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THE REVISED UNIFORM LIMITED PARTNERSHIP ACT: PROVISIONS AFFECTING THE RELATIONSHIP OF THE FIRM AND ITS MEMBERS TO THIRD PARTIES

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In 1916 the National Conference of Commissioners on Uniform State Laws promulgated the original Uniform Limited Partnership Act (1916 Act) to ameliorate the effect of the overly strict existing law.¹ The 1916 Act is based on the following dual premises:

First: No public policy requires a person who contributes to the capital of a business, acquires an interest in the profits, and some degree of control over the conduct of the business, to become bound for the obligations of the business; provided creditors have no reason to believe at the times their credits were extended that such person was so bound.

Second: That persons in business should be able, while remaining themselves liable without limit for the obligations contracted in its conduct, to associate with themselves others who contribute to the capital and acquire rights of ownership, provided that such contributors do not compete with creditors for the assets of the partnership.²

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¹ UNIFORM LIMITED PARTNERSHIP ACT § 1, Comment (1916) [hereinafter cited as 1916 Act].

² *Id.*

As of 1977, the 1916 Act had been adopted, subject to local modifications, in forty-nine states, the District of Columbia and the Virgin Islands.³

In 1976 the National Conference promulgated a revised Uniform Limited Partnership Act (1976 Act) "to modernize the prior uniform law while retaining the special character of limited partnerships as compared with corporations."⁴ The basic concept of a limited partnership as being a partnership with one or more general partners having unlimited liability and one or more limited partners having limited liability is retained.⁵ According to the draftsmen, the 1976 Act "clarifies many ambiguities and fills interstices in the prior uniform law by adding more detailed language and mechanics. In addition, some important substantive changes and additions have been made."⁶

The 1976 Act contains sixty-four separate sections ranging from definitions to derivative suits. Because of the extremely broad range of topics covered by these sixty-four sections and because of their length and complexity, this Article will not attempt an exhaustive treatment of all of them. Rather, its purpose is to examine those sections that principally affect the relationship of the limited partnership and its members to the public in general and to third parties dealing with the firm or its members in particular. The examination will consist primarily of a comparison of the 1976 Act with the corresponding provisions of the 1916 Act.⁷ It will focus both on the degree to which the 1976 Act clarifies ambiguities and fills interstices in the 1916 Act and on the degree to which it makes substantive changes in the law of limited partnerships.

I. FORMAL REQUIREMENTS

The 1976 Act continues the philosophy of the 1916 Act, treating limited partnerships as creatures of the state, more similar in this respect to corporations than to general partnerships. It goes beyond the scope of the 1916 Act, however, and integrates some of the basic formal requirements governing limited partnerships with those applicable to corporations. Because many of the practical problems relating to these matters are not dependent on the legal form of business organization, this approach seems both realistic and sensible.

A. Partnership Name

One of the first problems facing an entrepreneur about to embark on a business venture is selecting a name for his or her enterprise. Section 102 of the 1976 Act contains five requirements concerning the name of a limited partnership, all of which are designed to protect third parties from deception of one sort or another.

The first is that the name "shall contain without abbreviation the words 'limited partnership' . . ."⁸ This provision has no counterpart in the 1916 Act,⁹ although some

³ Louisiana is the only state that has failed to adopt the 1916 Act. 6 UNIFORM LAWS ANN. 94 (Supp.

⁴ UNIFORM LIMITED PARTNERSHIP ACT, Prefatory Note (1976) [hereinafter cited as 1976 Act].

⁵ *Id.* §§ 101(7), 303(a), 403.

⁶ *Id.*, Prefatory Note.

⁷ This Article will discuss primarily arts. 1, 2, and 3 of the 1976 Act as they compare to analogous provisions of the 1916 Act.

⁸ 1976 Act § 102(1).

⁹ See 1916 Act § 5.

states have adopted such requirements in variations from the official text.¹⁰ The requirement is designed to provide realistic creditor protection. The draftsmen have chosen the easiest and most obvious method to impart actual notice to the public that some of the partners¹¹ have sought to limit their liability, a method similar to provisions found in most jurisdictions governing corporate names.¹² While modern credit investigation practices might cause some to question its significance for all but the most unsophisticated creditor, the burden involved in compliance is so minor that any doubts as to the requirement's utility should be resolved in its favor.¹³ The express denial of permission to use abbreviations such as "Ltd.," however, would seem to make section 102(1) somewhat more onerous than is necessary.

The four remaining provisions of section 102 are negative in operation. Section 102(2), which essentially is a carry-over of section 5(1) of the 1916 Act, states that the firm name "may not contain the name of a limited partner unless (i) it is also the name of a general partner or the corporate name of a corporate general partner, or (ii) the business of the limited partnership had been carried on under that name before the admission of that limited partner"¹⁴ The rationale for this prohibition is that the appearance of the limited partner's name in the firm name could cause third parties to conclude mistakenly that the limited partner is a general partner with unlimited personal liability and to extend credit to the partnership on that basis. The exceptions are designed to avoid the necessity of sacrificing the good will that may inhere in a particular firm name simply because a limited partner has the same name as a present or former general partner. These exceptions clearly are a compromise with the general purpose of the prohibition and in some instances could be viewed as striking the balance too much in favor of the firm. For example, section 102(2)(ii) could be construed to permit a general partner's name to remain in the firm name after his or her withdrawal as a general partner and subsequent readmission as a limited partner.¹⁵ The possibility of confusion from a third person's point of view is clear in such an instance.

Section 303(d) provides the penalty for a violation of section 102(2), as follows: "A limited partner who knowingly permits his name to be used in the name of the limited partnership, except under circumstances permitted by Section 102(2)(i), is liable to creditors who extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner."¹⁶ This section is a recodification of section 5(2) of the 1916 Act with the addition of an element of culpability on the part of the limited partner sought to be charged. That is, the limited partner must know that his or her name is being used in the partnership name in order for liability to attach. Because of the drastic effect that imposition of personal liability

¹⁰ See, e.g., ALA. CODE tit. 10, § 10-9-23(c) (1975); FLA. STAT. ANN. § 620.05(1) (West 1977). Both states require that the name of every limited partnership contain the word "Limited" or its abbreviation "Ltd."

¹¹ The 1976 Act uses the term "partner" to describe both limited and general partners. 1976 Act § 101(8).

¹² See, e.g., DEL. CODE ANN. tit. 8, § 102(a)(1) (1974); N.Y. BUS. CORP. LAW § 301(a)(1) (McKinney 1963); ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 8(a) (West 1971).

¹³ See ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 8, Comment at 293 (West 1971).

¹⁴ 1976 Act § 102(2).

¹⁵ A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP § 81, at 466 n.1 (1968).

¹⁶ 1976 Act § 303(d).

may have, addition of the culpability requirement seems only fair and should not preclude recovery in many cases.

Section 303(d) carries over the negative reliance element of section 5(2). The creditor need not plead or prove actual reliance on the belief that the limited partner was a general partner. Rather, the limited partner will be liable to all creditors except those whom he or she can establish actually knew that he or she was a limited partner.

Section 303(d) also contains an apparent clerical error. Section 102(2) contains two exceptions to the prohibition of use of a limited partner's name in the firm name; such use is permitted if (i) the name is also the name of an individual or corporate general partner, or (ii) the business had been carried on under such name prior to admission of the limited partner. Section 303(d), in its cross-reference to section 102(2), inexplicably mentions only the first of these exceptions. Unless this apparent error is corrected, a limited partner who falls within the exception granted by section 102(2)(ii) nevertheless may incur liability under section 303(d).

While subsections (1) and (2) of section 102 are intended to prevent creditors from being misled concerning the status and liabilities of the partners, subsections (3), (4), and (5) have a broader purpose—avoidance of deception of the public regarding the nature, purpose, or identity of the business.

Section 102(3) prohibits the name of a limited partnership from "contain[ing] any word or phrase indicating or implying that it is organized other than for a purpose stated in its certificate of limited partnership."¹⁷ Section 106 grants broad authority to engage in any type of business that would be proper for a general partnership except certain specified activities, such as banking or insurance, that are to be designated individually by each adopting jurisdiction.¹⁸ Section 201(a)(2) requires that the certificate of limited partnership, which must be filed with the Secretary of State,¹⁹ contain a description of the general character of the business.²⁰ The purpose of section 102(3), then, is not to inhibit the type of business to be carried on by the limited partnership but simply to avoid misleading the public by a name that is indicative of some other type of business.²¹

Section 102(4) states that the firm name "may not be the same as, or deceptively similar to, the name of any corporation or limited partnership organized under the laws of this State or licensed or registered as a foreign corporation or limited partnership in this State."²² This section is similar to, and obviously intended to be integrated with, widespread legislation concerning corporate names.²³ Its purpose is twofold. First, it is designed to protect the public from deception regarding the identity of the enterprise with which it is doing business. Second, it is intended to protect other businesses from potential injury resulting from such a confusion of identities.²⁴ Integration of the registration of domestic and foreign limited partner-

¹⁷ *Id.* § 102(3).

¹⁸ *Id.* § 106.

¹⁹ *Id.* § 206.

²⁰ *Id.* § 201(a)(2).

²¹ Section 102(3) apparently was derived from a substantially identical provision in the Model Business Corporation Act. See ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 8(b) (West 1971).

²² 1976 ACT § 102(4).

²³ See, e.g., DEL. CODE ANN. tit. 8, § 102(a)(1) (1975); N.Y. BUS. CORP. LAW § 301(a)(2) (McKinney 1963); ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 8(c) (West 1971).

²⁴ See ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 8, Comment at 294 (West 1971). The legal problems attendant on such legislation are myriad, and a discussion of them is beyond the scope of this

ship and corporation names is long overdue and should greatly enhance the value of this type of legislation. Of course, the phraseology "deceptively similar" leaves much to the judgment of the Secretary of State,²⁵ but there really is no other practical solution to the problem. Presumably his or her action in accepting or rejecting a name would be subject to judicial review, at least in cases involving an abuse of discretion.²⁶

One potential constructional problem stems from the draftsmen's failure to make explicit the interaction between section 102(4) and section 103. The latter permits persons intending to use a particular name to reserve exclusive use of that name for periods of up to 120 days.²⁷ Section 102(4)'s prohibition, however, speaks only in terms of existing names of existing limited partnerships and corporations; it contains no reference to names reserved but not yet in use.²⁸ Clearly, a construction of section 102(4) limiting its strictures to names currently in use would undercut severely the viability of section 103, and, therefore, it should not be so construed. Unless individual action on this point is taken by the adopting jurisdictions, however, certainty may be achieved only at the expense of litigation.

