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Unincorporated Business Associations: An Overview of Their Advantages and Disadvantages

Richard A. Mann

Barry S. Roberts

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UNINCORPORATED BUSINESS ASSOCIATIONS: AN OVERVIEW OF THEIR ADVANTAGES AND DISADVANTAGES

Richard A. Mann*
and
Barry S. Roberts**

I. INTRODUCTION

There are many circumstances that make an unincorporated business association the most useful vehicle for a given business enterprise. Generally, tax considerations loom most significantly. In addition, there are four aspects of any business association that determine its appropriateness for any set of business objectives: control, external liability, fiduciary duties, and duty of care. This article will explore the comparative advantages of the unincorporated business associations with respect to these four attributes by presenting an overview of their most salient features. Such an approach will allow those interested in

* Assistant Professor of Legal Studies, University of North Carolina; J.D., Yale Law School, 1973.
** Assistant Professor of Legal Studies, University of North Carolina; J.D., University of Pennsylvania School of Law, 1973; L.L.M., Harvard University School of Law, 1976.

forming a noncorporate business association (which receives far less consideration than it merits and is frequently overlooked by practitioners) to select the most appropriate form to meet their particular requirements. In addition, those choosing to utilize any of these forms will have greater understanding of the legal requirements and possibilities of that mode of transacting business. No businessman should risk his personal fortune without having been fully apprised of the potential risks associated with conducting a business enterprise. Despite these hazards there are numerous situations in which a businessman is best advised to adopt one of these forms of unincorporated associations.

TABLE 1

BUSINESS ENTITIES

		1960	1965	1970	1974
NUMBER	PROPRIETORSHIPS	81%	80%	78%	78%
	PARTNERSHIPS	8%	8%	8%	8%
	CORPORATIONS	12%	12%	14%	14%
TOTAL RECEIPTS	PROPRIETORSHIPS	16%	14%	11%	10%
	PARTNERSHIPS	7%	5%	4%	4%
	CORPORATIONS	78%	81%	84%	85%
NET PROFIT	PROPRIETORSHIPS	29%	25%	30%	23%
	PARTNERSHIPS	11%	9%	9%	5%
	CORPORATIONS	60%	67%	60%	73%

As Table 1 indicates, the sole proprietorship remains the predominant form of doing business, while corporations clearly dominate with respect to gross business receipts and net profits. Nonetheless, since 1960 the partnership form (*i.e.*, unincorporated business associations, including joint ventures and limited partnerships) has represented about 8%[1] of all business enterprises. Thus, in 1974 there were 1,062,000 partnerships, compared with 1,966,000 corporations. Partnerships tend to be smaller than corporations—50.7% of partnerships in 1973 had business receipts totalling less than $25,000 whereas only 23.8% of corporations earned less than this amount. In fact, 77% of all

1. U.S. BUREAU OF CENSUS, DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 550-52 (1977). All figures in the table are rounded to the nearest percentage point. 1974 is the most recent year for which figures are available.

partnerships that year had gross receipts of less than $100,000 compared with 46% of corporations. Furthermore, extremely large partnerships tend to be quite rare. Only 1.6% of partnerships had business receipts greater than $1,000,000 while over 12% of corporations earned more than this amount.

Three forms of unincorporated business associations are commonly utilized: general partnerships, joint ventures, and limited partnerships. General partnerships have been used principally in finance, insurance, and real estate (40%), wholesale and retail trade (18%), and services (18%). Joint ventures have enjoyed popularity among major corporations planning to engage in cooperative research; in the exploitation of land and mineral rights; in the development, promotion and sale of patents, trade names and copyrights; and in manufacturing operations in foreign countries.[2] Limited partnerships have been widely utilized for enterprises such as real estate investment and development, motion picture and legitimate theatre productions, oil and gas ventures, and purchases of a single depreciable asset such as railroad rolling stock.[3]

II. General Partnership

A. Definition and Formation

The general partnership developed at common law and was based upon continental Europe's *societas*.[4] The rules governing the form have been generally codified in the Uniform Partnership Act (U.P.A.) which all states except Georgia, Louisiana, and Mississippi have adopted.[5] The U.P.A. defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit."[6] Partnerships can be formed without the slightest formality. Consequently, if two or more individuals share the control and profits of a business, the law may deem them partners irrespective of how they might characterize their relationship.[7] Thus, associates frequently discover, to their chagrin, that they have inadvertently formed a partnership and

2. For an excellent study of the current uses of joint ventures by large corporations, see G. Young & S. Bradford, Jr., Joint Ventures: Planning and Action (1977).
3. F. Kempin, Jr. & J. Wiesen, Legal Aspects of the Management Process 285 (1976).
4. A. Bromberg, Crane and Bromberg on Partnership 143 (1968) [hereinafter cited as Bromberg].
5. 6 Uniform Laws Annotated 7 (Supp. 1978).
6. Uniform Partnership Act § 6(1) [hereinafter cited as U.P.A.].
7. *See, e.g.*, Associated Piping & Eng'r Co. v. Jones, 17 Cal. App. 2d 107, —, 61 P.2d 536, 538 (1936); Martin v. Peyton, 246 N.Y. 213, —, 158 N.E. 77, 78 (1927).

have thereby subjected themselves to the duties and liabilities of partners.

The ease and informality of forming a partnership has its advantages—a partnership can be created without the absolute necessity of utilizing an attorney. Since a partnership is essentially a consensual relationship, it is malleable into nearly any arrangement desired by its members through the use of the partnership agreement. This agreement is a nonpublic contract that should be (but is not always required to be)[8] reduced to writing. When a well-drawn agreement is used, it can provide almost any conceivable arrangement of capital investment, control sharing, and profit distribution that the co-partners desire.[9] In addition, it can provide for continuity of the partnership in the event of one member's death or retirement. Since liquidation usually sacrifices going concern values, a provision for continuation of the partnership upon the occurrence of the many events[10] that can bring about its termination is absolutely essential and can be accomplished through a buy-out arrangement in the partnership agreement.

The consensual nature of a partnership gives rise to another of its characteristics—*delectus personae* or choice of person. The U.P.A. categorically states that "no person can become a member of a partnership without the consent of all the partners."[11] The intimate nature of the partnership relationship requires *delectus personae* and the strict fiduciary duties discussed below.[12] The effect of this concept is that each member's interest in a general partnership is nontransferable. It also sharply restricts the sources of additional capital, for any new contributors must be acceptable to *all* members of the firm. However, the partners may, by agreement, provide for freely transferable partnership interests or delegate the authority to consent to such transfers on behalf of all of the members of the partnership to one or more of the partners.[13]

B. Control

A partnership is a voluntary business relationship which exists as a

8. *In re* Foreman's Estate, 269 Cal. App. 2d 180, —, 74 Cal. Rptr. 699, 705 (1969). *See generally* A. CORBIN, CORBIN ON CONTRACTS 370-484 (one volume ed. 1952).

9. U.P.A. § 18; *In re* Imperial "400" Nat'l Inc., 429 F.2d 671, 678 (5th Cir. 1970).

10. For a listing of these events, see U.P.A. §§ 31-32.

11. U.P.A. § 18(g). A partner may assign his interest in the partnership, but this results only in an assignment of that partner's share of the profits, without a right to inspect the books or to have an accounting. U.P.A. § 27.

12. See notes 39-107 *infra* and accompanying text.

13. BROMBERG, *supra* note 4, at 43-44.

consequence of the parties' intent to be bound in such an association. By definition they are "co-owners" of the business enterprise.[14] Each partner, unless otherwise agreed, has an equal right to share in the management of the partnership without regard to his capital contribution or to his share in the profits and losses.[15] Given the general inability of a partner to transfer freely his interest in the partnership, the right to exercise control assumes crucial importance.

Generally, the majority of the partners determine and manage the ordinary business affairs of the partnership.[16] However, the U.P.A. requires unanimous approval for the partners to assign partnership property for the benefit of its creditors, to dispose of the business's goodwill, to do any act which would make it impossible to carry on the normal business operations of the partnership, to confess judgment, or to submit a particular action to arbitration.[17] The power of any partner to dissolve the partnership[18] represents an additional form of control—a type of veto power.

As noted above,[19] the partnership agreement can modify any of these provisions of the U.P.A. by authorizing less than a majority to handle ordinary, or even extraordinary, business matters.[20] Given the consensual nature of the partnership concept, it can be readily understood that the partners should have the freedom to organize the management of their enterprise in whatever form they desire, within certain public policy limits.

Also notable is the great degree of flexibility that the courts have occasionally allowed partnerships in granting creditors considerable control over the partnership's business operation without deeming the creditor a partner. The significance of this type of flexible arrangement becomes particularly noteworthy (and curious) in light of the extremely limited amount of control a limited partner has over his limited partnership, a point discussed below.[21] In one landmark case,[22] a creditor lent a partnership $2,500,000 in liquid securities in return for 40% of the firm's profits up to a maximum of $500,000, with a minimum return of $100,000. Moreover, the lender had the right (1) to join the partner-

14. U.P.A. § 6.
15. U.P.A. § 18(e).
16. U.P.A. § 18(h).
17. U.P.A. § 9(3).
18. U.P.A. §§ 31(1)(b), 31(2).
19. See note 9 *supra* and accompanying text.
20. U.P.A. § 9(3).
21. See notes 192-211 *infra* and accompanying text.
22. Martin v. Peyton, 246 N.Y. 213, 158 N.E. 77 (1927).

ship, (2) to receive information concerning all transactions affecting the borrowed securities, (3) to receive all dividends and income accruing from the borrowed securities, (4) to substitute securities of equal value, (5) to obtain information pertaining to the operation of the business, (6) to consult on important partnership matters, (7) to inspect the partnership's books, (8) to veto any speculative or highly risky venture, (9) to prohibit loans, (10) to limit distribution of profits to the partners, and (11) to demand the resignation of each member of the firm. The court, relying upon the extensive documentation in the loan agreement, found that the creditor had principally attempted to protect his loan and held that he was only a creditor and had not exercised control over the partnership.[23] This holding assumes great significance when viewed against the general principle that anyone who receives a percentage of a partnership's profits and exercises control may become subject to partnership liability.[24] If this case represents the absence of control with a corresponding absence of liability, then creditors who do not receive a share of the profits but merely receive fixed amounts of interest would seemingly be allowed to exercise virtually unlimited actual control without being subjected to partnership liabilities.

