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Three Policy Decisions Animate Revision of Uniform Partnership Ac

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*By Donald J. Weidner**

INTRODUCTION

The Uniform Partnership Act ("UPA") was approved by the National Conference of Commissioners on Uniform State Laws (the "Conference") in 1914 and the Uniform Limited Partnership Act ("*ULPA*") was approved in 1916. The ULPA was revised first in 1976 and again in 1985 ("RULPA"). After the ULPA had become RULPA, it was only a matter of time that the UPA would become RUPA. In 1984, Georgia enacted the UPA with many changes.[1] In January of 1986, an American Bar Association subcommittee issued a detailed report that recommended extensive changes to the UPA, many of them along the lines of the recent Georgia changes.[2] In the Fall of 1986, Congress enacted the Tax Reform Act of 1986.[3] The 1986 Act made partnerships more attractive by setting corporate income tax rates higher than individual income tax rates while tightening up on the corporate income tax.

In the Fall of 1987, the Conference appointed a Drafting Committee to Revise the Uniform Partnership Act. The Drafting Committee held its initial meeting in January of 1988, and has been meeting periodically ever since.

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1. Ga. Code Ann. §§ 14-8-1–43 (Harrison Supp. 1987). Unless stated otherwise, all references to the UPA are to the 1914 act, all references to the ULPA are to the 1916 act, and all references to RULPA are to the 1985 act.

2. UPA Revision Subcommittee of the Committee on Partnerships and Unincorporated Business Organizations, *Should the Uniform Partnership Act Be Revised?*, 43 Bus. Law. 121 (1987) (hereinafter "ABA Report").

3. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in 26 U.S.C.A. §§ 1–9602 (West 1989)).

Members of the subcommittee that prepared the ABA Report have been regular and active participants in all Drafting Committee meetings. In August of 1989, a draft of RUPA was presented to the Conference at its annual plenary session and the first of two required readings was begun. The first reading was completed at the annual meeting held in Milwaukee in July of 1990, and the second and final reading will begin and perhaps be concluded in the summer of 1991.

Although some UPA provisions are left intact, RUPA completely rewrites some of the most important rules of partnership law and amends many others. These numerous changes are best understood if they are put in the perspective of three basic policy decisions that were reached early in the process. First, RUPA makes a major move away from the aggregate or conduit theory of partnerships and toward the entity theory of partnerships. Second, RUPA rewrites the rules on partnership breakups and in the process gives more stability to partnerships. Third, RUPA reflects the supremacy of the partnership agreement and minimizes mandatory rules among partners.

THE MOVE TO THE ENTITY THEORY

THE DEBATE IN A NUTSHELL

The law of partnerships has long been characterized by efforts to identify those issues to be resolved in accord with the entity theory of partnerships and those to be resolved in accord with the aggregate theory of partnerships. The aggregate theory traditionally applied by the common law courts does not regard the partnership as an organization with a separate legal personality. The aggregate approach views the partnership as nothing more than a conduit for a collection of individuals. Each partner is seen as owning an undivided share of partnership assets and as conducting a pro rata share of partnership business. The entity theory traditionally applied in the mercantile courts, on the other hand, treats the partnership as a distinct entity interposed between partners and partnership assets. The partner's interest is viewed as a separate bundle of rights and liabilities associated with her participation in the organization, analogous to the interest of a corporate shareholder in her shares of stock.

The UPA is the product of drafters who espoused different theories. Dean James Barr Ames, who prepared the first two drafts, espoused the entity theory, whereas Dean William Draper Lewis, who took over the project after Ames' death and shepherded the project to completion, strongly supported the aggregate theory. After Lewis stepped in, there was a special conclave that resolved to abandon the entity theory.[4] As a result, the Conference abandoned Ames' definition of partnership as "a legal person" formed by an association of two or more individuals to carry on as co-owners of a business.[5] Nevertheless, the extent to which the final product incorporates the aggregate as opposed to the

4. *See* Lewis, *The Uniform Partnership Act,* 24 Yale L.J. 617, 640 (1915).

5. Lewis, *The Uniform Partnership Act—A Reply to Mr. Crane's Criticism,* 29 Harv. L. Rev. 158, 165 (1915).

entity theory is very much in the eye of the beholder. The UPA was greeted by the suggestion that it embodied the entity theory much more than its drafters cared to admit,[6] although others concluded that the aggregate theory predominated.[7]

Seventy-five years later, the consensus seems to be that a revised UPA should more directly adopt an entity model.[8] The ABA Report recommended that the entity theory "be incorporated into any revision of the UPA whenever possible and that the 'aggregate theory' should be retained only where it appears to be essential, e.g., because of tax considerations."[9] The Drafting Committee agrees with the basic thrust of the ABA Report, and RUPA contains a number of changes that move the law of partnership closer to an entity theory. In general, both for state law purposes and tax law purposes, an entity model is simpler.

6. Many UPA rules treat the partnership as an entity. The term "partnership property" is used in UPA § 8 and throughout the UPA. UPA § 8(3) permits the partnership to take and convey title in the partnership name. UPA § 9(1) makes every partner an agent of the partnership. UPA § 12 discusses a fraud by the partner on the partnership. UPA § 18(a) imposes on a partner the duty to contribute to the losses of the partnership. UPA § 18(b) requires the partnership to indemnify the partner in certain cases. UPA § 21 makes a partner accountable to the partnership, and UPA § 35 discusses the partner's power to bind the partnership after dissolution. The UPA's leading critic commented: "These extracts seem more consistent with the entity than with the aggregate view of the nature of the partnership and illustrate the difficulty, if not impossibility, not only of writing and talking about the partnership, but of formulating its rights and obligations without treating it as a legal person." Crane, *The Uniform Partnership Act: A Criticism*, 28 Harv. L. Rev. 762, 771 (1915). *See also* Crane, *The Uniform Partnership Act and Legal Persons*, 29 Harv. L. Rev. 838, 843 (1916). *See also* UPA § 25, defining the tenancy in partnership, which adopts an entity approach but states it in aggregate terms.

7. Learned Hand said it would be a "palpable perversion" to derive an entity approach from the UPA:

> The Uniform Partnership Act . . . did not . . . make the firm an independent juristic entity. . . . [T]he essentials of the old model were preserved. Indeed, many of the supposed innovations were not such; for example, the limitation upon a partner's power to assign firm property, the declaration that his interest in it "is his share of the profit and surplus" and the extent of an assignee's interest acquired by the assignment, had all been law before, at least in some jurisdiction. . . . With this history before us, it would be a palpable perversion to understand the act as creating a new juristic person, which owned the firm property and was obligor of the firm debts, against which the partners had only a chose in action, and to which they were liable as guarantors.

Helvering v. Smith, 90 F.2d 590, 591–92 (2d Cir. 1937) (citations omitted).

8. *See* M. Eisenberg, An Introduction to Agency and Partnership 36 (1987):

> On the whole . . . the use of an aggregate theory in the U.P.A. was unfortunate. Generally speaking, the entity theory of a partnership is much more functional than the aggregate theory. In those cases where the U.P.A. does not treat the partnership as if it were an entity, the result tends to be bad, and in need of correction. In those cases where the U.P.A. does treat the partnership as if it were an entity, the result is good, but the statutory approach is often made needlessly complex by the mechanics of reconciling the entity result with the aggregate theory.

But see Rosin, *The Entity-Aggregate Dispute: Conceptualism and Functionalism in Partnership Law*, 42 Ark. L. Rev. 395 (1989).

9. ABA Report, *supra* note 2, at 124.

The move closer to an entity theory also reflects the judgment that business people tend to perceive that many partnerships operate as stable organizations notwithstanding the departure of particular individuals.[10]

RUPA MAKES NUMEROUS CHANGES

The changes more fully incorporating an entity model are numerous. At common law, in the absence of an enabling statute, a partnership, not being a legal entity, could not sue or be sued in the firm name. RUPA section 5(a) changes this result by providing that a partnership "may sue and be sued in the partnership name." This eliminates the problem that exists in certain jurisdictions in which a partnership may sue or be sued only if every partner is named in the action. RUPA section 5(b) provides, on the other hand, that a partner "is not personally liable for any judgment against the partnership unless he [or she] has been served or has appeared in the action." UPA section 8(3) provides that any estate in real property may be acquired in the partnership name. RUPA section 8(e) expands this rule to include personal property and further provides that title "so acquired vests as partnership property in the partnership itself rather than in the partners individually." RUPA section 13 advances the entity theory by adding partners to the list of those who may sue the partnership on a tort or other theory. This addition expands the remedies of a partner far beyond the traditional remedies of actions for a dissolution or an accounting. RUPA section 15 provides that partners are jointly and severally liable for all partnership obligations, and not merely tort obligations, as under present law.[11] Although at first blush this does not sound like a move to an entity theory, RUPA section 15(b) further provides that creditors must seek satisfaction out of partnership assets before they can pursue the separate assets of partners. Under RUPA, the liability of partners is liability for the deficiency that cannot be collected from the entity. Partners are thus more like guarantors of the obligations of an entity than principal debtors.[12]

RUPA ELIMINATES THE TENANCY IN PARTNERSHIP

The shift closer to an entity model can perhaps best be illustrated by examining RUPA's discard of the UPA's tenancy in partnership. UPA section 24 states that every partner has "rights in specific partnership property." UPA section 25(1) elaborates by stating that each partner "is co-owner with his partners of specific partnership property holding as a tenant in partnership." These statements reflect an aggregate conception that each partner is a direct

10. Nebraska already defines partnerships as entities: "A partnership is an association of persons organized as a separate entity to carry on a business for profit." Neb. Rev. Stat. § 67-306(1) (1986).

11. *Compare* UPA § 15(b).

12. The ABA Report, *supra* note 2, at 143 states that "this result would be most consistent with general business expectations today."

owner of an undivided interest in the partnership business, including its assets. However, UPA section 25(2), which describes the "incidents of this tenancy," denies the individual partners the incidents of ownership of partnership assets. By process of elimination, the incidents of ownership that are taken from the partners are left in the partnership. Stated simply, the UPA's tenancy in partnership reaches an entity result but insists on stating that result in aggregate terms.

RUPA abandons the tenancy in partnership to reach an entity result that is stated in entity terms. RUPA section 25(a) states directly that property "transferred to or otherwise acquired by a partnership becomes property of the partnership rather than of the partners individually." RUPA also eliminates all reference to a partner's rights in specific partnership property. RUPA section 18X[13] reaffirms that partners are cut off from particular partnership assets, even ones they contribute, by providing that no partner has a right to receive a distribution in kind. Similarly, no partner can be forced to take a disproportionate distribution in kind. Closely related is RUPA section 26, which makes clear that a partner's assignable interest in the partnership is analogous to a share of stock. It provides that a partner's "assignable interest in the partnership is the partner's share of the distributions. The interest is personal property."

NEW BREAKUP RULES REFLECT ENTITY APPROACH

RUPA contains a complete reworking of the rules on partnership breakups. These rules are discussed more fully below but should be mentioned here to complete the big picture of a broad move to an entity model.

Under UPA section 29, a partnership is dissolved every time a member leaves. In some states, a partnership is also dissolved whenever a new member is added. Under RUPA, partnerships are no longer dissolved every time a partner leaves. Nor are they dissolved on the addition of a new member. Although some withdrawals trigger a winding up of the partnership business, others result only in a buyout of the departing partner.[14] RUPA provides that, in a buyout situation, the partnership continues uninterrupted by the departure. RUPA section 41(a) provides that, unless otherwise agreed, the relationships between a partnership and its creditors are unaffected by the departure of a partner or by the addition of a new partner. Because under RUPA the "old" partnership continues if the business is not liquidated, it is no longer necessary to deem the creation of a "new" partnership that must in turn be deemed to assume the

13. Because the provisions of the UPA are so well known, RUPA for the moment retains the UPA numbering, adding "X," "Y" or "Z" to designate certain provisions that are entirely new. For example, RUPA § 18 is a modification of UPA § 18, whereas RUPA § 18X is a completely new provision. On the other hand, there are certain provisions, such as RUPA§§ 31 and 32, that are completely new even though they do not end in X, Y or Z. It is expected that RUPA will be renumbered before it is completed.

14. Even under RUPA, however, any partner may cause a winding up of the partnership business if the partners have not contracted for continuation.

obligations of the "old" partnership. This "deemed assumption" approach is found in UPA section 41, which lists situations in which "creditors of the dissolved partnership are also creditors of the person or partnership continuing the business."[15] Under RUPA, the "old" partnership simply continues with its rights and obligations intact.

STATEMENT OF PARTNERSHIP AUTHORITY

The move to an entity theory and the notion that different partners have different functions is helped by a new provision that authorizes the public recording of statements of partnership authority. RUPA section 10X provides that partnerships may opt to file such statements, and that they are to be filed centrally rather than locally.

The most important goal of the statement of authority is to facilitate real property transfers. RUPA section 10X(a)(4) provides that the statement shall "specify the partners required to sign a transfer of real property held in the name of the partnership." However, the effect of a recorded statement is not limited to real property transfers. RUPA section 10X(a)(5) provides that the statement may "contain any other matters the partnership chooses, including the authority, or restrictions upon the authority, of some or all of the partners to enter into other transactions on behalf of the partnership."

The recording of an extraordinary grant of authority is treated differently than a recorded restriction on authority. A recorded grant of extraordinary authority, whether the grant concerns real estate or other transactions, binds the partnership. RUPA section 10X(c) provides:

> The filing of the statement . . . creates a conclusive presumption in favor of any bona fide purchaser or encumbrancer of partnership property, or any creditor of the partnership giving value, that the partners stated to be authorized to convey or encumber partnership property or enter into other transactions on behalf of the partnership are authorized to do so.

On the other hand, a recorded restriction on authority only binds nonpartners who have actual knowledge of the restriction. RUPA section 10X(d) provides:

> A statement of authority may limit or restrict the authority of a partner granted under [s]ection 9 to enter into transactions on behalf of the partnership, but a limitation on or restriction of authority . . . is effective only against persons who are not partners if they have knowledge of the restriction or limitation.