The remaining provision of section 102 simply is a prohibition of use in the firm name of specified words to be determined individually by the adopting jurisdictions.²⁹ Like section 102(3), this requirement seems intended to prevent deception as to the nature of the limited partnership's business and is similar to the law prevailing in some jurisdictions with respect to corporations.³⁰

Finally, it should be noted that the five requirements of section 102 all apply to the name of the firm "as set forth in its certificate of limited partnership."³¹ This adjectival phrase modifying "name" must have been included for some reason³² and raises the possibility that the limited partnership's name appearing other than in the certificate need not comply with section 102. This conclusion is reinforced by section 208, which provides that a certificate on file with the Secretary of State constitutes notice that the firm is a limited partnership and that the persons designated in the certificate as limited partners are limited partners.³³ Such a construction of section 102, however, would make many of its provisions almost meaningless in terms of realistic protection for third parties. For example, the requirement that the name contain the words "limited partnership" seems superfluous if it applies only to the name appearing in the certificate, since it would be difficult to read the certificate without being aware that the firm was a limited partnership. Moreover,

article. Some of the issues involved are (1) whether the statutory prohibition preempts or merely supplements the common law of unfair competition, (2) whether the two firms must be in competition or at least in the same line of business, (3) the effect upon other remedies of the Secretary of State's acceptance or rejection of the certificate for filing, (4) the necessity of actual confusion on the part of the public, and (5) the necessity of actual economic injury sustained by the other enterprise. For a discussion of these and other problems, see 6 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* §§ 2419-2441.2 (rev. perm. ed. 1968).

²⁵ The Secretary of State must conclude that each certificate conforms to law before accepting it for filing. See 1976 ACT § 206(a).

²⁶ 6 W. FLETCHER, *supra* note 24, § 2420.

²⁷ 1976 ACT § 103.

²⁸ Compare *id.* § 102(4) with DEL. CODE ANN. tit. 8, § 102(a)(1) (1975); N.Y. BUS. CORP. LAW § 301(a)(2) (McKinney 1963); and ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 8(c) (West 1971).

²⁹ 1976 ACT § 102(5).

³⁰ See, e.g., N.Y. BUS. CORP. LAW § 301(a)(5) (McKinney Supp. 1977).

³¹ 1976 ACT § 102.

³² Compare 1916 ACT § 5.

³³ 1976 ACT § 208.

even if it were possible to conclude under a strict reading of section 102 that its strictures apply only to names appearing in the certificate,³⁴ use of a different name elsewhere would not be advisable. For example, if the name of a limited partner appeared in the firm name as exhibited at its place of business, he or she could incur personal liability under principles of partnership by estoppel.³⁵ All of these problems could have been avoided had the draftsmen followed the approach taken by Alabama in its version of the 1916 Act—simply requiring the name of a limited partnership to conform to certain standards “in every instance in which the partnership name is used.”³⁶

B. Specified Office and Agent

Furthering the corporate analogy, section 104 of the 1976 Act requires each domestic limited partnership continuously to maintain in the state an office and an agent for service of process.³⁷ The address of the office and the name and address of the agent must be included in the certificate of limited partnership.³⁸ Any change of office or agent will necessitate an amendment of the certificate, but the procedure for such an amendment is relatively simple, requiring action by only a single general partner.³⁹

The purpose of the agent is stated expressly in section 104 as being “for service of process on the limited partnership”⁴⁰ Implicit in this statement is the notion that, at least for purposes of pleading, a limited partnership is an entity.⁴¹ The agent must be either an individual resident of the state, a domestic corporation, or a foreign corporation authorized to do business in the state.⁴²

Although the 1976 Act states that each domestic limited partnership shall maintain such an agent continuously, it does not prescribe specifically the consequences of failure to follow the mandate. The result is that at least two questions are left open. First, how may the firm be served with process? In the absence of statutory authority, substituted service on the Secretary of State probably would not be sufficient.⁴³ On the other hand, the mere existence of section 104 should not be interpreted to mean that service on the agent is the exclusive method for serving the firm. Rather, it should be interpreted to provide an additional method that leaves untouched those already recognized by law, such as service on any general partner.⁴⁴

Second, what, if any, penalty will be imposed on the firm or the partners for failure to maintain an agent? Certainly the offense is not of sufficient magnitude

³⁴ *But cf.* *Anzalone v. Durchslag*, 1 Ill. App. 3d 125, 273 N.E.2d 752 (1971) (violation of public policy for a corporation to use a name other than the one under which it was organized).

³⁵ UNIFORM PARTNERSHIP ACT § 16 (incorporated by reference by 1976 Act § 1105); 1976 Act § 208, Comment.

³⁶ ALA. CODE tit. 10, § 10-9-23(c) (1975).

³⁷ 1976 Act § 104. For the requirements governing foreign limited partnerships, see *id.* § 902(4)-(6).

³⁸ *Id.* § 201(a)(3).

³⁹ *Id.* § 204(a)(2).

⁴⁰ *Id.* § 104(2).

⁴¹ See *Blum v. Kawaguchi, Ltd.*, 331 F. Supp. 216 (D. Neb. 1971) (by implication); *Silliman v. DuPont*, 302 A.2d 327 (Del. Super. Ct. 1972), *aff'd per curiam*, 310 A.2d 128 (Del. 1973) (decision based on common name statute); *Ruzicka v. Rager*, 305 N.Y. 191, 111 N.E.2d 878 (1953) (dictum).

⁴² 1976 Act § 104(2).

⁴³ Compare *id.* §§ 902(5), 907(d); ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 14 (West 1971).

⁴⁴ *Hibou, Inc. v. Ramsing*, 324 A.2d 777, 782 (Del. Super. Ct. 1974); *Rait v. Jacobs Bros.*, 49 Misc. 2d 903, 268 N.Y.S.2d 750 (Sup. Ct. 1966) (construing local statute).

that it should impair the validity of firm contracts.⁴⁵ Nor in the absence of specific statutory authority should it result in involuntary dissolution of the partnership.⁴⁶ Failure to maintain an agent, however, could be construed as a change of circumstance making the designation of the agent in the certificate of limited partnership inaccurate. The result would be that any general partner who knew or should have known of the failure within sufficient time to have taken corrective action would be potentially liable under section 207(2) to any person who suffered a loss by reliance on the designation in the certificate.⁴⁷ Cases in which a third party actually suffers loss by reliance on the designation of an agent in a certificate would be fairly rare but theoretically are possible. For example, the statute of limitations on a cause of action against the firm could run because of an inability to locate the agent for service of process. In such a case it would seem that the third party would have a new cause of action under section 207 against any culpable general partner.

Any discussion of the office required to be maintained by section 104(1) should begin by noting that it need not be either the agent's office⁴⁸ or a place of the firm's business.⁴⁹ The only requirements are that it be in the state and that certain basic documents and records be kept there. These documents and records are specified in section 105 and consist of (1) a current alphabetical list of the name and last known business address of each partner (both general and limited), (2) a copy of the certificate of limited partnership, any amendments thereto and any powers of attorney pursuant to which any certificates have been executed, (3) copies of the three most recent federal, state, and local income tax returns of the partnership, (4) copies of any currently effective partnership agreements, and (5) copies of any financial statements of the firm for the three most recent years.⁵⁰ Thus, the principal significance of the specified office is as a place where members of the firm, particularly limited partners, can have sure and ready access to basic information regarding the firm and its business.⁵¹

The specified office also may have the effect of establishing the legal residence of the firm.⁵² This effect could be significant with respect to a number of diverse

⁴⁵ Cf. 1976 ACT § 907(b) (failure of foreign limited partnership to register as such does not impair the validity of any contract or prevent partnership from defending any suit or action); *House v. Bank of Lewisport*, 178 Ky. 281, 198 S.W. 760 (1917) (failure to appoint successor to corporate agent for service of process does not void corporate contract under statute making transaction of business before appointment of agent unlawful).

⁴⁶ The comment to § 201, which governs the contents and filing of the certificate of limited partnership, states, "Subparagraph (b) . . . make[s] it clear that the existence of the limited partnership depends only upon compliance with this section. Its continued existence is not dependent upon compliance with other provisions of this Act." 1976 ACT § 201, Comment. A number of corporation codes provide that failure to maintain a registered agent is a ground for involuntary dissolution in proceedings instituted by the state. E.g., ILL. ANN. STAT. ch. 32, § 157.82(d) (Smith-Hurd Supp. 1978); MO. ANN. STAT. § 351.525(4) (Vernon Supp. 1978); TEX. BUS. CORP. ACT ANN. art. 7.01(B)(2)-(C) (Vernon Supp. 1978); ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 94(d) (West 1971).

⁴⁷ 1976 ACT § 207(2). Liability arising from statements that become false through a change of circumstances is confined to general partners. Compare 1916 ACT § 6. For a detailed discussion of § 207, see text at notes 136-53 *infra*.

⁴⁸ See 1976 ACT §§ 104, 201(a)(3). Compare ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 12(b) (West 1971).

⁴⁹ 1976 ACT § 104(1).

⁵⁰ *Id.* § 105.

⁵¹ Section 105 expressly provides that any partner may inspect and copy the designated records, at his or her own expense, during ordinary business hours.

⁵² Cf. *Sweeny v. Keystone Driller Co.*, 122 Ohio St. 16, 170 N.E. 436 (1930) (purpose of requiring articles of incorporation to specify principal place of business is to avoid confusion by establishing definite place of residence).

matters. For example, if a limited partnership's principal place of business is in a different county than its specified office, venue in an action against the partnership could be held to be proper in either county.⁵³ Confusion also might be created regarding the proper place for filing financing statements by secured creditors of the firm.⁵⁴ At least in the absence of any important countervailing concerns, such problems, especially when coupled with the record maintenance requirement of section 105, militate against locating the specified office at a place other than the principal place of the partnership's business.

