to conclude that partners owe each other a duty to consult.<sup>109</sup>

Despite the statutory rules, it is case law that has reigned supreme in the area of fiduciary duties among partners. Criticism of the case law falls into two camps. One states that the language of the cases sets an unrealistically high standard of behavior among partners. In particular, this camp asserts that activist courts are prone to upset the terms of negotiated agreements by requiring partners to be selfless. Stated differently, some fear that written partnership agreements will be set aside, under the rubric of fiduciary obligation, whenever a judge thinks the provisions are unfair. The second, related camp, states that the rhetoric of the “fiduciary” opinions overstates what the courts are doing. This camp asserts that, upon close examination, it is clear that courts recognize many situations where a partner legitimately may pursue self-interest.<sup>110</sup>

Those in the first camp make a two-pronged assault. First, they assert that it is not appropriate to refer to partners as fiduciaries. They state that a partner is not a fiduciary in the same strict sense as a trustee.<sup>111</sup> They explain that a trustee is a person who acts solely on behalf of a beneficiary, whereas a partner by definition is a co-proprietor, a co-owner acting on his or her own behalf. Second, the more extreme members of this camp state that the basic notion of freedom of contract should enable partners in negotiated transactions to draft away all aspects of fiduciary obligation.

108. *Id.* § 20. The “on demand” language of this section is tempered by the fact that a duty to consult has been found in UPA § 18(e), which provides that “[a]ll partners have equal rights in the management and conduct of the partnership business.” See Robert W. Hillman, *Power Shared and Power Denied: A Look At Participatory Rights in The Management of General Partnerships*, 1984 U. ILL. L. REV. 865, which provides in pertinent part:

Nothing in the U.P.A. gives partners with sufficient power to control a venture a license to ignore *consistently* the views of minority participants about matters within the ordinary course of business. The principal importance of section 18(e) lies in its recognition and enforcement of dignity interests, and the basis it provides for a participant to resist unwanted exile from partnership affairs.

*Id.* at 887 (emphasis in original); see also MELVIN A. EISENBERG, AN INTRODUCTION TO AGENCY AND PARTNERSHIP 42 (1987). UPA § 20 arguably limits the thrust of the UPA § 18(e) information right by suggesting that it be honored “on demand” rather than volunteered as appropriate. RUPA § 403(c) retains the UPA’s “on demand” language.

109. See, e.g., EISENBERG, *supra* note 108, at 42 (citing Hillman, *supra* note 108, at 883-87).

110. See Robert W. Hillman, *Private Ordering Within Partnerships*, 41 U. MIAMI L. REV. 425 (1987).

111. See Model Act § 8.30 Official Comment:

Section 8.30 does not use the term “fiduciary” in the standard for directors’ conduct, because that term could be confused with the unique attributes and obligations of a fiduciary imposed by the law of trusts, some of which are not appropriate for directors of a corporation.

Stated differently, they argue that fiduciary duties should be merely default rules and not mandatory rules.

## *RUPA SECTION 404*

### *Partners as Limited Fiduciaries*

Section 404<sup>112</sup> is a compromise on an extraordinarily controversial topic. No amount of debate ever will close the gap between those who want powerful and immutable fiduciary duties<sup>113</sup> and those who want them confined statutorily and reduced to default rules.<sup>114</sup> Section 404 is a compromise that, on the one hand, continues the use of the term *fiduciary* and the language of duty of loyalty and, on the other hand, confines their application.

Section 404(a) states that the "only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty

#### 112. SECTION 404. GENERAL STANDARDS OF PARTNER'S CONDUCT.

(a) The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c).

(b) A partner's duty of loyalty to the partnership and the other partners is limited to the following:

(1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity, without the consent of the other partners;

(2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership without the consent of the other partners; and

(3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership without the consent of the other partners.

(c) A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

(d) A partner shall discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing.

(e) A partner does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the partner's conduct furthers the partner's own interest.

(f) A partner may lend money to and transact other business with the partnership. The rights and obligations of a partner who lends money to or transacts business with the partnership are the same as those of a person who is not a partner, subject to other applicable law.

(g) This section applies to a person winding up the partnership business as the personal or legal representative of the last surviving partner as if the person were a partner.

113. See Claire Moore Dickerson, *Is It Appropriate to Appropriate Corporate Concepts: Fiduciary Duties and the Revised Uniform Partnership Act*, 64 U. COLO. L. REV. 111 (1993); Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 522 (forthcoming 1993).

114. See Larry E. Ribstein, *A Mid-Term Assessment of the Project to Revise the Uniform Partnership Act*, 46 BUS. LAW. 111, 138 (1990).

of care,” as set forth in subsections (b) and (c).<sup>115</sup> Section 404 then states that partners are not subject to the same fiduciary duties as disinterested trustees, defines the duties of loyalty and care, and provides that partners are subject to an overall “obligation” of good faith and fair dealing.<sup>116</sup>

### *Partners Are Not Disinterested Trustees*

RUPA continues to use the term *fiduciary* to preserve the great bulk of the case law describing partners as fiduciaries. Partners and other co-owners<sup>117</sup> have been long held to be fiduciaries.<sup>118</sup> Indeed, the law of partnership reflects the broader law of principal and agent, which states that every agent is a fiduciary.<sup>119</sup> Section 301(1) continues the rule of UPA section 9 that every partner is a general agent of the partnership. Moreover, section 104(a) provides that the principles of law and equity supplement the Act “unless displaced by particular provisions.”<sup>120</sup>

115. RUPA § 404(a).

116. *Id.* § 404(b), (c).

117. *See, e.g.*, 2 Russell D. Niles & William F. Walsh, *Concurrent Estates and Their Characteristics*, in 2 AMERICAN LAW OF PROPERTY § 6.16, at 69 (1952): “Historically, cotenants have been regarded in equity as fiduciaries of one another where they have acquired their interests at the same time, either by inheritance from a common ancestor or by the same deed or will.”

118. Although Chief Judge Cardozo’s opinion in *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928), probably is considered the classic statement of the fiduciary duties of partners, there is much earlier authority to the same effect. *See Salhinger v. Salhinger*, 105 P. 236 (Wash. 1909): “There is no stronger fiduciary relation known to the law than that of a copartnership, where one man’s property and property rights are subject to a large extent to the control and administration of another.” *Id.* at 237; *see also* *Latta v. Kilbourn*, 150 U.S. 524, 543 (1893).

119. *See* RESTATEMENT (SECOND) OF AGENCY § 1(1) (1958): “Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.”

120. RUPA § 104(a). This continues the rule of UPA section 4(3) which applies the law of principal and agent to partnerships. RESTATEMENT (SECOND) OF AGENCY § 14A cmt. a (1958) states: “The rights and liabilities of partners with respect to each other . . . are largely determined by agency principles.”

In *Waite v. Sylvester*, 560 A.2d 619 (N.H. 1989), the court stated that reasonable minds can disagree on when to impose fiduciary duties:

The rule generally accepted . . . imposes a fiduciary duty not only with respect to transactions occurring during the partnership but also with respect to “those taking place during the negotiations leading to the formation of the partnership.” This rule reflects the assumption that during negotiations to form a partnership, the parties are not dealing with one another at arm’s length, but rather are attempting to structure a common enterprise, one which must be based on trust and loyalty. An equally valid assumption, that parties negotiating to form a partnership deal at arm’s length in a struggle for competitive advantage, gives rise to the alternative rule imposing no fiduciary duty until the actual formation of a partnership.

*Id.* at 625 (citations omitted).

On the other hand, RUPA deletes the traditional agency rule that would require abnegation of self: "Unless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency."<sup>121</sup> RUPA rejects that agency rule in section 404(e), by providing that neither the fiduciary duty of loyalty nor the obligation of good faith and fair dealing is violated "merely because the partner's conduct furthers that partner's own interest."<sup>122</sup> This statement is designed to recognize and protect the legitimate pursuit of self-interest among partners. It reflects the current case law that permits partners to bargain among themselves and to agree that certain benefits will not be shared.<sup>123</sup>

Section 404(f) is a more narrow expression of the general rule that a partner may pursue self-interest. It states: "The rights and obligations of a partner who lends money to or transacts business with the partnership are the same as those of a person who is not a partner."<sup>124</sup> That rule codifies the case law holding that dual-capacity transactions do not necessarily violate the duty of loyalty.<sup>125</sup> In particular, the goal is to confirm that a person may be both a partner and a lender. Wearing the hat of lender, lender remedies may be pursued.<sup>126</sup>

121. RESTATEMENT (SECOND) OF AGENCY § 387 (1958).

122. RUPA § 404(e). Section 4.04(f) of the new Texas partnership act provides explicitly: "*Trustee Standard Inapplicable*. A partner, in that capacity, is not a trustee and is not held to the same standards as a trustee." 1993 Tex. Sess. Laws Serv. 917, § 4.04(f) (Vernon).