15. *See* UPA §§ 41(1)–(6). UPA § 41(7) provides that a new partner's liability for pre-admission obligations is nonrecourse: "[t]he liability of a third person becoming a partner in the partnership continuing the business . . . to the creditors of the dissolved partnership shall be satisfied out of partnership property only." RUPA § 17 preserves the rule that a new partner's liability for preadmission obligations is nonrecourse.

The Drafting Committee felt that it would be unfair to bind third parties to recorded restrictions on authority they were most unlikely to consult.

FLEXIBILITY REMAINS

It was only after making these and other changes that moved RUPA closer to an entity model that the Drafting Committee amended RUPA to define partnerships as entities. The latest draft of RUPA section 7 defines a partnership as "an entity resulting from the association of two or more persons to carry on as co-owners a business for profit." RUPA does not, however, declare that the aggregate theory is never appropriate. Nor does RUPA suggest the relentless application of any general theory of the partnership form.

The text of RUPA anticipates that an aggregate approach will continue to be applied in certain situations. The aggregate approach often seems suited to the small partnership, including the inadvertent partnership. Small partnerships seem more personal, and so does the aggregate theory. Parties often document small partnerships in aggregate terms. Larger partnerships seem less personal, and hence more likely to be candidates for the application of the entity theory.[16] The larger the partnership, moreover, the greater the harvest from the simplicity of the entity model. With respect to both large and small partnerships, however, an aggregate approach is particularly useful to state the traditional fiduciary duties among partners. Therefore, despite RUPA's major move toward the entity theory, RUPA section 21(a) states that a partner has a duty of good faith and fair dealing "towards the partnership *and the other partners*." Similarly, RUPA section 21(b) states that a partner has a duty of loyalty "to the partnership *and the other partners*." Not only must partners be concerned about the effect of their conduct on the partnership as an entity, but also they must avoid oppressive behavior toward individual partners. It is true that this result can be reached under an entity theory, but it may be more readily understood if it is stated also in aggregate terms.

It is to be hoped that courts will not needlessly apply either theory. The resort to the general theory of the business organization is all too often a substitute for analysis, and we do not urge a return to a jurisprudence of conceptions. There are many cases in which the general theory of the business organization should be of no concern. Unfortunately, shorthand statements of theory are often treated as talismanic. Consider, for example, the recent case of *Mississippi*

16. In Hopkins v. Price Waterhouse, 52 Fair Empl. Prac. Cas. (BNA) 1275, 53 Empl. Prac. Dec. (CCH) ¶ 39,922 (D.D.C. 1990), the court ordered Price Waterhouse, an accounting firm of 900 partners, to admit as a partner a successful Title VII plaintiff. In rejecting the argument that no one should be made a partner against the will of the other partners, the court stated that "Price Waterhouse lacks the intimacy and interdependence of smaller partnerships, so concerns about freedom of association have little force." The court nevertheless admitted that, as a result of its order, "[i]t is, indeed, a strained partnership relationship that lies ahead in the immediate future." Stated somewhat differently, the court's perception of a lack of intimacy supported its implicit holding that Title VII preempts UPA § 18(g), which states that "[n]o person can become a member of a partnership without the consent of all the partners."

Valley Title Insurance Co. v. Malkove,[17] which illustrates the point. Two individuals received a conveyance of a parcel of land and obtained a title insurance policy. Within the year, they formed a partnership with two other individuals and contributed the parcel. A restrictive covenant encumbering the parcel was discovered, and suit was brought against the title insurance company. The suit is good, said the majority, applying the logic of the aggregate theory. The two individuals remained co-owners of the property even after they contributed it to the partnership, said the court, relying on the UPA's declaration of a tenancy in partnership. Not so, said the dissent, because the thrust of the tenancy in partnership provisions, especially when put in the context of other UPA provisions, is that an entity theory must be applied. And, concluded the dissent, the entity theory means that the partnership owns the property, not the two individuals. The partners may have some interest in the property, but "these mere derivative rights are simply inadequate to support a finding" against the title insurance company.[18]

Mississippi Valley need not have been decided on the basis of the general theory of the business organization. It should have been decided on the basis of the right result under the insurance policy rather than on the basis of the general theory of the organization to which the property was contributed. Yet there was no discussion either of the likely understanding of the parties to the contract or of the fact that the subsequent contribution to the partnership created no additional risk for the insurer. No attempt was made to distinguish title insurance from general business liability insurance. Not even the most enthusiastic supporters of RUPA's move closer to an entity theory believe the theory should shortcircuit policy analysis.

There is no reason why the logic of the entity theory should be any more ineluctably applied in the partnership area than in the corporate area, in which the entity theory is often set aside to reach the right result. In *Sandler v. New Jersey Realty Title Insurance Co.*,[19] for example, the fee owner purchased a title insurance policy and subsequently conveyed the fee to his wholly-owned corporation. The court said that the title insurance policy would not be defeated by "any change short of a complete transfer of his entire interest." It held that it was sufficient to retain an insurable interest and that such an interest is retained by a person who contributes property to his wholly-owned corporation. In short, *Sandler* was decided on the basis of the right result under the insurance policy, and not by blind application of the general entity theory of corporations. It is to be hoped that similar decisions will be reached under RUPA.

It remains to be asked whether there is a downside to the move to the entity theory. In 1916, Dean Lewis explained the rejection of the entity theory in part as follows: "those with the largest practical experience present were opposed to regarding the partnership as a 'legal person' because of the effect of the theory

17. 540 So. 2d 674 (Ala. 1988).
18. *Id.* at 682.
19. 36 N.J. 471, 178 A.2d 1 (1962).

in lessening the partner's sense of moral responsibility for partnership acts."[20] Although RUPA section 21 retains for emphasis an aggregate as well as an entity statement of the fiduciary duties of partners, Lewis' observation is still troubling. As discussed below, RUPA section 21, when coupled with RUPA section 4X, provides that the only mandatory fiduciary duty among partners is the duty of good faith and fair dealing. Under RUPA, all other fiduciary duties, including the duty of loyalty, are merely default rules. Further, RUPA section 21 contains two new provisions that attempt to protect a partner's pursuit of self interest. In short, RUPA's move to the entity theory is arguably accompanied by the narrowing of fiduciary duties that was feared at the turn of the century.

NEW RULES ON PARTNERSHIP BREAKUPS

CONFUSION CONCERNING DISSOLUTION

At the beginning of this century, the law of partnership breakups was couched in terms of dissolution and was confused. Dean William Draper Lewis, the Reporter who saw the UPA to completion, thought that the concept of dissolution was perfectly logical but sadly misunderstood. According to Lewis, "[t]he subject of the dissolution and winding up of a partnership is involved in considerable confusion principally because of the various ways in which the word 'dissolution' is employed."[21] His solution to the confusion, which was approved by the Conference and incorporated into the UPA, was to continue with the term dissolution and define in the statute both what dissolution is and what it is not. UPA section 29 states what dissolution is: "the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business." UPA section 30 states what dissolution is not: "[o]n dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed." All the UPA provisions on partnership breakups are then activated by, and only by, a dissolution.[22]

Seventy-five years later, the law of partnership breakups is still couched in terms of dissolution and it is still confused. There are cases that find a dissolution and apply the strict logic of dissolution even though justice seems to require otherwise.[23] There are cases that struggle to reach a right result by refusing to find a dissolution even though the statute seems to require a dissolution.[24] More basically, there are cases that appear to reflect a complete

20. Lewis, *supra* note 5 at 173.

21. Lewis, *supra* note 4 at 626–27.

22. *See* UPA §§ 33–38 and 40–43.

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

24. *See* Zeibak v. Nasser, 12 Cal. 2d 1, 82 P.2d 375 (Cal. 1938), in which the court said that the death of a partner does not necessarily dissolve the partnership, especially if the partner who dies is a passive investor. The court's discussion is difficult to reconcile with UPA § 31(4), which states that dissolution is caused "[b]y the death of any partner."

misunderstanding of the concept of dissolution as it is used in the statute.[25] It is not surprising, therefore, that the ABA Report recommended 66 changes to the dissolution provisions.[26]

Consider the UPA section 29 definition of dissolution as a "change in the relation of the partners caused by any partner ceasing to be associated in the carrying on" of the business. This definition of dissolution is actually an indirect definition of partnership. More precisely, it is an aggregate conception that a partnership is a unique aggregation of individuals, a specific cast of characters. The cast is "dissolved" whenever anyone leaves. Consider the simple example of a firm of four partners. Assume all the partners, including the departing partner, happily and harmoniously agree the departing partner will leave and the remaining partners will continue with the business. Assume it also is agreed that the withdrawing partner will neither be required to make any additional contributions nor entitled to receive any additional distributions. Can't we just say that the partnership continues? That's what the tax law says.[27] No, says the UPA, the "old" partnership is dissolved and a "new" partnership is created.

Could that possibly mean that property of the "old" partnership must be conveyed to the "new" partnership? Yes it could.[28] Could it possibly mean that contracts of the "old" partnership lapse because the old partnership, the party to the contract, no longer exists, leaving only a "new" partnership that is simply a stranger to the bargain? Yes it could.[29]

25. In Great Hawaiian Fin. Corp. v. Aiu, 863 F.2d 617, 620 (9th Cir. 1988), the court said that the withdrawal of three managing partners "indicates that the original partnership including those partners was dissolved as to *those partners*," but did not necessarily indicate that the partnership was dissolved as to the remaining partners (emphasis in original). *See also* Cowan v. Maddin, 786 S.W.2d 647 (Tenn. Ct. App. 1989) and Adams v. Jarvis, 23 Wis. 2d 453, 127 N.W.2d 400 (1964). The UPA does not support the argument that the partnership is dissolved as to some partners but not as to others.

26. *See* ABA Report, *supra* note 2 at 124-27 for a summary of these changes.

27. I.R.C. § 708 (1990).

28. *See* Va. Code § 50-37.1, which supplements the UPA. It provides that if the partnership is dissolved but its business is continued "without liquidation of the partnership affairs, the title to any real estate or any interest therein vested in the dissolved or former partnership shall be deemed to be transferred to and vested in such new partnership as may be created by the remaining partners without further act or deed."

29. *See* Frederick C. Smith Clinic v. Lastrapes, 111 Ohio App. 42, 170 N.E.2d 497 (1959), which held that the withdrawal of a partner terminated an employment agreement that said it would automatically end on dissolution of the partnership. Even though the assets of the partnership were transferred to a successor partnership that continued the business, the successor partnership was not permitted to enforce a covenant not to compete against an employee who resigned almost two years after the dissolution. Dissenting, Judge Younger asked rhetorically:

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

Id. at 51, 170 N.E.2d at 503 (J. Younger, dissenting).

Consider the illustration of a recent case that caught the attention of the Committee early in the project. In *Fairway Development Co. v. Title Insurance Co.*,[30] a real estate development partnership of three individuals took out a title insurance policy. Subsequently, two of the partners "transferred not just their interest in the partnership, i.e., their respective shares of profits and surplus, but their entire respective bundles of partnership rights" to the remaining partner and a third person.[31] An undisclosed pipeline easement was discovered and the surviving partnership sued the title insurance company.

The court began its discussion with the "fundamental principle of law" that "any change in the personnel of a partnership will result in its dissolution."[32] Accordingly, the old partnership was dead, a new partnership was born, and the new partnership had no "standing" to bring the action because it was not a party to the insurance contract.[33] The court was unimpressed with the argument that, even if there was an "old" partnership and a "new" partnership, all members of both partnerships intended the new partnership to continue with all the rights and liabilities of the old partnership.[34]

The problem with the UPA's use of the term "dissolution" is clearly much more fundamental than the absence of explicit definitions. The problem is with the way dissolution is defined and the role it is given in the statute. The basic problem with dissolution under the UPA is that it reflects an aggregate conception of partnership that fails to recognize the stability of partnerships as business organizations. The UPA actually destabilizes many partnerships,

30. 621 F. Supp. 120 (N.D. Ohio 1985).

31. *Id.* at 124.

32. *Id.* at 122. The court reiterated its strict aggregate approach by stating that UPA § 41(1) "seems to assume that a dissolution occurs upon the admission of a new partner or the retirement of an old partner." *Id.* at 123.

33. *Id.* at 125. The court said its approach "accords with the aggregate theory of partnership, which, applied to this case, recognizes Fairway Development I not as an entity in itself, but as a partnership made up of three members. . . . That partnership ceased when the membership of the partnership changed." *Id.* at 124.

34. *Id.* at 121. In addition to the UPA provisions, the Ohio statutes also contain a special supplement on fraud in partnership affairs and the use of fictitious names in partnerships. Partnerships transacting business in Ohio under names that are fictitious or do not reveal the names of all the partners must record a certificate stating the name and residence of each partner. Ohio Rev. Code Ann. § 1777.02 (Anderson 1985). The *Fairway Development* court found significance in the requirement to file a new certificate whenever there is a change in membership in a registered partnership. 621 F. Supp. at 123. *See* Ohio Rev. Code Ann. § 1777.03 (Anderson 1985). Incorrectly assuming that the special Ohio provisions are part of the UPA, the court found them further support for the aggregate theory:

> Where members of a general partnership change, the partnership must file a new certificate of partnership, unlike a limited partnership, which simply may amend its certificate of partnership. The fact that the Uniform Partnership Law makes this distinction supports a finding that the authors of the Uniform Partnership Act recognized that a change of the members of a general partnership in fact changes the original partnership and creates a new partnership requiring a new certificate, as opposed to an amendment to the original certificate.

621 F. Supp. at 123.

particularly those that have continuation agreements. The UPA suggests that the partnership business is coming to a close when it may not be. All that may be coming to a close is one person's participation. In short, the UPA does not adequately distinguish a departure that triggers a winding up of the business from a departure that does not.

RUPA'S NEW PROVISIONS

The Approach Rejected by RUPA

If the UPA declares a partnership dissolved in too many situations, why not simply amend the UPA to provide that there are certain situations in which there is no dissolution? For example, why not simply provide in the statute that, whenever the partnership agreement so provides, the withdrawal of a partner will not cause a dissolution? That is the approach taken in a California amendment[35] to the UPA and in RULPA.[36] RULPA section 801(4) provides that a limited partnership is not dissolved on the withdrawal of a general partner if the business is continued by the remaining general partners pursuant to a right given them in the partnership agreement.