Once again, the 1976 Act does not prescribe specifically the consequences of failure to establish or maintain an office at the location specified in the certificate of limited partnership.⁵⁵ And, once again, such a failure might produce liability under section 207, either as a statement in the certificate that initially was false, or one that became false through a change in circumstances. Unlike the case of failure to maintain an agent, however, most potential liability here would seem to be internal. That is, since the primary function of the specified office is as an inspection point for the partners with respect to basic partnership documents and records, the "one who suffers loss by reliance on the statement"⁵⁶ most probably would be one of the partners rather than an outsider. Potential liability in such instances would seem to be even rarer than in the case of failure to maintain an agent.

II. TRANSACTIONS OF PARTNER WITH PARTNERSHIP

One of the most important relationships between the members of a limited partnership and third parties is that which occurs upon liquidation of the firm and distribution of its assets. Inherent in the concept of ownership status is the notion that creditors must be paid fully before any distributions of an equity nature may be made. It is possible, however, that the owners of a business may have entered into transactions with it that ordinarily would create a creditor status. With respect to such claims, the owners may attempt to compete for the assets of the business on an equal basis with third party (nonowner) creditors. In the case of a limited partnership the problem is complicated by the existence of two types of owners—general partners and limited partners. Because general partners are liable personally for partnership obligations, individual creditors of a general partner as well as firm

⁵³ Cf. *Ward v. Fairway Operating Co.*, 364 S.W.2d 194 (Tex. 1963) (in action against corporation, venue proper in either county of principal place of business or county where registered office located). *But see Rait v. Jacobs Bros.*, 49 Misc. 2d 903, 268 N.Y.S.2d 750 (Sup. Ct. 1966); *Bulkley v. O'Donnell*, 148 Misc. 186, 265 N.Y.S. 495 (Sup. Ct.), *aff'd mem.*, 240 App. Div. 929, 267 N.Y.S. 983 (1933). Both cases involved limited partnerships whose certificates of limited partnership specified the firms' principal places of business. In both cases venue was held to be proper in any county in which a general partner resided. *Bulkley* stressed the aggregate theory of partnership law, but *Rait* relied principally on a statute providing that a partnership was a resident of any county in which a partner resided.

⁵⁴ Cf. *Sweeny v. Keystone Driller Co.*, 122 Ohio St. 16, 170 N.E. 436 (1930) (chattel mortgage invalid as against other creditors under statute requiring filing in county of debtor's residence when filed in county where corporate debtor was transacting major business rather than in county designated in articles of incorporation as principal place of business); *accord, In re Norma Footwear Corp.*, 2 N.Y.2d 887, 141 N.E.2d 628, 161 N.Y.S.2d 143 (1957) (mem.). Confusion regarding the proper place of filing should be alleviated by the central filing requirements that predominate under the Uniform Commercial Code. U.C.C. § 9-401(1). Subsection (6), added in 1972, provides that in instances for which local filing remains necessary, "the residence of an organization is its place of business if it has one or its chief executive office if it has more than one place of business." *Id.* § 9-401(6) (1972 official text).

⁵⁵ Compare ILL. ANN. STAT. ch. 32, § 157.82(e) (Smith-Hurd Supp. 1978); ALI-ABA MODEL BUS. CORP. ACT ANN. 2d § 94(e) (West 1971).

⁵⁶ 1976 Act § 207.

creditors may be affected. In addition, the rights of general and limited partners *inter se* often will be involved.

Both the 1916 and 1976 Acts attempt to resolve the problems created by these conflicting interests. The following discussion will begin with a brief comparison of the general features of the two Acts and then will proceed to a more detailed discussion of specific problem areas.

A. General Comparison

Section 13 of the 1916 Act provides,

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

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

(b) Receive from a general partner or the partnership any payment, conveyance, or release from liability, if at the time the assets of the partnership are not sufficient to discharge partnership liabilities to persons not claiming as general or limited partners.

(2) The receiving of collateral security, or a payment, conveyance, or release in violation of the provisions of paragraph (1) is a fraud on the creditors of the partnership.⁵⁷

Section 13 has three effects. It permits limited partners to transact business with the partnership and to stand on a relatively equal footing with nonpartner (outside) creditors with respect thereto. The only limitation imposed is that if the partnership assets are insufficient to discharge liabilities to outside creditors, a limited partner may neither receive a payment, conveyance, or release from liability nor take a security interest in partnership property.⁵⁸ The equality of limited partners claiming as creditors with outside creditors is reinforced by section 23 of the 1916 Act, which provides that upon dissolution the firm liabilities of the highest rank are those owing "to creditors, in the order of priority as provided by law, except those to limited partners on account of their *contributions*, and to general partners."⁵⁹

Section 13 confines this equality of treatment to persons who are solely limited partners. A person who is a general partner or both a general and a limited partner may transact business with the partnership, but any claims arising from such business always will be subordinate to the claims of outside creditors and limited partners. This conclusion again is reinforced by section 23, which ranks liabilities owing to general partners claiming as creditors fourth after liabilities owing (1) to

⁵⁷ 1916 Act § 13.

⁵⁸ Most authorities agree that the last clause of § 13(1)(b) also was intended to modify § 13(1)(a). Thus, § 13(1)(a) is not seen as an absolute bar to a limited partner's holding a security interest in firm property. *Hughes v. Dash*, 309 F.2d 1 (5th Cir. 1962); *Grainger v. Antoyan*, 48 Cal. 2d 805, 313 P.2d 848 (1957) (by implication); *A.T.E. Fin. Serv., Inc. v. Corson*, 111 N.J. Super. 254, 268 A.2d 73 (1970); *Kratovil & Werner, Fixing Up the Old Jalopy—the Modern Limited Partnership under the ULPA*, 50 ST. JOHN'S L. REV. 51, 62-66 (1975); see 1916 Act § 1, Comment at 565. A contrary argument could be made on the basis that § 13(1) speaks of sharing "pro rata" with "general creditors." If a security interest given to a limited partner is recognized as valid, the limited partner will not share with general creditors but will have priority over them.

⁵⁹ 1916 Act § 23(1)(a) (emphasis added).

outside creditors and limited partners claiming as creditors, (2) to limited partners in respect to profits, and (3) to limited partners in respect to capital.⁶⁰

Finally, section 13(2), in effect, creates a special fraudulent conveyance provision applying to receipt by a limited partner of a security interest, payment, conveyance, or release from liability at a time when the assets of the partnership are not sufficient to satisfy the claims of outside creditors.

In contrast, section 107 of the 1976 Act provides, "Except as provided in the partnership agreement, 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."⁶¹ This single sentence encompasses four important points, all of which must be kept in mind in assessing the effect of section 107 on the law of limited partnerships. First, it contains no express limitation on preferential transfers or fraudulent conveyances from the partnership to the partners. Second, by being phrased in terms of "partner" it applies to both limited and general partners.⁶² Third, its provisions are "subject to other applicable law." Fourth, its provisions are subject to change by a partnership agreement.

B. Fraudulent Conveyances

The absence of a specific prohibition in the 1976 Act regarding the creation of a security interest, payment, conveyance, or release from liability at a time when partnership assets are insufficient to satisfy the claims of outside creditors at first glance would appear to make significant and undesirable changes in the law. It must be remembered, however, that section 107's provisions are "subject to other applicable law," including a state's fraudulent conveyance statute and the Federal Bankruptcy Act.

Section 8 of the Uniform Fraudulent Conveyance Act states,

Every conveyance of partnership property and every partnership obligation incurred when the partnership is or will be thereby rendered insolvent, is fraudulent as to partnership creditors, if the conveyance is made or obligation is incurred,
 (a) To a partner, whether with or without a promise by him to pay partnership debts⁶³

"Conveyance" is defined by that Act as including "every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any lien or incumbrance."⁶⁴ Insolvency of a partnership occurs when the amount that probably will be required to meet existing debts as

⁶⁰ *Id.* § 23(1)(a)-(d).

⁶¹ 1976 Act § 107.

⁶² "Partner" means a limited or general partner." *Id.* § 101(8).

⁶³ UNIFORM FRAUDULENT CONVEYANCE ACT § 8(a). Section 67d(4) of the Bankruptcy Act is similar in its effect. Bankruptcy Act § 67d(4), 11 U.S.C. § 107(d)(4) (1976). With respect to voidable preferences, § 60a(1) of the Bankruptcy Act further provides,

A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

Id. § 60a(1), 11 U.S.C. § 96(a)(1) (1976).

⁶⁴ UNIFORM FRAUDULENT CONVEYANCE ACT § 1.

they become due exceeds the present fair salable value of its assets.⁶⁵ For this purpose the firm's assets include the individual assets of each general partner to the extent they exceed the amount probably necessary to meet individual creditors' claims and also the amount of any unpaid subscription of each limited partner, provided his or her individual assets are probably sufficient to satisfy his or her individual debts, including the unpaid subscription.⁶⁶

It would seem, then, that unless "assets of the partnership," as used in section 13 of the 1916 Act, includes these additional amounts, it provides a more stringent test for the validity of these sorts of conveyances than does section 8 of the Uniform Fraudulent Conveyance Act. There may be cases in which the firm's assets, when viewed narrowly, would not exceed its liabilities to outsiders, which would make any conveyance to a limited partner fraudulent under section 13. When supplemented by the partners' contributions the same firm's assets could exceed its liabilities, which would make the same conveyance not fraudulent under section 8.⁶⁷ Thus, under the 1916 Act a limited partner might be prevented from obtaining payment of a debt owed him or her by the partnership or conveyance of collateral security even though at the time, under the Uniform Fraudulent Conveyance Act, the partnership's assets were sufficient to satisfy the partnership debts. By deleting section 13's special fraudulent conveyance provision, section 107 of the 1976 Act makes clear that a payment of a debt or conveyance of collateral security to a limited partner is permissible as long as the partnership retains sufficient assets, as defined by the Uniform Fraudulent Conveyance Act, to meet its current liabilities. Section 107 of the 1976 Act, therefore, may make some change in present law, although the magnitude of the change is uncertain.⁶⁸

⁶⁵ *Id.* § 2(1).