123. There is a certain tension between authorizing the pursuit of self-interest and continuing to use the term *fiduciary*. Case law continues to state that the partner as fiduciary is to be selfless. For example, the New York Court of Appeals recently stated:

[I]t is elemental that a fiduciary owes a duty of undivided and undiluted loyalty to those whose interests the fiduciary is to protect. This is a sensitive and "inflexible" rule of fidelity, . . . requiring avoidance of situations in which a fiduciary's personal interest possibly conflicts with the interest of those owed a fiduciary duty. . . . [A] fiduciary . . . is bound to single mindedly pursue the interests of those to whom a duty of loyalty is owed.

*Birnbaum v. Birnbaum*, 539 N.E.2d 574, 576 (N.Y. 1989) (emphasis added) (citations omitted).

On the other hand, commentators such as Professor Hillman emphasize that the courts cannot possibly mean the logical consequences of their broad statements. See Hillman, *supra* note 110, at 457.

124. RUPA § 404(f).

125. See, e.g., *Westminster Properties, Inc. v. Atlanta Assocs.*, 301 S.E.2d 636 (Ga. 1983).

126. In *Westminster Properties* 301 S.E.2d 636, prior to Georgia's adoption of the UPA, the court rejected the argument that a partner's duties prevented him or her from exercising rights as a secured creditor.

On the other hand, a partner cannot wrongfully cause a default merely to activate his or her nonpartner rights. See *Natpar Corp. v. E.T. Kassinger, Inc.*, 365 S.E.2d 442 (Ga. 1988), in which the court granted an interlocutory injunction prohibiting a partner named Natpar from foreclosing on certain property mortgaged to Natpar by its own partnership:

The essence of [the] complaint is that Natpar has wrongly brought about the default of the partnership to Natpar by failing to comply with its obligation under the partnership

## DUTY OF CARE

### *Mixed Statement in the Present Law*

As previously discussed, agency law and partnership law are interwoven.<sup>127</sup> The Restatement position is that a paid agent owes a duty to the principal to act with "standard care" and skill.<sup>128</sup> The leading hornbook on partnerships, on the other hand, states that partners "are not subject to the ordinary care standard applicable to a paid agent."<sup>129</sup> Yet there are both old and new statements that partners are subject to an ordinary care standard.

Writing in 1841, Mr. Justice Story opined that "good faith, reasonable skill and diligence, and the exercise of sound judgment and discretion, are naturally, if not necessarily, implied from the very nature and character of the relation of partnership."<sup>130</sup> He traced the principle to Roman law, which he summarized as follows: "In cases of partnership the same diligence is ordinarily required of each partner, as reasonable and prudent men generally employ about the like business; unless the circumstances of the particular case repel such a conclusion."<sup>131</sup> Much more recently, the Supreme Court of Maine stated that partners are subject to an "ordinarily prudent person" standard.<sup>132</sup>

### *RUPA Section 404(c): A Gross Negligence Standard*

Section 404(c) provides that a "partner's duty of care to the partnership and the other partners . . . is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing vio-

agreement to pay its share of operating expenses. Obviously, although the partnership granted Natpar a security deed, the partnership did not grant Natpar the right to refuse to pay its obligation to the partnership. We find that equitable relief is appropriate . . . and is not inconsistent with our decision in *Westminster Properties*, in which it was undisputed that Westminster took no wrongful action which precipitated the default to it.

*Id.* at 444-45.

127. See *supra* text accompanying notes 119-120.

128. See RESTATEMENT (SECOND) OF AGENCY § 379(1) (1958):

Unless otherwise agreed, a paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform and, in addition, to exercise any special skill that he has.

129. 2 ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON PARTNERSHIP § 6, at 6:85 (1988).

130. JOSEPH STORY, COMMENTARIES ON THE LAW OF PARTNERSHIP 261 (1841).

131. *Id.* at 263.

132. *Rosenthal v. Rosenthal*, 543 A.2d 348 (Me. 1988). See also *Roper v. Thomas*, 298 S.E.2d 424, 429 (N.C. Ct. App. 1982), in which the court said it was meritless to argue that a general partner "may be personally liable for gross neglect of his duties, mismanagement, fraud and deceit resulting in loss to a third person, but not for error of judgment made in good faith."

lation of law."<sup>133</sup> At first glance, it might sound preposterous to reject the conclusion that partners owe each other the duty to use reasonable care. On the other hand, the question is how partners allocate risk of loss among themselves. As among all the partners, should a partner bear all the losses caused by his or her own negligence? Or is a loss caused by a partner's negligence to be allocated among the partners according to the same rules that allocate losses caused by the negligence of a non-partner?

It is clear that partners may agree to share losses in any way they like and that the task is to identify the appropriate default rule. The general default rule under RUPA is that partners share partnership losses, whether capital or operating, in accordance with their share of the profits.<sup>134</sup> The issue, therefore, is whether there should be a separate default rule for losses caused by the negligence of a partner.

The share in profits generally considered the *sine qua non* of partner status suggests that the interests of partnership and partner tend to converge. That may be easiest to see if there are few partners and each has an equal share. Perhaps more importantly, the exposure of partners to unlimited personal liability to all contract and tort creditors provides a powerful incentive to exercise due care.<sup>135</sup> It also provides incentive to monitor the behavior of other partners. It therefore does not appear necessary to allocate the risk of loss inside the partnership in order to encourage either good performance or good monitoring.

To the extent partners know that they vary in ability or attitude toward care, they are likely to contract. Their contracting may take a form other than an altered loss-sharing ratio. Rather, they may assign low-risk functions to high-risk partners. On the other hand, contracting for a reasonable care standard may be far less likely when partners assume they are equally skillful and careful.

If partners believe that losses due to negligence are an inevitable series of costs that over time will be imposed randomly and equally on all partners, a contract to share those losses seems likely. In that situation, an agreement to share losses primarily affects the timing of a partner's loss, not the amount of his or her loss. An agreement to share losses due to a partner's negligence in effect allows each partner to amortize the losses he or she incurs. The loss-sharing agreement thus avoids a material distortion of income at the level of the individual partner.

An assumption of equality, therefore, is what supports RUPA's default rule that partners tacitly agree to share the losses caused by each other's

133. RUPA § 404(c).

134. *Id.* § 401(b). Capital and operating losses are treated the same. Profits are shared equally by the partners under RUPA § 401(b). These are merely default rules. RUPA § 103.

135. At least one article contends that such an explanation is insufficient to sustain a theory that partners should not be held to an ordinary care standard. See Norwood P. Beveridge, *Duty of Care: The Partnership Cases*, 15 OKLA. CITY U. L. REV. 753, 765 (1990).



ordinary negligence.<sup>136</sup> If equality is assumed, it is likely that the partners as a group will agree either to self-insure or to purchase third-party insurance. Thus, there should not be a default rule that specially allocates the losses caused by the negligence of a partner. Unless the partnership agreement provides otherwise, the losses are shared equally.

### *DUTY OF LOYALTY*

RUPA section 404(b) purports to be an exclusive statement of the duty of loyalty of partners. It provides that every partner has a duty of loyalty to the partnership and the other partners that is limited to three specific rules. Those rules may be abrogated by agreement only to a point which is not “manifestly unreasonable.”<sup>137</sup>

The specific and exclusive nature of the section was motivated in part by a sense that vague, broad statements of a duty of loyalty cause too much uncertainty. It was suggested that overly broad judicial language has left practitioners uncertain about whether their negotiated agreements will be voided. It was said that lawyers and their clients want to be able to negotiate transactions, reduce their agreements to writing, and have some comfort that those agreements will not be undone by “fuzzy” notions of fiduciary duties. The first specific rule imposes a duty

to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity, without the consent of other partners.<sup>138</sup>

This provision is drawn virtually unchanged from UPA section 21(1), which suggests that it will continue to be viewed as the statutory foundation of a broad and powerful duty of loyalty.

The other two rules comprising RUPA's duty of loyalty are new to the partnership act. The first provides that each partner has a duty “to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership without the consent of the other partners.”<sup>139</sup> The second provides that each partner has a duty “to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership without the consent of the other partners.”<sup>140</sup> Neither of these rules, however, is new to the law.<sup>141</sup>

136. RUPA § 404(b).

137. *See id.* § 103(b)(3).

138. *Id.* § 404(b)(1).

139. *Id.* § 404(b)(2).

140. *Id.* § 404(b)(3).