The problem is that the approach taken in the California UPA and in RULPA does not work. Given the way the UPA is drafted, you cannot simply say that certain withdrawals will not cause a dissolution. To do so leaves a big hole in the statute. If you draft away dissolution on withdrawal, you draft away the rules that govern the relations among withdrawing and continuing partners and third parties. For example, what statutory provisions wind down the agency power of a departing partner to bind the partnership? What statutory provisions govern the departing partner's liability for obligations incurred in completing unfinished business? The provisions of the UPA that govern these matters are activated by and only by a dissolution.[37] If you draft away a dissolution, you draft away the last quarter of the UPA.[38] The simple solution, therefore, is too simple to work.[39]

35. Cal. Corp. Code § 15031(7) (West 1977).

36. RULPA § 801(4), *infra* note 73. *See also* ULPA § 20.

37. *See* UPA §§ 33–38 and 40–43.

38. For an interesting case in which departing general partners attempted to rely on a hole in the statute, *see* Baltzell-Wolfe Agencies, Inc. v. Car Wash Inv. No. 1, Ltd., 12 Ohio Op. 3d 219, 389 N.E.2d 517 (Ohio Ct. App. 1978). Two general partners withdrew from a limited partnership and were replaced by a corporate general partner. An amended certificate of limited partnership was filed to reflect the substitution. The departing general partners sought to avoid their obligations under UPA § 35 by arguing that, by virtue of ULPA § 20, there had been no "dissolution" of the limited partnership when they withdrew. The court apparently concluded that neither ULPA § 20 nor UPA § 35 applied: "The circumstances herein involved do not precisely fall within any provision of either [the UPA or the ULPA]." *Id.* at 221, 389 N.E.2d at 519. Nevertheless, the court applied the "principles" of UPA § 35.

39. *See generally* Hillman, *Law Firms and Their Partners: The Law and Ethics of Grabbing and Leaving,* 67 Tex. L. Rev. 1, 33 n. 159 (1988):

> All of this raises a question concerning the effect of the California variation. If a withdrawal is not a dissolution of the original partnership, then what is the status of the withdrawing

Breakups Proceed Down One of Two Tracks

A partnership breakup can result in a winding up of the partnership business or in a buyout of the departing partner. RUPA attempts to identify and clearly define these two tracks. In the process, RUPA gives stability to partnerships that have contracted for stability.

Consider the policy goals that must be achieved when a partner leaves. Return to our simple example of the four-person firm of contented partners. Assume, once again, that one of the four will withdraw from the business and the remaining three will continue the business. Assume, now, however, that the withdrawing partner is entitled to a payment for her interest in the business. There are four basic things the partnership statute must do. First, it must end the power of the withdrawing partner to bind the partners she has just left. Second, it must undertake to extinguish the power of the continuing partners to bind the withdrawing partner. Third, it must take into account the departing partner's continuing liability for unfinished business. Fourth, it must pay the withdrawing partner for her interest in the business.

It is clear that these four goals are interrelated. For example, if there is unfinished business for which everyone remains liable, there must be authority to complete that business. For further example, a large partnership debt will affect the departing partner's payment for her interest. The UPA provides that the partnership must be dissolved before *any* of these goals can be achieved. The UPA breakup provisions, in Part VI, designed to achieve these goals, are triggered only by a dissolution. *Yet it may not be necessary to declare the partnership dissolved to do any of these things.* For the sake of simplicity, why not let the partnership continue if the business is to continue?

RUPA has three central provisions on partnership breakups that attempt to distinguish departures that cause a winding up of the business from those that cause only a buyout of the departing partner. First, RUPA section 31 lists all the ways in which one ceases to be a partner. It says nothing about whether there will be a buyout as opposed to a liquidation of the business. RUPA section 31 is simply a list of the occasions for beginning down one of the two basic tracks. Second, RUPA section 31Y identifies the departures that cause a winding up of the partnership business. Third, RUPA section 32 is the residual provision. It states that any departure not listed in RUPA section 31Y will result in a buyout of the departing partner rather than a winding up of the business. In the event of a buyout, the partnership continues without the departing partner but without beginning a business windup—the departing partner simply leaves an entity that continues the business without her. The theory is much like the theory of the "right of survivorship" incident to a joint

partner, and how is this status different from that accorded by the UPA to a partner who withdraws under an agreement giving the other partners the right to continue the business? It is noteworthy that the California definition of "dissolution" as a "change in the relation of the partners caused by any partner ceasing to be associated in the carrying on . . . of the business" is the same as the UPA's.

tenancy. The last surviving joint tenant "takes all" not because there is a transfer to the survivor but because everyone else has left the entity.[40]

The RUPA section 31 list of ways in which one "ceases to be a partner" is the Committee's attempt to answer the question whether enough has happened to say that a person ceases to be a co-owner of an ongoing business. The list parallels RULPA section 402, entitled "Events of Withdrawal," which lists the ways in which one "ceases to be a general partner of a limited partnership." The term "ceases to be a partner" is awkward and, as discussed below, misleading. The Drafting Committee felt that "cessation of partner status" encompassed a wider range of departures than the term "withdrawal." The Committee did not think the term withdrawal was appropriate, for example, in cases of expulsion. Under RUPA, the cessation of partner status triggers rules to achieve the first three policy objectives: (i) end the power of the departing partner to bind the others; (ii) end the power of the others to bind the departing partner; and (iii) take into account the departing partner's continuing liability for unfinished business. The fourth policy objective, the payment to the departing partner for interest, is then achieved either by a business windup or a buyout, depending upon the cause of the cessation of partner status.

The Business Windup

RUPA section 31Y lists the cessations that trigger a winding up, or liquidation, of the partnership business. RUPA section 31Y provides that "[a] partnership is dissolved and its business shall be wound up on the occurrence of any of the" listed events. In the case of a business windup, "there is no power to compel one side of the controversy to buy out the interests of the other."[41] RUPA section 31Z(a) provides that, if a winding up is triggered, "the assets of the partnership must be applied to discharge its liabilities, and any surplus applied to pay in cash the net amount distributable to the partners." As recommended by the ABA Report,[42] RUPA section 37(b) provides that there

40. *See* J. Cribbet, C. Johnson, R. Findley & E. Smith, Cases and Materials on Property 323 (6th ed. 1990):

> A second form of concurrent ownership, an ancient part of common-law jurisprudence known as "joint tenancy," is rooted in the concept that the cotenants comprise, for at least one purpose, not a number of individuals, each owning an undivided interest, but a corporate unity —a singular legal entity which owns the property. The consequence of this is that joint tenancy involves what is termed "right of survivorship." This signifies that upon the death of one joint tenant no interest can be transferred from him to any other person by testate or intestate succession. The surviving joint tenants (if two or more survive) continue to comprise the unity or entity which owns the property, and eventually the one who lives longest comprises the unit alone and is therefore sole owner. [The] concept is that upon the death of a joint tenant he simply ceases to be a part of the owning entity—i.e., no interest is "transferred" from him to anyone . . .

41. Paciaroni v. Crane, 408 A.2d 946, 955 (Del. Chanc. 1979) (discussing the dissolution of an at-will partnership).

42. ABA Report, *supra* note 2, at 168.

need not be an immediate sale of partnership assets: "Persons winding up a partnership's affairs . . . may preserve the partnership business or property as a going concern for a reasonable time. . . ."[43]

Note that RUPA section 31Z(a) continues the "in cash" language of UPA section 38(1). The result is that a partner cannot be forced to accept a liquidation in kind on the winding up of partnership business.[44] The Committee disapproved of in-kind distributions because of difficult valuation problems and because the "in cash" rule gives more bargaining power to minority partners.[45] In addition, there was further thought that, if there were a single major asset, it

43. See *Paciaroni*, 408 A.2d 946, 956.

44. The "in cash" rule proved controversial at the 1990 meeting of the Conference, and the Drafting Committee is expected to reconsider it. The controversy at the Conference suggests the split in the case law. *See* Dreifuerst v. Dreifuerst, 90 Wis. 2d 566, 280 N.W.2d 335 (Wis. Ct. App. 1979):

> Winding-up is often called liquidation and involves reducing the assets to cash to pay creditors and distribute to partners the value of their respective interests. Thus, lawful dissolution (or dissolution which is caused in any way except in contravention of the partnership agreement) gives each partner the right to have the business liquidated and his share of the surplus paid *in cash*.

Id. at 570, 280 N.W. 2d at 338 (citations omitted) (emphasis in original). A sale of the business was required; it was not appropriate for the trial court to determine the fair market value of the assets and order a share paid to the protesting partner. A "sale is the best means of determining the true fair market value of the assets. . . . While judicial sales in some instances may cause economic hardships, these hardships can be avoided by the use of partnership agreements." *Id.* at 573, 280 N.W. 2d at 339. *But see* Rinke v. Rinke, 330 Mich. 615, 48 N.W. 2d 201 (1951), which *Dreifuerst* refused to follow.

45. RUPA, § 31Z (Comment, Draft Discussion before the National Conference of Commissioners on Uniform State Laws, July 1990 at 118) [hereinafter references to comments will be cited as Comment]. Although a sale may be the most likely way to determine true value, the Committee recognized that the sale is often a far from perfect resolution. The problems are similar to those of real estate foreclosure sales generally:

> The foreclosure sale process, whether judicial or under a power of sale, is hardly designed to bring a fair price for mortgaged real estate. Frequently, the mortgagee is not only the foreclosure sale purchaser, but the only bidder attending the sale. There are several reasons for this phenomenon. First, because the mortgagee can bid up to the amount of the mortgage debt without putting up new cash, he has a distinct bidding advantage over a third party bidder, who will have out-of-pocket expenses from the first dollar bid. Second, while foreclosure statutes require notice by publication to potential third party bidders, the notice, especially in urban areas, is published in legal newspapers of limited circulation. Moreover, because the publication is technical in nature, a potential third party purchaser has little idea what real estate is being sold. Third, many potential third party purchasers are reluctant to buy land at a foreclosure sale because of the difficulty of ascertaining if a purchaser will receive good and marketable title. Fourth, when a mortgagee forecloses on improved real estate, potential bidders often find it difficult to inspect the premises prior to sale. While it may be in the self-interest of the mortgagor to allow third party inspection of the premises, mortgagors who are about to lose their real estate through a foreclosure sale understandably are reluctant to cooperate.

G. Nelson & D. Whitman, Real Estate Finance Law 627–28 (2d ed. 1985).

would not make sense to force people who are not getting along into another cotenancy.

The Buyout

The UPA has little to say about the buyout of a partner. UPA section 38(2) provides that, in the case of a wrongful dissolution, the partners who have not wrongfully dissolved may continue the business "during the agreed term" if they unanimously agree to do so. To do so, they must "secure the payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any damages recoverable . . . , and in like manner indemnify him against all present or future partnership liabilities."[46] There is no further definition of the buyout.

RUPA has a much more extensive buyout provision. It applies to both wrongful and nonwrongful dissolutions and defines the terms of the buyout in much greater detail. Most basically, RUPA section 32(a) provides that if a person ceases to be a partner but no event triggers a winding up of the business, the partnership "*shall purchase* the interest of the person who ceases to be a partner *for its fair market value.*" RUPA section 32(f) provides, however, that a partner "who has withdrawn by express will before the expiration of a specified term or undertaking need not be paid any portion" of the buyout price "until the expiration of the term or undertaking," unless the partner persuades a "court that payment be made over a lesser term." This rule is designed to protect the nonbreaching partners from an unexpected loss of capital. The Drafting Committee, in the comment to section 31, rejected the suggestion to declare term partnerships specifically enforceable.

RUPA section 32(b) attempts to give some guidance on "fair market value," recognizing the difficulty in determining value in the context of closely-held businesses. It begins with a rule drawn from case law that fair market value "must be determined as of the moment of the event causing cessation" of partner status.[47] Fair market value is defined by section 32(b) as "the amount that would have been distributable to [the departing partner] in a winding up of the partnership business." The sense of the statute is that, theoretically, the departing partner should get the same amount through the buyout route that she would get in a winding up of the business.

To determine the amount that would have been distributed in a winding up, RUPA section 32(b) provides that partnership assets "must be valued at the greater of (i) liquidation value or (ii) value based on sale of the entire business as a going concern without the departing partner." This language is intended to cut through some of the confusion in the cases concerning the term "going concern value." Many have grown up thinking of going concern value as a term

46. UPA § 38(2)(b). In "ascertaining the value of the partner's interest the value of the good-will of the business shall not be considered." UPA § 38(2)(c)II. *See also* UPA § 42.

47. *See* United States v. Land, 303 F.2d 170 (5th Cir. 1962).

used to explain that assets that are part of a going concern have greater value than the sum of the values of the individual assets.[48] On the other hand, there is recent estate tax case law that states that going concern value is lower than liquidation value if the assets cannot be liquidated because they are committed to a going concern.[49] In effect, dedication to a going concern is seen as an encumbrance. Valuation of the going concern "without the departing partner" is intended to emphasize that the person being bought out need not be paid for the human capital she takes with her. Whether liquidation value or going concern value is used, RUPA section 32(b) provides that the assets are to be valued "on the basis of the price that would be paid by a willing buyer to a willing seller, neither being under any compulsion to buy or sell, and with the knowledge of all relevant facts." The "willing buyer-willing seller" standard is taken from the estate tax regulations, which are also used for income tax purposes.[50]

RUPA section 32(b) contains a rule that was included primarily to protect the spouse of a deceased partner. In the case of "a partnership in which capital is a material income producing factor, regularly scheduled distributions must continue to be made to the former partner or successor in interest." The intent was to prevent surviving partners from pressuring a surviving spouse to sell out at a low price by withholding distributions that would have been made in the normal course. The concept of a partnership in which capital is a material income producing factor has long been in the federal income tax rules concerning family partnerships.[51]

Continuing Obligations of Partners

Whether the departure of a partner triggers a winding up of the partnership business or merely a buyout, it can be very complicated—more complicated than in a corporation. There are two features of partner status that are not ordinarily found in shareholder status. First, partners are personally liable to the contract and tort creditors of the business. Second, partners are general agents of the partnership. You cannot simply say "I quit" and thereby end the relationship. You can resign and prevent your participation as a partner in future business, but you cannot end your personal liability for obligations previously incurred nor for obligations that will arise in the completion of unfinished business.