⁶⁶ *Id.* § 2(2).

⁶⁷ The somewhat different definitions of "insolvency" also could give rise to disparate results. Compare *id.* § 2(1) with 1916 Act § 13(1).

⁶⁸ It is possible to argue that "assets of the partnership," as used in § 13 of the 1916 Act does include limited partners' unpaid subscriptions and general partners' individual assets to the extent they are available to satisfy claims of partnership creditors. Section 17 of the 1916 Act states that a limited partner is liable to the partnership for (1) the difference between his or her contribution as reflected in the certificate of limited partnership and the contribution actually made, and (2) any unpaid contribution that the limited partner agreed in the certificate to make in the future. It also provides that a limited partner holds as trustee for the partnership specific property stated in the certificate as having been contributed but which actually was not contributed. Under certain circumstances these liabilities may be enforced by a creditor of the firm. 1916 Act § 17(1)(a)-(b), (2)(a), (3). As the first two items are amounts owed to the firm and the third is property of which the firm is equitable owner, arguably all are firm "assets" within the meaning of § 13.

The argument regarding general partners' individual assets requires resort to §§ 15 and 40 of the Uniform Partnership Act, incorporated by § 29 of the 1916 Act. Section 15 imposes joint and several liability on general partners for torts and breaches of trust chargeable to the partnership and joint liability for other partnership debts and obligations. UNIFORM PARTNERSHIP ACT § 15. Section 40 provides that, in settling accounts after dissolution, the "assets of the partnership" include not only partnership property but also contributions from the individual assets of partners to the extent necessary to satisfy all partnership liabilities. *Id.* § 40(a); see *id.* § 40(d). Reading these sections together, and keeping in mind the purpose of the limitation in § 13 of the 1916 Act, one could conclude that general partners' individual assets also are firm assets to the extent that they can be reached by firm creditors. See *id.* § 40, Comment. To ignore the excess of a general partner's individual assets over his or her individual liabilities in construing a provision designed to protect partnership creditors would be to ignore the most significant feature of a general partner's status—personal liability to such creditors. The result would be a provision more restrictive than necessary to achieve the desired protection and needlessly intrusive on the limited partner's status as a creditor of the firm (since it would preclude him or her from receiving payment or holding collateral security even though the firm is solvent under the definition in the Uniform Fraudulent Conveyance Act).

C. Transactions by General Partners—Effect on Creditors

Also significant is section 107's extension to general partners of the right to transact business with the partnership and stand on an equal footing with other creditors. The extension of this right to general partners has a potential impact on third party creditors of the partnership, on individual creditors of a general partner, and on limited partners. For purposes of simplicity, the following discussion will focus first on the rights of creditors under the 1976 Act. Thereafter, the rights of general partners vis-à-vis limited partners will be considered.⁶⁹

Any discussion of the rights and obligations of these various parties necessarily must consider the relative priority of their claims to partnership assets upon liquidation. Section 23 of the 1916 Act requires that the partnership assets be applied to its liabilities in the following order: (1) to creditors, including limited partners claiming as creditors; (2) to limited partners with respect to profits; (3) to limited partners with respect to capital; (4) to general partners claiming as creditors; (5) to general partners with respect to profits; and (6) to general partners with respect to capital.⁷⁰ In contrast, section 804 of the 1976 Act prescribes the following order: (1) to creditors, including partners claiming as creditors; (2) unless otherwise provided in a partnership agreement, to partners with respect to accrued but unpaid interim distributions; and (3) unless otherwise provided in a partnership agreement, to partners first for the return of capital contributions and secondly with respect to their partnership interests.⁷¹

The effect of sections 107 and 804 on outside partnership creditors and on individual creditors of a general partner can best be examined by a series of greatly simplified examples. Each of the following examples concerns a limited partnership with a single general partner, G, and a single limited partner, L. X is a nonpartner creditor of the partnership, and Y is an individual creditor of G. In each example it is assumed that there are no current partnership profits and that there are no accrued but unpaid interim distributions.

EXAMPLE 1

General Partner Solvent, Partnership Solvent

Partnership Balance Sheet			
Assets	\$4,000	Liabilities to X	\$1,000
		Liabilities to G	1,000
		Capital, L	1,000
		Capital, G	1,000
		Retained earnings	0
	\$4,000		\$4,000

G owes Y, his individual creditor, \$1,000. In addition to his interest in the partnership and the \$1,000 owed him by the partnership, G has other individual assets totalling \$500.

Under sections 13 and 23 of the 1916 Act, if the partnership were liquidated at this point X would receive \$1,000 as a creditor, L would receive \$1,000 with respect to capital, and G would receive \$1,000 as a creditor and \$1,000 with respect to capital.

⁶⁹ Although examination of the relationships between partners *inter se* generally is beyond the scope of this Article, a consideration of § 107 that ignored such relationships would be unrealistic.

⁷⁰ 1916 Act § 23(1).

⁷¹ 1976 Act § 804.

G's individual assets would total \$2,500. This amount would be more than sufficient to satisfy his liability to Y.

Under sections 107 and 804 of the 1976 Act, if the partnership were liquidated at this point X and G each would receive \$1,000 as creditors, and L and G each would receive \$1,000 with respect to capital. G's individual assets would total \$2,500. This amount would be more than sufficient to satisfy his liability to Y.

Thus, when both the partnership and the general partner are solvent, sections 107 and 804, although they alter the order of distribution of partnership assets, effect no real change of practical significance to the parties.

EXAMPLE 2

General Partner Insolvent, Partnership Solvent

Partnership Balance Sheet			
Assets	\$4,000	Liabilities to X	\$1,000
		Liabilities to G	1,000
		Capital, L	1,000
		Capital, G	1,000
		Retained earnings	0
	\$4,000		\$4,000

G owes Y, his individual creditor, \$3,000. In addition to his interest in the partnership and the \$1,000 owed him by the partnership, G has other individual assets totalling \$500.

Under sections 13 and 23 of the 1916 Act, if the partnership were liquidated at this point, X would receive \$1,000 as a creditor, L would receive \$1,000 with respect to capital, and G would receive \$1,000 as a creditor and \$1,000 with respect to capital. G's individual assets would total \$2,500. This amount would be insufficient to satisfy his liability to Y, with the result that Y would absorb a \$500 loss.

Under sections 107 and 804 of the 1976 Act, if the partnership were liquidated at this point, X and G each would receive \$1,000 as creditors, and L and G each would receive \$1,000 with respect to capital. G's individual assets would total \$2,500. This amount would be insufficient to satisfy his liability to Y, with the result that Y would absorb a \$500 loss.

Once again, if the partnership is solvent, the difference in order of distribution of the partnership assets has no practical significance. Y, G's individual creditor, bore the risk of G's personal insolvency and must absorb a loss of \$500 under either the 1916 Act or the 1976 Act.

EXAMPLE 3

General Partner Solvent, Partnership Insolvent

Partnership Balance Sheet			
Assets	\$1,000	Liabilities to X	\$1,000
		Liabilities to G	1,000
		Capital, L	1,000
		Capital, G	1,000
		Retained earnings	(3,000)
	\$1,000		\$1,000

G owes Y, his individual creditor, \$1,000. In addition to his interest in the partnership and

the \$1,000 owed him by the partnership, G has other individual assets totalling \$1,000.

Under sections 13 and 23 of the 1916 Act, if the partnership were liquidated at this point X would receive \$1,000 as a creditor. Because payment to X would entirely deplete the partnership assets, neither G nor L would receive any distribution from the partnership. G's individual assets would total \$1,000. This amount would be sufficient to satisfy his liability to Y.

Under sections 107 and 804 of the 1976 Act, if the partnership were liquidated at this point X and G each would receive \$500 as creditors. Because these payments would entirely deplete the partnership assets, G would receive no further distributions and L would receive no distributions whatsoever from the partnership. G's individual assets after the distribution would total \$1,500. This amount would be sufficient to satisfy his liability of \$1,000 to Y and also his personal liability for partnership obligations of \$500 to X.

Thus, X theoretically is not harmed by G's sharing in partnership assets as a creditor. X, however, will face the practical problem of recovering the \$500 from G. This may necessitate incurring the expenses of litigation and leaves open the possibility that the funds may be dissipated or otherwise lost during the interim.⁷² In such a situation, X would receive greater protection by petitioning to have the partnership adjudicated an involuntary bankrupt prior to any distribution of its assets.⁷³ If this is done X can be fully protected in either of two ways. First, if the partnership is adjudged bankrupt, the court may administer the estates of general partners even though they have not been adjudged individually bankrupt. This procedure is justified on the basis of the liability of a general partner's estate for partnership obligations.⁷⁴ To the extent that it exceeds individual obligations the general partner's estate may be considered a partnership asset subject to the jurisdiction of the bankruptcy court.

A second, more direct and less disruptive solution would be to subordinate G's claim against the partnership to X's claim. This procedure would allow payment of X's claim in full from the partnership assets and seems to be done almost as a matter of course by the bankruptcy courts.⁷⁵ Moreover, there is nothing in the 1976 Act to prevent subordination. In fact, this solution seems to be contemplated by the language of sections 107 and 804.⁷⁶

⁷² Where available, prejudgment attachment would reduce the danger of loss or dissipation.

⁷³ This course of action is open only if the partnership has committed an act of bankruptcy, as defined in § 3a of the Bankruptcy Act. Bankruptcy Act § 3a, 11 U.S.C. § 21(a) (1976).

⁷⁴ 1 W. LAUBE, W. HILL & L. KING, COLLIER BANKRUPTCY MANUAL ¶ 5.08, at 5-12 to -13 (rev. 1976); 2 R. ROWLEY & D. SIVE, ROWLEY ON PARTNERSHIP § 46.12, at 101-02 (2d ed. 1960).

⁷⁵ *Wallerstein v. Ervin*, 112 F. 124 (3d Cir. 1901); *In re Hess*, 1 F.2d 342 (W.D. Pa. 1923); *In re Effinger*, 184 F. 728 (D. Md. 1911); *In re Rice*, 164 F. 509 (E.D. Pa. 1908). In *Effinger* the firm and all general partners had been adjudged bankrupt. In arguing that a general partner's claim against the partnership estate for money advanced should not be subordinated to claims of other partnership creditors, an individual creditor of the general partner admitted that if the general partner were solvent subordination would be proper. In such a situation, any partnership assets distributable to the general partner would remain subject to the court's jurisdiction and to the claims of partnership creditors, which would make distribution a superfluous step. 184 F. at 733-34.