However, this is not necessarily true, for other cases have inexplicably gone practically to the other extreme.[25] In one case,[26] the court held a creditor liable as a partner where the creditor had furnished financing and warehouse space to a buyer to enable the buyer to take advantage of a quantity discount and market structure which greatly favored early purchases. The creditor did not receive a percentage of the buyer/borrower's profit but only received interest at the rate of 6% and compensation for his warehousing. The court, however, held that the creditor was a partner because it had received a benefit, as did the buyer/borrower, from the mutual business arrangement in which they both had shared control.

> There can be no question but that the parties had joint control over this enterprise. This follows from the fact that United [buyer] initially determined how much to buy but such determination was subject to Cold Storage's [creditor] right to determine whether the proposed collateral would be

23. *Id.* at 223, 158 N.E. at 80.
24. U.P.A. § 7(4); BROMBERG, *supra* note 4, at 65-72.
25. 1 Z. CAVITCH, BUSINESS ORGANIZATIONS § 5.01(4) (1976) [hereinafter cited as 1 CAVITCH].
26. Minute Maid Corp. v. United Foods, Inc., 291 F.2d 577 (5th Cir.), *cert. denied*, 368 U.S. 928 (1961).

> "acceptable." Also, it was provided that in case of pending price increases, which the court found would offer the opportunity to speculate on inventory, the parties would agree on the volume to be purchased.
>
> . . . .
>
> [W]e think the operation . . . was clearly within the joint control of the parties.[27]

Thus, a creditor must use extreme caution in exercising control of his borrower's business and great care in preparing the documents. As the first case discussed above indicates,[28] the preparation of the documents can be a key factor in persuading a court that a lender-debtor relationship is all that has been established.

C. *External Liability*

The principal disadvantage of the partnership is the degree to which partners are exposed to external liability.[29] External liability arises in a variety of ways, but for most enterprises the crucial and most commonly occurring causes of loss are tort and contract liability. The first results from some act or omission on behalf of the partnership that falls below the standard of care that society demands of all its members. As a general rule that standard is one of reasonableness, but a trend toward imposition of strict or absolute liability has emerged in this century.[30] Losses from contract liability can occur as a result of incorrect judgments about market conditions, constrictions in cash flow that render the firm unable to meet its debt service, as well as a host of other problems. Each partner must account entirely out of his own assets to third parties (*i.e.*, nonmembers of the partnership) for these losses. Consequently, if the partnership encounters disastrous business reverses and does not have sufficient funds to pay its debts, each and every partner is personally liable to the creditors for the full amount of the debts owing them.[31] Similarly, if one partner acting in the ordinary course of business negligently injures a third party, each and every

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27. *Id.* at 583.
28. See notes 22-24 *supra* and accompanying text.
29. U.P.A. § 15 provides:

> All partners are liable
>
> (a) Jointly and severally for everything chargeable to the partnership under sections 13 and 14.
>
> (b) Jointly for all other debts and obligations of the partnership. . . .

Section 13 deals with partners' wrongful acts while section 14 addresses partners' breaches of trust.

30. This is particularly true in the areas of products liability and ultrahazardous activities. *See generally* W. PROSSER, HANDBOOK OF LAW OF TORTS 508-12, 657-58 (4th ed. 1971).
31. U.P.A. § 15(b). *See, e.g., In re* Fowler, 407 F. Supp. 799 (W.D. Okla. 1975).

member of the partnership is personally liable to that third party for the full amount of the injury.[32]

The partners cannot limit their external liability by their partnership contract because this personal liability arises as a matter of law.[33] However, the partners may determine by agreement their internal liability, *i.e.*, how to share partnership losses among themselves.[34] External liability enables outsiders to hold any or all of the partners liable for losses initially, while the U.P.A. allows the partners to reallocate these losses internally in any way they see fit.

> The rights and duties of the partners in relation to the partnership shall be determined, *subject to any agreement between them*, by the following rules:
>
> (a) Each partner . . . must contribute towards the losses, whether capital or otherwise, sustained by the partnership according to his share in the profits.[35]

Accordingly, by an agreed upon sharing of profits or by an explicit loss sharing arrangement, the partners can distribute the losses in whatever fashion they choose. This gives a partner who has initially borne an external liability the right to indemnity from the partnership (*i.e.*, the other partners) for that portion of the loss beyond his internally allocated share.[36] Of course, the value of this right of indemnification depends upon the solvency of the partnership and of the other partners. It also depends upon the partner's properly discharging his fiduciary duties,[37] as well as his duty of care,[38] both of which are discussed below.

D. Fiduciary Duty

It has long been recognized that partners are bound in a fiduciary relationship with one another and, by virtue of their business association, repose the greatest trust and confidence in each other.

> If fiduciary relation means anything I cannot conceive a stronger case of fiduciary relation than that which exists between partners. Their mutual confidence is the life blood of the concern. It is because they trust one another that they are partners in the first instance; it is because they continue to

32. U.P.A. §§ 15(a), 13. *See, e.g.*, Payne v. Payne, 313 N.Y.S.2d 312 (1970).
33. U.P.A. §§ 15(a), 13.
34. U.P.A. § 18.
35. *Id.* (emphasis added).
36. U.P.A. § 18(b).
37. See notes 39-107 *infra* and accompanying text.
38. See notes 109-147 *infra* and accompanying text.

trust one another that business goes on.[39]

Moreover, nothing less than absolute and utmost good faith, fairness, and honesty will suffice.[40] The extent of this fiduciary duty, which binds all fiduciaries and not just partners, has been most eloquently expressed by the often quoted words of Judge (later Justice) Cardozo:

> Joint adventurers, like co-partners, owe to one another, while the enterprise continues, the duty of the *finest loyalty*. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. *Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior*. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.[41]

Problems involving the duty of loyalty have usually arisen in situations involving some form of potential self-dealing.[42] No partner can favor himself at the expense of the partnership or of his partners, nor can he place himself in a situation where his interests conflict with those of the partnership. In addition, he has a fundamental duty to disclose fully to his partners any business dealing he makes on his own account as well as all facts which are material to that dealing.[43]

> 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

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39. Helmore v. Smith, 35 Ch. D. 436, 444 (1887).

40. Bakalis v. Bressler, 1 Ill. 2d 72, 115 N.E.2d 323 (1953); 1 S. ROWLEY, ROWLEY ON PARTNERSHIP § 21.1 (2d ed. 1960) [hereinafter cited as 1 ROWLEY]; 1 CAVITCH, *supra* note 25, at § 17.01.

41. Meinhard v. Salmon, 249 N.Y. 458, 459, 164 N.E. 545, 546 (1928) (emphasis added).

42. The cases dealing with the duty of loyalty of trustees also typically involve self-dealing. For example, Bogert's discussion in G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES (2d ed. 1960) of the trustee's duty of loyalty deals with factual situations in which: (1) a trustee buys at his own sale; (2) a trustee leases trust property to himself; (3) a trustee purchases trust property at a sale forced by an encumbrance; (4) a trustee sells his own property to the trust; (5) a corporate trustee buys or holds its own stock for the trust; (6) a trustee of two trusts sells some property between the trusts; (7) a trustee accepts a renewal of a lease on trust property for himself; (8) a trustee lends trust funds to himself; (9) a trustee employs himself to do specialized work for the trust; and (10) a trustee engages in a competing business. *Id.* at § 541.

43. *E.g.*, Herring v. Offutt, 266 Md. 593, —, 295 A.2d 876, 879 (1972).

connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.[44]

The remainder of this section will outline the contours of this rigorous fiduciary duty and formulate guidelines for a partner to follow to comply with his fiduciary responsibilities.[45]

1. *Any partner who gains any advantage by fraud, misrepresentation or concealment of any material fact in connection with a partnership transaction must account to his partners for his ill-gotten benefits.*

The enforcement of this rule enables partners to entrust the conduct of partnership business to one another without fear of exploitation. Accordingly, this proscription would be violated by a partner's stating a sum larger than he actually advanced in furthering the interests of the partnership,[46] or by his informing the firm of a price for an asset purchased for the partnership in excess of that which he had actually paid.[47]

Moreover, a partner may not purchase for his own interest or benefit a creditor's claims against the partnership.[48] If he attempts to do so, he will be held to have purchased the claim in the name of the partnership and therefore to be entitled only to contribution from his partners for their *pro rata* share of the acquisition.[49] Thus any discount the purchasing partner has received will inure to the benefit of the firm.[50] For example, in one case[51] the defendant partner secretly purchased the building in which the partnership bakery shop was located, thereby acquiring not only the right of rental payment from the partnership but also its good will, since under the terms of the lease the partnership's good will belonged to the landlord. The court held this to be a breach of fiduciary duty and decreed that the defendant held title to the building in trust for the partnership.[52]

44. U.P.A. § 21(1).
45. *See generally* Note, *Fiduciary Duties of Partners*, 48 IOWA L. REV. 902 (1963).
46. R. C. Gluck & Co. v. Tankel, 24 Misc. 2d 841, 199 N.Y.S.2d 12 (Sup. Ct.), *aff'd*, 12 App. Div. 2d 339, 211 N.Y.S.2d 602 (1960).
47. Gates v. Megargel, 266 F. 811 (2d Cir.), *cert. denied*, 254 U.S. 639 (1920); Smith v. Hart, 179 Ill. App. 98 (1912).
48. *See* Nudelman v. Haimowitz, 314 Ill. App. 329, 41 N.E.2d 310 (1942), *aff'd*, 382 Ill. 87, 46 N.E.2d 33 (1943).
49. *Id.*
50. However, it should be noted that neither this rule of conduct nor any other prevents a partner from making a good faith purchase of a partnership asset from a receiver or at a judicial sale; however, the utmost good faith must be exercised. Evans v. Carter, 176 S.W. 749 (Tex. Civ. App. 1915).
51. Bakalis v. Bressler, 1 Ill. 2d 72, 115 N.E.2d 323 (1953).
52. *Id.* at 82, 115 N.E.2d at 328.