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

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

50. Treas. Reg. § 20.2031-1(b) (as amended in 1965).

51. I.R.C. § 704(e) (1990).

Indeed, if certain third parties are not notified, liability continues unaffected by the resignation.

Many people fail to understand how fully the *relationship* of partnership continues after a dissolution. The logic of the UPA is clear, but its significance continues to elude people. Under UPA section 29, a dissolution is merely a "*change* in the relation" of the partners, not an *end* to the relation. UPA section 30 attempts to clarify both the continuation of the relationship and the nature of the change by providing that the partnership "continues until the winding up of partnership affairs is completed."[52] The nature of this altered relationship can be complicated and is explained in detail in UPA sections 33–43.

UPA sections 36 and 35 are particularly important. UPA section 36 provides that dissolution "does not of itself discharge the existing liability of any partner." In addition, UPA section 35(1)(a) provides that, after dissolution, partners can bind each other "by any act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution. . . ."[53] Indeed, if third parties have no notice of the dissolution, they can bind the partnership "[b]y any transaction which would bind the partnership if dissolution had not taken place. . . ."[54] To oversimplify slightly to emphasize the point: the UPA says that, on dissolution, nothing at all happens to the partnership relationship except that the scope of partnership business narrows, perhaps only very slightly. These rules also apply to general partners who withdraw from limited partnerships.[55]

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

> It is significant that defendants do not assert that the Partnership is "wound up," but rather that they have not engaged in "winding up activities" since 1978. In any event, in the light of plaintiff's unresolved claim, it is questionable whether the Partnership's affairs could be considered to be completely wound up.

53. There are certain exceptions listed in UPA § 35(3).

54. UPA § 35(1)(b). The strongest notice requirement is for those who had extended credit to the partnership prior to dissolution. UPA § 35(1)(b)(i). RUPA § 35(a)(2)(i) limits the most protected class, in the case of a business windup, to those who "had extended credit to the partnership *within two years* before the event causing a winding up and had no notice that a winding up had been caused." In the case of a buyout, the most protected class includes anyone who "was a creditor of the partnership *within two years* before [the departure] and . . . had no notice of the person's ceasing to be a partner." At a minimum, "extended credit to" and "was a creditor of" should be conformed.

55. UPA § 6(2) provides that the UPA "shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith." RULPA § 1105 provides: "In any case not provided for in this [Act,] the provisions of the Uniform Partnership Act govern." Although the RULPA language is more suggestive of pre-emption, the Comment to RULPA § 1105 suggests the same substance as UPA § 6(2). In Baltzell-Wolfe Agencies, Inc. v. Car Wash Inv. No. 1, Ltd., 12 Ohio Op. 3d 219, 389 N.E.2d 517 (Ohio Ct. App. 1978), the court applied "the principles" of UPA § 35 to two general partners who withdrew from a limited partnership and filed an amended certificate:

Redman v. Walters,[56] which involved a law firm breakup,[57] illustrates that partners who resign have continuing liability as to unfinished business.[58] In 1969, plaintiff Redman "employed legal representation of the 'Law Offices,' or partnership, or association, or some other arrangement of attorneys, known as 'MacDonald, Brunsell & Walters.' "[59] Redman retained the firm to begin and maintain a lawsuit. In 1970, Walters "severed his relationship" with the other attorneys in the "grouping" and relocated his law practice.

> [W]here credit is extended to a limited partnership after a change of general partners by a creditor having no notice or knowledge of such change of general partners, and who had extended credit to the partnership prior to such change, the withdrawing general partners are liable to the creditor for such credit extended despite the substitution of a new general partner. . . . We reject [the departing general partner's] contention that constructive notice by filing of the amended certificate of limited partnership is sufficient.

Id. at 221, 389 N.E.2d at 519–20.

56. 88 Cal. App. 3d 437, 152 Cal. Rptr. 42 (1979).

57. There is authority for the proposition that the continuing liability of a withdrawn law partner is greater than that of an "ordinary business" partner. *See* the *dictum* in Vollgraff v. Block, 458 N.Y.S.2d 437, 117 Misc. 2d 489 (N.Y. Sup. Ct. 1982):

> It is apparently movant's argument that dissolution of his firm releases him from any liability in malpractice occurring after dissolution with respect to the firm's clients. As to ordinary business relationships between partnerships and third persons, this may be so. However, the relationship between a law partnership and its clients is not an ordinary business relationship, it is a fiduciary relationship and requires a high degree of fidelity and good faith. An attorney is bound to keep a client informed of the latter's business. This Court concludes that the fiduciary relationship is breached if a law partnership's clients are not advised of the partnership's dissolution and some prejudice thereby results. This is but an application of the general rule that even after dissolution, the members of a partnership are liable to persons who have no knowledge of the dissolution of the firm and who deal with the firm.

Id. at 440, 117 Misc. 2d at 492–93 (citations omitted). On the other hand, *Redman v. Walters* has been cited as authority outside the law firm context. *See, e.g.,* Hartford Fin. Sys. v. Florida Software Serv., 550 F. Supp. 1079 (D. Me. 1982), involving a data processing services partnership. The court made clear that the departing member remains liable even for obligations that have not yet matured:

> For purposes of U.P.A. § 36 the term "existing liability" refers to *all* partnership obligations, no matter their type and no matter when they mature, so long as the obligations are *incurred* before dissolution of the partnership.

Id. at 1089 (citations omitted). *See also* Levy v. Disharoon, 106 N.M. 699, 749 P.2d 84 (N.M. 1988), concerning a partnership to purchase and operate a jet airplane. Relying on UPA § 35(1)(a), the court held that a partner was liable for the operation of the airplane even after giving written notice of his intent to "terminate" his relationship. Liability extends through the winding-up period, which in this case required steps to preserve partnership assets:

> A liquidating partner can act on behalf of his former associates in matters in which they still have a common interest and are under a common liability. Sometimes the period between dissolution and termination requires that the partnership business be conducted for the preservation of its assets.

Id. at 703, 749 P.2d at 88 (citations omitted).

58. Partners who are forced out may have the same continuing liability. *See* Palomba v. Barish, 626 F. Supp. 722 (E.D.Pa. 1985).

59. 88 Cal. App. 3d at 450, 152 Cal. Rptr. at 43.

> He had "never met" Redman, nor was he "aware he existed," nor had he "ever discussed or in any way participated in any review of the [subject] legal services. . . ." Nor had he a "communication of any nature from any party or any attorney on this lawsuit, and to my knowledge I have not participated in nor received any compensation whatsoever for any services purportedly rendered on behalf of Fred Redman." All of Redman's dealings in relation to his lawsuit had been with Attorney Brunsell.[60]

Four years after Walters' departure, Redman's lawsuit was dismissed for failure to bring it to trial within five years. Redman then filed a malpractice action in which he included as defendants "MacDonald, Brunsell & Walters, a Partnership," and "William Walters."

The court held that "MacDonald, Brunsell & Walters" was "a partnership or its equivalent, an ostensible partnership or partnership by estoppel," and that Redman reasonably believed that he had engaged the partnership to commence and prosecute his lawsuit. The lower court had granted Walters' motion for summary judgment. It had held that the partnership was dissolved on Walters' departure in 1970 and that as a result Walters "was not the attorney of record . . . on October 14, 1974 the date of the alleged negligent act" and "had no duty to perform and as such there was no negligent act on his part"[61] The court of appeal reversed, stating that, on dissolution, the partnership "was not terminated in respect of its duty to fulfill its contractual obligation to Redman." "MacDonald, Brunsell & Walters," in other words, "continued as a partnership and Walters as a partner."[62] Among the "partnership affairs" to be "wound up" was the "performance of its agreement" with Redman. UPA section 36 provides that, unless Redman consented, expressly or impliedly, "or perhaps by estoppel," to nonrepresentation by Walters, Walters remained liable on the contract.

RUPA was not intended to change the result in *Redman v. Walters*. Rather, RUPA attempts to state more directly the continuing obligations of partners. First, RUPA section 30 rewords and slightly expands UPA section 30:

> SECTION 30. PARTNERSHIP CONTINUES UNTIL WINDING UP COMPLETED. ~~NOT TERMINATED BY DISSOLUTION.~~

60. *Id.*

61. *Id.* at 452, 152 Cal. Rptr. at 44. The lower court further reasoned that, upon Walters' departure, the association minus Walters became his attorneys and attorneys of record and thus "[a]s his agents they had knowledge of the 'dissolution' and that they alone had become Redman's attorneys. This knowledge, by operation of law, was 'imputed' to Redman, the principal." *Id.* The court of appeal said that knowledge of the dissolution was of a matter not within the scope of the authority granted to the firm by the client and hence would not be imputed to the client. *Id.* at 454, 152 Cal. Rptr. at 45. The court further said that the rule of imputed knowledge of the principal only applies in respect of third persons acting for the agent. *Id.* Finally the court noted "even were we to presume, arguendo, such notice to Redman, it does not reasonably follow that he had consented, or had as a matter of law waived objection, or been estopped to object, to a change in the partnership's obligation to represent him." *Id.* at 454, 152 Cal. Rptr. at 46.

62. *Id.* at 453, 152 Cal. Rptr. at 45.

> When a partnership is dissolved and a winding up is commenced under Section 31Y,~~On dissolution~~ the partnership ~~is not terminated, but~~ continues ~~until~~ for the limited purpose of winding up the partnership business and terminates when the winding up ~~of partnership affairs~~ is completed. Until termination, the partners are associated in the winding up of the partnership business.[63]

RUPA section 30 only applies to those departures that cause a winding up of the partnership business. Second, RUPA section 29X emphasizes that there is a continuing relationship even in the case of a buyout:

> SECTION 29X. CESSATION THAT DOES NOT CAUSE A WINDING UP OF PARTNERSHIP BUSINESS.
>
> If the cessation of a partner's status does not cause a dissolution and winding up of the partnership business under Section 31Y, he [or she] shall have a continuing relationship with the remaining partners for the limited purpose of completing business undertaken while he [or she] was a member of the partnership.[64]

Both sections emphasize that a partner cannot walk away from an interest in a partnership as easily as can a shareholder from a share of stock. Even in a buyout situation, the departing partner has continuing obligations to third parties unless those obligations are extinguished pursuant to RUPA section 36. Therefore, even in the case of a buyout, there must be a "mini-windup."

RUPA Section 31 Revisited

RUPA's provisions clarifying the continuing obligations of partners suggest that RUPA section 31 events should not be described as resulting in the "cessation of partner status." Because partners who resign continue to be liable as partners, it is misleading to say that their status as partners has "ceased." Partner status does not end simply because someone says "I quit" or "You're out." It may take time to "close the books" on a partner, whether she is paid the value of her interest through a business liquidation or a buyout. RUPA sections 29X and 30 attempt to clarify that, upon a RUPA section 31 departure, the partnership continues, although with a more narrow scope. In the case of a buyout, the scope continues unaltered for those partners who continue with the business.[65] With respect to the partner being bought out, the scope narrows. In the case of a business liquidation, the scope of the business narrows with respect to all partners.

63. Note that the words "a partnership is dissolved and" have no function in this section. *See* the discussion *infra* on the use of the word "dissolution."

64. Note that the words "dissolution and" have no function in this section. *See* the discussion *infra* of the continued use of the term "dissolution."

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

It seems preferable to couch RUPA section 31 in terms of events that cause a "withdrawal" rather than in terms of a cessation of partner status. Although the term withdrawal has to be stretched to include an expulsion, it is less misleading to say that a partner "withdraws" than it is to say that he "ceases to be a partner" on a RUPA section 31 event. There is precedent in RULPA, which includes expulsions in its list of "Events of Withdrawal."[66] Another possibility is to consider reinstating the word "disassociation," which was stricken from an early draft because it seemed awkward.

Continued Use of The Word "Dissolution"

Initially, RUPA's new rules on breakups were forged without the use of the term "dissolution." After more than two years of work, the Drafting Committee put the word dissolution back in the statute. Yet an examination of RUPA's breakup provisions indicates that the word as reinstated is surplussage.

Throughout the project, there have been those who have urged the Drafting Committee to reinstate the word dissolution. They were asked to defer discussion of this suggestion to give the Committee a chance to draft a statute without "the D word." They finally had a chance to state their case, and the Drafting Committee in the Spring of 1990 decided to reinstate the word without changing either the basic structure we had drafted or the substantive decisions we had hung on that structure. Accordingly, RUPA section 29 provides that "[a] partnership is dissolved when an event causes the winding up of its business under Section 31Y." RUPA section 31Y, in turn, states that "[a] partnership is dissolved and its business shall be wound up on the occurrence of" certain events. This echoes the language at the beginning of RULPA section 801 that a limited partnership "is dissolved and its affairs shall be wound up upon the happening" of certain events.

The Drafting Committee was told that there might be strong opposition to RUPA if the word dissolution were deleted. First, not everyone believes that the term dissolution causes confusion. Some apparently believe that a major reworking of the "dissolution" provisions is fixing something that "ain't broke." Second, RUPA uses the word dissolution, and there are those who believe that RUPA should follow RULPA whenever possible. Third, some fear that RUPA might be perceived as too radical a change in the law if the word dissolution were omitted. Yet these reasons do not seem adequate to explain the intense and unceasing insistence on the use of one word. Would RUPA's elimination of the word dissolution have left the law of general partnerships in a more confused state? I do not think so. It was suggested to the Committee that RUPA *sans* dissolution might cause trouble for limited partnerships, particularly those with sole corporate general partners, by providing an occasion for the Treasury Department to reconsider the regulations that distinguish partnerships from corporations for federal income tax purposes.