⁷⁶ Section 107 states that "subject to other applicable law," a partner who transacts business with the partnership has the same rights and obligations as a nonpartner. 1976 Act § 107. Section 804(1) provides that partnership assets shall be distributed first to creditors, including partners claiming as creditors, "to the extent permitted by law." *Id.* § 804(1). The draftsmen state, "Of course, other doctrines developed under bankruptcy and insolvency laws may require the subordination of loans by partners under appropriate circumstances." *Id.* § 107, Comment.

Even absent such an indication in the 1976 Act, it seems clear that in case of conflict, doctrines developed under federal bankruptcy law would control. See cases cited note 75 *supra*. *Wallerstein v. Ervin*,

EXAMPLE 4

General Partner Insolvent, Partnership Insolvent

Partnership Balance Sheet

Assets	\$1,000	Liabilities to X	\$2,000
		Liabilities to G	1,000
		Capital, L	1,000
		Capital, G	1,000
		Retained earnings	(4,000)
	<hr/>		<hr/>
	\$1,000		\$1,000

G owes Y, his individual creditor, \$1,000. In addition to his interest in the partnership and the \$1,000 owed him by the partnership, G has other individual assets totalling \$1,000.⁷⁷

Under sections 13 and 23 of the 1916 Act, if the partnership were liquidated at this point X would receive \$1,000 as a creditor. Because payment to X would entirely deplete the partnership assets, neither G nor L would receive any distribution from the partnership. X would have a claim of \$1,000 against G's individual assets, which, in turn, would consist of \$1,000 since G's claim against the partnership would be uncollectable. In this situation section 40 of the Uniform Partnership Act, which prescribes what is known as the dual priorities rule, becomes relevant. This rule states that partnership creditors have priority over individual creditors of a general partner with respect to partnership assets but that individual creditors have priority over partnership creditors with respect to the general partner's individual assets.⁷⁸ The effect of this rule is that G's \$1,000 of individual assets would be applied to satisfy Y's \$1,000 claim in full, with the result that X would absorb a \$1,000 loss.

Under sections 107 and 804 of the 1976 Act, if the partnership were liquidated at this point, X would receive \$666 as a creditor and G would receive \$333 as a creditor. Because these payments would entirely deplete the partnership assets, G would receive no further distributions and L would receive no distributions whatsoever from the partnership. G's individual assets after the distribution would total \$1,333. Under section 40(i) of the Uniform Partnership Act these assets would be applied first to satisfy Y's \$1,000 claim in full. The remaining \$333 would be applied to X's claim of \$1,333, with the result that X would absorb a \$1,000 loss.

Again, X theoretically is not harmed by the change in the law effected by the 1976 Act. X bore the risk of partnership insolvency and consequently will suffer a loss of \$1,000 under either the 1916 Act or the 1976 Act. As long as G's "other individual assets" are at least equal to his liabilities to individual creditors, X's rights are no less under the latter statute than under the former. X will, however, face the

112 F. 124 (3d Cir. 1901), expressly recognized the supremacy of federal bankruptcy law over state partnership law with regard to this issue.

The moneys advanced in excess of the amount agreed to be contributed were, it is true, in many, if not in all, instances, called "loans," and the merchandise supplied was no doubt regarded by the parties themselves as having been "sold," and it may well be conceded that upon any accounting between the partners the appellant would, after satisfaction of the firm debts, be entitled to priority of credit for its surplus advances of either kind; yet as the proof proposed would, if allowed, have reduced the fund to which the general creditors of the firm were constrained to look for the partial payment of their claims, the law imperatively required its rejection.

Id. at 125.

⁷⁷ G is designated as insolvent because he does not have sufficient assets to satisfy both his individual creditors and partnership creditors to the extent that their claims are not satisfied from partnership assets.

⁷⁸ UNIFORM PARTNERSHIP ACT § 40(b), (h), (i).

same practical problems regarding collection as were discussed in Example 3, and the same solutions are applicable.⁷⁹

EXAMPLE 5

General Partner Insolvent, Partnership Insolvent

Partnership Balance Sheet

Assets	\$1,000	Liabilities to X	\$1,000
		Liabilities to G	1,000
		Capital, L	1,000
		Capital, G	1,000
		Retained earnings	(3,000)
	<hr/>		<hr/>
	\$1,000		\$1,000

G owes Y, his individual creditor, \$1,000. In addition to his interest in the partnership and the \$1,000 owed him by the partnership, G has other individual assets totalling \$500.

Under sections 13 and 23 of the 1916 Act, if the partnership were liquidated at this point X would receive \$1,000 as a creditor. Because payment to X would entirely deplete the partnership assets, neither G nor L would receive any distribution from the partnership. G's individual assets would consist of \$500 since G's claim against the partnership would be uncollectable. This amount would be insufficient to satisfy Y's claim of \$1,000, with the result that Y would absorb a \$500 loss.

Under sections 107 and 804 of the 1976 Act, if the partnership were liquidated at this point X and G each would receive \$500 as creditors. Because these payments would entirely deplete the partnership assets, G would receive no further distributions and L would receive no distributions whatsoever from the partnership. G's individual assets after the distribution would total \$1,000. Against this amount Y would have a claim of \$1,000 and X would have a claim of \$500. The dual priorities rule would require that G's individual assets be applied first to Y's claim, with the result that X would absorb a \$500 loss.

It is apparent that when a general partner's "other individual assets" are insufficient to satisfy liabilities owing to his or her individual creditors and the partnership is insolvent, the combination of sections 107 and 804 and the dual priorities rule results in shifting the risk of his or her personal insolvency from individual creditors to the partnership creditors. This occurs because, to the extent that a general partner is permitted to share in a distribution of partnership assets on a pro rata basis with other partnership creditors, the partnership assets are converted into individual assets of the general partner over which his or her individual creditors have a prior claim.

The solution to this problem again may be found in bankruptcy law. Although section 5g of the Bankruptcy Act codifies the dual priorities rule,⁸⁰ section 5h provides for marshalling the assets of the bankrupt partnership and bankrupt general partner "to prevent preferences and secure the equitable distribution of the property of the several estates."⁸¹ In this case, subordination of G's claim against the partner-

⁷⁹ If both G and the partnership are adjudged bankrupt, the Bankruptcy Act specifically provides that any surplus of G's individual assets, after payment of individual creditors, will be applied to partnership debts. It further provides for marshalling of the respective estates to prevent preferences and to secure equitable distributions. Bankruptcy Act § 5g-h, 11 U.S.C. § 23(g)-(h) (1976).

⁸⁰ *Id.* § 5g, 11 U.S.C. § 23(g) (1976).

⁸¹ *Id.* § 5h, 11 U.S.C. § 23(h) (1976).

Under sections 13 and 23 of the 1916 Act, if the partnership were liquidated at this point L would receive \$1,000 as a creditor and \$1,000 with respect to capital. Similarly, G would receive \$1,000 as a creditor and \$1,000 with respect to capital. In contrast under sections 107 and 804 of the 1976 Act, if the partnership were liquidated at this point L and G each would receive \$1,000 as creditors and \$1,000 with respect to capital. As was the case in Examples 1 and 2, the 1976 Act has changed the order of distribution of partnership assets, but the change has no practical significance if the partnership is solvent and its capital is unimpaired.

EXAMPLE 7

Partnership Capital Impaired

Partnership Balance Sheet

Assets	\$3,000	Liabilities to L	\$1,000
		Liabilities to G	1,000
		Capital, L	1,000
		Capital, G	1,000
		Retained earnings	(1,000)
	<hr/>		<hr/>
	\$3,000		\$3,000

Under sections 13 and 23 of the 1916 Act, if the partnership were liquidated at this point L would receive \$1,000 as a creditor and \$1,000 with respect to capital. G would receive the remaining \$1,000 as a creditor and would absorb the full capital loss of \$1,000.

Under sections 107 and 804 of the 1976 Act, if the partnership were liquidated at this point L and G each would receive \$1,000 as creditors and \$500 with respect to capital. Each would absorb a capital loss of \$500.

The difference in result reflects an underlying difference in philosophy between the two Acts. Under the 1916 Act a limited partner enjoys not only limited liability but also a status roughly analogous to a preferred shareholder in a corporation. Upon liquidation he or she is entitled to a return of his or her capital intact before a general partner, the supplier of the primary risk capital, can share in the partnership assets in any way. The 1976 Act, in contrast, envisions a sharing of risk among general and limited partners. However, the operative provision, section 804(3), clearly states that its rule applies only if the partnership agreement does not provide otherwise.⁸⁴ Thus, there is sufficient flexibility to restore limited partners to a preferred status with respect to capital should the parties wish to do so. Section 804(2) includes a similar exception for accrued but unpaid interim distributions.⁸⁵

EXAMPLE 8

Partnership Insolvent

Partnership Balance Sheet

Assets	\$1,000	Liabilities to L	\$1,000
		Liabilities to G	1,000
		Capital, L	1,000
		Capital, G	1,000
		Retained earnings	(3,000)
	<hr/>		<hr/>
	\$1,000		\$1,000

⁸⁴ 1976 Act § 804(3); see *id.* § 804, Comment.

⁸⁵ *Id.* § 804(2).

Under sections 13 and 23 of the 1916 Act, if the partnership were liquidated at this point L would receive \$1,000 as a creditor and would absorb a \$1,000 capital loss. G would receive no distribution whatsoever from the partnership and would absorb losses of \$2,000.

Under sections 107 and 804 of the 1976 Act, if the partnership were liquidated at this point L and G each would receive \$500 as creditors. Each would absorb losses of \$1,500.