141. *See* RESTATEMENT (SECOND) OF AGENCY §§ 389, 393 (1958).

## *THE OBLIGATION OF GOOD FAITH AND FAIR DEALING*

RUPA provides that each partner "shall discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing."<sup>142</sup> This obligation may not be varied by agreement, except that the partners may "determine the standards by which the performance is to be measured, if the standards are not manifestly unreasonable."<sup>143</sup>

The "good faith" requirement draws upon both the fiduciary law of cooperative relationships and the contract law of adversarial relationships. Partnership loyalty cases are replete with statements that partners owe each other the duty to act "in good faith" or some variant, such as "utmost good faith."<sup>144</sup> Indeed, in an earlier draft of RUPA, good faith and fair dealing was referred to as a "duty" rather than as an "obligation" and was the only mandatory fiduciary duty.<sup>145</sup>

On the other hand, the duty of good faith and fair dealing has roots in the contract law that governs purely adversarial relationships. In the contract context, the requirement of good faith has been described as an "excluder" rule, one that is defined by what it excludes rather than by

142. RUPA § 404(d). Cf. THE AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.01 (Proposed Final Draft, Mar. 31, 1992):

§ 5.01. Duty of Fair Dealing of Directors, Senior Executives, and Controlling Shareholders

Directors [§ 1.13], senior executives [§ 1.33], and controlling shareholders [§ 1.10], when interested [§ 1.23] in a matter affecting the corporation, are under a duty of fair dealing, which duty may be fulfilled as set forth in Chapters 2 and 3 of Part V. This duty includes the obligation to make appropriate disclosure as provided in such Chapters.

143. RUPA § 103(b)(5). That language is drawn from U.C.C. § 1-102(3) (1989), which provides that the obligation of good faith "may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance . . . is to be measured if such standards are not manifestly unreasonable."

Academic commentary suggests that the manifestly unreasonable standard "invites judicial scrutiny of contract terms without . . . regard to the bargaining process by which those terms were reached." J. Dennis Hynes, *The Revised Uniform Partnership Act: Some Comments on the Latest Draft of RUPA*, 19 FLA. ST. U. L. REV. 727, 757 (1991). It is further suggested that this standard imbues courts with the power to act as "roving commissions" to search out injustice in partnership agreements. *Id.*

144. See, e.g., *Levy v. Disharoon*, 749 P.2d 84, 89 (N.M. 1988); *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 515 (Mass. 1975) (dictum); *Page v. Page*, 359 P.2d 41, 44 (Cal. 1961).

145. See REVISED UNIF. PARTNERSHIP ACT (Draft, Aug. 2, 1991).

what it includes.<sup>146</sup> The general definition of good faith in the Uniform Commercial Code (U.C.C.) is simply "honesty in fact in the conduct or transaction concerned."<sup>147</sup> The U.C.C. is more exacting in the case of a merchant, for whom good faith means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."<sup>148</sup> Because RUPA assumes cooperative rather than adversarial relationships, the obligation of good faith and fair dealing presumably will be given a more powerful reading in the partnership context.<sup>149</sup>

### SEPARATE STATEMENT OF INFORMATION AND CONSULTATION RIGHTS

The section 404 assertion that it contains an exclusive list of the fiduciary duties of partners is subject to one major qualification: the information and consultation rights of partners remain, as they were under the UPA,<sup>150</sup> separately stated. RUPA includes obligations that have been considered fiduciary in nature without describing them as fiduciary duties. For ex-

146. See Robert S. Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 41 VA. L. REV. 195, 262 (1968).

The *Restatement (Second) of Contracts* also recognizes a duty of good faith and fair dealing: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." The comment states that the meaning of good faith varies with the context:

Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving "bad faith" because they violate community standards of decency, fairness or reasonableness.

RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1979).

147. U.C.C. § 1-201(19) (1990).

148. *Id.* § 2-103(1)(b). That definition of good faith applies for purposes of Article 2 "unless the context otherwise requires." *Id.*

149. See *Page v. Page*, 359 P.2d 41 (Cal. 1961) (the court stated that the power to dissolve a partnership at will is confined by the duty of good faith, which it seemed to equate with a powerful duty of loyalty). *Page* is criticized in ROBERT W. HILLMAN, *LAW FIRM BREAKUPS* 81-84 (1990).

The duty of loyalty is discussed as part of the duty of good faith in *Levy v. Disharoon*, 749 P.2d 84 (N.M. 1988):

In a partnership relationship, each partner has the right to have his co-partner exercise good faith in all partnership matters. It follows from the general requirement of good faith in partnership dealings that a partner is not allowed to gain any advantage over a co-partner by fraud, misrepresentation or concealment, and for any advantage so obtained he must account to the co-partner.

*Id.* at 89 (citations omitted). See generally *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505 (Mass. 1975) (the court emphasized that partners owe each other the "utmost good faith and loyalty," referring repeatedly to it as a "strict good faith standard," and holding the shareholders of a close corporation to a similar standard).

150. See UPA §§ 19 (right of access to books), 20 (duty to render information on demand).

ample, section 403(b) states: "A partnership shall provide partners and their agents and attorneys access to its books and records."<sup>151</sup> That right is not conditioned on the partner's purpose or motive.<sup>152</sup> Former partners also are given information rights, but limited "to the period during which they were partners."<sup>153</sup>

Beyond access to the partnership's books and records, each partner and the partnership also is required to furnish, on demand, "to the extent just and reasonable, complete and accurate information concerning the partnership."<sup>154</sup> Absent such a demand, an affirmative disclosure duty may arise under some circumstances. For example, it has been suggested that the equal right of all partners under the UPA to participate in management<sup>155</sup> gives rise to an interstitial duty to provide partners with material information.<sup>156</sup> RUPA provides an identical management right and thus presumably provides identical information rights.<sup>157</sup>

### *THE IRREDUCIBLE MINIMUM OF FIDUCIARY DUTIES*

RUPA takes the position that there is an irreducible core of fiduciary duties that cannot be drafted away. As one Drafting Committee member put it, "Fiduciary duty is the glue that holds the partnership together."<sup>158</sup> Although the case law rarely states that fiduciary duties are mandatory, RUPA echoes the recent United States Court of Appeals for the First Circuit opinion in *Wartski v. Bedford*.<sup>159</sup> The court stated that "[t]he fiduciary duty of partners is an integral part of the partnership agreement whether or not expressly set forth therein. It cannot be negated by the words of the partnership agreement."<sup>160</sup>

RUPA states that four fiduciary and information rules cannot be negated by the partnership agreement.<sup>161</sup> First, the agreement may not "unreasonably restrict the right of access to books and records."<sup>162</sup> Second, the agreement may not "eliminate the duty of loyalty,"<sup>163</sup> "but the partners by agreement may identify specific types or categories of activities that do

151. RUPA § 403(b).

152. *See id.* § 403 cmt. 2; *cf.* Model Act § 16.02(c)(1) (shareholder access to certain corporate books and records conditioned on proper purpose).

153. *See* RUPA § 403(b).

154. *See id.* § 403(c).

155. UPA § 18(e).

156. *See supra* note 109 and accompanying text.

157. RUPA § 401(f). *See id.* § 403 cmt. 3.

158. Remark by Judge William C. Gardner, Uniform Commissioner from Washington, D.C.

159. 926 F.2d 11 (1st Cir. 1991).

160. *Id.* at 20.

161. *See* RUPA § 103(b).

162. *Id.* § 103(b)(2).

163. *Id.* § 103(b)(3).

not violate the duty of loyalty, if not manifestly unreasonable."<sup>164</sup> Third, the agreement may not "unreasonably reduce the duty of care."<sup>165</sup> Fourth, the agreement may not "eliminate the obligation of good faith and fair dealing,"<sup>166</sup> "but the partners by agreement may determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable."<sup>167</sup>

Controversies about whether rules are default rules or mandatory rules arise primarily because different policy conclusions can be reached by different people. A libertarian, free-market oriented policy maker is likely to suggest that all the rules governing the relations among partners should be merely default rules and that partners ought to be held to whatever bargain they negotiate.<sup>168</sup> A more parentalistic policy maker, on the other hand, is more inclined to support mandatory fiduciary duties, especially to protect minority partners.

RUPA adopts an approach that does not satisfy fully the purists on either side of the debate. Libertarians fault RUPA for failing to include provisions analogous to two recent additions to the Delaware limited partnership act:

(c) It is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.

(d) To the extent that, at law or in equity, a partner has duties (including fiduciary duties) and liabilities relating thereto to a limited partnership or to another partner (i) any such partner acting under a partnership agreement shall not be liable to the limited partnership or to any such other partner for the partner's good faith reliance on

164. *Id.* § 404(c).