66. RULPA § 402(3).

The Tax Classification Issue

The limited partnership is a corporate antecedent, an historical compromise on the road to general incorporation acts. It is therefore not surprising that questions have been raised about the proper tax classification of limited partnerships, particularly those with sole corporate general partners.[67] The Treasury Regulations that distinguish a partnership from a corporation for tax purposes are known as the "association" regulations.[68] Those regulations identify four characteristics that tend to be found in a "pure corporation" and state that three of the four must be present before an organization will be classified as a corporation. This "numerical supremacy" test provides that, if only two of these characteristics are present, partnership classification results. Stated from the point of view of someone who hopes to classify a limited partnership as a partnership for tax purposes, the goal is to eliminate any two of the corporate characteristics.

The association regulations are highly formalistic and the characteristics are defined in bizarre ways. Continuity of life is one of the four characteristics that limited partnerships typically say is not present. The elimination of continuity of life is a "freebie" in the sense that it is a characteristic that is eliminated independent of the factual circumstances of the limited partnership under consideration. Continuity of life is eliminated as a formalistic matter because the regulations state that it is not present if the departure of any partner causes a "dissolution."[69] Take away the dissolution, it is argued, and you may make it

67. For a brief history of limited partnerships in the United States that includes a discussion of the tax classification issue, see Weidner, *The Existence of State and Tax Partnerships: A Primer,* 11 Fla. St. U. L. Rev. 1, 46–92 (1983).

68. Treas. Reg. § 301.7701-2 (as amended in 1983).

69. *Id.* at 2(b)(1):

> An organization has continuity of life if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization. On the other hand, if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will cause a dissolution of the organization, continuity of life does not exist.

The regulations state that it does not matter if the partners have a continuation agreement, so long as a dissolution takes place:

> An agreement by which an organization is established may provide that the business will be continued by the remaining members in the event of the death or withdrawal of any member, but such agreement does not establish continuity of life if under local law the death or withdrawal of any member causes a dissolution of the organization. Thus, there may be a dissolution of the organization and no continuity of life although the business is continued by the remaining members.

Id. at 2(b)(2). Even though the partner who dissolves in contravention of the agreement has lesser rights than one who dissolves in accordance with the agreement and can be liable for breach, the power to dissolve precludes a finding of continuity of life:

> [I]f the agreement provides that the organization is to continue for a stated period or until the completion of a stated transaction, the organization has continuity of life if the effect of the agreement is that no member has the power to dissolve the organization in contravention of the agreement. Nevertheless, if, notwithstanding such agreement any member has the power under

more difficult for limited partnerships to argue that the corporate characteristic of continuity of life is negated.

There are two basic responses to the argument that the word dissolution should be retained to preserve present tax classification results. First, RULPA has received the endorsement of the I.R.S.[70] even though as a formal matter it eliminates dissolution in many situations. Under RULPA, many withdrawals of general partners no longer result in dissolutions.[71] Second, more basically and wholly apart from the formal elimination of the word dissolution, RUPA retains the substantive rules of the UPA that as a practical matter deprive partnerships of continuity of life in the corporate sense.

The key to the elimination of continuity of life is discussed in *Larson v. Commissioner*,[72] the leading case interpreting the association regulations. The various opinions in *Larson* recognized that the regulations are highly formalistic but nevertheless tried to make some sense out of them. Judge Tannenwald's majority opinion contains the following trenchant observation about why partnerships do not have continuity of life in a corporate sense:

> The significant difference between a corporation and a partnership as regards continuity of life, then, is that a partner can always opt out of continued participation in and exposure to the risks of the enterprise. A

> local law to dissolve the organization, the organization lacks continuity of life. Accordingly, a general partnership subject to a statute corresponding to the Uniform Partnership Act and a limited partnership subject to a statute corresponding to the Uniform Limited Partnership Act both lack continuity of life.

Id. at 2(b)(3). This last sentence has been referred to as "the shorthand test" to determine whether a limited partnership has continuity of life. It appears, however, not to be a test but a flat rule that ULPA limited partnerships do not have continuity of life.

70. Rev. Rul. 89-123, 1989-2 C.B. 261.

71. RULPA § 801(4) is far from a model of clarity on this point:

> § *801. Nonjudicial Dissolution*
>
> A limited partnership is dissolved and its affairs shall be wound up upon the happening of the first to occur of the following:
>
> * * *
>
> (4) an event of withdrawal of a general partner unless at the time there is at least one other general partner and the written provisions of the partnership agreement permit the business of the limited partnership to be carried on by the remaining general partner and that partner does so, but the limited partnership is not dissolved and is not required to be wound up by reason of any event of withdrawal, if, within 90 days after the withdrawal, all partners agree in writing to continue the business of the limited partnership and to the appointment of one or more additional general partners if necessary or desired. . . .

It is unclear how this provision meshes with the UPA rules on breakups, which as a general matter are only activated by a dissolution. *See* UPA §§ 33–38 and 40–43. For example, assume that a general partner withdraws from a limited partnership operating under an agreement that gives the remaining general partner the right to continue the business. If the remaining general partner does so and there is no dissolution because of RULPA § 801(4), what rules end the authority of the departing partner to bind the partnership?

72. 66 T.C. 159 (1976), *acq.*, 1979-2 C.B. 2.

> corporate shareholder's investment is locked in unless liquidation is voted or he can find a purchaser to buy him out.[73]

It follows, therefore, that the key to eliminate continuity of life of the corporate sense is the preservation of the substance of present law that permits partners to opt out of continued participation.

Although RUPA rewrites the breakup rules, it retains the substance of the UPA that permits partners easy exit from partnerships. First, RUPA retains the UPA right of each member of an at-will partnership to force a liquidation of the business.[74] If the partnership is at-will, RUPA section 31Y(1) gives the withdrawing partner the same right she had under the UPA to demand the liquidation of partnership business, satisfaction of partnership liabilities, and distribution in cash of any surplus.[75] Second, RUPA section 31(1) retains the traditional rule that every partner has the "power," even if not the right, to withdraw from the partnership at any time. The Drafting Committee considered and rejected the suggestion that partnerships for a specified term or undertaking should be specifically enforceable.[76] If there is a binding continuation agreement, the withdrawing partner has, as she did under the UPA, the

73. 66 T.C. at 173–74.

74. The right to liquidate an at-will partnership is criticized in Ribstein, *A Statutory Approach to Partner Dissociation,* 65 Wash. U.L.Q. 357 (1987):

> [T]he parties to a partnership relationship would not be likely to give each partner the right to liquidate at will. Because liquidation at will is ordinarily beneficial in terms of valuation of the partnership assets only if accompanied by a costly squeezeout, liquidation at will offers the partners only the opportunity to be on the winning side of a zero-sum reallocation of values among the partners. If the partners do not know *ex ante* whether they will be winners or losers, they have little to gain by gambling in this way. If the partners can predict who will benefit from a liquidation right, it is unlikely the potential losers will agree unless they are offered strong inducements under a customized agreement. By comparison, the buyout right is desirable because it offers all of the partners, including those who are unlikely to be able to use the buyout as a squeeze-out device, a cost-efficient way to reduce the substantial risks associated with illiquidity.

Id. at 395–96. There is authority under UPA §38(2) that there can be a "wrongful" dissolution of an at-will partnership. A continuation right was given to the "innocent" partners in an at-will partnership in Monteleone v. Monteleone, 147 Ill. App. 3d 265, 497 N.E.2d 1221 (1986), in which the court said that UPA § 38(2):

> recognizes that the term originally agreed upon by the partners (here, at will) shall remain in effect during the innocent partners' continuation of the partnership business. . . . Section 38(2) accords to innocent partners the right to continue the partnership enterprise, rather than to share in the proceeds of sale or liquidation of the partnership estate.

Id. at 271–72, 497 N.E.2d at 1225–26.

75. RUPA § 31Y(1) provides that the business of the partnership shall be wound up "on the giving of notice by one partner to another partner of the first partner's express will to withdraw as a partner, unless the partners, including the withdrawing partner, agree in the partnership agreement or at any other time that the business of the partnership be continued by the remaining partners."

Compare UPA § 38(1).

76. *See* Hillman, *Indissoluble Partnerships,* 37 U. Fla. L. Rev. 691 (1985):

right to be paid the fair market value of her interest, minus any damages caused by her breach of the continuation agreement.

Those who wanted the word "dissolution" reinstated responded that its deletion would invite the Treasury to reconsider the association regulations. Unfortunately, there is no logic that can dispel this objection. The question is essentially a political one. It cannot be said as a matter of logic or fact that the deletion of the word dissolution will not cause the Treasury to reconsider its regulations. Nor can it be said that limited partnership sponsors are not served by the retention of the word dissolution. It can only be suggested that a potentially significant improvement in the law of general partnerships is being defeated because it *might* prompt the Treasury to reopen a long-standing issue of federal tax policy. Because the tax classification issue is revisited every few years, the fear is really only that it will be revisited sooner rather than later. Indeed, it may not be the limited partnership but the current excitement about the limited liability company[77] that next lets the tax classification cat out of the bag. Finally, even if the issue were forced sooner rather than later, historical experience suggests that limited partnerships that are not publicly-traded will win and those who wish to classify them as corporations will lose.[78]

Summary of Improvement in Breakup Rules

On the one hand, it is disappointing that the word dissolution has been retained. This word that has generated such confusion was not reinstated in RUPA until the new breakup rules were close to final form. It was reinstated in part in response to the concern that the tax classification of limited partnerships might be jeopardized without it. Continued use of the word is likely to generate confusion for two reasons: (i) it always has; and (ii) RUPA now defines dissolution in a very different way than it has been defined for over 75 years.

On the other hand, the continued use of the word dissolution may be a minor issue. Even with the word reinstated, RUPA's new rules on breakups constitute a major improvement in the law. The definition and use of the word dissolution in RUPA's latest draft are far preferable to the definition and use of the word in the UPA. Dissolution is redefined by RUPA section 29 in a more workable way

> Because an agreement concerning duration is normally reached as a method of stabilizing a partnership, it should be given just that effect. If permitted to bargain effectively on this issue, partners most concerned with the adverse consequences of an early dissolution could pay the price for, and enjoy the benefits of, stability. Partnership law can facilitate this objective by denying a partner the unilateral power to dissolve a partnership by express will prior to the expiration of the term previously accepted by that partner.

Id. at 731.

77. *Compare* Fla. Stat. Ann. §§ 608.401–608.471 (West Supp. 1990) with Colo. Rev. Stat. §§ 7-80-101–7-80-913 (West Supp. 1990).

78. In 1982, the American Law Institute ("ALI") approved its Federal Income Tax Project on Subchapter K. Proposal Q would classify all Uniform Act limited partnerships as partnerships unless they are publicly traded. ALI, *Federal Income Tax Project, Subchapter K, Proposals on the Taxation of Partners 392* (1984). The Revenue Act of 1987, P.L. 100-203, title X, § 10211(a), added I.R.C. § 7704, under which certain publicly-traded partnerships are treated as corporations.

to refer to the commencement of the winding up of the business of the partnership rather than to the change in the relationship caused by the departure of any member. This new definition helps distinguish a breakup that results in a business windup from a breakup that results in a buyout of the departing partner by partners who continue with the business. RUPA gives partnerships that use the buyout much greater theoretical stability by providing that they continue rather than dissolve and proceed to termination. Although RUPA's provisions are more lengthy than present law, the length adds specificity and clarity. The new rules present a much clearer and more detailed roadmap to buyouts *versus* liquidations. In particular, the terms of the buyout are for the first time defined in detail in the statute. Finally, the new breakup rules emphasize that a relationship must be wound down whether there is a buyout or a business windup. In both situations, care must be given to the extinguishment of agency authority and power and personal liability.

DEFAULT VERSUS *MANDATORY RULES AND FIDUCIARY DUTIES*

AMBIGUITY UNDER THE UPA

The UPA has a wide range of provisions that govern the rights and obligations among partners. It is not completely clear which of these rules are default rules and which are mandatory rules. A default rule is one that applies only in the absence of a provable partnership agreement to the contrary. A mandatory rule, on the other hand, is one that applies even in the face of a partnership agreement to the contrary.

Some but not all of the UPA rules governing the relations among partners state that they are "subject to" a contrary agreement. UPA section 18, for example, is the basic section that defines the rights and liabilities among partners. Its introductory language provides that its rules are "subject to any agreement between" the partners, thus making it clear that its rules are default rules rather than mandatory rules. There are, however, other provisions governing the relations among partners that do not expressly state they are subject to contrary agreement. Does *expressio unius est exclusio alterius,* the maxim of statutory construction, require or at least suggest that the remaining rules in the UPA are mandatory because they lack qualifying language?

Consider some of the places where the UPA is ambiguous about whether a rule is mandatory or default. For example, is only part of UPA section 19 subject to contrary agreement? UPA section 19 provides that partnership books and records shall be kept, "subject to any agreement between the partners," at the partnership's principal place of business. It then provides, without express qualification, that "every partner shall at all times have access to and may inspect and copy any" partnership books. If the partnership agreement limits or eliminates completely a partner's access to partnership books, is it enforceable? A related question concerns UPA section 20, which provides without qualification that partners "shall render on demand true and full information of all things affecting the partnership to any partner. . . ." Is an attempt to contract away this rule enforceable? Consider also the rule of UPA section 21 that partners must account for any profits they derive "without the consent of the other partners from any transaction connected with the . . . conduct . . . of the partnership. . . ." Is a partnership agreement that waives all right to bring a claim under UPA section 21 enforceable? Finally, consider the rights of partners on dissolution. UPA section 38(1), which governs "rightful" dissolutions, applies "unless otherwise agreed." On the other hand, UPA section 38(2), which governs "wrongful" dissolutions, contains no qualifier. Are the wrongful dissolution provisions mandatory even though the rightful dissolution provisions are merely default rules?

Questions about whether rules are default rules or mandatory rules arise not only because textual analysis raises the inevitable comparisons. They arise because different policy conclusions can be reached by different people. A libertarian, free-market oriented policy maker is likely to suggest that all the rules governing the relations among partners should be merely default rules—that partners ought to be held to whatever bargain they negotiate. A more parentalistic policy maker, on the other hand, would be more inclined to support mandatory fiduciary duties to protect minority partners. A parentalist, for example, might resist the conclusion that a minority partner should be permitted to contract away her access to partnership books and records.