Once again the preferred status of the limited partner has been replaced by equality. The question remains whether, with respect to loans or advances, a limited partner can regain a preference over general partners by an appropriate provision in the partnership agreement. Unlike sections 804(2) and 804(3), section 804(1), the operative provision here, contains no express exception for a contrary ordering of priorities by means of a partnership agreement. Section 107, however, does contain such an exception.⁸⁶ This apparent conflict between sections 107 and 804(1) should be resolved in favor of section 107 for two reasons. First, there appears to be no rational basis for making a distinction, regarding the partners' relations on this issue *inter se*, among advances or loans, accrued but unpaid interim distributions, and capital contributions. In addition, the absence of an express exception in section 804(1) is explainable on the basis that it states a general rule applicable to all creditors, partners and nonpartners alike. It seems clear that the status of outside creditors should not be subject to being altered by a private agreement among partners. The absence of an express exception in section 804(1), therefore, should not be construed to preclude the possibility of giving a limited partner claiming as a creditor priority over a general partner with a similar claim.

In conclusion, it may be stated that the 1976 Act makes a fairly radical change in the priorities of limited partners vis-à-vis general partners. This change may be negated by private agreement, with the result that section 804 may operate essentially as a "default" provision, *i.e.*, it operates only if the partners fail to provide otherwise. At least by expressly validating provisions in partnership agreements that vary the statutory scheme of distribution, the 1976 Act introduces a flexibility that is lacking in the 1916 Act. On the other hand, one may question whether this desirable flexibility is outweighed by the change in the underlying statutory scheme. The new scheme clearly reflects a basic change in the philosophy of limited partnership law in the area of venture capital. No longer will general partners be the sole suppliers of the primary risk capital. Rather, risk will be apportioned among both general and limited partners.⁸⁷ Although the 1976 Act grants limited partners additional rights in the partnership affairs,⁸⁸ such investors will continue to remain relatively passive.⁸⁹ Moreover, in many limited partnerships, particularly large, commercial ones, the limited partners may not have sufficient leverage to obtain an

⁸⁶ *Id.* § 107.

⁸⁷ The risk is not truly equal, of course, because a limited partner enjoys limited liability while a general partner does not. It also should be recognized that the rough equality imposed by § 804 may be achieved under the 1916 Act by having the general partner occupy a dual status as both a general and a limited partner. 1916 Act § 12(2).

⁸⁸ *See, e.g.*, 1976 Act §§ 105, 305, 1001.

⁸⁹ The draftsmen of the 1976 Act clearly recognize the inactive nature of the limited partner's role. For example, they state, "In view of the passive nature of the limited partner's position, it has been widely felt that limited partners are entitled to access to certain basic documents, including the certificate of limited partnership and any partnership agreement." *Id.* § 105, Comment.

agreement altering section 804's scheme of distribution. In light of these considerations the wisdom of this change in the law appears at least questionable.

III. CERTIFICATE OF LIMITED PARTNERSHIP

Article 2 of the 1976 Act contains requirements relating to the execution, contents, and filing of the original certificate of limited partnership, amendments to the certificate, and cancellation of the certificate. It also contains a provision imposing liability for false statements appearing in any of these documents. Article 2 is of critical importance with respect to the relationship of the firm and its members to third parties. The certificate is significant not only in creating the limited partnership and establishing the basic rights and duties among the partners *inter se* but also in providing a source of information regarding these rights and duties to interested members of the public.

The following discussion will begin with a brief survey of the requirements governing formation of the partnership and contents of the original certificate. It then will proceed to a detailed examination of the duty to amend the certificate and liability for false statements appearing in the certificate.

A. Certificate of Limited Partnership

Formation of a limited partnership is accomplished by filing two copies of a certificate of limited partnership with the Secretary of State.⁹⁰ The certificate must be signed by all partners, both general and limited.⁹¹ Unlike the 1916 Act, section 201(b) of the 1976 Act specifically provides that the partnership is formed at the time of filing.⁹² Since the Secretary of State must note the filing date on both copies of the certificate, evidence of the time of formation should be readily available.⁹³ Section 201(b) also permits delayed effectiveness of the certificate, if for any reason that is desirable.⁹⁴

Section 201(a) lists twelve specific items that the certificate must contain.⁹⁵ These items are substantially similar to those required by the 1916 Act,⁹⁶ with a few deletions and some revisions in wording to make section 201 consistent with the terminology and concepts employed in the remainder of the 1976 Act.⁹⁷ The purpose, of course, is to provide creditors an opportunity to learn certain basic facts relating to the business, membership, and financial structure of the partnership.⁹⁸ The certificate constitutes constructive notice, however, only of the fact that the firm is a limited partnership and that the persons designated as limited partners are limited partners.⁹⁹

The items required to be included in the certificate may be divided into two

⁹⁰ *Id.* §§ 201(a), 206(a). After endorsement the Secretary of State is to return one copy to the partnership. *Id.* § 206(a)(3).

⁹¹ *Id.* § 204(a)(1). The 1976 Act further provides that "[t]he execution of a certificate by a general partner constitutes an affirmation under the penalties of perjury that the facts stated therein are true." *Id.* § 204(c). For a discussion of this provision, see text at notes 154-70 *infra*.

⁹² Compare 1916 Act § 2 with 1976 Act § 201(b).

⁹³ 1976 Act § 206(a)(1).

⁹⁴ *Id.* § 201(b).

⁹⁵ The certificate also may include "any other matters the partners determine." *Id.* § 201(a)(13).

⁹⁶ Compare *id.* § 201(a) with 1916 Act § 2(1)(a).

⁹⁷ 1976 Act § 201, Comment.

⁹⁸ *Id.*

⁹⁹ *Id.* § 208.

rough categories—those providing general information about the partnership, and those relating more specifically to its financial structure. Items in the first category are (1) the name of the partnership, (2) the general character of its business, (3) the address of its specified office and the name and address of its agent for service of process, (4) the name and business address of each partner, with the general partners and limited partners designated separately as such,¹⁰⁰ (5) any power of a limited partner, and the terms and conditions relating thereto, to grant an assignee of his or her partnership interest the right to become a limited partner, (6) any time at which or events upon the occurrence of which the partnership will be dissolved and its affairs wound up, and (7) any right of the remaining general partners to continue the business after withdrawal of a general partner.

The items relating to the financial structure of the partnership are (1) with respect to each partner, the amount of cash and a description and statement of the agreed value of any property or services contributed or to be contributed in the future,¹⁰¹ (2) with respect to each partner, the times at which or events upon the occurrence of which additional contributions are agreed to be made, (3) any agreed upon time at which or events upon the occurrence of which a partner may terminate his or her membership, the amount or method of determining the distribution respecting his or her partnership interest, and the terms and conditions of the termination and distribution, (4) the rights of the partners to receive distributions from the partnership, and (5) any right of a general partner to make, or of any partner to receive, distributions that include part or all of the partner's contribution.¹⁰²

It should be noted that many of the items relating to financial structure that in the 1916 Act applied only to limited partners, have been extended to all partners by the 1976 Act. The new approach seems preferable since the certificate will convey a more complete picture of the financial arrangement of the business as a whole. It also should be noted that neither Act contemplates that the certificate explicate all rights and duties of the partners *inter se*. The details of the partners' relationship are left to the partnership agreement, which, unlike the certificate, is a private document. In case of conflict between provisions of the certificate and those of an agreement, the former, being a public and statutory document, should control.

A limited partnership achieves *de jure* existence by substantial compliance with the requirements of section 201.¹⁰³ The doctrine of substantial compliance is a carry-over of the rule of the 1916 Act,¹⁰⁴ which itself was a significant liberalization of the law in effect prior to that time.

¹⁰⁰ A second function of the certificate and any amendments thereto is to fix the time a person becomes a partner. *Id.* §§ 101(5)-(6), 201, Comment, 301(b).

¹⁰¹ Although § 201(a)(5) of the 1976 Act, like 1916 Acr § 2(1)(a)VI, speaks in terms of "agreed value," not "actual value," the two have been construed as synonymous with respect to third parties who rely on the statement in the certificate. *Walraven v. Ramsay*, 335 Mich. 331, 55 N.W.2d 853 (1952). To the extent that the partners agree upon a value of property or services that differs from actual value, there is potential liability for a false statement in the certificate. *See* 1976 Acr § 207. The practical problems involved in valuing property and services, and thus the potential for falsity, may be great. Liability under § 207, however, is predicated on knowing falsity with respect to limited partners and either knowing or negligent falsity with respect to general partners. While these elements of culpability may alleviate the valuation problem to some extent, clearly § 207 does not go as far as analogous provisions in some corporation codes. *E.g.*, DEL. CODE ANN. tit. 8, § 152 (Supp. 1977) (judgment of directors concerning value of consideration for issuance of stock is conclusive absent actual fraud).

¹⁰² 1976 Acr § 201(a)(13) permits the certificate also to contain "any other matters the partners determine to include therein."

¹⁰³ *Id.* § 201(b).

¹⁰⁴ 1916 Acr §§ 1, Comment, 2(2).

Section 2(2) of the 1916 Act contains two independent elements—substantial compliance with the filing requirements and a good faith belief in compliance. Section 201(b) of the 1976 Act eliminates the element of good faith and retains only substantial compliance. This change seems desirable. Substantial compliance is an objective standard but good faith connotes a difficult subjective inquiry into the honesty of the partners in their attempt to comply with the filing requirements. If the purpose of these requirements is to impart notice of certain essential information to creditors, that purpose is fulfilled by substantial compliance regardless of the honesty of the partners. If the certificate is knowingly false or incomplete those who suffer loss have a remedy under section 207.¹⁰⁵ Unlike the possibly drastic consequences of nonformation of the limited partnership, the section 207 remedy is tailored to the magnitude of the wrong and operates only in favor of those whose loss is caused by it.¹⁰⁶ On the other hand, if the partners' actions do not even amount to substantial compliance with the filing requirements, there are significant policy reasons for imposing the more drastic consequence of unlimited liability to all third parties who deal with the firm. First, a limited partnership is a statutory creation and its existence depends upon the grant of a privilege by the state. Failure to comply with the statutory requirements precludes a claim of the privileged status accorded a limited partner. Second, if lack of substantial compliance constitutes a complete failure to file a certificate of limited partnership, the most common defect, no third party can be on notice that the business entity purports to be a limited partnership. In such a case there is no reason to require a third party to show his or her reliance on the belief that the defendant was a general partner; the reliance should be presumed.¹⁰⁷ If, however, there is substantial compliance with the filing requirements, third parties at least have notice that the business is a limited partnership and therefore have no cause to complain unless they have relied to their detriment on false statements appearing in the certificate. What constitutes substantial compliance, of course, will continue to be determined on a case by case basis.¹⁰⁸

¹⁰⁵ See text at notes 136-53 *infra*. It should be noted that § 207 specifically proscribes only false statements. It seems clear, however, that even if the statements contained in a certificate are technically true, the omission of information that might qualify the statements made can render them inaccurate and misleading. For this reason § 207 should and probably will be construed to apply to certificates of limited partnership that are incomplete in this sense. Cf. SEC Rule 10b-5(b), 17 C.F.R. § 240.10b-5(b) (1977) (making unlawful the omission of material facts necessary to make statements made not misleading).