165. *Id.* § 103(b)(4).

166. *Id.* § 103(b)(5).

167. *Id.* § 404(e).

168. See 2 BROMBERG & RIBSTEIN, *supra* note 129, § 6.07, at 6:68: ("Fiduciary duties are essentially part of the standard form contract that governs partnerships in the absence of contrary agreement. . . .") That is a narrow view of fiduciary duties which finds some support in recent case law. See, e.g., *Jordan v. Duff & Phelps, Inc.*, 815 F.2d 429 (7th Cir. 1987), *cert. dismissed*, 485 U.S. 901 (1988), in which Judge Easterbrook stated: "Because the fiduciary duty is a standby or off-the-rack guess about what parties would agree to if they dickered about the subject explicitly, parties may contract with greater specificity for other arrangements." *Id.* at 436. On the other hand, Judge Easterbrook's opinion, and the dissenting opinion of Judge Posner, have been described as unprecedented:

The definition of fiduciary obligation articulated in the *Jordan* opinions appears to be literally unprecedented in prior Anglo-American caselaw. The opinions define fiduciary obligation as the court's guess about what the parties would have agreed to, had they bargained over the matter. To the extent that the *Jordan* opinions suggest that this definition is anything other than a novel departure from prior caselaw, the representation is not accurate.

the provisions of such partnership agreement, and (ii) the partner's duties and liabilities may be expanded or restricted by provisions in a partnership agreement.<sup>169</sup>

Parentalists, on the other hand, complain that RUPA has taken far too sharp a turn toward the libertarians. For example, it has been suggested that a partner's right of access to partnership books and records should never be varied by agreement.<sup>170</sup> Perhaps the fact that neither extreme is satisfied fully indicates a balanced approach that legislators will recognize as a reasonable compromise on a difficult issue.

## ***NATURE AND TRANSFER OF PARTNERSHIP PROPERTY***

### ***NATURE OF PARTNERSHIP PROPERTY***

RUPA's relative simplicity regarding the nature of partnership property is perhaps the most dramatic illustration of the benefits of an entity approach. Section 203 states simply that "[p]roperty transferred to or otherwise acquired by a partnership is property of the partnership and not of the partners individually."<sup>171</sup>

### ***Tenancy in Partnership Abolished***

The shift to an entity model permits RUPA to discard completely the confusing tenancy in partnership of the UPA. UPA section 24 provides that every partner has "rights in specific partnership property."<sup>172</sup> UPA section 25(1) elaborates by stating that each partner "is co-owner with his partners of specific partnership property holding as a tenant in partnership."<sup>173</sup> These statements reflect an aggregate conception that each partner is a direct owner of an undivided interest in the partnership business, including its assets. UPA section 25(2), which describes the "incidents of this tenancy," however, denies the individual partners the incidents of ownership of partnership assets. By process of elimination, the incidents of ownership that are taken from the partners are left in the partnership. Stated simply, the UPA's tenancy in partnership reaches an entity result but insists on stating that result in aggregate terms. RUPA abandons the tenancy in partnership to reach an entity result that is stated in entity

169. DEL. CODE ANN. tit. 6, § 17-1101 (Supp. 1992). It is significant that Delaware permits a partner's duties to be restricted in a limited partnership agreement, but not eliminated. Cf. RUPA § 103(b); but see Georgia Limited Liability Company Act § 14-11-305(4) (fiduciary duties of members and managers may be eliminated by agreement, without limitation), Ga. H.B. 264, 142d Gen. Assembly, 1st Reg. Sess. (1993).

170. RUPA § 103(b)(2) bars only the unreasonable restriction of a partner or former partner's access rights. See Model Act § 16.02 (mandatory inspection rights).

171. RUPA § 203. See generally Edward S. Merrill, *Partnership Property and Partnership Authority Under the Revised Uniform Partnership Act*, *infra* p. 83.

172. UPA § 24(1).

173. *Id.* § 25(1).

terms. All reference to a partner's rights in specific partnership property is eliminated. In order to emphasize the change from prior law, section 501 expressly provides that "[a] partner is not a co-owner of partnership property" and has no transferrable interest in partnership property.<sup>174</sup> Closely related is section 502, which makes clear that a partner's transferable interest in the partnership is analogous to a share of stock: "The only transferable interest of a partner in the partnership is the partner's interest in distributions. The interest is personal property."<sup>175</sup>

### ***Property Acquired in the Name of the Partnership***

RUPA enhances certainty regarding when property is acquired by the partnership and thus becomes partnership property. First, it sharply distinguishes property acquired "in the name of the partnership" from other partnership property.<sup>176</sup> Property so acquired is conclusively deemed to be partnership property, thereby promoting reliance on record title.<sup>177</sup> The certainty of subsequent transfers of partnership property also is enhanced by clear rules when the partnership holds record title.<sup>178</sup> The protection afforded by record title to both the partnership and third parties is extended to cover personal property as well as real property.<sup>179</sup>

Under section 204(b), "[p]roperty is acquired in the name of the partnership by a transfer to (1) the partnership in its name; or (2) [to] one or more partners in their capacity as partners in the partnership, if *the name of the partnership* is indicated in the instrument transferring title to the property."<sup>180</sup> Thus, if property is acquired and held in the name of the partnership, the partnership's interest can be ascertained from the record.

### ***Property Not Held in the Name of the Partnership***

Property also may be partnership property even if it is not acquired in the name of the partnership. First, property is partnership property if

174. RUPA § 501. RUPA § 402 reaffirms that partners are cut off from particular partnership assets, even assets they contribute, by providing that no partner has a right to receive a distribution in kind. Similarly, no partner can be forced to accept a distribution in kind.

175. *Id.* § 502.

176. *Id.* § 204.

177. *Id.* § 204(a)(1).

178. See *infra* text accompanying notes 185-240 (transfer of partnership property).

179. UPA § 8(3) provides that real property may be acquired in the partnership name, but is silent regarding personal property.

180. RUPA § 204(b) (emphasis added). RUPA focusses on whether the instrument of transfer to the partnership, such as the deed or certificate of title, indicates the correct partnership name. That focus becomes critical in the rules governing the transfer of partnership property from the partnership, because transferees cannot ascertain the partnership's interest from the record unless the partnership name is correct. RUPA yields to the state's general conveyancing law when minor variations occur, such as a slight misspelling. *Id.* § 104; see R.G. PATTON, III AMERICAN LAW OF PROPERTY § 12.76, at 344 (1952).

acquired in the name of "one or more partners with an indication in the instrument transferring title to the property of the person's capacity *as a partner* or of the existence of a *partnership* but without an indication of the name of the partnership."<sup>181</sup> As among the partners, either indication evidences an intention that the property is being acquired for the partnership. It also alerts third parties who check the record of a potential partnership interest in the property.

Second, even if the instrument transferring title to one or more of the partners does not indicate their capacity as a partner or the existence of a partnership, the property nevertheless may be partnership property. Section 204(c) presumes that property belongs to the partnership if it is acquired with partnership funds.<sup>182</sup> If partnership funds are not used to acquire the property, it is presumed to be the separate property of the named partners, even though used for partnership purposes.<sup>183</sup> Both presumptions are rebuttable. Ultimately, as among the partners, their intention controls whether the property belongs to the partnership or to one or more of the partners. The presumptions apply when the partners have failed to express their intention.<sup>184</sup> The easiest way to prevent disputes is to acquire partnership property in the name of the partnership.

### *TRANSFER OF PARTNERSHIP PROPERTY*

RUPA rewrites many of the rules governing the transfer of partnership property. The changes are designed to enhance certainty and convenience, especially in the transfer of real property, and to afford third parties greater protection in dealing with partnerships. First, RUPA modifies the general rules in the UPA<sup>185</sup> on the agency authority of partners.<sup>186</sup> Second, RUPA modifies the special rules in the UPA<sup>187</sup> concerning the transfer of partnership property.<sup>188</sup> Finally, RUPA introduces a completely new system for filing voluntary statements concerning the authority of partners and the status of their relationship.<sup>189</sup>

#### *Partners' Agency Authority Generally*

The general agency authority of partners under RUPA is basically the same as under the UPA, with several minor changes. Under section 301, each partner has both actual and apparent authority to bind the partner-

181. RUPA § 204(a)(2) (emphasis added).

182. That continues the presumption of UPA § 8(2).

183. RUPA § 204(d).

184. *See id.* § 204 cmt. 3.

185. UPA § 9.

186. *See infra* text accompanying notes 190-204.

187. *See* UPA § 10.

188. *See infra* text accompanying notes 205-216.