RUPA MINIMIZES MANDATORY RULES

The Drafting Committee wanted to make clear that all but a very few of the rules governing the relations among partners are merely *default* rules. It was only in rare situations that the Committee felt that the rules should be *mandatory*. Mandatory rules governing the relations among partners are essentially parentalistic, and the Committee felt that, with only very limited exception, adults in nonconsumer transactions should be held to their agreements. The results of the Committee deliberations are reflected in RUPA's new section 4X and Comments.

RUPA section 4X(a) contains the general rule that "[u]nless the partnership agreement provides otherwise, the provisions of this [Act] govern relations among the partners." It thus states, although somewhat indirectly, the basic principle that the agreement of the partners is supreme. The statement of general principle avoids the need for repetitive parenthetical statements that individual rules are "subject to" contrary agreement. This statutory structure also avoids the interpretative problems that would inevitably arise if a parenthetical were inadvertently omitted. Given the basic libertarian policy perspective of the Drafting Committee, it is easier to note the limited expressions of parentalism than the much more numerous expressions of the supremacy of the partnership contract.

RUPA section 4X lists the handful of mandatory rules that govern the relations among partners. First, under RUPA section 4X(a)(1) the partners' general duty of good faith and fair dealing under RUPA section 21(a) may not be varied. Second, the agreement may not vary the requirement to wind up the partnership business in certain situations.[79] Third, the agreement may not vary the partners' right to expel a member by judical decree in certain situations.[80] Finally, the agreement may not vary the power of any partner to withdraw from the partnership at any time.[81] RUPA section 4X(b) clarifies that the partnership agreement is supreme only as to matters among the partners. It states that the partnership agreement "may not deprive third parties of rights they have under this [Act]."

As RUPA nears completion, it is important to ask whether the RUPA section 4X list of mandatory rules is complete. Assume, for example, that a partnership agreement provides that partnership interests may not be assigned. Under RUPA, may a creditor obtain an order charging his debtor's partnership interest? Even if the charging order is a third-party right that RUPA section 4X(b) states may not be denied by the partnership agreement, may one partner obtain a charging order against the interest of another partner? In *Tupper v. Kroc,*[82] a limited partner obtained a charging order against the interest of his general partner in three limited partnerships. Pursuant to the charging order, a sheriff's sale was held at which the limited partner purchased all three partnership interests for $2,500. The Nevada Supreme Court rejected the general partner's attempt to defend on the basis of the "nonassignability" clause in the partnership agreement. First, the court said that a sale pursuant to a charging order is not an assignment. Second, and more importantly, the court said that a partner may not contract away her charging order remedy: "the partnership agreements could not divest the district court of its powers provided by statute to

79. RUPA § 4X(a)(2) provides that the agreement may not vary "a requirement to wind up the partnership business in the events specified in Sections 31Y(5) [court order upon application of a purchaser of a partnership interest if the partnership is at will], 31Y(6) [illegality of all or substantially all of the partnership business] and 31Y(9) [upon application by a partner if an appropriate forum decrees (i) that the partnership's economic purpose is likely to be unreasonably frustrated or (ii) that it is not reasonably practicable to carry on in conformity with the partnership agreement or (iii) that the business conduct of a partner makes it not reasonably practicable to carry on with that partner]."

80. RUPA § 4X(a)(3) states that the agreement may not vary the "partners' right to judicial expulsion of a partner in the events specified in Section 31(2)(ii). . . . " RUPA § 31(2)(ii) provides that a person ceases to be a partner pursuant to a judicial determination that:

> (A) the expelled partner has been guilty of conduct tending to affect prejudicially the carrying on of the partnership business; or
>
> (B) the expelled partner has wilfully or persistently committed a breach of the partnership agreement or otherwise breached a partnership duty to the other partners or the partnership to the extent that it is not reasonably practicable to carry on the business in partnership with that partner.

81. RUPA § 4X(a)(4) provides that the agreement may not vary "a power of a partner to withdraw as a partner under Section 31(1)." RUPA § 31(1) provides that a person ceases to be a partner "upon the future date specified in a notice, or, in the absence of such a date, on the giving of notice by one partner to another partner of his [or her] express will to withdraw as a partner. . . . "

82. 88 Nev. 146, 494 P.2d 1275 (1972).

charge and sell an interest of a partner in a partnership."[83] Although *Tupper* appears to be reversed by RUPA section 4X, there is no clear Committee intent to that effect. Thought should be given to this and other changes that might be made inadvertently by the sweeping exclusivity of RUPA section 4X's list of mandatory rules.

An extreme libertarian would argue that our list of mandatory rules is too long. For example, we were urged to abandon the UPA rule that every partner has the power to withdraw at any time. More broadly, we have been asked to consider two recent additions to the Delaware limited partnership act:

> (c) It is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.
>
> (d) To the extent that, at law or in equity, a partner has duties (including fiduciary duties) and liabilities relating thereto to a limited partnership or to another partner (i) any such partner acting under a partnership agreement shall not be liable to the limited partnership or to any such other partner for the partner's good faith reliance on the provisions of such partnership agreement, and (ii) the partner's duties and liabilities may be expanded or restricted by provisions in a partnership agreement.[84]

One who prefers a more parentalistic system, on the other hand, would argue for more mandatory rules. For example, it has been suggested that we give every partner a right of access to partnership books that can not be varied by agreement.[85]

RUPA SECTION 21 AND THE TERM "FIDUCIARY"

Controversy over default *versus* mandatory rules has been particularly heated concerning fiduciary duties, particularly the duty of loyalty. Traditional legal analysis of fiduciary duties distinguishes the duty of care from the duty of loyalty. This is true in the general law of principal and agent,[86] and in the law of corporations.[87] The UPA has no duty of care provision. It does, however,

83. *Id.* at 154, 494 P.2d at 1280.

84. 67 Del. Laws 348 § 27 (1990) (amending Del. Code Ann. tit. 6. § 17-1101 (1974)).

85. *Compare* the mandatory inspection rights in Revised Model Business Corp. Act § 16.02 (1984).

86. *Compare Restatement (Second) of Agency* § 379 (1958) ("Duty of Care and Skill") *with Restatement (Second) of Agency* § 387 (1958) ("General Principle") animating the duties of loyalty in *Restatement (Second) of Agency* §§ 388–98 (1958).

87. The Revised Model Business Corporation Act distinguishes the duty of care from the duty of loyalty by providing separate sections on General Standards for Directors (duty of care) and on Director Conflict of Interest (duty of loyalty). Revised Model Business Corp. Act §§ 8.30 and 8.31 (1984). Similarly, the ALI's Corporate Governance Project continues the distinction. The Institute's treatment of the duty of loyalty begins with the following statement of its relation to the duty of care:

> [B]oth analytically and normatively the principle of loyalty precedes that of due care. Analytically, the principle of loyalty has primacy in that the duty of care entails the principle of loyalty. As stated in § 4.01(a) of Tentative Draft No. 4, the conduct of an officer or director

contain a number of provisions that can be said to express duties of loyalty. A duty to consult has been found in UPA section 18(e), which provides that "[a]ll partners have equal rights in the management and conduct of the partnership business."[88] UPA section 19 provides that "every partner shall at all times have access to and may inspect and copy" partnership books, and UPA section 20 provides that "[p]artners shall render on demand true and full information of all things affecting the partnership to any partner. . . ." UPA section 21, entitled "Partner Accountable as a Fiduciary," provides, in part, as follows:

> Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.[89]

Although a basic purpose of this language was to give excluded partners priority over the separate creditors of a disloyal partner as to traceable usurped assets,[90] it has been treated by courts as the statutory foundation for broad and powerful fiduciary duties among partners, particularly duties of loyalty.

RUPA section 21 is couched in terms of an integrated and exclusive statement of the fiduciary duties of partners:

> conforms to the duty of care when it is "in good faith, in a manner he reasonably believes to be in the best interest of the corporation. . . ." Normatively, the principle of loyalty to the corporation specifies the direction in which the efforts are to be made that are regulated by the due care requirement.

ALI, *Principles of Corporate Governance: Analysis and Recommendations* 9 (Tent. Draft No. 5, 1986).

88. An extraordinarily powerful article on this point is Hillman, *Power Shared and Power Denied: A Look At Participatory Rights in The Management of General Partnerships,* 1984 U. Ill. L. Rev. 865, which provides in part:

> Because of the coexistence under partnership law of efficiency and dignity considerations, one must distinguish between consultations about specific transactions and the general role of a minority partner in partnership management. Nothing in the U.P.A. gives partners with sufficient power to control a venture a license to ignore *consistently* the views of minority participants about matters within the ordinary course of business. The principal importance of section 18(e) lies in its recognition and enforcement of dignity interests, and the basis it provides for a participant to resist unwanted exile from partnership affairs.

Id. at 887. See also M. Eisenberg, An Introduction to Agency and Partnership 42 (1987). UPA § 20 arguably limits the thrust of the UPA § 18(e) information right by suggesting that it be honored on "demand" rather than volunteered as appropriate. RUPA § 20 does not have the "on demand" language.

89. UPA § 21(1).

90. UPA § 21(1) Official Comment:

> A, B and C are partners; A, as a result of a transaction connected with the conduct of the partnership, has in his hands, so that it may be traced, a sum of money or other property. A is insolvent. Is the claim of the partnership against A a claim against him as an ordinary creditor, or is it a claim to the specific property or money in his hands? The words "and hold as trustee for the partnership any profits" indicate clearly that the partnership can claim as their own any property or money that can be traced.

SECTION 21. ~~PARTNER ACCOUNTABLE AS A~~ FIDUCIARY DUTIES OF A PARTNER.

A partner's only fiduciary duties are the duty of good faith and fair dealing and the duty of loyalty [and the duty of care] set out in this Section.

(a) A partner has a duty of good faith and fair dealing towards the partnership and the other partners in all matters related to the formation, conduct or liquidation of the partnership. This general duty of good faith and fair dealing may not be varied by agreement, but the parties by agreement may identify specific conduct that does not violate the general duty of good faith and fair dealing. A partner shall not be considered to have violated the general duty of good faith and fair dealing merely because the partner's actions furthered that partner's individual interest.

(b) A partner has a duty of loyalty to the partnership and the other partners that is limited to the following:

(1) ~~Every partner must~~ to account to the partnership ~~for any benefit,~~ and hold as trustee for it any profit or benefit ~~profits~~ derived by the partner ~~him~~ without the informed consent of the other partners, from any transaction connected with the formation, conduct, or liquidation of the partnership or from any personal use ~~by him~~ of ~~its~~ partnership property;~~.~~

(2) to refrain from dealing with the partnership as, or on behalf of, an adverse party without the informed consent of the partnership; and

(3) to refrain from competing with the partnership without the informed consent of the partnership.

This Section 21(b) does not preclude a partner from purchasing the assets of the partnership in a foreclosure sale or upon liquidation of the partnership.

(c) [a duty of care rule is under study]

(d) ~~(2)~~ This Section 21 ~~section~~ applies also to the personal representatives of a deceased partner or the legal representatives of any other partner engaged in the liquidation of the affairs of the partnership as the legal ~~personal~~ representatives of the last surviving partner.

Before considering the three specific duties listed in RUPA section 21, it is important to note the more general controversy over the use of the word "fiduciary." There are those who would rather not have partners described as fiduciaries. The title and first sentence of RUPA section 21 include the word fiduciary even though the Drafting Committee was repeatedly urged to strike it. It was said that a partner is not a fiduciary in the same strict sense as a trustee.[91] It was said that a trustee is a person who acts solely on behalf of a beneficiary, whereas a partner by definition is a co-proprietor, a co-owner acting on his own

91. *Compare* Revised Model Business Corp. Act § 8.30 Official Comment (1984): "[l]ikewise, Section 8.30 does not use the term 'fiduciary' in the standard for directors' conduct, because that term could be confused with the unique attributes and obligations of a fiduciary imposed by the law of trusts, some of which are not appropriate for directors of a corporation."

behalf. On the other hand, partners and other co-owners have long been held to be fiduciaries.[92]

The Drafting Committee retained the word fiduciary because it found no reason to abandon the traditional notion that partners are fiduciaries.[93] Indeed, the law of partnerships reflects the broader law of principal and agent, which states that every agent is a fiduciary.[94] RUPA section 9 continues the rule of UPA section 9 that every partner is a general agent of the partnership, and RUPA section 4(a) continues the rule of UPA section 4(3) that the law of principal and agent applies. According to the *Second Restatement of Agency,* "the rights and liabilities of partners with respect to each other . . . are largely determined by agency principles."[95] It is therefore possible for courts to find that fiduciary duties have arisen even before a partnership is formed.[96]

92. *See, e.g.,* 2 R. Niles & W. Walsh, *Concurrent Estates and Their Characteristics,* 2 American Law of Property § 6.16 at 69 (1952):

> Historically, cotenants have been regarded in equity as fiduciaries of one another where they have acquired their interests at the same time, either by inheritance from a common ancestor or by the same deed or will. In such case, the principle that a cotenant who has acquired an outstanding title holds it for the benefit of his cotenants is applicable.

93. Although Chief Judge Cardozo's opinion in Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928), is probably considered the classic statement of the fiduciary duties of partners, there is much earlier authority to the same effect. *See* Salhinger v. Salhinger, 56 Wash. 134, 105 P. 236 (1909):

> There is no stronger fiduciary relation known to the law than that of a copartnership, where one man's property and property rights are subject to a large extent to the control and administration of another. "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 trust one another that the business goes on. These properties of partnership render it eminently a relation of trust. All its effects are held in trust, and each partner is, in one sense, a trustee for the newly created entity, the partnership, and for each member of the firm who thus becomes a beneficiary under the trust."

56 Wash. at 137–38 105 P. at 237 (citation omitted). *See also* Latta v. Kilbourn, 150 U.S. 524, (1893):

> By the well-settled law of partnership each member of the firm is both a principal and an agent to represent and bind the firm and his associate partners in dealings and transactions within the scope of the copartnership. No express authority is necessary to confer this *agency or fiduciary relation* in respect to the business of the firm.

Id. at 543 (emphasis added).

94. *See Restatement (Second) of Agency* § 1(1) 1958 "[a]gency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."