¹⁰⁶ If there is no good faith substantial compliance with the filing requirements of § 2 of the 1916 Act, the limited partnership is not recognized vis-à-vis third parties. The result is that unless the limited partner promptly renounces his or her interest in the income of the business, under § 11 of the 1916 Act, he or she will be liable to third parties as a general partner. *Bisno v. Hyde*, 290 F.2d 560 (9th Cir. 1961) (dictum), *cert. denied*, 368 U.S. 959, *rehearing denied*, 369 U.S. 808 (1962); *Tiburon Nat'l Bank v. Wagner*, 265 Cal. App. 2d 991, 71 Cal. Rptr. 832 (1968); *Arrow Petroleum Co. v. Ames*, 128 Ind. App. 10, 142 N.E.2d 479 (1957); *Atlanta Stove Works, Inc. v. Keel*, 255 N.C. 421, 121 S.E.2d 607 (1961) (per curiam). It is unnecessary for the third party to plead or prove reliance. *Tiburon Nat'l Bank v. Wagner*, 265 Cal. App. 2d 991, 71 Cal. Rptr. 832 (1968).

¹⁰⁷ See text at notes 204-09 *infra*.

¹⁰⁸ The case law under the 1916 Act with respect to the substantial compliance issue is fairly meager. Many cases involve a complete failure to file, which clearly does not constitute substantial compliance. See cases cited note 106 *supra*. Between this extreme and absolute, literal compliance, the question should be decided with reference to the purpose of the filing requirement—notice to third parties. Thus, a slight misspelling of a name, cf. *Bowen v. Argall*, 24 Wend. 495 (N.Y. Sup. Ct. 1840) (decided under pre-1916 Act law), or a contribution by check rather than cash as stated in the certificate, *Henningsen v. Barnard*, 117 Cal. App. 2d 352, 255 P.2d 837 (1953), should not vitiate compliance. *But see Bergeson v. Life Ins. Corp. of America*, 170 F. Supp. 150 (D. Utah 1958), *aff'd in part and rev'd in part on other grounds*, 265 F.2d 277 (10th Cir.), *cert. denied*, 360 U.S. 932 (1959) (holding that signing but failing to swear to the certificate was not substantial compliance). On the other hand, major defects that impart notice, such as filing in the wrong place, should be held to preclude substantial compliance. Cf. *O'Connor*

B. Amendments and Civil Liability for False Statements

Section 202(a) of the 1976 Act provides that amendments of the certificate are to be effected by filing with the Secretary of State a certificate of amendment setting forth the name of the limited partnership, the date of filing of the certificate, and the amendment.¹⁰⁹ Unlike the original certificate, which must be signed by all partners,¹¹⁰ an amendment need be signed only by a single general partner and any other partner designated in the amendment as a new partner or as one whose contribution is stated as having been increased.¹¹¹

It is obvious that the partners may amend the certificate any time they wish to make a change in their relationship with respect to a matter governed by the certificate.¹¹² The more difficult issues relate to the circumstances under which the partners are obligated by law to amend the certificate and the consequences attendant upon their failure to do so. The following discussion first will describe the situation that exists under the 1916 Act and then will explore the changes introduced by the 1976 Act.

Section 24(2) of the 1916 Act states that the certificate shall be amended when (1) there is a change in the partnership's name, or in the amount or character of any limited partner's contribution, (2) a person is admitted as a substituted or additional limited partner, (3) a person is admitted as a general partner, (4) the business is continued after the death, retirement, or insanity of a general partner, (5) there is a change in the character of the partnership's business, (6) there is a false or erroneous statement in the certificate, (7) there is a change in the time for dissolution of the partnership or for return of a contribution, (8) if the original certificate does not fix a time for dissolution or return of a contribution, such a time is fixed, and (9) the partners desire to change any other statement in the certificate so that it accurately reflects the agreement among them.¹¹³

It should be noted that section 24(2) imposes a duty to amend when changes occur regarding certain items in the certificate but that the itemization in section 24 is not coextensive with the contents of the certificate as prescribed by section 2.¹¹⁴ Thus, section 24(2) does not require specifically that the certificate be amended when changes occur with respect to any of the following: (1) the location of the firm's principal place of business; (2) the residence of any of the partners; (3) the agreement, if any, of a limited partner to make additional contributions; (4) the share of profits to be received by each limited partner; (5) the right, if any, of a limited partner to designate his or her assignee as a substituted limited partner; (6) the right, if any, of the partners to admit additional limited partners; (7) the right, if any, of certain limited partners to priority over other limited partners; (8) the right, if any, of the remaining general partner to continue the business on

v. Graff, 186 App. Div. 116, 173 N.Y.S. 730 (1919), *aff'd mem.*, 230 N.Y. 552, 130 N.E. 890 (1920) (decided under pre-1916 Act law). In this regard, it might be noted that the 1976 Act's system of central, rather than local, filing should make compliance easier for the partners, but at the same time it probably will undercut the value of the certificate as a device for imparting actual notice to creditors.

¹⁰⁹ 1976 Act § 202(a).

¹¹⁰ *Id.* § 204(a)(1).

¹¹¹ *Id.* § 204(a)(2). The 1916 Act requires execution by all partners. If the amendment substitutes a limited partner it must be executed by both the incoming and outgoing limited partner. If it merely adds a limited or general partner it must be executed by the incoming partner. 1916 Act § 25(1)(b).

¹¹² See 1976 Act § 202(d); 1916 Act § 24(2)(j).

¹¹³ 1916 Act § 24(2).

¹¹⁴ Compare *id. with id.* § 2(1)(a).

the death, retirement, or insanity of a general partner; and (9) the right, if any, of a limited partner to receive property other than cash in return for his or her contribution.

The reason for this lack of specific correlation between the two sections is not clear. As many of the items omitted from section 24(2) concern only the relations of the partners *inter se*, the draftsmen may have felt that there was no need to impose a specific duty to amend. Not all of the omitted items are of this sort, however. For example, a change in the obligation of a limited partner to make future contributions could be very important to a potential creditor. Other similarly important examples include changes in the right of a remaining general partner to continue the business and the right of a limited partner to receive property other than cash in return for his or her contribution.¹¹⁵

It could be argued that a duty to keep the certificate currently accurate in all respects is imposed by section 24(2)(g)'s mandate to amend the certificate if it contains a false or erroneous statement.¹¹⁶ The difficulty with this construction is that it makes the remainder of section 24(2) superfluous.¹¹⁷ For this reason, it would seem that section 24(2)(g) relates only to statements in the certificate that were false at the time of filing rather than also to those that became false by reason of subsequent changes in circumstances.¹¹⁸ It would follow that, apart from the items mentioned specifically, section 24(2) imposes no general duty to keep the certificate current.¹¹⁹

However the duty to amend is construed, there remain to be considered the consequences flowing from breach of that duty. Section 24 itself imposes only the duty; it is silent regarding the consequences of breach. Section 6, imposing liability for false statements in the certificate, would appear to be the next logical point of focus. Section 6 provides,

If the certificate contains a false statement, one who suffers loss by reliance on such statement may hold liable any party to the certificate who knew the statement to be false.

- (a) At the time he signed the certificate, or
- (b) Subsequently, but within a sufficient time before the statement was relied upon to enable him to cancel or amend the certificate, or to file a petition for its cancellation or amendment as provided in Section 25(3).¹²⁰

Section 6 potentially is applicable to all partners because they all are parties to the certificate. As a practical matter, because a general partner is personally liable for partnership obligations regardless of the accuracy of the certificate, section 6 liability has been asserted primarily against limited partners.¹²¹ Unlike the situation prevailing prior to the 1916 Act,¹²² the plaintiff in a section 6 action must establish

¹¹⁵ Since the certificate should control over a contrary provision in a private agreement, it may be that legally effective changes in these items can be made only by an amendment to the certificate.

¹¹⁶ 1916 ACT § 24(2)(g). *Id.* § 24(2)(j) also may lend support to this view.

¹¹⁷ 2 R. ROWLEY & D. SIVE, *supra* note 74, § 53.24, at 592.

¹¹⁸ *Id.*

¹¹⁹ This reading is supported by 1976 ACT § 202, Comment, stating, Paragraph (c) makes it clear, as it was not clear under subdivision (2)(g) of former Section 24, that the certificate of limited partnership is intended to be an accurate description of the facts to which it relates at all times and does not speak merely as of the date it is executed.

¹²⁰ 1916 ACT § 6.

¹²¹ 2 R. ROWLEY & D. SIVE, *supra* note 74, § 53.6, at 566.