189. *See infra* text accompanying notes 217-240.



ship in carrying on the partnership business in the usual way.<sup>190</sup> A partner's actual authority may be expanded by the partnership agreement to include extraordinary matters outside the partnership's usual course of business or it may be restricted as to ordinary matters.<sup>191</sup>

RUPA clarifies and slightly expands the scope of a partner's apparent authority. UPA section 9(1) provides that a partner has apparent authority for carrying on in the usual way "the business of the partnership."<sup>192</sup> RUPA section 301(1) adds "or business of the kind carried on by the partnership."<sup>193</sup> This codifies the so-called English rule, which enhances the protection of persons dealing with a partnership unfamiliar to them.<sup>194</sup>

If a partner's actual authority is restricted,<sup>195</sup> the partner still may have apparent authority to bind the partnership, unless the other party "knew or had received a notification" of the lack of authority.<sup>196</sup> That is a subtle change from UPA section 9(1), which provides that the partnership is not bound if the other party has "knowledge" of the lack of authority.<sup>197</sup>

Under RUPA, the term *knew* is confined to actual knowledge, which is cognitive awareness.<sup>198</sup> Under the UPA, on the other hand, the term *knowledge* also embodies a species of implied knowledge and thus is more akin

190. RUPA § 301(1) provides that "each partner is an agent of the partnership for the purpose of its business."

191. A partner's act outside the usual course of business is not binding on the partnership unless the partner has actual authority. *See id.* § 301(2). As a general rule, the burden is on the other party to establish the partner's actual authority to act beyond the usual course of business. *See, e.g.,* *Stone v. First Wyo. Bank, N.A.*, 625 F.2d 332 (10th Cir. 1980); *Chelsea Nat'l Bank v. Lincoln Plaza Towers Assocs.*, 461 N.Y.S.2d 328 (N.Y. App. Div. 1983), *aff'd*, 462 N.E.2d 130 (N.Y. 1984); *Burns v. Gonzalez*, 439 S.W.2d 128 (Tex. Civ. App. 1969). The partnership is bound, however, by a filed statement of partnership authority granting a partner extraordinary authority. *See* RUPA § 303(d).

UPA § 9(3) sets forth a list of acts deemed extraordinary as a matter of law, thus requiring unanimous partner consent. The list includes such obviously extraordinary acts as disposing of the good-will of the business (i.e., a sale of the business), as well as acts that might be rather inconsequential (e.g., submitting a partnership claim to arbitration). RUPA leaves those determinations to be made on a case by case basis.

192. UPA § 9(1).

193. RUPA § 301(1).

194. *See* JUDSON A. CRANE & ALAN R. BROMBERG, *LAW OF PARTNERSHIP* § 49, at 276 (1968).

195. A partner's authority may be restricted in the partnership agreement or by action of a majority of the partners.

196. RUPA § 301(1).

197. *See also* UPA § 9(4) (act in contravention of restriction on authority not binding on persons having "knowledge" of the restriction).

198. RUPA § 102(a). The RUPA concepts and definitions of *knew*, *notice*, and *a notification* are drawn from U.C.C. § 1-201(25)-(27) (1990). They were edited to improve clarity and style, but no substantive change from the U.C.C. meanings is intended. *See* RUPA § 102 cmt.

to the RUPA concept of *notice*.<sup>199</sup> Therefore, despite the similarity in language, RUPA provides greater protection to third persons dealing with partners, who may rely on the partner's apparent authority absent actual knowledge or notification of a restriction.<sup>200</sup> In this regard, RUPA effects a slight reallocation of the risk of unauthorized agency power in favor of third parties. That is consistent with notions of the expanded liability of principals since the UPA was drafted.

RUPA attempts to balance its shift toward greater protection of third parties by providing several new ways for partners to protect themselves against unauthorized actions by a rogue partner. First, the partnership may notify a third party of a partner's lack of authority.<sup>201</sup> Such notification is effective upon receipt, whether or not the third party actually learns of it.<sup>202</sup> More significantly, the partnership may file a statement of partnership authority restricting a partner's authority.<sup>203</sup> As discussed *infra*, third parties are deemed to know of a restriction on a partner's authority to transfer real property contained in a properly recorded statement.<sup>204</sup>

### ***Rules for Transfer of Partnership Property***

UPA section 10 contains a number of confusing rules governing the transfer of partnership real property. RUPA section 302 rewrites those rules to add clarity and certainty, using the key concept of property held in the name of the partnership.<sup>205</sup> RUPA also extends the coverage of the rules to titled personal property and other property acquired by an instrument of transfer evidencing the partnership's interest.<sup>206</sup>

Partnership property held in the name of the partnership may be transferred by an instrument executed by any partner in the partnership

199. Compare UPA § 3(1) (a person has "knowledge" of a fact when he or she has "knowledge of such other facts as in the circumstances shows bad faith") with RUPA § 102(b)(3) (a person has "notice" of a fact when he or she has "reason to know it exists from all of the facts known to the person at the time in question"). Under RUPA, a person also has notice if he or she knew or had received a notification of a fact. See RUPA § 102(b)(1), (2).

200. Absent actual knowledge, third parties have no duty to inspect the partnership agreement or inquire otherwise to ascertain the extent of a partner's actual authority in the ordinary course of business, absent actual knowledge even if they have some reason to question it. See RUPA § 301(1) (partnership bound unless third party knew or had received a notification that partner lacked authority; notice insufficient).

201. *Id.* §§ 303(a)(2), 304.

202. See *id.* § 102(d) (a notification is effective when it is duly delivered at a person's place of business or at any other place held out by the person as a place for receiving communications).

203. See *id.* § 303(a)(2).

204. See *id.* § 303(d)(2). Non-partners are not deemed to know of other limitations on a partner's authority contained in a filed statement of authority, and thus they are not bound by them. See *id.* § 303(f).

205. See *id.* § 204.

206. *Id.* § 302(a)(2).

name.<sup>207</sup> If the partnership wants to recover the property on the ground that it was transferred by a partner without authority, the partnership has the burden of proving that the partner executing the instrument of transfer lacked authority.<sup>208</sup> Whether the partner had authority is determined under the usual partnership agency rules, subject to the effect of a statement of partnership authority.<sup>209</sup> Therefore, every partner has authority to transfer partnership property in ordinary course transactions, unless the transferee knows of a restriction on the partner's authority.<sup>210</sup> A transfer not in the ordinary course, however, must be authorized by the other partners.<sup>211</sup>

The rules are somewhat different for the transfer of partnership property not held in the name of the partnership. If title is held in the name of one or more of the partners, the property may be transferred by the partners in whose name it is held.<sup>212</sup> It makes no difference whether there is an indication in the record of their capacity as partners or the existence of a partnership.

The rules for avoiding unauthorized transfers of property held in the name of one or more partners differ, however, depending on whether the record reflects a possible partnership interest in the property. If there is an indication of the partner capacity of the titleholders or of the existence of a partnership, the partnership may recover the property by proving that the transfer was unauthorized.<sup>213</sup> If the transfer is in the ordinary course of the partnership's business, the partnership must prove that the transferee knew of the partner's lack of authority to execute the instrument of transfer.<sup>214</sup> If the title does not reflect a possible partnership interest, the partnership also must prove that the transferee (if for value) knew it

207. *Id.* § 302(a)(1). To be property held in the name of the partnership, the instrument transferring title to the partnership must be in the partnership's name or indicate the name of the partnership, if title is held in the partners' names. *See id.* § 204(b). If property is held in the name of the partnership, transferees always may ascertain the partnership's interest from the record.

208. *See id.* § 302(b)(1)(i). To recover from a remote transferee for value, the partnership also must prove that the remote transferee knew the initial transfer from the partnership was unauthorized (or received a notification thereof). *Id.* § 302(b)(1)(ii). A partnership is barred from recovering the property once it has passed through the hands of a transferee with good title. *See id.* § 302(c).

209. *See id.* § 301; *see also infra* text accompanying notes 217-226.

210. *See* RUPA § 301(1). A transferee also is bound if he or she receives a notification of a restriction on the partner's authority, even if it does not actually come to his or her attention. *See id.* §§ 301(1), 102(e); *see also supra* text accompanying notes 185-204.

211. *See* RUPA § 301(2).

212. *See id.* § 302(a)(2), (3).

213. *Id.* § 302(b)(1).