Fiduciary duties apply even when the illicit benefit has been obtained during the formation or liquidation of the partnership.[53] The fiduciary relationship commences with the formation of the partnership and does not terminate until the partnership is completely liquidated.[54] Furthermore, the presence of "bad blood" or ill will between or among the partners in no way relaxes the high standards of their fiduciary duty.[55] Moreover, although the U.P.A. requires only that "partners shall render on demand true and full information on all things affecting the partnership to any partner,"[56] this section has generally been interpreted (in accordance with the rule at common law prior to the U.P.A.) to require the partners to disclose voluntarily any and all information affecting the partnership, even in the absence of any specific demand.[57]

Somewhat related to the duty of disclosure in the formation of a partnership is the possible impact of federal and state securities regulation.[58] Membership in some partnerships, joint ventures, and many limited partnerships has been deemed a security under the extremely broad definition of the Security Act of 1933[59] and under some state blue sky laws.[60] Classification as a security does not of itself require registration since one of several exemptions from registration may be available.[61] But if none of the exemptions apply, the disclosure of information to persons purchasing an interest in the partnership must meet the requirements of federal[62] and state securities laws.[63] In addition, even if the security qualifies for an exemption from registration, it will be subject to the antifraud provisions that regulate the sale of securities.[64] These include sections 12(2)[65] and 17(a)[66] of the Securities

53. Bovy v. Graham, Cohen & Wampold, 17 Wash. App. 567, 564 P.2d 1175 (1977).
54. U.P.A. § 21(1).
55. Karle v. Seder, 35 Wash. 2d 542, —, 214 P.2d 684, 688 (1950).
56. U.P.A. § 20.
57. BROMBERG, *supra* note 4, at 388.
58. *See generally* Erwin, *Partnership Interests as Securities: An Alice in Wonderland Tour*, 9 CREIGHTON L. REV. 310 (1975).
59. SEC v. W.J. Howey Co., 328 U.S. 293 (1946); Kroungold v. Triester, 407 F. Supp. 414 (E.D. Pa. 1975).
60. *See, e.g.*, UNIFORM SECURITIES ACT § 401(1). This legislation has been adopted in part or whole by 35 states. *See* [1977] 1 BLUE SKY L. REP. (CCH) ¶ 4901.
61. Among the exemptions under federal law most relevant to partnerships are "private placements," 15 U.S.C. § 77d(2) (1976); 17 C.F.R. § 230.146; "intrastate offerings", 15 U.S.C. § 77c(a)(11) (1976), 17 C.F.R. § 230.147; and "small issues", 15 U.S.C. § 77c(b) (1976), 17 C.F.R. §§ 230.251-.263.
62. 15 U.S.C. § 771 (1976).
63. *See, e.g.*, UNIFORM SECURITIES ACT §§ 301, 403.
64. *E.g.*, 15 U.S.C. § 77q (1976).
65. 15 U.S.C. § 771(2) (1976).
66. 15 U.S.C. § 77q(a) (1976).

Act of 1933, as well as section 10(b)[67] of the Securities Exchange Act of 1934 and the rules promulgated thereunder. Furthermore, these requirements do not supplant the fiduciary duties under the law of partnership but rather supplement them.

2. *No partner shall, without the consent of his co-partners, make a profit from any transaction with the partnership or with his fellow partners.*

A partner has an obligation to act for the benefit of the partnership in all transactions within the scope of the enterprise's business and has no right to earn a secret profit from any partnership business, including the purchase or sale of a partnership asset.[68] Thus, it constituted a breach of duty for a partner to retain a secret discount on purchases of petroleum which he obtained through acquisition of a bulk plant, and the partnership was entitled to the entire amount of the discount.[69] Moreover, where an equal partner received $3,500,000 from the sale of a partnership asset, he was entitled to assume that the selling partner had sold the asset for $7,000,000, and the selling partner was under an obligation to account for the discrepancy if this was not the case.[70]

Generally, it is not necessary to distinguish a partner's duty of loyalty to the partnership from that owed to a co-partner, because their respective interests and rights are common.[71] However, the interests of the partnership and of the partners do diverge in the fairly common situation in which one partner attempts to purchase a co-partner's interest.[72] Nonetheless, the purchasing partner owes his fellow partner(s) an affirmative duty to disclose all material information concerning the partnership and cannot conceal any fact affecting the value of the enterprise.[73] If challenged, the sale will be upheld only if it was made in good faith and for fair consideration, as well as upon full disclosure of all material information. Furthermore, a purchasing partner cannot circumvent this rule by employing an "undisclosed agent"[74] to purchase his co-partner's interest or even by having an independent third party purchase the interest.[75]

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67. 15 U.S.C. § 78j(b) (1976).
68. *See* U.P.A. § 21(1).
69. Liggett v. Lester, 237 Or. 52, 390 P.2d 351 (1964).
70. Vogel v. Brewer, 176 F. Supp. 892 (E.D. Ark. 1959).
71. BROMBERG, *supra* note 4, at 394.
72. *Id.* at 394-95.
73. *Id.*
74. A person representing another without disclosing the existence or identity of the principal. RESTATEMENT (SECOND) OF AGENCY § 4(3) (1957).
75. Yost v. Critcher, 112 Va. 870, 72 S.E. 594 (1910).

In one case[76] two partners operating oil and gas leases had entered into a contract whereby one partner (the defendant) agreed to purchase the other partner's (the plaintiff's) interest for $1,500. Shortly thereafter, the defendant sold the business to a third party for $10,500. Negotiations for this second sale had been initiated prior to the plaintiff's sale of his one-half interest in the business to the defendant, yet the defendant had failed to inform the plaintiff of these negotiations. In deciding that the defendant must compensate the plaintiff for the profit made in selling the plaintiff's share of the business to the third party ($5,250 less $1,500), the court pertinently stated that the absolute duty to disclose was upon the defendant since the parties were not dealing with each other at arm's length.[77]

As has been seen, a partner's fiduciary duty mandates that he be completely honest and fair in dealing with his partners or with the partnership, that he disclose all material information, and that he refrain from obtaining secret profits on any transaction with or on behalf of the partnership or his partners. Furthermore, the courts will carefully scrutinize any such transaction for compliance with these requirements. This approach contrasts sharply with the hands-off attitude of the courts toward arm's length transactions, which include the typical business transaction between those not connected in a fiduciary relationship. When parties deal at arm's length, they need only be honest and fair in their representations, but they ordinarily have no affirmative duty to disclose information unless questioned specifically about a matter.[78] Moreover, in the absence of fraud or misrepresentation, the courts will not inquire into the fairness of the transaction.[79] Thus, the individual parties remain free of judicial scrutiny to negotiate the best agreement, absent actual fraud or misrepresentation, that each can possibly obtain for himself. Partners, on the other hand, cannot deal with each other at arm's length but must adhere to the stringent standard of exercising the utmost good faith and honesty.

3. *No partner shall make a personal profit from the use of partnership property.*

The U.P.A. provides:

> A partner, subject to the provisions of this act and to any agreement between the partners, has an equal right with his

76. Johnson v. Peckham, 132 Tex. 148, 120 S.W.2d 786 (1938).
77. *Id.* at —, 120 S.W.2d at 788.
78. J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS § 9-20, at 288 (2d ed. 1977).
79. *Id.* at 282.

> partners to possess specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners.[80]

A partner who violates this section must account to the partnership for any such misappropriation.[81] Thus, when one partner employed the partnership's property and assets to realize significant earnings, that entire sum was found to have inured to the benefit of the partnership.[82]

4. *No partner shall take a partnership business opportunity for his individual benefit.*[83]

When a partner is offered or learns of a business opportunity while acting in his partnership capacity, he must first allow the partnership the opportunity to accept the offer.[84] He cannot, without first offering the opportunity to the partnership, divert a partnership opportunity to his own use or benefit. However, if the partnership refuses to accept or cannot accept the offered opportunity, the offering partner may take advantage of the opportunity, as long as his doing so does not violate his fiduciary duty in some other way, such as by putting him in competition with the firm. It should be noted that this duty to refrain from usurping partnership opportunities is generally restricted to those which the partner learns of while acting within his capacity as a partner and which are within the scope of the partnership business.[85] Thus the courts have customarily permitted a partner to utilize information received in his capacity as a partner for his own advantage provided that the information is not used for any purpose within the scope of the partnership business nor for any purpose in competition with the partnership business.[86] Nevertheless, partners should be extremely cautious and circumspect in any such dealings.

The following situations illustrate the variety of ways in which a partner may breach this aspect of the fiduciary duty: a partner in a car rental agency personally accepting the opportunity to purchase a similar franchise in a neighboring community,[87] a partner's dissolving his partnership upon receiving information that a company would award

80. U.P.A. § 25(2)(a).
81. U.P.A. § 22(a), Comments.
82. Deaner v. O'Hara, 85 P. 1123 (Colo. 1906).
83. BROMBERG, *supra* note 4, at 391.
84. *See* cases cited in Note, *Fiduciary Duties of Partners*, 48 IOWA L. REV. 902, 909 nn.51-53 (1963).
85. *Id.* at 910; 1 ROWLEY, *supra* note 40, at 534, 537.
86. 1 ROWLEY, *supra* note 40, at 534, 537.
87. Stark v. Reingold, 18 N.J. 251, 113 A.2d 679 (1955).

his firm a contract in order to obtain the contract solely for himself,[88] and a partner's renewing a partnership lease in his own name and not the partnership's.[89] The last of these factual situations creates the greatest number of problems. Even when the partnership does not have an option to renew the lease, the courts have held that the partnership nevertheless has the right to expect that none of its members will hinder it in its renewal negotiations.[90] Any interference by a partner with this partnership opportunity is a breach of the duty of loyalty.