95. *Restatement (Second) of Agency* § 14 A, Comment a (1958).

96. Waite v. Sylvester, 131 N.H. 663, 560 A.2d 619 (1989), is a refreshing opinion that indicates that the point of imposition of fiduciary duties is one on which reasonable people can disagree:

> The rule generally accepted . . . imposes a fiduciary duty not only with respect to transactions occurring during the partnership but also with respect to "those taking place during the

THE DUTY OF GOOD FAITH AND FAIR DEALING

The duty of good faith that was in RUPA's original duty of care rule was moved to RUPA section 21(a), which provides that each partner "has a duty of good faith and fair dealing towards the partnership and the other partners in all matters related to the formation, conduct or liquidation of the partnership." The reference to "the partnership and the other partners" suggests that conduct must pass muster under both entity and aggregate approaches before it can be concluded that the duty of good faith and fair dealing has been satisfied. As noted earlier, it is not necessary to retain the aggregate approach to put partners under this duty to each other. Nevertheless, statement of the duty in aggregate terms may highlight concern with oppressive behavior toward a particular partner that might arguably be of benefit to the entity as a whole.

As stated in RUPA section 21(a), the general duty of good faith and fair dealing "may not be varied by agreement, but the parties by agreement may identify specific conduct that does not violate" it. This last language is drawn from the U.C.C. rule that says that the duty of good faith "may not be disclaimed by agreement but the parties may by agreement determine the standards by which performance . . . is to be measured if such standards are not manifestly unreasonable."[97] Perhaps RUPA should follow the lead of the U.C.C. more closely by placing a "manifestly unreasonable" or other limit on the ability of the parties to identify specific conduct that does not violate the general duty.

The nonwaivable nature of the duty of good faith and fair dealing is clear because it is listed in RUPA section 4X. Because no other fiduciary duties are listed in RUPA section 4X, the duty of good faith and fair dealing is mandatory and all the other fiduciary duties are simply default rules. It is striking that the only mandatory fiduciary duty in RUPA is taken from the contract law governing relations not generally seen as involving mutual confidence. One

> negotiations leading to the formation of the partnership." This rule reflects the assumption that during negotiations to form a partnership, the parties are not dealing with one another at arm's length, but rather are attempting to structure a common enterprise, one which must be based on trust and loyalty. An equally valid assumption, that parties negotiating to form a partnership deal at arm's length in a struggle for competitive advantage, gives rise to the alternative rule imposing no fiduciary duty until the actual formation of a partnership.

Id. at 673, 560 A.2d at 625 (citations omitted). *Waite* also rejected a managing partner's claim that his partners owed him "a fiduciary duty to provide him with notice and an opportunity to be heard before" they removed him. *Id.* at 669, 560 A.2d at 622–23.

97. U.C.C. § 1-102(3) (1989). It is interesting that the U.C.C. has three different concepts: the document, the agreement, and the contract. The document is the piece of paper that states rights and obligations. The agreement, on the other hand, is "the bargain of the parties in fact as found in their language or by implication from other circumstances. . . ." U.C.C. § 1-201(3) (1989). "Contract," under the U.C.C., means "the total legal obligation which results from the parties' agreement as affected by this Act and any other applicable rules of law." U.C.C. § 1-201(11) (1989). A contract under the U.C.C., therefore, includes mandatory rules.

wonders whether there should be a higher floor for a relationship widely considered as far more intimate.[98]

On the one hand, the duty of good faith and fair dealing might be considered a relatively weak duty because it is from the contract law that governs adversarial relationships. Indeed, the U.C.C. has a general definition of good faith that states that good faith is simply "honesty in fact in the conduct or transaction concerned."[99] On the other hand, the U.C.C. is more exacting in the case of a merchant, for whom good faith "means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."[100] In addition, there is authority that suggests that the duty of good faith will be given a much more powerful reading in the partnership context.[101]

RUPA section 21(a) concludes with the statement that a partner "shall not be considered to have violated the general duty of good faith and fair dealing merely because the partner's actions furthered that partner's individual interest." This attempts to recognize and protect the legitimate pursuit of self-interest by partners. After all, RUPA seems to say, if other adversaries can pursue self-interest, so can partners. It was argued that partnership is a

98. *See generally* R. Dworkin, Law's Empire 200 (1986), discussing the general responsibility of members of an association:

> A commercial partnership or joint enterprise, conceived as a fraternal association, is in that way different from even a long-standing contractual relationship. The former has a life of its own: each partner is concerned not just to keep explicit agreements hammered out at arm's length but to approach each issue that arises in their joint commercial life in a manner reflecting special concern for his partner as partner. Different forms of association presuppose different kinds of general concern each member is assumed to have for others.

99. U.C.C. § 1-201(19) (1989).

100. U.C.C. § 2-103(1)(b) (1989). This definition of good faith applies for purposes of Article 2 "unless the context otherwise requires." *Id.* The definition of "merchant" is extremely broad:

> "Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

U.C.C. § 2-104(1) (1989).

101. *See* Page v. Page, 55 Cal. 2d 192, 10 Cal. Rptr. 643, 359 P.2d 41 (1961), in which the court said that the power to dissolve a partnership at will is confined by the duty of good faith, which it seemed to equate with a powerful duty of loyalty. *Page* is criticized in R. Hillman, Law Firm Breakups 81–84 (1990). The duty of loyalty is discussed as part of the duty of good faith in Levy v. Disharoon, 106 N.M. 699, 704, 749 P.2d 84, 89 (1988):

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

See generally Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505 (1975), in which the court said partners owe each other the "utmost good faith and loyalty," referring repeatedly to a "strict good faith standard."

dynamic, not a static relationship, and that partners have a right to rebargain for a larger piece of the collective pie. Yet the contrary is suggested by judicial opinions that declare a vague yet powerful duty of loyalty. To clarify the law, the argument concludes, the statute should reflect the legitimate pursuit of self-interest that has been approved by case law holdings, even if it is not protected by case law language.[102]

DUTY OF LOYALTY

RUPA section 21(b) purports to be an exclusive statement of the duty of loyalty of partners. It provides that every partner has a duty of loyalty to the partnership and the other partners "that is limited to" three rules. RUPA section 21(b) appears to have been motivated in part by a sense that vague, broad statements of a powerful duty of loyalty cause too much uncertainty. It was suggested that, even if there are no bad holdings, overly broad judicial language has left practitioners uncertain about whether their negotiated agreements will be voided. It was said that attorneys and their clients want to be able to negotiate transactions, reduce their agreements to writing, and have some comfort that those agreements will not be undone by "fuzzy" notions of fiduciary duties. RUPA sections 4X and 21 now provide an exclusive checklist of the duties of loyalty and further provide that they can all be drafted away.

First, RUPA section 21(b)(1) provides that every partner has a duty "to account to the partnership and hold as trustee for it any profit or benefit derived by the partner without the informed consent of the other partners, from any transaction connected with the formation, conduct, or liquidation of the partnership or from any personal use of partnership property." Given that a partner may make and retain any profit with the "informed consent" of her other partners, it is unclear why this rule should not be included in the RUPA section 4X list of mandatory rules. Even if it is not listed in RUPA section 4X, the fact that it is drawn virtually unchanged from UPA section 21(1) suggests that it will probably continue to be viewed as the statutory foundation of a broad and powerful duty of loyalty.

The final two duty of loyalty rules in RUPA sections 21(b)(2) and (3) are new to the partnership act. RUPA section 21(b)(2) provides that each partner has a duty "to refrain from dealing with the partnership as, or on behalf of, an adverse party without the informed consent of the partnership." RUPA section 21(b)(3) provides that each partner has a duty "to refrain from competing with the partnership without the informed consent of the partnership." Neither of these rules, however, is new to the law. They are drawn from sections 389 and 393 of the *Second Restatement of Agency.*

Interestingly, the Drafting Committee deleted the "general principle" that the *Restatement* describes as animating the more specific rules:

> [Section] 387. General Principle

102. Hillman, *Private Ordering Within Partnerships,* 41 U. Miami L. Rev. 425 (1987).

> Unless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency.

Elimination of this rule of abnegation of self from the statutory text is consistent with the earlier decision that the good faith duty is not violated "merely because the partner's actions furthered that partner's individual interest." On the other hand, it is inconsistent with the decision to retain the word fiduciary. As the New York Court of Appeals recently affirmed:

> [I]t is elemental that a fiduciary owes a duty of undivided and undiluted loyalty to those whose interests the fiduciary is to protect. This is a sensitive and "inflexible" rule of fidelity, . . . requiring avoidance of situations in which a fiduciary's personal interest possibly conflicts with the interest of those owed a fiduciary duty. . . . [A] fiduciary . . . *is bound to single-mindedly pursue the interests of those to whom a duty of loyalty is owed. . . .*[103]

RUPA section 21(b) concludes by stating that a partner is not precluded "from purchasing the assets of the partnership in a foreclosure sale or upon liquidation of the partnership." This rule is a more narrow expression of the general notion that a partner is an owner who naturally will pursue self-interest. More specifically, it is an attempt to confirm that dual-capacity transactions do not necessarily violate the duty of loyalty.[104] In particular, the goal was to confirm that a person may be both a partner and a lender. Wearing the hat of lender, lender remedies may be pursued.[105]

103. Birnbaum v. Birnbaum, 73 N.Y.2d 461, 466, 539 N.E.2d 574, 576 (1989) (emphasis added) (citations omitted).

104. Nonpartner capacity transactions are expressly authorized in RULPA § 107, which states that "a partner may lend money to and transact other business with the limited partnership and, subject to other applicable law, has the same rights and obligations with respect thereto as a person who is not a partner." *See also* I.R.C. § 707(a) (1990), which states the general rule for income tax purposes: "If a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall . . . be considered as occurring between the partnership and one who is not a partner."

105. In Westminster Properties, Inc. v. Atlanta Assoc., 250 Ga. 841, 301 S.E.2d 636 (1983), prior to Georgia's adoption of the UPA, the court rejected the argument that a partner's duties as a partner prevented it from exercising its rights as a secured creditor:

> [A] partnership which gives security to a partner for a loan cannot enforce the partnership duties owed it by the secured partner which duties impair the rights of the secured partner. (This prohibition is applicable to the partners as well as to the partnership.) If the rule were otherwise, a partnership could not obtain secured financing from its partners because its partners would not provide such financing.

Id. at 843, 301 S.E.2d at 638. On the other hand, a partner cannot in his partner capacity wrongfully cause a default merely to activate his nonpartner rights. *See* Natpar Corp. v. E.T. Kassinger, Inc., 258 Ga. 102, 365 S.E.2d 442 (1988), in which the court granted an interlocutory injunction prohibiting a partner named Natpar from foreclosing on certain property mortgaged to Natpar by its own partnership:

DUTY OF CARE

The Current Draft of RUPA

An earlier draft of RUPA contained a duty of care rule that was based on the Revised Model Business Corporation Act section 8.30(a) ("*MBCA*"). Like its MBCA predecessor, RUPA's early draft sought to avoid making managers personally liable for every incorrect decision. The rule provided that a partner "managing or conducting" partnership affairs has a duty to act: "(i) in good faith; (ii) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (iii) in a manner he [or she] reasonably believes to be in the best interests of the partnership." To borrow from the MBCA Comment, RUPA's early draft focused "on the manner in which the [partner] peforms his duties, not the correctness of his decisions."[106] Under this approach, a partner is free from liability for a decision that is properly reached, even if the decision ultimately proves to be a bad one. Like the MBCA provision, RUPA's rule was silent on the application of the business judgment rule.[107]

Later drafts have changed RUPA's early rule. Part of the early rule has been retained and part of it has been deferred for further consideration. The "good faith" component of the duty of care rule has been retained and made a part of RUPA section 21's "duty of good faith and fair dealing." The "ordinarily

> The essence of [the] complaint is that Natpar has wrongly brought about the default of the partnership to Natpar by failing to comply with its obligation under the partnership agreement to pay its share of operating expenses. Obviously, although the partnership granted Natpar a security deed, the partnership did not grant Natpar the right to refuse to pay its obligation to the partnership. We find that equitable relief is appropriate . . . and is not inconsistent with our decision in *Westminster Properties,* in which it was undisputed that Westminster took no wrongful action which precipitated the default to it.

Id. at 105–06, 365 S.E. 2d at 444–45.

106. Revised Model Business Corp. Act. § 8.30 Official Comment (1984), which also provides:

> In determining whether to impose liability, the courts recognize that boards of directors and corporate managers continuously make decisions that involve the balancing of risks and benefits for the enterprise. Although some decisions turn out to be unwise or the result of a mistake of judgment, it is ureasonable to reexamine these decisions with the benefit of hindsight. Therefore, a director is not liable for injury or damage caused by his decision, no matter how unwise or mistaken it may turn out to be, if in performing his duties he met the requirements of section 8.30.

107. Revised Model Business Corp. Act § 8.30 Official Comment (1984) explains the silence as follows:

> Even before statutory formulations of directors' duty of care, courts sometimes invoked the business judgment rule in determining whether to impose liability in a particular case. In doing so, courts have sometimes used language similar to the standards set forth in section 8.30(a). The elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts, in view of that continuing judicial development, section 8.30 does not try to codify the business judgment rule or to delineate the differences, if any, between that rule and the standards of director conduct set forth in this section. That is a task left to the courts and possibly to later revisions of this Model Act.

prudent person" portion of the early rule is still under consideration. The Drafting Committee has not yet decided whether to state a duty of care among partners beyond any that might be implicit in the duty of good faith and fair dealing. Most basically, the Committee is unsure about stating that partners owe each other the duty to use reasonable care. First, there are conflicting statements on the duty of care partners owe each other. Second, it is not clear what the law ought to be.

Mixed Statement in the Law

As indicated when discussing RUPA's continued use of the term "fiduciary," agency law and partnership law are interwoven. The *Restatement* position is that a paid agent is subject to a duty to the principal to act with "standard care" and skill.[108] The leading hornbook on partnerships, on the other hand, states that partners "are not subject to the ordinary care stardard applicable to a paid agent."[109] Yet there are both old and new statements that partners are subject to an ordinary care standard.