214. *See id.* § 301(1). A notification of the partner's lack of authority would also suffice. *See id.*; *see also supra* notes 190-191.

was partnership property.<sup>215</sup> This additional requirement affords transferees greater protection than under the UPA.<sup>216</sup>

### *Effect of Statement of Partnership Authority*

#### *Use of Statements Generally*

RUPA provides for a regime of voluntarily filed statements containing certain basic information about a partnership, such as the agency authority of its partners.<sup>217</sup> Because of the informality of many partnerships, and the inadvertence of some, mandatory filings were deemed inappropriate and in some cases impossible. It was the Drafting Committee's belief, however, that filings would become routine for sophisticated partnerships and would be required by lenders and others for major transactions.<sup>218</sup>

An effective filing system for partnerships is one of RUPA's significant contributions. The use of public statements brings to partnership affairs a greater degree of certainty than was possible under the UPA. Not only does reliance on filed statements provide greater protection to those doing business with the partnership, but it also affords the partnership greater protection against a partner's unauthorized acts. Finally, filed statements are more convenient and less costly than the cumbersome practices used under the UPA to ensure that partners acting on behalf of a partnership have the authority to do so, especially with respect to the transfer of real property.<sup>219</sup>

To be effective, statements filed on behalf of the partnership must be executed by at least two partners.<sup>220</sup> This is a compromise between the security of requiring all or a majority of the partners to sign and the convenience of a single signatory. A copy of all statements filed must be sent promptly to all partners and persons named as partners in the statement.<sup>221</sup> To be effective with respect to real property, a certified copy of the statement also must be recorded in the office for recording transfers of real property.<sup>222</sup> In most states, that will mean recording in the county

215. RUPA § 302(b)(2).

216. *Cf.* UPA § 10(3) (no proof required that transferee knew property was partnership property).

217. *See* RUPA § 105(a) (eschewing a mandatory filing system in favor of a voluntary system).

218. *See id.* § 105 cmt. 1.

219. For example, third parties often require that a deed or mortgage be executed by all the partners or that an affidavit of authority be executed and recorded.

220. RUPA § 105(c). A single partner may execute individually and file a statement on his or her own behalf. To be effective, the partner must declare personally, under penalty of perjury, that the statement is accurate. *Id.* §§ 105(c), 303(c).

221. *Id.* § 105(e). Failure to send a copy to every partner, however, does not limit the statement's effectiveness. *Id.*

222. *See id.* § 105(b).

where the real property is located. Statements may be amended or canceled,<sup>223</sup> and the accuracy of any statement may be denied.<sup>224</sup>

### *Statement of Partnership Authority*

The most important goal of the statement of partnership authority is to facilitate real property transfers. The statement must include the names of the partners authorized to execute instruments transferring real property held in the name of the partnership.<sup>225</sup> The scope of a statement of authority is not limited, however, to real property transfers. The statement also may include the authority, or limitations on the authority, of any partner to enter into other transactions on behalf of the partnership, as well as "any other matter" the partners choose to include.<sup>226</sup>

Because all partners have at least apparent authority to transfer partnership property and otherwise bind the partnership in ordinary course transactions, a grant of authority in a statement is most significant if it bestows extraordinary authority on a partner. Otherwise, it merely duplicates the default authority rule. Similarly, a limitation of authority in a statement is significant only if it restricts a partner's authority to act in ordinary course transactions. Under RUPA, the legal effect of a statement of authority differs depending upon whether the transaction involves a transfer of real property held in the name of the partnership, or whether it is a transaction not involving the transfer of real property.

#### Effect on Transfer of Real Property Held in the Name of the Partnership

The effect of a properly recorded statement of partnership authority is virtually absolute with respect to the authority of a partner to transfer real property held in the name of the partnership.<sup>227</sup> This is consistent

223. *Id.* § 105(d). Unless earlier canceled, a statement of authority is canceled by operation of law five years after the date on which the statement, or the most recent amendment, was filed. *Id.* § 303(g).

224. *Id.* § 304 (statement of denial).

225. *Id.* § 303(a)(1)(iv). The statement also must include: (i) the name of the partnership; (ii) the address of its chief executive office and, if any, of at least one office in the state; and (iii) the names and addresses of all the partners or of an agent from whom a list of partners may be obtained. *Id.* § 303(a)(1), (b). Naming the partners is a "disclosure tax" on the privilege of filing a statement of partnership authority. Failure to name the partners does not affect the validity of the statement. *Id.* § 303(c).

226. *Id.* § 303(a)(2).

227. The execution, filing, and recording of statements is governed by RUPA § 105. To be effective, a statement granting or limiting a partner's authority to transfer real property must be recorded in the office for recording the transfer of the real property that is being conveyed. *Id.* § 303(d)(2), (e). To be effective, the statement recorded must be a certified copy of the statement filed with the Secretary of State. *Id.* § 105(b). This is to prevent conflicts between statements. Statements may be amended and canceled. *Id.* § 105(d). A partner or a person named as a partner who believes a filed statement is erroneous may file a statement of denial. *Id.* § 304. A statement of denial operates as a limitation on the authority granted in the original statement. *Id.*

with the policy supporting reliance on record title involving real property. A recorded statement of authority has no effect on the authority of a partner to transfer partnership real property not held in the name of the partnership.<sup>228</sup> In that case, a search of the record would not disclose the partnership's interest in the property.

With respect to real property held in the name of the partnership, RUPA makes the authority conferred on a partner in a properly recorded statement conclusive in favor of a person who gives value without actual knowledge to the contrary.<sup>229</sup> Thus, a grant of extraordinary authority to transfer real property outside the ordinary course of the partnership's business is binding on the partnership, even if the partner executing the instrument of transfer in fact has no authority, unless the transferee knows the partner lacks authority.

A statement of authority is, however, a two-way street. Under RUPA, third parties are conclusively deemed to know of properly recorded limitations on a partner's authority to transfer real property held in the name of the partnership.<sup>230</sup> Third parties thus have constructive knowledge of such restrictions and are bound, under the general rules governing a partner's agency authority, even if the transfer is within the ordinary course of business.

The conclusive effect of a recorded grant of authority is, however, subject to a recorded limitation of authority.<sup>231</sup> In effect, conflicting statements of authority cancel each other out. In that case, third parties may not rely on the record, but must ascertain from other sources the extent of a partner's actual authority.

### Effect on Non-Real Property Transactions

A filed statement of authority has a more limited effect in other transactions that do not involve the transfer of real property, such as the transfer of partnership personal property or the execution of a contract on the

228. RUPA contains no positive statement to this effect. It is the negative implication of reading § 303(d)(1), which deals with grants of authority "except for transfers of real property," and § 303(d)(2), which deals only with grants of authority to transfer real property held in the name of the partnership. Section 303(e), which deals with limitations on a partner's authority to transfer real property, also is effective only with respect to property held in the name of the partnership.

229. RUPA § 303(d)(2). Where a recorded statement conflicts with the authority granted in another statement of authority, such as a recorded statement of denial, it operates as a limitation on the authority granted to the extent of the conflict and destroys the presumption. In that event, third parties may not rely on the record and must find another way to establish the actual authority of the partners to convey the property. *See id.* § 304.

230. *See id.* § 303(e).

231. *See id.* § 303(d)(2), which provides that a grant of authority is conclusive "so long as and to the extent that . . . a limitation on that authority is not then of record." A statement of denial, as well as a conflicting statement of authority, may operate as a limitation on authority for that purpose. *Id.* § 304.

partnership's behalf. In those cases, the effect also differs depending on whether the statement is a grant of extraordinary authority or a limitation of authority.

A filed grant of authority is conclusive in favor of a person who gives value without knowledge to the contrary.<sup>232</sup> That binds the partnership, thereby protecting third parties who rely on the record.

Except for transfers of real property held in the name of the partnership, third parties are not deemed to know of a filed limitation on a partner's authority.<sup>233</sup> Apart from the transfer of real property, the effectiveness of a filed limitation on a partner's authority is determined by the general rules on the authority of partners. Section 301 provides that third parties are not bound by a limitation on a partner's authority, unless they actually know (or have been notified) of the limitation.<sup>234</sup> Thus, a statement restricting the authority of a partner has no limiting effect, except in the case of real property transfers, other than as a potential source of actual knowledge to third parties who search the record.

Because they are not bound, third parties dealing with a partner do not need to monitor the partnership's filings in order to protect themselves against unknown restrictions (except in real estate transactions). To require parties dealing with the partnership in everyday commercial transactions to check the record continually would be inefficient. In those cases, the risk of a rogue partner exceeding his authority is better allocated to the partnership.

### *Effect of Statement of Dissociation and Statement of Dissolution*

RUPA contains two important exceptions to the general rule that third parties are not deemed to know of a filed limitation on a partner's authority, other than to transfer real property.<sup>235</sup> RUPA provides that third parties are deemed to have notice of a statement of dissociation<sup>236</sup> and a statement of dissolution<sup>237</sup> ninety days after they are filed.<sup>238</sup> Thereafter, both statements operate to limit a partner's apparent authority to bind

232. *Id.* § 303(d)(1). As in the case of real property, the binding presumption of authority is subject to a limitation contained in another statement then of record. *See supra* note 229.