5. *No partner shall compete with the partnership.*

A partner cannot, without the permission of his partners, engage in any other business within the scope of the partnership enterprise.[91] Any profit acquired from a competing or similar business must be disgorged by the disloyal partner together with compensation for any damage suffered by the existing partnership as a result of the competition.[92] However, a partner may enter into any business not in competition with nor within the scope of the partnership's business. For example, a partner in a law firm may, without violating his fiduciary duty, act as an executor or administrator of an estate, and need not account for his fees where it cannot be shown that his partnership suffered by his service in this other capacity (*e.g.*, by his lack of attention).[93] This is so even if the partner uses information obtained in the course of his partnership business to benefit his new business.[94]

The troublesome question in this area is whether mere membership in a competing enterprise constitutes a breach of this duty or whether something more is required, such as active participation in the other business. Unfortunately, the courts are seemingly at odds on this question,[95] so the prudent course would be for a partner to secure the consent of all his co-partners before becoming a member of any competing or similar enterprise. Finally, it should be noted that a partner may properly engage in a second enterprise only if neither firm requires all of his time.[96]

88. Williamson v. Monroe, 101 F. 322 (W.D. Ark. 1900).
89. Ferry v. McNeil, 214 Cal. App. 2d 411, 29 Cal. Rptr. 577 (1963).
90. Bakalis v. Bressler, 1 Ill. 2d 72, 115 N.E.2d 323 (1953).
91. 1 ROWLEY, *supra* note 40, at 533; BROMBERG, *supra* note 4, at 391.
92. 1 ROWLEY, *supra* note 40, at 533-34.
93. Metcalfe v. Bradshaw, 145 Ill. 124, 33 N.E. 1116 (1893).
94. *E.g.*, Aas v. Benham, 2 Ch. 244 (1891).
95. *See* cases cited by Rowley who states that mere membership in a competing enterprise is permissible. 1 ROWLEY, *supra* note 40, at 536. *But cf.* those cited by Bromberg who asserts that a partner is under a duty not to compete with the partnership within the scope of its business. BROMBERG, *supra* note 4, at 391.
96. Murrell v. Murrell, 40 La. 841, 40 So. 841 (1881).

6. *A special conflict of interest problem arises for the directors of a corporation which enters into a partnership.*

The corporate directors serve in a fiduciary capacity to their corporation,[97] and, by entering into a partnership, they occupy a fiduciary role to the partnership as the managers of the corporate partner. Thus, the corporate directors now stand in a dual fiduciary relationship with countless possibilities of conflicts of interest arising since a transaction most favorable to the partnership may not be as desirable for the corporate partner.[98]

Two possible solutions to this predicament have been suggested.[99] First, the corporation should enter the partnership only as a limited partner. Second, the corporation and partnership should provide safeguards in the articles of incorporation and in the partnership agreement. The first of these safeguards would protect the validity of transactions between the corporation and the partnership. The following provision in the articles of incorporations could serve this purpose.

> No contract or other transaction between a corporation and a co-partner shall be either void or voidable because the officers and/or directors may occupy a conflicting fiduciary position because of the corporation's membership in a partnership, if:
>
> (1) the contract or transaction was approved in good faith by all parties concerned after full disclosure of all material facts as to the conflict and the contract or transaction; or
>
> (2) the contract or transaction is fair and reasonable to the corporation and co-partners.[100]

A similar provision should appear in the partnership agreement.

In addition, where authorized by statute,[101] the corporation should purchase and maintain insurance to indemnify[102] any director or officer

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97. H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS § 235, at 457-59 (1970) [hereinafter cited as HENN].

98. *See* Note, *The Close Association Doctrine Revisited*, 16 LOYOLA L. REV. 435 (1970).

99. *Id.* at 446.

100. This is a modified version of a provision suggested in *id.* at 448.

101. *E.g.*, DEL. CODE tit. 8, § 145 (1974); ABA-ALI MODEL BUS. CORP. ACT § 5 (1953).

102. For example, the Delaware statute provides:

> A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under the provisions of this section.

in a suit for breach of fiduciary duty where he acted in good faith and in a manner he reasonably believed to be in the best interests of the corporation. The use of these devices should protect the directors and officers sufficiently to permit them to function effectively in an otherwise delicate situation.

The rigorous requirements imposed by the fiduciary duties of co-partners invite attempts to relax these standards by agreement among the parties. Partners may include in their partnership agreement any provision that is neither legally prohibited nor contrary to public policy.[103] It is well recognized, in the analogous area of trust, that the trust agreement may allow a trustee to exercise enumerated powers beyond those generally authorized, to occupy a position with possible conflicts of interest, or even to self-deal.[104] There would appear to be no reason for the fiduciary duties of a partner to be any more restrictive, and there is judicial authority to this effect.[105] Moreover, the U.P.A. expressly provides:

> Every partner must account to the partnership for any benefit and hold as trustee for it any profit derived by him *without the consent* of the other partners from any transactions connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.[106]

Thus, given the required explicit consent through a provision in the partnership agreement, a partner could (1) compete with the partnership; (2) make a profit on a transaction with the partnership or with his co-partners (although it is not certain whether the amount of this profit must be disclosed); (3) withhold information from the partnership or his co-partners except upon demand; (4) use partnership property to earn individual profit; and (5) take a partnership business opportunity for his own use. However, it is unclear whether it would violate public policy for the partnership to grant a partner an unlimited, as opposed to a case by case, right to usurp any partnership opportunity for his own benefit that he desires.

In relation to all of the above conduct, it is not only uncertain but also highly dubious that the law would permit partners to agree to sub-

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DEL. CODE tit. 8, § 145(g) (1974).

103. Weil v. Diversified Properties, 319 F. Supp. 778 (D.D.C. 1970).

104. "An express grant of authority to a trustee to perform acts which would otherwise be disloyal has been held to be effective in a number of cases." G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 543, at 583-85 (2d ed. 1960).

105. Riviera Congress Assocs. v. Yassky, 18 N.Y.2d 540, 223 N.E.2d 876, 277 N.Y.S.2d 386 (1966); Bassan v. Investment Exch. Corp., 83 Wash. 2d 922, 524 P.2d 233 (1974).

106. U.P.A. § 21(1) (emphasis added).

ject themselves to standards less demanding than those governing an arm's length transaction. Moreover, the law remains unclear on how closely co-partners may approach the arm's length standard with their modifications of their fiduciary duties. In all events, any partner desiring to mitigate his fiduciary duties should utilize extreme care in preparing a comprehensive and clear statement of the agreed upon relaxation of his duties. He should leave nothing to chance nor to the mercy of the courts which are manifestly unsympathetic to "undermining the rule of undivided loyalty"[107] for fiduciaries.

E. Duty of Care

Whereas a partner "is held to something stricter than the morals of the market place"[108] it will be seen that he is held to something less than the skill of the market place. As discussed above, each partner has equal rights in the management of the partnership,[109] although the partnership agreement can provide for concentration of management in one or more partners. As a corollary, each partner owes a duty to the partnership of faithful service to the best of his ability.[110] Nonetheless, he need not possess the degree of knowledge and skill of an ordinary paid agent.[111] The latter has a duty to act with the skill standard in the locality for the kind of work which he is employed to perform and, in addition, to exercise any special skill which he has.[112] Furthermore, he will be liable for losses caused by failure to conform to this standard.[113]

On the other hand, a partner must merely manage the partnership affairs without fraud, culpable negligence, or bad faith.[114] If he does so, any losses experienced by the firm as a result of his management will be borne by the firm and by each partner according to the loss sharing agreement. Since managerial decisions involving either bad faith or fraud generally result in a breach of a partner's fiduciary duty as well, these two components of the duty of care will not be discussed here.[115] In most, if not all, situations compliance with the strictures of

107. Meinhard v. Salmon, 249 N.Y. 458, 459, 164 N.E. 545, 546 (1928). The full text is quoted at note 41 *supra*.
108. 249 N.Y. at 459, 164 N.E. at 546.
109. See note 15 *supra* and accompanying text.
110. BROMBERG, *supra* note 4, at 395.
111. *Id.*
112. W. SEAVEY, LAW OF AGENCY § 140, at 235 (1964); RESTATEMENT (SECOND) OF AGENCY § 379 (1957).
113. RESTATEMENT (SECOND) OF AGENCY § 379 (1957).
114. Note, *Fiduciary Duties of Partners*, 48 IOWA L. REV. 902, 904 (1963).
115. They have been discussed at notes 39-107 *supra* and accompanying text.

the fiduciary duty discussed above should demonstrate the absence of bad faith and fraud. Therefore, only the remaining component of the duty of care, culpable negligence, will be discussed here.

In attempting to define the degree of care required of a partner who manages the firm's business, the courts have used various descriptions including willful disregard,[116] wantonness,[117]reckless disregard,[118] gross negligence,[119] and culpable negligence.[120] Although not synonomous, each of these expressions seems to require something more than the ordinary negligence of a partner before he must bear the entire loss caused by his conducting firm business. For the purpose of this discussion, the phrase "culpable negligence" will be used to express this concept.

The courts have yet to reach a uniform meaning for culpable negligence, having ranged in their definitions from ordinary negligence[121] to gross negligence.[122] The majority view is that it is more than ordinary negligence yet short of gross negligence.[123] Thus a partner does not assume liability for the loss (but merely his share of the losses per the partnership agreement) occasioned by his errors of judgment or failure to use ordinary skill and care in transacting partnership affairs in the absence of fraud, culpable negligence, or bad faith. For example, consider a partner assigned to keep the books whose complicated system of bookkeeping produced numerous mistakes, resulting apparently from lack of care and diligence. Since these errors resulted simply from poor judgment rather than fraud and were neither intended to nor did they operate to the personal advantage of the bookkeeping partner, the negligent partner was not liable to his co-partners for the resulting losses.[124]

It should be noted that while many, if not most, jurisdictions[125] have adopted the good faith-culpable negligence standard which allows a partner a certain amount of leeway for mistakes and faulty judgment,

116. Watt v. German Sav. Bank, 183 Iowa 346, 165 N.W. 897 (1917).
117. Charlton v. Sloan, 76 Iowa 288, 41 N.W. 303 (1888).
118. Hurter v. Larrabee, 224 Mass. 218, 112 N.E. 613 (1916).
119. Tygart v. Wilson, 39 App. Div. 58, 56 N.Y.S. 827 (1899).
120. Thomas v. Milfelt, 222 S.W.2d 359 (Mo. App. 1949).
121. Carlin v. Donegan, 15 Kan. 495 (1875).
122. Tygart v. Wilson, 39 App. Div. 58, 56 N.Y.S. 827 (1899).
123. Note, *Fiduciary Duties of Partners*, 48 Iowa L. Rev. 902, 904-05 (1963).
124. Hurter v. Larrabee, 224 Mass. 218, 112 N.E. 613 (1916).
125. State v. Bolsinger, 221 Minn. 154, 21 N.W.2d 480 (1946); Henderson v. State, 199 Miss. 629, 25 So. 2d 133 (1946); Warren v. New York Tel. Co., 70 Misc. 2d 794, 335 N.Y.S.2d 25 (1972); State v. Reddish, 269 N.C. 246, 152 S.E.2d 89 (1967); State v. Barnett, 218 S.C. 415, 63 S.E.2d 57 (1951).

some states still apply an ordinary negligence standard.[126] The commentators[127] generally agree that the modern trend in judicial opinion is toward the relaxed culpable negligence standard. This development stands in distinct opposition to the development of the required duty of care for corporate directors.[128] Corporate directors must now discharge their duties in good faith and with that diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances in their personal affairs[129]—the common negligence standard.