Writing in 1841, Mr. Justice Story opined that "good faith, reasonable skill and diligence, and the exercise of sound judgment and discretion, are naturally, if not necessarily, implied from the very nature and character of the relation of partnership."[110] He traced the principle to Roman law, which he summarized as follows: "in cases of partnership the same diligence is ordinarily required of each partner, as reasonable and prudent men generally employ about the like business; unless the circumstances of the particular case repel such a conclusion."[111]

Much more recently, the Supreme Court of Maine has said that partners are subject to an "ordinarily prudent person" standard.[112] In *Rosenthal v. Rosenthal,*[113] the court listed "four specific fiduciary duties" business associates owe one another.

> (1) To act with that degree of diligence, care and skill which ordinarily prudent persons would exercise under similar circumstances in like positions;

108. *See Restatement (Second) of Agency* § 379(1) (1958):

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

109. A. Bromberg & L. Ribstein, Partnership 6:85 (1988) (hereinafter "Bromberg & Ribstein").

110. J. Story, Commentaries on the Law of Partnership 261 (1841).

111. *Id.* at 263.

112. *See also* Roper v. Thomas, 60 N.C. App. 64, 72, 298 S.E.2d 424, 429 (1982), in which the court said it was "meritless" to argue that a general partner "may be personally liable for gross neglect of his duties, mismanagement, fraud and deceit resulting in loss to a third person, but not for error of judgment made in good faith."

113. 543 A.2d 348 (Me. 1988).

> (2) To discharge the duties affecting their relationship in good faith with a view to furthering the interests of one another as to the matters within the scope of the relationship;
>
> (3) To disclose and not withhold from one another relevant information affecting the status and affairs of the relationship;
>
> (4) To not use their position, influence or knowledge respecting the affairs and organization that are subject to the relationship to gain any special privilege or advantage over the other person or persons involved in the relationship.
>
> This delineation of fiduciary obligation reflects accurately the duties of care and loyalty owed under Maine law by a corporate director to the corporation and its shareholders, as well as the duties of a partner to the partnership and his fellow partners.[114]

The *Rosenthal* statement is instructive for a number of reasons. First, like RUPA, it retains the word fiduciary. Second, it uses an ordinarily prudent person standard. Third, it puts the partner and the director on a level playing field.[115] Fourth, like RUPA, it defines the fiduciary duties of partners in both entity and aggregate terms. A partner's duties include not only "furthering the interests of the business enterprise," but also "furthering the interests of one another.'[116] Fifth, the statement is followed by the caveat that the general fiduciary standards are qualified by the business judgment rule.[117]

114. *Id.* at 352.

115. The state of the law in the context of close corporations has been summarized in 2 F. O'Neal & R. Thompson, Oppression of Minority Shareholders § 10.04 (2d ed. 1985):

> In spite of the principles of majority rule and the business judgment rule, many courts in this country are moving steadily, though slowly and often clumsily and gropingly, to provide a remedy for oppressed minority shareholders. This they are doing principally by imposing a fiduciary duty on controlling shareholders and corporate directors for the benefit of minority interests, and by gradually expanding the scope of that fiduciary duty. Furthermore, some courts have made clear that they will not apply the business judgment rule unless the directors not only have acted in good faith but also have exercised proper care, skill and diligence.

116. *Rosenthal,* 543 A.2d at 352. *See also* Birnbaum v. Birnbaum, 73 N.Y.2d 461–62, 539 N.E.2d 574–75 (1989), in which the court said that partners, "and particularly managing partners, owe a fiduciary duty to the other partners . . . to protect their interests. . . . "

117. In Shinn v. Thrust IV, Inc., 56 Wash. App. 827, 786 P.2d 285 (1990), limited partners sued their corporate general partner for various acts of alleged negligence. When the general partner attempted to use the business judgment rule as a shield, the court cited with approval cases that state that the business judgment rule "not only requires directors to act with 'good faith,' but also requires them to act with such care as an ordinarily prudent person in a like position would use under similar circumstances." *Id.* at 833, 786 P.2d at 289. The court declined "to apply the business judgment rule" to the actions of the general partner:

> First, even if the rule is applicable to partnerships, it could not apply here because [the general partner's] conduct violated the due care standard requisite to application of the rule. In every instance where the trial court found that [the general partner] breached its fiduciary duties or the limited partnership agreement, the court expressly or implicitly found a failure . . . to use due or reasonable care. . . .

The elegance and simplicity of the *Rosenthal* statement are sufficient reason to keep it in mind. *Rosenthal* also raises a question about RUPA's contribution. Assume that RUPA rejects a reasonable care standard, perhaps on the assumption that a gross negligence standard is appropriate. Assume that a member of the Maine legislature is attempting to decide whether to vote to enact RUPA in Maine and asks what effect RUPA will have on the law of her state. In light of *Rosenthal,* is not the answer that RUPA would decrease the duty of care of partners and in so doing create a distinction between partners on the one hand and agents and directors on the other?

The Elusive "Right Result"

The major reason the duty of care rule is still under study is that there is no clear "right result." It should be emphasized that the duty of care rule at issue concerns the rights of partners among themselves. As among all the partners, should a partner bear all the losses caused by her own negligence? Or is a loss caused by a partner's negligence to be allocated among the partners according to the same rules that allocate losses caused by the negligence of a nonpartner? The Committee has never questioned that partners may agree to share losses in any way they like. RUPA section 18(b) provides that "[e]ach partner shall share in the losses, whether of capital or otherwise," in accordance with her profit share, and RUPA section 4X makes clear that this is a default rule rather than a mandatory rule. The issue, therefore, is whether there should be a separate default rule for losses caused by the negligence of a partner.

It is not clear that *Rosenthal* is correct in suggesting that partners should be governed by the rules applicable to corporate directors, particularly those in publicly-held corporations.[118] The share in profits generally considered the *sine qua non* of partner status suggests that the interests of partnership and partner

> Second, the fiduciary duty owed by all general partners of limited partnerships includes a duty to exercise due care in managing the partnership.

Id. at 836, 786 P.2d at 290–91(citations omitted). The court also said that "perhaps more importantly," the partnership agreement required more than a general "good faith" standard. On the other hand, the language it cited did not specify a reasonable care standard; it merely required the general partner to act "in the best interest of the Partnership," use "its best efforts" and proceed "in accordance with" specifications. *Compare* Bane v. Ferguson, 890 F.2d 11, 14 (7th Cir. 1989), in which a retired partner sued the managing partners of his former firm for negligently causing elimination of his retirement benefits. Even if the managing partners are fiduciaries of the former partner, wrote Judge Posner, "the business judgment rule would shield them from liability for mere negligence in the operation of the firm, just as it would shield a corporation's directors and officers, who are fiduciaries of the shareholders." *See also* Waite v. Sylvester, 560 A.2d 619, 626 (N.H. 1989), in which the court said that a managing partner's "error of judgment" was no defense to his claim to compensation. The court implied that there would be a different result if there were "a deliberate departure from the partnership's best interest."

118. There is authority for the general proposition that general partners owe greater fiduciary duties to limited partners who do not participate in management. *See, e.g.,* Boley v. Pineloch Assoc., Ltd., Fed. Sec. L. Rep. (CCH) ¶ 95, 407, 1990 U.S. Dist. Lexis 9912 (S.D.N.Y. 1990): "[t]he duties of a general partner to limited partners are even more intense because the limited partners do not directly participate in management." *Id.*

tend to converge. This may be easiest to see if there are few partners and each has an equal share. Perhaps more importantly, the exposure of partners to unlimited personal liability to all contract and tort creditors provides a powerful incentive to exercise due care. It also provides incentive to monitor the behavior of other partners. It therefore does not appear necessary to allocate the risk of loss inside the partnership in order to encourage either good performance or good monitoring.

The Drafting Committee has attempted to craft default rules that are efficient and fair. The basic idea is that default rules should reflect what most partners would regard as implicit in their partnership agreements. A default rule that accurately reflects implicit agreements tends to save people the cost of drafting agreements and also tends to avoid unexpected results. Unpopular default rules add unnecessary cost to the extent they put people to the expense of drafting around them. Stated differently, the short-form contract contained in RUPA is less useful to the extent partners feel compelled to incur costs to modify it. Furthermore, it is unfair to burden people who fail to incur the modification costs with losses they would not have agreed to bear.

It is not clear what duty of care rule would be included in most partnership agreements if the matter were addressed. To the extent partners know that they vary in ability or attitude toward care, they are likely to contract. Their contracting may not take the form of an altered loss-sharing ratio. Rather, their contracting may take the form of assigning low-risk functions to high-risk partners. On the other hand, contracting for care may be far less likely when partners either know little about each other or assume they are equally skillful and careful. If they believe that negligent injuries are an inevitable series of costs that over time will be imposed randomly and equally by all partners, a contract to share losses seems a likely outcome. In such a situation, an agreement to share losses primarily affects the timing of a partner's loss, not the amount of her loss. The agreement to share losses in effect allows each partner to amortize the losses she incurs. To borrow from the argot of the tax person, the loss-sharing agreement avoids a material distortion of income at the level of the individual partner. An assumption of equality, therefore, may explain the opinion of those who believe that partners tacitly agree to share the losses caused by each other's ordinary negligence. If one assumes equality, it seems likely that the partners as a group would agree either to self insure or to purchase third party insurance. This suggests that there should not be a special default rule for the losses caused by the negligence of a partner. Stated differently, as among the partners, there should be no duty of care rule to specially allocate losses to the partners who negligently cause them.

SUMMARY OF RUPA SECTION 21

Pause should be given by the statement in RUPA section 21 that it contains an exclusive list of the fiduciary duties of partners. First, the list fails to include obligations that have been considered part of a partner's fiduciary duties. For example, under UPA section 19, every partner "shall at all times have access to and may inspect and copy" the partnership books. Because every right is the flip side of a duty, UPA section 19 imposes a duty to permit other partners to inspect and copy partnership books "at all times." UPA section 20 is more directly stated in terms of a "Duty of Partners to Render Information." Partners must "render on demand true and full information of all things affecting the partnership to any partner or the legal representative of any deceased partner or partner under legal disability." More interstitial is the UPA section 18(e) duty to provide other partners with continuing information and consultation. Second, the idea of an exclusive list of fiduciary duties seems inconsistent with the fiduciary approach. It suggests a "draft them all away" approach when the very point of retaining the language of fiduciary law is to retain judicial discretion to deal with specific situations.

In summary, RUPA section 21 turned into a battleground between the libertarians and the parentalists. The results are equivocal. On the one hand, the libertarians achieved a victory to the extent that RUPA section 21 can be seen as a three-pronged attempt to restrain judicial imposition of fiduciary duties: (i) it purports to be an exclusive statement of fiduciary duties, which in turn purports to include an exclusive list of the duties of loyalty; (ii) in conjunction with RUPA section 4X, it makes it clear that all fiduciary duties other than the duty of good faith and fair dealing are merely default rules; and (iii) it gives statutory legitimacy to the pursuit of individual self-interest. The second is probably the sweetest victory for the libertarians, who hold sacred that fiduciary duties are merely default rules and not mandatory.[119] On the other hand, the parentalists can also claim victory for two basic reasons: (i) RUPA continues to use the term fiduciary; and (ii) RUPA section 21(b)(1) continues the language from UPA section 21(1) that the courts have treated as the statutory foundation for a vague and powerful duty of loyalty. The libertarians and parentalists may collide once again when the Drafting Committee reconsiders a duty of care rule and when the Conference gives RUPA section 21 a second reading.

119. Bromberg & Ribstein, *supra* note 109 at 6:68. "Fiduciary duties are essentially part of the standard form contract that governs partnerships in the absence of contrary agreement." *Id.* This is a narrow view of fiduciary duties that finds some support in recent case law. *See* Jordan v. Duff & Phelps, Inc., 815 F.2d 429 (7th Cir. 1987), *cert. dismissed,* 485 U.S. 901 (1988), in which Judge Easterbrook stated: "[b]ecause the fiduciary duty is a standby or off-the-rack guess about what parties would agree to if they dickered about the subject explicitly, parties may contract with greater specificity for other arrangements." 815 F.2d at 436. On the other hand, *Jordan* has been described as unprecedented:

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

DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation,* 1988 Duke L.J. 879, 885.

CONCLUSION

In many important areas, RUPA continues without change the major policy decisions embodied in the UPA. On the other hand, RUPA attempts to respond to the practical problems experienced under the UPA. Although much remains to be done before RUPA is completed, many of the changes yet to be made should flow from one of the three major policy decisions on which there appears to be very strong consensus.

The first decision is that most of the rules that govern the relations among partners should be default rules rather than mandatory rules. RUPA provides that, in almost all situations, the partnership agreement is supreme. The greatest controversy over mandatory rules has been in the area of the fiduciary duties of partners, and the only mandatory fiduciary duty in RUPA is the duty of good faith and fair dealing.

The second decision is that RUPA should make a major move away from the aggregate theory and closer to the entity theory. The basic purpose is to simplify the law, particularly in its statement of the property rights of partnership and partner. Although RUPA defines partnerships as entities, it retains an aggregate approach for some purposes, in particular, to emphasize the fiduciary duties of partners.

The third decision is to give a major overhaul to the rules on partnership breakups. The "dissolution" rules were completely rewritten to clarify and elaborate the rights of partners when they break up. RUPA redefines the concept of dissolution in a way that reflects its broader move to an entity theory. In particular, the new rules distinguish breakups that lead to a liquidation of the business from those that lead to a buyout of the departing partner. These rules avoid unnecessary dissolution of partnerships that use the buyout. Furthermore, the terms of the buyout are for the first time described in detail in the statute.

Far from implementing an agenda for the radical change of partnership law, RUPA endorses most of the major policy underpinnings of the UPA. It also seeks to refine, clarify, and adapt the precepts of partnership law to the demands of a society far more complex than that existing when the UPA was adopted. The UPA has served remarkably well in its eight decades as a framework for regulating the affairs of partners. Informed by the UPA and the vast body of case law interpreting its provisions, RUPA reflects rather than repudiates the experience of the past and provides for the future a statutory framework well equipped to facilitate the ordering of the wide range of relationships now called partnerships.