233. RUPA § 303(f). To some extent, this might deter third parties from searching the record because ignorance is rewarded.

234. *Id.* § 301(1).

235. RUPA § 303(f) provides that a third party is not deemed to know of a filed limitation on authority "except as provided in . . . Sections 704 and 805."

236. *See* RUPA § 704; *see also supra* text accompanying notes 24-40.

237. *See* RUPA § 805; *see also supra* text accompanying notes 54-63.

238. *See* RUPA §§ 704(c), 805(c). If properly recorded, those statements operate immediately as a limitation on the partners' authority to transfer real property held in the name of the partnership. *Id.* § 303(d). After filing a statement of dissolution, the partnership may file a new statement of authority specifying those partners who may transfer real property during the winding up period. *Id.* § 806(d).

the partnership, even if the other party does not actually have notice of the partner's dissociation or of the partnership's dissolution.<sup>239</sup>

The greater impact of those statements on the rights of third parties is justified by the likely visible effects of a partner's dissociation or the partnership's dissolution—alerting those dealing with the partnership to inquire or to check the record. The partners' need for a relatively prompt and effective way to terminate apparent authority also is greater in those situations.<sup>240</sup>

## CONVERSIONS AND MERGERS

Article 9 is new and authorizes the conversion and merger of partnerships.<sup>241</sup> Because conversions and mergers were unthinkable under the aggregate theory, it is not surprising that the UPA is silent on the subject. Today, however, partnership conversions and mergers are quite common, although the absence of statutory authority in most states makes their validity and legal consequences unclear.<sup>242</sup> RUPA provides much needed

239. Unless a statement of dissociation is filed, a dissociated partner has lingering apparent authority for two years if the third party does not have notice of the partner's dissociation and reasonably believes he or she still is a partner. *Id.* § 702(a); *see also supra* text accompanying notes 92-95. Likewise, after dissolution, the partners' usual apparent authority continues unless the third party has notice of the dissolution. RUPA § 804(2); *see also supra* text accompanying notes 96-100.

240. The cost of the partners' enhanced protection, however, falls on third parties dealing with the partnership who must check the record at least every 90 days to be assured that a partner's authority has not been limited by dissociation or dissolution. *See* RUPA §§ 704, 805.

241. *Id.* §§ 901-902.

242. At least 14 states authorize the merger of limited partnerships. *See* Craig B. Smith, *Limited Partnerships—Expanded Opportunities Under Delaware's 1988 Revised Uniform Limited Partnership Act*, 15 DEL. J. CORP. L. 43, 89 (1990), for a chart comparing the attributes of each state's limited partnership act. In addition to the ten states shown in the chart, four more states authorized the merger of limited partnerships. *See* CAL. CORP. CODE § 15678.1 (West 1990); MO. REV. STAT. § 359.1 (1986), as amended, Laws 1993, S.B. 66 & 20, West No. 146; VA. CODE ANN. § 50-73.48:1 (Michie Supp. 1993); WASH. REV. CODE ANN. § 25.10.800 (West 1991). Seven jurisdictions authorize cross-entity mergers of limited partnerships and other business entities, such as corporations, business trusts, or limited liability companies. In addition to the three jurisdictions shown in the chart, the new Missouri, Virginia, and Washington statutes, *supra*, and Texas authorize such cross-entity mergers. *See* TEX. REV. STAT. ANN. art. 6132a-1, § 2.11(a) (West 1992). In addition to Missouri and Texas, Delaware authorizes the merger of limited and general partnerships. *See* DEL. CODE ANN. tit. 6, § 17-211 (Supp. 1993).

Only one state authorizes the conversion of a general partnership to a limited partnership. *See* VA. CODE ANN. § 50-73.11:1 (Michie Supp. 1993). Four states authorize the conversion of a general partnership to a limited liability company. *See* GA. CODE ANN. § 14-11-212(a) (1993); MO. REV. STAT. § 359.777 (1986), as amended, Laws 1993, Mo. S.B. 66 & 20, West No. 146; VA. CODE ANN. § 13.1-1010.1 (Michie Supp. 1993); W. VA. CODE § 31-1A-47(a) (Supp. 1993).



certainty as to their validity and clear answers to basic questions about their legal effect.

## SAFE HARBOR

Article 9 is merely a “safe harbor.” Its requirements are not mandatory, and a partnership may convert or merge in any other manner provided by law.<sup>243</sup> If the requirements of Article 9 are followed, a partnership conversion or merger is legally valid and has the effect provided in the Act. As a result of the added comfort to lawyers rendering opinion letters regarding the validity of partnership conversions and mergers, it is likely that Article 9 will be followed in most cases.<sup>244</sup>

## CONVERSIONS

RUPA authorizes the conversion of a general partnership to a limited partnership and of a limited partnership to a general partnership.<sup>245</sup>

### *Effects of Conversion*

A converted partnership is the same entity that existed before the conversion.<sup>246</sup> This avoids an unwanted and unnecessary dissolution of the old entity and the creation of a new entity, thereby preserving the benefits of a continuing entity. Specifically, upon the effective date of the conversion, all property owned by the converting partnership remains vested in the converted entity.<sup>247</sup> Likewise, all obligations of the converting partnership

243. See RUPA § 908. In states where the limited partnership act authorizes the conversion of a limited partnership to a general partnership or the merger of limited and general partnerships, those procedures may be followed. Common law conversions and mergers of general partnerships still are possible.

244. The requirements of Article 9 are subject to modification in the partnership agreement. See *id.* § 103(a). The “safe harbor,” however, is available only if the requirements of Article 9 are followed, unless modification in the partnership agreement is invited expressly. For example, RUPA § 902(b) permits the voting requirements for approval of a conversion to be fixed in the agreement.

The application of Article 9 is not limited to the conversion and merger of domestic partnerships. See *id.* § 906(b). That is because it often is unclear where a partnership is domiciled, and under RUPA a partnership generally can select the law to govern its internal affairs. See *id.* §§ 103(a), 106 cmt. No harm appears likely to result from extending the right to convert or merge under local law to foreign partnerships. Whether the conversion or merger of a partnership is recognized by another jurisdiction depends on the law of that jurisdiction.

245. See *id.* §§ 902, 903. RUPA § 901 provides four definitions especially for Article 9, including the terms *general partner*, *limited partner*, and *limited partnership*. The term *partnership* is restricted to its general statutory meaning of a general partnership. See *id.* § 101(4). As used in Article 9, the term *partner* includes both general and limited partners. *Id.* § 901(4).

246. See *id.* § 904(a).

247. *Id.* § 904(b)(1). Because title remains vested in the converted entity, no further act or deed is necessary.

continue as obligations of the converted entity.<sup>248</sup> Actions and proceedings pending against the converting partnership continue as if the conversion never occurred.<sup>249</sup>

### *Approval of Conversion*

In a so-called "upstream" conversion of a general partnership to a limited partnership, the terms of the conversion must be approved by all the partners unless the partnership agreement specifically authorizes a conversion by a lesser vote.<sup>250</sup> In a "downstream" conversion of a limited partnership to a general partnership, the conversion must be approved by "all the partners," notwithstanding a provision in the partnership agreement purporting to authorize a lesser vote.<sup>251</sup> That includes all the limited partners.<sup>252</sup> The mandatory unanimity requirement reflects the Conference's caution in according deference to partnership agreements in the relatively novel context of partnership conversions. It was believed that a limited partner should not be at risk of having his or her status changed to that of a general partner, with its attendant personal liability, without actual consent, despite a contractual provision to the contrary.<sup>253</sup> This also is consistent with the traditional rule that one does not become a partner without consenting to the substance of the relationship.<sup>254</sup>

### *Personal Liability of Partners After Conversion*

A general partner who becomes a limited partner by conversion remains liable as a general partner for all obligations incurred by the partnership before the conversion.<sup>255</sup> Thereafter, the partner's liability is that of a limited partner, with one narrow exception.<sup>256</sup> The newly minted limited partner is personally liable for any obligation incurred within ninety days after the conversion takes effect if the third party reasonably believes that

248. *Id.* § 904(b)(2).

249. *Id.* § 904(b)(3). This means the action or proceeding may be continued in the name of the converting partnership. The style of the case may be changed to reflect the name of the converted entity.

250. RUPA § 902(b) provides that a conversion "to a limited partnership must be approved by all the partners or by a number or percentage specified for conversion in the partnership agreement." A general voting provision in the partnership agreement will not satisfy that requirement.

251. RUPA § 903(b). The partnership may, nevertheless, be converted based on the vote specified in the partnership agreement, but the conversion will not qualify for "safe harbor" treatment. *Id.* § 908.