In addition to exercising due care according to the standard adopted by a given jurisdiction, a partner should adhere to the following principles related to care in management in order to avoid potential liability to the partnership and to the other partners.

1. *Unless otherwise agreed, partners should devote sufficient time to partnership affairs.*

In the absence of any special provision in the partnership agreement, all partners are expected to render services to the partnership, but do not receive compensation for these services other than their share of the profits.[130] The partnership agreement may require that a partner devote all of his time to the partnership, none of his time, or that he receive compensation for his services. A partner who fails to serve without an express exemption in the partnership agreement will be liable to the partnership for either the cost of hiring an employee to perform his services or for the value of the services he neglected to perform, or under some circumstances the other partners may receive compensation for their services.[131] Thus, where one partner in a sales firm failed to maintain his share of the partnership workload, the other partner received a credit for his own services in addition to his share of the profits.[132]

2. *All partners should transact partnership affairs in compliance with the partnership agreement.*

Notwithstanding the conclusion reached above that no partner acts as an insurer of his business decisions,[133] a partner must bear alone any losses resulting from acts in breach of the partnership agreement or

126. *E.g.*, Bohrer v. Drake, 33 Minn. 408, 23 N.W. 840 (1885); *In re* Moore, 134 Pa. 486, 19 A. 753 (1890).

127. *E.g.*, Note, *Fiduciary Duties of Partners*, 48 IOWA L. REV. 902, 902-07 (1963).

128. HENN, *supra* note 97, § 234, at 454-55.

129. *Id.*

130. U.P.A. § 18(f).

131. BROMBERG, *supra* note 4, at 380-81.

132. Davis v. Spengler, 93 So. 2d 348 (Fla. 1957).

133. See notes 123-129 *supra* and accompanying text.

from those acts beyond the scope of the firm business.[134] This is reasonable since the members of a partnership should be liable only for losses arising from the enterprise they agreed to conduct. Thus, a partner who, in violation of an express agreement not to extend credit to relatives, advanced money from partnership funds and sold goods on credit to an impecunious relative was held personally liable for the unpaid debt.[135] In like fashion, two members of a mercantile partnership were held personally liable for losses arising from speculating in cotton futures with firm funds without the consent of the third partner of the firm.[136]

The general requirement that partners act within the scope of their authority also applies during the winding up of the partnership. The U.P.A. provides that, upon dissolution, "each partner is liable to his co-partners for his share of any liability created by any partner acting for the partnership as if the partnership had not been dissolved *unless* . . . the partner acting for the partnership had *knowledge of the dissolution*."[137] This provision denies the right of contribution from co-partners to a partner who transacts new partnership business with knowledge that the partnership has been dissolved.

Partnerships exist as rather fragile forms of business that technically dissolve upon any partner's terminating his association with the partnership.[138] This termination can occur by the death, retirement, expulsion, lunacy, incapacity, or bankruptcy of any member to mention but a few of the events that can trigger dissolution.[139] A well-drafted partnership agreement should anticipate these situations by including a buy-out provision[140] which would allow the continuation of the partnership after the occurrence of any of these events. But if the partnership has been dissolved, each partner having knowledge of the dissolution must not enter any new transactions on behalf of the partnership but must limit himself to winding up the affairs of the partnership and to completing unfinished transactions.[141] If he fails to do so and any liability results, he will bear the loss alone without contribution from his co-partners.[142]

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134. 1 ROWLEY, *supra* note 40, § 18.0, at 447; BROMBERG, *supra* note 4, at 274-75.
135. McCoy v. Crosfield, 54 Or. 591, 104 P. 423 (1909).
136. Burson v. Stone & Co., 135 Ga. 115, 68 S.E. 1038 (1910).
137. U.P.A. § 34 (emphasis added).
138. U.P.A. § 29.
139. See U.P.A. §§ 31-32 for a complete listing.
140. For a discussion of buy-out provisions, see BROMBERG, *supra* note 4, at 509-516.
141. U.P.A. §§ 33-34.
142. U.P.A. § 34.

3. *Whenever possible, partners should transact business after consulting with the other partners.*

This injunction becomes more crucial as the business transacted becomes more extraordinary. Consider two individuals who formed a partnership for the sole purpose of purchasing and selling a particular tract of land. Partner A purchased the land on behalf of the partnership after which partner B attempted to sell it. However, partner B erroneously concluded that the partnership had defective title to the property and, without consulting partner A, expended funds in order to remedy the defect in title. Partner B was denied any contribution from partner A for the expenditure because he had failed to consult his partner with regard to a business transaction, not in the usual course of the partnership business, but rather which went to the very foundation of the partnership.[143]

4. *Partners should exercise at least ordinary care when acting on behalf of the firm.*

When a partner acts within his authority on behalf of the partnership, he may render the firm liable to third parties as a result of his own negligence.[144] For example, if a partner operates the partnership's automobile in a negligent fashion while pursuing firm business and thereby causes injuries to a third party, that third party may sue the firm and/or the negligent partner and recover damages.[145] If the injured party sues the firm alone, the negligent partner must indemnify the firm for the amount of any judgment.[146] Similarly, if the negligent partner is sued alone, he must bear the loss alone as he is not entitled to contribution from the other partners.[147] Even though the liability will ultimately fall solely upon the negligent partner, the possibility is all too great that the partner may not have sufficient assets to satisfy the judgment and that the liability will have to be borne by the other partners. Therefore, prudence dictates that the partnership purchase sufficient liability insurance.

Thus, it behooves all partners who take part in the firm's management to exercise due care. They will, at least partially, bear any losses experienced by the firm, since each partner must contribute to the losses of the partnership according to his share in the profits or accord-

143. Yorks v. Tozer, 59 Minn. 78, 60 N.W. 846 (1894).
144. This is a consequence of U.P.A. §§ 13, 15. *See e.g.*, Payne v. Payne, 313 N.Y.S.2d 312 (1970).
145. *E.g.*, Eule v. Eule Motor Sales, 34 N.J. 537, 170 A.2d 241 (1961).
146. 1 ROWLEY, *supra* note 40, § 18(f).
147. BROMBERG, *supra* note 4, at 372.

ing to any other loss sharing arrangement agreed upon. Further, if the partner acting for the firm does so with fraud, culpable negligence, or bad faith, he must assume liability to the partnership for the entire loss sustained.

F. Conclusion

From the above discussion it can be seen that, in spite of varying standards among jurisdictions, certain basic concepts must be considered by one wishing to enter a partnership. The partnership agreement should be explicit in setting forth variations of the partner's right to control. The potential partner should consider both external and internal liability, again with the agreement clearly delineating the scheme for the allocation of losses. The partner should appreciate the extent of his duties of loyalty and care to other members of the firm. In particular, the partner must devote all (or the agreed upon amount) of his time to the partnership business; he must always act within the scope of the partnership activity for the interest of the enterprise; and he should consult with his partners when possible in conducting firm business.

III. Joint Venture

A. Definition and Formation

The joint venture as a mode of transacting business has truly ancient roots. Traders from Babylonia, Egypt, Phonecia, and Syria made use of the form to further their commercial interests.[148] But the concept of the joint venture as a legal relationship has purely American origins dating from about 1890.[149] While the courts have failed to agree on the definition of a joint venture, certain common elements have been judicially recognized.

> A joint venture is an association of two or more persons based on intent, who combine their money, property, knowledge, skills, experience, time or other resources in the furtherance of a particular project or undertaking, usually agreeing to share the profits and the losses and each having some degree of control over the venture.[150]

The agreement between co-adventurers need not always be in

148. 2 S. Williston & W. Jaeger, A Treatise on the Law of Contracts § 318, at 547 n.12 (3rd ed. 1959) [hereinafter cited as 2 S. Williston].
149. *Id.* at 548.
150. *Id.* at 554.

writing[151] and can be inferred from the conduct of the parties.[152] The duty required of a co-adventurer will be the standard against which the conduct of one who finds himself in such an implied joint venture will be measured. Therefore, it is crucial that a potential participant be aware of the obligations that can arise from his actions.

Although many joint ventures arise inadvertently, a good number result from the restriction in the majority of jurisdictions that forbids corporations from entering into partnerships in the absence of specific statutory or charter authorization.[153] However, the modern trend in incorporation statutes[154] avoids such chance formations of joint ventures by permitting corporations to join general or limited partnerships. In any event, this majority restriction is somewhat illusory as it is exceedingly difficult in practice to distinguish between a joint venture and a general partnership, and both give rise to virtually identical duties.

B. Control

For purposes of management and control of the business, a joint venture follows the rules of partnership.[155] However, due to the more limited duration and scope of a joint venture, a joint venturer is commensurately more restricted in the extent to which he may bind the enterprise.[156]

C. External Liability

The external liability of joint venturers is in all respects identical to that of partners,[157] with the only distinguishing feature resulting from the more limited scope of a joint venture. Since each of several joint venturers has the power to bind the others and to subject them to liability to third persons in matters which are strictly within the scope

151. *See generally* A. CORBIN, CORBIN ON CONTRACTS 370-484 (one volume ed. 1952).

152. 2 S. WILLISTON, *supra* note 148, at 557-59.

153. HENN, *supra* note 97, at 79.

154. *See, e.g.*, DEL. CODE tit. 8, § 122(11) (1974); N.J. STAT. ANN. § 14A:3-1(m) (West 1969); N.Y. [BUS. CORP.] LAW § 202(a)(15) (McKinney 1963); PA. STAT. ANN. tit. 15, § 1302(18) (Purdon 1967); OHIO REV. CODE ANN. tit. 17, § 1701.13(f)(4) (Baldwin 1964).

155. See notes 14-30 *supra* and accompanying text.

156. Within the scope of the venture, the individual joint venturer clearly may bind the enterprise. Hobdey v. Wilkinson, 201 Md. 517, 94 A.2d 625 (1953). In that case the defendant venturer sold houses in a subdivision which was the subject of a real estate development venture, and his co-adventurers were bound by his act. But where one venturer personally borrowed money from the owner of a warehouse in which the joint venture stored its goods, and the lender-warehouser assumed the money was for the use of the venture but it was not so stated, the lender-warehouser could not recover against the joint venture. J. Abrams & Co. v. Clark, 298 Mass. 542, 11 N.E.2d 449 (1937).

157. See notes 29-38 *supra* and accompanying text.

of the joint enterprise, the narrower scope of joint ventures restricts the potential liability of its members. However, this distinction is one of degree, and any losses arising from wrongful acts or omissions or business debts and sustained within the scope of the joint venture are recoverable in their entirety from the personal assets of each joint venturer.[158]

Many joint venturers have successfully limited liability to those dealing with the enterprise by incorporating the joint venture, forming in the case of corporate joint venturers a commonly-owned subsidiary. Regardless of the status of the co-venturers as corporations or as individuals, the incorporation of the venture will effectively limit the liability of the participants to the funds invested.[159] Of course, this assumes that the joint venture corporation meets with the jurisdiction's requirements for adequate capitalization as well as for operational formalities.

D. Fiduciary Duty

The fiduciary duties of joint venturers parallel those imposed upon partners. However, a joint venturer's duty to refrain from entering competitive businesses is much narrower than that of a partner due to the more limited scope of a joint venture. A landmark decision[160] concerning the general nature of fiduciary relationships involved a joint venture that had leased a hotel in one of the joint venturer/defendant's name. The defendant assumed managerial responsibility over the hotel and, prior to the expiration of the lease, renewed the lease for his own purposes. He also leased from the same landlord a larger adjoining tract. In finding that the defendant held both premises in trust for the co-venturer/plaintiff, the court relied upon the defendant's use of his joint venturer status to his own advantage in obtaining both leases in violation of his duty of loyalty.[161] The court reached this conclusion notwithstanding that the joint venture had no right of renewal and that the defendant had honestly assumed that with the end of the original lease the venture had terminated.[162] To the contrary, the court reasoned that the defendant had nevertheless breached his fiduciary duty

158. Mayer v. Sampson, 157 Colo. 278, 402 P.2d 185 (1965) (tort liability); Joseph W. O'Brien Co. v. Highland Lake Constr. Co., 9 Ill. App. 3d 408, 292 N.E.2d 205 (1973) (contractual debt).

159. HENN, *supra* note 97, § 146, at 253; Flickema v. Henry Kraker Co., 252 Mich. 406, 233 N.W. 362 (1930) (contractual debt); Cone v. Acme Markets, Inc., 41 App. Div. 2d 409, 343 N.Y.S.2d 765 (1973) (tort liability); Chisnell v. Ozier Co., 140 Ohio St. 355, 44 N.E.2d 464 (1942) (contractual debt); Schuster v. Largman, 318 Pa. 26, 178 A. 45 (1935) (breach of contract).

160. Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928).

161. *Id.* at 465, 164 N.E. at 547.

162. *Id.* at 467-68, 164 N.E. at 548.

of loyalty by usurping a business opportunity which rightfully belonged to the joint venture.[163]

As was demonstrated above, liability arising from the external relationships between the joint venture and third parties can be limited by incorporation of the venture.[164] On the other hand, the effect of such an incorporation upon the fiduciary duties of the co-venturers is not as clear.[165] Under the commonly found statutory rules for corporations shareholders do not owe each other fiduciary duties.[166] Some courts have held accordingly that once the joint venture has incorporated, the fiduciary duty that the joint venturers had previously owed each other terminates.[167] This conclusion seems to be based upon a perceived inconsistency between the presence of limited liability and the continued existence of fiduciary duties. Despite this perception, the trend in judicial authority appears to be that the joint venture and the accompanying fiduciary duties survive the incorporation.[168]

The majority of jurisdictions thus consider that joint venturers may limit their external liability to third parties but not their internal liability for breach of fiduciary duties by the stratagem of incorporating the joint venture. If the joint venturers desire to terminate their fiduciary relationship, they should clearly manifest this intent and not rely solely upon the act of incorporation.

As with partnerships, members of a joint venture must render true and full information of all things affecting the joint venture.[169] The following illustrates the application of this stricture. Two theatrical producers entered into a joint venture to produce a play, with an explicit agreement to share the profits after specified royalties were paid to the author. One of the joint venturers failed to disclose that he had an arrangement with that author to receive a share of the royalties and consequently had to disgorge a *pro rata* share of the royalties he had received to his joint venturer.[170]

The duty to disclose can become quite troublesome in joint ventures comprised by corporations that engage in identical or similar in-

163. *Id.* at 468, 164 N.E. at 548.

164. See note 159 *supra.*

165. *See* Comment, *Survival of Joint Adventure Agreements*, 7 WASHBURN L.J. 110 (1967).

166. *See generally* HENN, *supra* note 97, §§ 235-42, at 457-83.

167. *E.g.*, Jackson v. Hooper, 76 N.J. Eq. 592, 75 A. 568 (1910); Weisman v. Awnair Corp. of America, 3 N.Y.2d 444, —, 165 N.Y.S.2d 745, 750 (1957).

168. Campbell v. Campbell, 198 Kan. 181, 422 P.2d 932 (1967). *See also* Comment, *Survival of Joint Adventure Agreements*, 7 WASHBURN L.J. 110, 114 (1967).

169. See notes 56-57 *supra* and accompanying text.

170. Selwyn & Co. v. Waller, 212 N.Y. 507, 106 N.E. 321 (1914).

dustries. A hypothetical should serve to suggest the nature and extent of potential problems.[171] Two mining corporations form a joint venture to extract fissionable minerals from a specific tract of land. During the early stages of operation, one of the corporations discovers a non-patentable method of extraction that would prove extremely valuable not only for the joint venture but also in many of the discovering corporation's other operations. Must that corporation disclose the new process to its fellow joint venturer? The high level of fiduciary duty would seem to indicate an affirmative answer. One possible solution to such problems would be for the co-venturers to limit specifically the duty of disclosure in their agreement.[172] Another possible solution might be to incorporate the joint venture at the outset if the jurisdiction is among those which do not consider that the fiduciary duties of joint venturers survive incorporation.

E. Duty of Care

As intimated above, the courts have traditionally applied the law of partnerships to joint ventures.[173] As a result, joint venturers are held to the same duty of care as general partners,[174] subject to the same, if not greater, possibility of limitation by agreement. The narrower scope of activities and briefer duration of joint ventures can produce two minor variations in the duty of care. First, joint venturers may not be required to devote as much time to the enterprise as are partners, as they seldom contemplate the contribution of all of the participants' time and energy.[175] Second, the narrower scope of the business truncates the authority of associates to act for the joint venture.[176] Consequently, each member must exercise commensurately greater care to comply with the joint venture agreement. In all other respects, the duty of care of joint venturers should not differ from those of general partners.

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171. This hypothetical is based in part upon one suggested by Professor Berle in Berle, *Developments in the Pattern of Corporate Joint Enterprise*, 14 BUS. LAW. 309, 312 (1959).

172. Note, *Joint Venture Corporations: Drafting the Corporate Papers*, 78 HARV. L. REV. 393, 415 (1964).

173. *E.g.*, Bank of Cal. v. Connolly, 36 Cal. App. 3d 350, 111 Cal. Rptr. 468 (1973).

174. See notes 108-147 *supra* and accompanying text.

175. BROMBERG, *supra* note 4, at 189, 192-93.

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

IV. LIMITED PARTNERSHIP

A. Definition and Formation

The unattractiveness of the unlimited personal liability associated with general partnerships (and joint ventures) gave rise to the limited partnership, a form unknown to both English and American common law. The device had its origins in the *commenda* which arose in medieval Europe,[177] but it did not make its appearance in the United States until 1822.[178]

The Uniform Limited Partnership Act (U.L.P.A.), which has been adopted in all jurisdictions except Louisiana,[179] defines a limited partnership as "a partnership formed by two or more persons under the provisions of Section 2, having as members one or more general partners and one or more limited partners."[180] Limited partnership enjoyed wide use when corporate charters were not readily granted but fell into disuse upon the passage of general incorporation statutes permitting wholesale formation of corporations.[181] However, the past twenty-five years have witnessed a resurgence in the use of limited partnerships, with perhaps the most visible utilization occurring in real estate investment and development.[182]

The limited partnership is the least likely of the three forms discussed herein to be thrust upon unwitting participants, for it is a statutory creation which requires the public filing[183] of a certificate of limited partnership. The certificate calls for information not dissimilar to that in a corporate charter, but it often requires more frequent amendments to reflect any changes in the membership or in the capital contribution of any limited partner.[184]

The death or retirement of a general partner has the same effect upon a limited partnership as it does upon a general partnership—termination of the enterprise[185] unless otherwise provided for in the certificate. On the other hand, the death or withdrawal of a limited

177. BROMBERG, *supra* note 4, at 143-44.
178. New York was the first state to provide statutory authorization for limited partnerships. Act of —, ch. 244, 1822 N.Y. Laws.
179. 6 UNIFORM LAWS ANNOTATED 559 (1978).
180. UNIFORM LIMITED PARTNERSHIP ACT § 1 [hereinafter U.L.P.A.]. Section 2 specifies the required content of the certification and filing procedures.
181. BROMBERG, *supra* note 4, at 149.
182. *Id.*
183. U.L.P.A. § 2.
184. *See* U.L.P.A. §§ 24-25.
185. U.L.P.A. § 20.

partner does not terminate the limited partnership.[186] In addition, if provided for in the certificate, a limited partner may sell his interest, and the purchaser may then become a limited partner.[187] Furthermore, capital may be raised by admitting additional limited partners upon the filing of an amendment to the certificate.[188] Thus, the limited partnership affords greater continuity, transferability of interest, and capital raising potential than does a general partnership.