252. *See id.* § 901(4).

253. *See id.* § 903 cmt.

254. *See* CRANE & BROMBERG, *supra* note 194, § 5, at 39.

255. RUPA § 901(c).

256. *See id.* § 902(e).

partner still is a general partner.<sup>257</sup> This conforms to the general rule imposing lingering liability on all dissociated partners.<sup>258</sup> In effect, third parties transacting business with the partnership after its conversion are deemed to have knowledge of a limited partner's status ninety days after the certificate of limited partnership is filed.<sup>259</sup> Of course, a partner becoming a limited partner can protect against any lingering personal liability by immediately notifying partnership creditors of his or her limited partner status.

Upon the conversion of a limited partnership to a general partnership, a former limited partner who becomes a general partner is personally liable only for obligations incurred after the conversion takes effect.<sup>260</sup> Thus, for obligations incurred by the limited partnership before the conversion, the new general partner's liability generally is limited to his or her investment in the firm.<sup>261</sup>

## MERGERS

RUPA expressly authorizes the merger of a general partnership with one or more general or limited partnerships.<sup>262</sup> The RUPA provisions governing partnership mergers are similar in most respects to corporate merger rules. The terms of the merger, and the manner and basis of converting the interests of each party to the merger into interests or obligations of the surviving entity, must be set forth in a plan of merger.<sup>263</sup> The surviving entity may be either a general partnership or a limited partnership.<sup>264</sup>

257. *See id.* § 902(e). The merger takes effect when the certificate of limited partnership is filed, unless a later date is specified. *Id.* § 902(d).

258. *See id.* § 703(b).

259. The certificate of limited partnership must set forth the name of each general partner. *See* RULPA § 201(a)(3).

260. *See* RUPA § 903(e). A conversion takes effect when the certificate of limited partnership is canceled. *Id.* § 903(d). Thus, a converted limited partner is treated the same as a newly admitted general partner. *See id.* § 309.

261. *See* RULPA § 303(a). A limited partner theoretically may become personally liable if he or she participates in the control of the business, but only to creditors who reasonably believe, based on the partner's conduct, that he or she is a general partner. *Id.*

262. RUPA § 905(a).

263. *Id.* § 904(b). Partnership interests may, instead, be converted into money or other property, in whole or in part. *Id.* § 905(b)(5).

264. *Id.* § 905(b)(3). The former partners of the partnerships being merged may continue as partners of the surviving entity or they may be dissociated incident to the merger. *See id.* § 906(e). If the surviving entity is a limited partnership, the continuing partners may be either general partners or limited partners. In that case, the plan of merger must specify the status of each continuing partner. *Id.* § 905(b)(3).

### *Effects of Merger*

When a merger takes effect,<sup>265</sup> the separate existence of every partnership that is a party to the merger (other than the surviving entity) ceases.<sup>266</sup> At that time, all property owned by each of the merged partnerships vests in the surviving entity.<sup>267</sup> All obligations of every party are thereafter obligations of the surviving entity.<sup>268</sup> Actions and proceedings then pending against each party to the merger continue as if the merger never occurred.<sup>269</sup>

### *Approval of Merger*

The plan of merger must be approved by all the partners of each general partnership that is a party to the merger, unless a lesser number or percentage is specified in its partnership agreement for the approval of mergers.<sup>270</sup> The plan also must be approved by all the partners, general and limited, of a limited partnership that is a party to the merger, notwithstanding a provision to the contrary in the partnership agreement, unless the law under which the limited partnership is organized specifically requires otherwise for mergers.<sup>271</sup>

### *Personal Liability of Partners After Merger*

Following a merger, a general partner of the surviving entity is personally liable for any pre-merger obligation for which he or she was personally liable, as well as all post-merger obligations of the surviving entity.<sup>272</sup> The general partner is not personally liable for the pre-merger obligations of a party to the merger for which he or she was not personally liable, such as the obligations of the merging partnerships of which he or she was not

265. A merger takes effect on the later of (i) the approval of the plan by all parties to the merger, (ii) the filing of all documents required to be filed as a condition of the merger, or (iii) any effective date specified in the plan. *Id.* § 905(e).

266. *Id.* § 906(a)(1).

267. *Id.* § 906(a)(2).

268. *Id.* § 906(a)(3). If the surviving entity is a foreign partnership, the Secretary of State is constituted its agent for service of process to enforce any obligation of a domestic partnership that is a party to the merger. *Id.* § 906(b). The purpose of this rule is to make it more convenient for local creditors to sue a foreign surviving entity when the credit was extended to a domestic partnership that disappeared as a result of the merger.

269. *Id.* § 906(a)(4). The surviving entity may be substituted as a party to the action or proceeding. *Id.*

270. *Id.* § 905(c)(1).

271. *Id.* § 905(c)(2). RULPA does not contain a special voting rule for mergers. *See* RULPA §§ 302, 405 (partners' voting rights governed by partnership agreement). RUPA does not defer to the limited partnership's contractual voting provisions because of concern regarding a limited partner becoming liable as a general partner without actual consent. *See* RUPA § 905 cmt.

272. RUPA § 906(c).

a general partner.<sup>273</sup> A limited partner of the surviving entity has no personal liability, unless he or she also was a general partner of a party before the merger.<sup>274</sup>

The surviving entity is liable for all pre-merger obligations of every party to the merger and all post-merger obligations.<sup>275</sup> Therefore, every partner of the surviving entity, general or limited, is liable for all obligations of the surviving entity at least to the extent of the partner's interest in that entity.<sup>276</sup> The general partners of the surviving entity also are personally liable for all post-merger obligations and for the pre-merger obligations of the partnership of which they were a general partner.<sup>277</sup>

A former partner of a constituent partnership who does not become a partner of the surviving entity is deemed dissociated as of the effective date of the merger.<sup>278</sup> Unless otherwise provided in the plan of merger, that partner's interest must be purchased by the surviving entity in the same manner as a buyout under Article 7,<sup>279</sup> and that partner's lingering agency power and continuing liability for post-merger transactions is the same as a dissociated partner's.<sup>280</sup>

### *Statement of Merger*

After a merger, the surviving partnership may file a statement of merger.<sup>281</sup> Once the statement is filed and, in the case of real property, recorded, all property that before the merger was held in the name of a party other than the surviving entity becomes property held in the name of the surviving entity for the purposes of the partnership property transfer rules.<sup>282</sup> Under section 302, every partner has the authority to transfer

273. *See id.* § 906(c)(1), (3).

274. *See id.* § 906(c)(2).

275. *Id.* § 906(a).

276. If any pre-merger liabilities of a constituent partnership are not satisfied out of the property of the surviving entity, the former general partners of that partnership must contribute the amount necessary to satisfy that party's obligations. *See id.* § 906(d).

277. *Id.* § 906(c).

278. *Id.* § 905(e).

279. *See supra* text accompanying notes 87-95.

280. *See* RUPA § 906(e). A statement of dissociation may be filed in connection with the merger, with the same effect as provided in §§ 703 and 704.

281. *Id.* § 907(a). The statement must contain the names of the surviving and disappearing partnerships, the address of the surviving entity's chief executive office and local office, if any, and whether the surviving entity is a general or limited partnership. *Id.* § 907(b).

282. *See id.* § 907(c), (d). Section 907(e) is a savings provision. If the statement of merger fails to contain all of the information required by subsection (b), the statement still will have the operative effect provided by subsections (c) and (d) if it is executed and declared to be accurate pursuant to RUPA § 105(e). It must correctly name the party to the merger in whose name the property was held before the merger, thereby preserving the integrity of the record.

property held in the name of the partnership, subject to the effect of a limitation in a statement of partnership authority.<sup>283</sup>

### **CONCLUSION**

RUPA represents a major overhaul of the venerable UPA. Perhaps its greatest contribution is the complete reworking of the law of partnership breakups. The old concept of dissolution is abandoned. Partnerships that contracted for stability now find great support in the statute. Partnerships that have not contractually anticipated their own breakup now have a complete set of readily understandable default rules. On the other hand, RUPA continues most of the major policies in the UPA, and rejects the arguments of those who pressed for more extreme changes to the law of partnership. For example, RUPA rejects the argument that the law should be changed to deny partners at will their historic right to liquidate. Similarly, RUPA rejects the argument that the fiduciary duties of partners should be mere default rules. Instead, RUPA reflects a more traditional approach while at the same time attempting to facilitate private ordering of the wide range of relationships now called partnerships.

283. The surviving partnership may file and record an amended statement of partnership authority granting or restricting the authority of partners to transfer partnership property. *See id.* § 303; *see also supra* text accompanying notes 225-234.