B. Control

General partners are vested with control and management of the business of a limited partnership. "A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners" within certain minor limitations.[189] Thus, the one or more general partners of a limited partnership have almost exclusive control of the management of the enterprise accompanied by personal liability for all debts of the partnership, regardless of their partnership contribution. In fact, a general partner need not provide any contribution, while a limited partner must contribute "cash or other property, . . . not services."[190]

As noted above,[191] the principal reason for entering such an enterprise as a limited partner is protection from unlimited liability for the debts and obligations of the business association. However, a "limited partner shall not become liable as a general partner *unless* . . . he takes part in the control of the business."[192] Hence, when an individual agrees to become a limited partner and to accept the associated benefits of limited liability, he must also relinquish control and management of the business. Therefore, the crucial question is the extent to which a limited partner can participate in the management of the business[193] without subjecting himself to the unlimited liability of a general partner. The U.L.P.A. places certain limitations on the powers which a general partner can exercise without the concurrence of all the limited partners.[194] At the same time, the U.L.P.A. makes clear that limited

186. *See* U.L.P.A. §§ 20-21.
187. U.L.P.A. § 19.
188. U.L.P.A. §§ 8, 25.
189. U.L.P.A. § 9.
190. U.L.P.A. § 4.
191. See text immediately preceding note 177 *supra*.
192. U.L.P.A. § 7 (emphasis added).
193. The U.L.P.A. does not define the term "control."
194. (1) A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except

partners are extended certain specific rights of the general partner.[195]

Moreover, it is generally agreed that a limited partner may serve in the nonmanagerial employ of the limited partnership without forfeiting his rights as a limited partner as long as his position does not entail his "controlling" the enterprise.[196] Neither section 7[197] (which provides for relinquishment of limited liability upon taking control of the business) nor section 4[198] (which forbids the contribution of a limited partner to consist of services) prevents a limited partner from serving as an employee of the enterprise, but neither section defines "control." One commentator, in attempting to define the amounts of control that a limited partner may undertake, has stated that "the important test seems to be whether a limited partner has the ultimate power and authority to make important business decisions for the partnership."[199] However, the judicial decisions pertaining to this question do not readily lend themselves to generalization nor does the above test really resolve the question as it leaves unanswered the question of which business decisions are "important." The cases leave a great deal of uncertainty as to precisely where, between the extremes of a totally passive limited partner and one who actually carries on the daily operation and management of the limited partnership, a limited partner should be deemed to have exercised control.

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that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to

(a) Do any act in contravention of the certificate,

(b) Do any act which would make it impossible to carry on the ordinary business of the partnership,

(c) Confess a judgment against the partnership,

(d) Possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose,

(e) Admit a person as a general partner,

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

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

U.L.P.A. § 9.

195. (1) A limited partner shall have the same rights as a general partner to

(a) Have the partnership books kept at the principal place of business of the partnership, and at all times to inspect and copy any of them.

(b) Have on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable, and

(c) Have dissolution and winding up by decree of court.

(2) A limited partner shall have the right to receive a share of the profits or other compensation by way of income, and to the return of his contribution as provided in Sections 15 and 16.

U.L.P.A. § 10.

196. 1 CAVITCH, *supra* note 25, § 39.07[a], at 1088.

197. U.L.P.A. § 7.

198. U.L.P.A. § 4.

199. 1 CAVITCH, *supra* note 25, § 39.07[2], at 1087-88.

For example, in one case[200] two limited partners in a farming enterprise were held to have exercised control over the business operations and thus were personally liable as general partners on the basis of having engaged in the following activities: they determined, over the general partner's disapproval, what crops should be raised; they visited the farm at least twice a week; they replaced the general partner who did the farming with another; and they were needed to countersign all checks—in fact any two of the partners, general or limited, could sign checks, hence the two limited partners alone could issue checks.

In another decision, however,[201] a limited partner who was employed by the limited partnership as an auto repair foreman, who had occasionally consulted with the general partner about important business transactions and had purchased parts as needed, but who could neither extend credit nor issue checks, was held not to be liable as a general partner. The court ruled that a limited partner does not forfeit the right to advise and consult with the general partner about transactions which the general partner wishes to discuss.[202] Finally, a third case[203] held that a limited partner who had acted as the automobile sales manager of the limited partnership and who had occasionally signed checks did not assume liability as a general partner since he had no power to hire or fire employees, to purchase new automobiles, or to establish automobile prices or trade-in allowances.

All of this uncertainty has led one author to conclude:

> Neither the Act nor the decisions under it are very helpful on the critical question of how much review, advisory, management selection or veto power a limited partner may have without being regarded as taking part in control. The resulting uncertainty is probably the greatest drawback of the limited partnership form.[204]

In response to this quagmire, some states[205] and the Revised Uniform Limited Partnership Act[206] have altered section 7 to provide greater guidance for the limited partner in determining what role he may play

200. Holzman v. De Escamilla, 86 Cal. App. 2d 858, 195 P.2d 833 (1948).
201. Silvola v. Rowlett, 129 Colo. 522, 272 P.2d 287 (1954).
202. *Id.* at —, 272 P.2d at 290-91.
203. Grainger v. Antoyan, 48 Cal. 2d 805, 313 P.2d 848 (1957).
204. BROMBERG, *supra* note 4, at 147 (footnotes omitted).
205. ALA. CODE tit. 10, § 9-41 (1975); DEL. CODE ANN. tit. 6, § 1707(a) (1974); NEB. REV. STAT. § 67-207 (1971); NEV. REV. STAT. § 88.080 (1973); N.Y. [PARTNERSHIP] LAW § 96 (McKinney Supp. 1978); OR. REV. STAT. § 69.280 (1971); WASH. REV. CODE § 25.08.070 (Supp. 1978).
206. REVISED UNIFORM LIMITED PARTNERSHIP ACT § 303(b). This act has not yet been adopted by any state. *See generally* 6 UNIFORM LAWS ANNOTATED 114 (Cum. Supp. 1978).

in the operation of the limited partnership. Moreover, all of these amended provisions allow the limited partner a certain amount of managerial participation while none require a literal interpretation of the original section 7. In fact, three of these revisions[207] establish a reliance test providing that a

> limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business, and then only to persons who transact business with the partnership reasonably believing that the limited partner is a general partner.[208]

In support of the propriety of the reliance test is the analysis written by one of the draftsmen of the U.L.P.A.

> The Uniform Act [U.L.P.A.], prepared and adopted by the Commissioners, is based upon two fundamental assumptions;
>
> First: That no public policy requires a person who contributes to the capital of a business, acquires an interest in the profits, and some degree of control over the conduct of the business, to become bound for the obligations of the business; provided creditors have no reason to believe at the times their credits were extended that such person was so bound.
>
> Second: That persons in business should be able, while remaining themselves liable without limit for the obligations contracted in its conduct to associate with themselves others who contribute to the capital and acquire rights of ownership, provided that such contributors do not compete with creditors for the assets of the business.[209]

Moreover, all seven variations from the official U.L.P.A. text incorporate, without excluding other powers, certain enumerated powers which are not to be deemed "control" of the limited partnership. These approved powers include:

(1) the power to advise the general partners;

(2) the power to elect or remove a general partner;

(3) the power to terminate the partnership;

(4) the power to amend the partnership agreement;

207. ALA. CODE tit. 10, § 9-41(b) (1975); DEL. CODE ANN. tit. 6, § 1707(a) (1974); REVISED U.L.P.A. § 303(b).

208. DEL. CODE ANN. tit. 6, § 1707(a) (1974).

209. 1 ROWLEY, *supra* note 40, at 551.

(5) the power to veto a sale of all or substantially all the partnership assets; and

(6) the power to serve in the employ of the partnership.

Although these approved powers may provide some guidance to the current direction of legal thought, they can not be relied upon by limited partners in jurisdictions which have not modified section 7 of the original U.L.P.A. Instead, they must adhere to the current standardless test which requires, for certain compliance, a nearly totally passive limited partner. The newly adopted standards may in fact represent an upper limit to those powers a limited partner may exercise in jurisdictions which have not amended the U.L.P.A., but as yet no court has so held.

An intriguing case[210] presenting a possible way to circumvent this problem involved a landlord who brought suit for a breach of contract against his tenant (a limited partnership), the general partner, and the twenty-two limited partners. The landlord alleged that three of the limited partners should be personally liable due to the control and management of the limited partnership they had exercised by serving as officers and members of the board of directors of the corporation which was the sole general partner. In holding in favor of the three limited partners, the trial court accepted their uncontradicted affidavits stating that they did not exercise control over the limited partnership's corporate general partner. However, in reversing on appeal, the Texas Supreme Court perceptively stated:

> The defendant limited partners argue that they acted only through the corporation and that the corporation actually controlled the business of the limited partnership. In response to this contention, we adopt the following statements in the dissenting opinion of Chief Justice Preslar in the court of civil appeals:
>
> "I find it difficult to separate their acts for they were at all times in the dual capacity of limited partners and officers of the corporation. Apparently the corporation had no function except to operate the limited partnership and Appellees were obligated to their other partners to so operate the corporation as to benefit the partnership. Each act was done then, not for the corporation, but for the partnership. Indirectly, if not directly, they were exercising control over the partnership. Truly 'the corporation fiction was in this instance a fiction.' "

210. Delaney v. Fidelity Lease Ltd., 517 S.W.2d 420 (Tex. Civ. App. 1974), *modified*, 526 S.W.2d 543 (Tex. 1975).

> Thus, we hold that the personal liability, which attaches to a limited partner when "he takes part in the control and management of the business," cannot be evaded merely by acting through a corporation.[211]

However, it should also be noted that the court in so deciding nevertheless rejected the reliance theory.

Incidentally, Revenue Procedure 72-11 of the Internal Revenue Service (IRS) is consistent with this holding, stating that a limited partnership with a corporation as the general partner would only be considered a partnership for taxation purposes if, among other criteria, the limited partners do not own more than 20%, in aggregate, of the stock of the general partner corporation.[212] Thus, the IRS has also focused upon control and set a conservative upper limit to the permissible degree of control exercisable by a limited partner.

In light of this discussion, a limited partner should proceed with great caution before exercising control of the partnership if he wishes to retain his limited personal liability.

C. External Liability

One of the most appealing features of a limited partnership is the limited personal liability it offers to limited partners. The U.L.P.A. states clearly that "[t]he limited partners as such shall not be bound by the obligations of the partnership."[213] However, this protection is subject to three conditions: (1) that there is substantial compliance in good faith with the requirement that a certificate of limited partnership be filed,[214] (2) that the surname of the limited partner does not appear in the partnership name,[215] and (3) that the limited partner does not take part in control of the business.[216] As long as the limited partner abides by these conditions, his liability is limited to his capital contribution, to which he has a claim subordinate to outside creditors but superior to the general partners.[217]

The general partners of a limited partnership have the same external liability as a partner in a partnership without limited partners.[218]

211. 526 S.W.2d 543, 545 (1975).
212. Rev. Proc. 72-13, 1972-1 C.B. 735.
213. U.L.P.A. § 1.
214. U.L.P.A. § 2(2).
215. U.L.P.A. § 5(2). Limited liability is forfeited in this instance only to creditors who extend credit to the limited partner without actual knowledge that he is not a general partner. *Id.*
216. U.L.P.A. § 7. See notes 189-212 *supra* and accompanying text.
217. U.L.P.A. §§ 16, 23.
218. See notes 29-38 *supra* and accompanying text.

The U.L.P.A. makes this explicit by stating that "[a] general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners."[219] The Uniform Partnership Act implicitly provides that "this act shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith."[220] However, even this residue of unlimited personal liability can be avoided in those jurisdictions that permit a corporation to be a general partner.[221] This is accomplished by forming a limited partnership consisting of a corporation as general partner and any number of natural persons as limited partners. Since the corporation enjoys limited liability from the corporation law and the individuals from the U.L.P.A., unlimited personal liability has been effectively circumvented.[222]

With regard to internal liability, the partnership agreement can provide for virtually any arrangement of loss sharing among the general partners and the limited partners. For example, the U.L.P.A. permits a member to be a general partner and a limited partner in the same partnership at the same time.[223] This means that he has the rights of control and the external liabilities of a general partner but the rights against the other members with respect to his capital contribution which he would have were he a limited partner.

D. Fiduciary Duties

A general or managing partner of a limited partnership occupies a fiduciary relationship with respect to his limited partners. This is a consequence of the U.L.P.A. provision that a "general partner shall have all the rights and powers and be subject to all the restrictions of a partner in a partnership without limited partners."[224] This fiduciary duty imposed upon the general partner has extreme importance to the limited partners since the restricted role that a limited partner may play in the control[225] and management of the business enterprise places the limited partners at the mercy of the almost total managerial power possessed by the general partners. In fact, this situation has led some to

219. U.L.P.A. § 9.
220. U.P.A. § 6(2).
221. BROMBERG, *supra* note 4, at 147.
222. It should be noted that this particular configuration must meet certain stock ownership and net worth requirements to retain partnership status with regard to federal income taxation. See note 212 *supra* and accompanying text.
223. U.L.P.A. § 12.
224. U.L.P.A. § 9.
225. See notes 192-212 *supra* and accompanying text.

argue that a general partner in a limited partnership should have an even greater obligation to the limited partners than a partner of a general partnership owes his co-partners.[226] This argument reasons that since the relationship between general partner and limited partner is a close analogy to that between a corporate director and shareholder, the duties owed by the general partner should be as high. However, apparently neither the state legislatures nor the courts have accepted this argument, although one recent case seems to have moved in that direction.[227]

This landmark decision involved a real estate limited partnership in which the plaintiffs, six of thirty-five limited partners, brought suit against the general partner (a corporation) for breach of its fiduciary duty. The plaintiffs alleged that the general partner had purchased property subsequent to the formation of the partnership for a substantial profit without the approval of the limited partners. The court held that the defendant's self-dealing had indeed breached its fiduciary duty.[228] However, the court further stated that the limited partners could have provided in the partnership agreement for the general partner to make a profit on transactions of this sort, as long as the amount of profit was specifically stated or could be derived from an express formulation (full disclosure of profit skimming) and the transactions were fair.[229] This would have permitted the partners to modify the fiduciary standard but not to the point of allowing an arm's length transaction. The court may have imposed this constraint of judicial scrutiny as to the fairness of the transaction in recognition of the difference in managerial power of the two groups (general partners versus limited partners) and the dependence of the limited partner upon the general partner, thus in effect analogizing the limited partnership to a corporation rather than a partnership. Consequently, this limitation might not extend to general partnerships.

A most interesting sidelight of this decision (and another reason for the judicial scrutiny) appeared in the disclosure of a similar situation in which a general partner of a real estate syndicate, who was permitted in the partnership agreement to re-sell property he had purchased to the limited partnership at the fair market value, could utilize such a provision to his advantage by obtaining an inflated ap-

226. BROMBERG, *supra* note 4, at 148-149.
227. Bassan v. Investment Exch. Corp., 83 Wash. 2d 922, 524 P.2d 233 (1974).
228. *Id.* at —, 524 P.2d at 238.
229. *Id.* at —, 524 P.2d at 236.

praisal. In fact, in this particular case one of the tracts of land in question had been appraised by two different individuals during the same period with one appraisal of $688,000 and the second of $325,000. Thus, it is understandable that the court, in formulating its test, reserved the right to examine the fairness of these transactions even when the allowable profit was to be calculated from an express formula.

Another significant decision[230] in this area also involved a real estate limited partnership (the Syndicate) in which five limited partners, out of a total of 350 partners, brought suit against the four general partners for rent due under a limited partnership lease. The Syndicate owned a hotel in New York City, and the partnership agreement specified that the Syndicate was to lease the hotel to a corporation which was owned by the Syndicate's general partners. The partnership agreement also provided that the lease could be assigned with the approval of the Syndicate's general partners. Through a complex series of transactions involving other business entities which were owned or controlled by the Syndicate's general partners, the hotel lease was assigned several times, until the Syndicate was in possession of its own hotel without a paying tenant.

The plaintiffs sued on behalf of the Syndicate, alleging that the defendants had breached their fiduciary duty to the limited partners by approving the assignment of the hotel lease to business entities which the defendants owned or controlled, and then releasing those entities from liability. The court stated that such self-dealing would ordinarily render such releases invalid, but since the partnership agreement specified that the Syndicate was to lease the hotel to the defendant's corporation, a certain amount of self-dealing had been contemplated and authorized by the parties. Therefore, the defendants were exonerated from any adverse inferences which might have been drawn against them by such self-dealing, and a trial was necessary in order to determine whether the defendants had acted honestly and in good faith.

This case is significant in suggesting the extent to which courts permit partners, even in a limited partnership, to relieve themselves by express agreement of personal liability for breach of their fiduciary duty. At what point public policy would invalidate such agreement was not considered by the court. Nonetheless, these facts indicate be-

230. Riviera Congress Assocs. v. Yassky, 18 N.Y.2d 540, 277 N.Y.S.2d 386 (1966).

havior that transcends the point which any fiduciary should be allowed to pass.

On the other hand, it remains unclear whether a limited partner stands in a fiduciary relation to his general partners. There exists very limited authority on this question, but it seems to point towards not placing such a burden on the limited partner.[231] Given the severely circumscribed role in the control of the enterprise allowed a limited partner, this approach makes sense.

E. Duty of Care

As with fiduciary duty, the law does not distinguish between the duty of care owed by a general partner to a general partnership[232] and that owed by a general partner to a limited partnership. This results in part from section 6 of the Uniform Partnership Act which provides that "the act will apply to limited partnerships except in so far as it is inconsistent with the statutes relating to such partnerships."

On the other hand, a limited partner owes no duty of care to a limited partnership as long as he remains a limited partner. As discussed above, a limited partner may not take part in the control of the business if he wishes to retain his limited liability.[233] Thus, the limited partner engages in no firm business to which some duty of care could be applied. Of course, if a limited partner disregards this restriction (subjecting himself to external liability), he will likely be held to the same duty of care as are general partners. Furthermore, since the U.L.P.A. does not preclude a limited partner from providing services as long as such services are not deemed his contribution to the limited partnership,[234] the limited partner may perform services on a contract basis.[235] Under this aegis the limited partner would be an independent contractor or paid agent and therefore would be obligated to exercise

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231. Skolny v. Richter, 139 App. Div. 534, 124 N.Y.S. 152 (1910).

> Indeed throughout the whole act, from whatever standpoint it may be viewed, the special partner so far as concerns his relations to his general partners, is treated as a mere contributor of capital with none of the rights or liabilities belonging to general partners, such as universal agency, unlimited liability for debts, and a property interest in the firm name and good will. The element of mutual trust and confidence, which is the keynote in the relation between general partners, is wholly and conspicuously lacking.

Id. at —, 124 N.Y.S. at 157.

232. See notes 109-147 *supra* and accompanying text.

233. See notes 189-212 *supra* and accompanying text.

234. U.L.P.A. § 4. *See also* note 188 *supra* and accompanying text.

235. Section 13 of the U.L.P.A. states that "a limited partner may also loan money to and transact business with the partnership."

ordinary care.[236] However, this type of arrangement courts danger as the contribution of services in some instance may constitute "taking control of the business" in the hindsight of a court, with the consequent forfeiture of limited liability. The general failure of the courts and of the legislature to delineate clearly the permissible degree of control has been discussed above[237] and has produced such uncertainty that limited partners should warily render services to the partnership.

V. CONCLUSION

Businessmen frequently decide to join forces with one or more associates, usually in order to gain additional (and otherwise unavailable) capital or expertise. Once this decision has been made, a second and equally as significant a one must be reached—the form of business organization which should be utilized. Presently, there are four viable options: general partnership, joint venture, limited partnership, and corporation. Which of these forms is most appropriate cannot be determined in any general way but depends entirely upon the particular circumstances and needs of the associates. There are a host of factors, other than tax considerations, that are relevant to this decision, all of which should be considered carefully before choosing one of these forms of business organizations. This article has described the comparative advantages of the three unincorporated forms with respect to four of the most important of these factors:[238] control, external liability, duty of loyalty, and duty of care. A business person should not *a priori* choose the incorporated form without fully exploring the benefits of unincorporated forms of business organizations. Moreover, he should be fully cognizant of his duties and responsibilities whatever form he chooses. Since the selection of the appropriate form of business organization is one of the first and most crucial decisions the entrepreneur will encounter, it should be made wisely and with all due consideration. This article should provide attorneys whose clients are contemplating the formation of a business association a basis upon which an intelligent and informed choice may be made.

236. W. SEAVEY, HANDBOOK OF THE LAW OF AGENCY § 140 (1964).
237. See notes 189-212 *supra* and accompanying text.
238. Tax factors, which are always an important consideration, have not been addressed in this article.