¹²² See *Abendroth v. Van Dolsen*, 131 U.S. 66 (1889).

more than a mere false statement appearing in the certificate. He or she also must prove actual reliance on the statement.¹²³ In addition, the damage for which plaintiff is seeking recovery must have been caused by such reliance.¹²⁴ Although there is no requirement of materiality with respect to the false statement, the elements of reliance and causation serve much the same purpose.¹²⁵ Finally, it must be established that the defendant knew the statement was false either at the time he or she executed the certificate or thereafter but within a sufficient time before the plaintiff's reliance to have enabled the defendant to take corrective action.¹²⁶

Liability under section 6 for false statements does not appear to be correlated directly to the duty to amend the certificate imposed by section 24(2). Section 6 speaks in terms of the certificate containing a false statement and then refers to two time periods—(a) the time at which the certificate was executed, and (b) subsequently. These periods, however, expressly relate to the defendant's knowledge of the falsity and not necessarily to the time at which the statement was or became false. Thus, section 6 could be read to apply only to statements false when the certificate was executed and not also to those becoming false due to a change in circumstances.¹²⁷ The objection to this construction is that it necessitates the conclusion that the 1916 Act provides no consequences for breach of the duty to amend, even as to the items specifically enumerated in section 24(2) (the only exceptions being sections 24(2)(g) and (h)).¹²⁸

Alternatively, it can be argued that statements originally true but becoming false by reason of a change in circumstances literally fall within the language of section 6. By hypothesis, at the time the plaintiff relied on the certificate, it must have contained a false statement. Although it would have been impossible for the defendant to have known of the falsity at the time he or she signed the certificate (because the statement was not false at that time), he or she may have acquired such knowledge "subsequently," at or after the change in circumstances. The objection to this reading, of course, is that unless section 24(2)(g) is construed similarly (*i.e.*, to impose a duty to amend the certificate for statements that become false because of a subsequent change in circumstances), the scope of liability under section 6 will be broader than the scope of the duty imposed by section 24(2).

The 1976 Act resolves some of the uncertainty inherent in the 1916 Act, but in so

¹²³ *Giles v. Vette*, 263 U.S. 553 (1924) (dictum); *Henningsen v. Barnard*, 117 Cal. App. 2d 352, 255 P.2d 837 (1953); *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, 80 A.2d 906 (Ct. App. 1951) (dictum); *Walraven v. Ramsay*, 335 Mich. 331, 55 N.W.2d 853 (1952).

¹²⁴ See cases cited note 123 *supra*.

¹²⁵ 2 R. ROWLEY & D. SIVE, *supra* note 74, § 53.6, at 566.

¹²⁶ *Walraven v. Ramsay*, 335 Mich. 331, 55 N.W.2d 853 (1952).

¹²⁷ See *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, ..., 80 A.2d 906, 911 (Ct. App. 1951); 2 R. ROWLEY & D. SIVE, *supra* note 74, § 53.6, at 566. *But see* *Lewis, The Uniform Limited Partnership Act*, 65 U. PA. L. REV. 715, 729 (1917).

¹²⁸ Section 24(2)(g) imposes a duty to amend if the certificate contains a false statement. A breach of this duty would result in § 6 liability, provided the plaintiff could establish the other elements of a cause of action under § 6. Section 24(2)(h) requires the partners to amend the certificate if there is a change in the time fixed for dissolution or for return of a contribution. 1916 ACT § 24(2)(h). If the term of the partnership as originally set in the certificate expires, it would seem that the partnership is dissolved unless the partners have amended the original certificate or have filed a new one. UNIFORM PARTNERSHIP ACT § 31(1)(a). If the partners continue the business without taking formal action to extend the term of the partnership, the limited partners run the risk of incurring personal liability as general partners unless, upon ascertaining the error, they promptly renounce their interests in the income of the business. 1916 ACT § 11; *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, 80 A.2d 906 (Ct. App. 1951); 2 R. ROWLEY & D. SIVE, *supra* note 74, § 53.24, at 591. *But see* *Vulcan Furniture Mfg. Corp. v. Vaughn*, 168 So. 2d 760, 764 (Fla. Dist. Ct. App. 1964).

doing it creates new problems, equally if not more difficult. Sections 202(b) and 202(c) of the 1976 Act impose affirmative duties with respect to amending the original certificate. Section 202(b) requires an amendment reflecting any of the four following events to be filed within thirty days after the occurrence of the event: (1) a change in the quantity or quality of a partner's contribution or a change in a partner's obligation to make a contribution; (2) the admission of a new partner; (3) the withdrawal of a partner; and (4) the continuation of the business after withdrawal of a general partner.¹²⁹ Section 202(e) provides that if the amendment is filed within thirty days of the occurrence of any of these four events, no person will incur liability with respect to the interim period between the occurrence of the event and the filing of the amendment.¹³⁰ In effect, if filed within thirty days of the event, the amendment will relate back to the time at which the event occurred.

Section 202(c) imposes on general partners a broad duty to amend, in the following terms:

(c) A general partner who becomes aware that any statement in a certificate of limited partnership was false when made or that any arrangements or other facts described have changed, making the certificate inaccurate in any respect, shall promptly amend the certificate, but an amendment to show a change of address of a limited partner need be filed only once every 12 months.¹³¹

These two sections make it clear that there is a continuing duty to keep the certificate current in light of changing circumstances.¹³² The exact scope of the duties imposed and the relationship between the two sections themselves, however, are less clear.

It appears that the draftsmen have segregated the four events listed in section 202(b) from all other events requiring amendment and have imposed special rules regarding them. The comment to section 202 states that these four events are "so central to the function of the certificate of limited partnership that they require prompt amendment."¹³³ This comment indicates that amendments reflecting the four events referred to in section 202(b), if filed within thirty days of the event's occurrence, will comply with the broader, overlapping promptness requirement of section 202(c). This conclusion also is supported by section 202(e)'s "safe harbor" and by the constructional maxim that specific language controls general.

It is significant that the thirty day time period of section 202(b) begins to run upon *occurrence* of one of the four specified events, whereas the promptness requirement of section 202(c) relates to the speed of a general partner's action after he or she first becomes *aware* of an inaccuracy in the certificate. While these two points in time often may coincide, that will not always necessarily be the case. If they do not coincide, the provisions of section 202(b), imposing an absolute duty with respect to the matters covered thereby, should control. For example, if the power is granted in the certificate of limited partnership, it is possible that through an assignment of his or her interest a limited partner could grant the assignee the right to become a limited partner, without the knowledge of any general partner.¹³⁴ If a general

¹²⁹ 1976 Act § 202(b).

¹³⁰ *Id.* § 202(e).

¹³¹ *Id.* § 202(c).

¹³² *Id.* § 202, Comment.

¹³³ *Id.*

¹³⁴ *See id.* §§ 301(a)(2), 704(a)(1).

partner became aware of this event twenty days after it occurred it would seem that he or she would have only ten additional days to cause an amendment to be filed.¹³⁵ If the amendment is not filed until the eleventh day after the general partner learned of the assignment, he or she will have breached his or her duty under section 202(b), notwithstanding that such action could be viewed as prompt within the meaning of section 202(c). If the general partner did not become aware of the assignment until thirty-one days after it occurred, a literal reading of section 202(b) requires the conclusion that its duty has been breached regardless of the speed with which the general partner acts thereafter.

Thus, in theory section 202(b) imposes a stricter duty to amend than does section 202(c). By making the event's occurrence, rather than a general partner's awareness, the operative feature, it also may be viewed as imposing a duty to keep informed concerning fundamental events affecting the partnership. The major consequence of breaches of these duties is an inability to rely on the "safe harbor" provision of section 202(e).

The nature of the duty to amend imposed by section 202(c), with regard to changes in circumstances other than those governed by section 202(b), is somewhat more nebulous. Corresponding with the view that these events are relatively less important to interested third parties, the duty theoretically is more lenient in two respects than that imposed by section 202(b). First, as already discussed, the duty to amend is triggered not by the occurrence of the event but by a general partner's awareness of such occurrence. Second, compliance with the duty is measured not by a strict thirty day time limit but by the promptness of the general partner's action.

Whether an amendment has been filed promptly will be a question of fact to be determined on a case by case basis. For this reason section 202(c), in some cases, could result in imposition of a *stricter* standard of conduct than section 202(b). For example, if the partners appointed a new agent for service of process and all general partners were aware of the appointment at the time it occurred, it might be determined that a deliberate twenty-nine day delay in filing an amendment did not constitute prompt action. On the other hand, it could be argued that action within thirty days of the event's occurrence satisfies the duty imposed by section 202(c) as a matter of law. The basis for this argument is the draftsmen's perception of events covered by section 202(c) as being less crucial than those covered by section 202(b). If a thirty day period, described in the comment as "prompt," is permitted under section 202(b), the leeway under section 202(c) should be at least as great.

An outer limit on the definition of "promptly" is suggested by the last clause of section 202(c), which requires amendments reflecting changes in addresses of limited partners to be filed only once every twelve months. This clause is drafted as an *exception* to the promptness requirement, possibly because the draftsmen believed the address of a limited partner to be the least important item of information to a third party. If this explanation is correct it would follow that as a matter of law, regardless of awareness, any other amendment filed twelve months or more after the occurrence of the event it reflects is not filed "promptly." Section 202(c), construed in this manner, may not be strictly logical, but it does make practical sense. That is, although awareness ordinarily is a subjective element, there is a point in

¹³⁵ The new limited partner also is required to execute the amendment. *Id.* § 204(a)(2).

time when it strains credulity for a general partner to plead ignorance. At this point it seems proper to remove the question from the realm of factual issues. Moreover, the question is purely academic unless specific consequences flow from breach of the duty imposed by section 202(c).

Unfortunately, the lack of correlation between duty and consequences that is present in the 1916 Act has been carried over into the 1976 Act. Like section 24(2) of the 1916 Act, section 202 fails to specify any consequences for failure to follow its mandate; and, like section 6 of the 1916 Act, section 207 of the 1976 Act imposes liability for false statements appearing in the certificate independent of the duties imposed by section 202. Section 207 provides,

If any certificate of limited partnership or certificate of amendment or cancellation contains a false statement, one who suffers loss by reliance on the statement may recover damages for the loss from:

- (1) any person who executes the certificate, or causes another to execute it on his behalf, and knew, and any general partner who knew or should have known, the statement to be false at the time the certificate was executed; and
- (2) any general partner who thereafter knows or should have known that any arrangement or other fact described in the certificate has changed, making the statement inaccurate in any respect within a sufficient time before the statement was relied upon reasonably to have enabled that general partner to cancel or amend the certificate, or to file a petition for its cancellation or amendment under Section 205.¹³⁶

Section 207 is similar to section 6 of the 1916 Act in that it retains the basic elements of falsity, culpability, reliance, and causation. Beyond this, section 207 clarifies and changes the law prevailing under the 1916 Act, but in doing so it creates some new problems. Sections 6 and 207 best can be compared by focusing on three points—the documents covered, liability for statements originally false, and liability for statements becoming false due to a change in circumstances.

Section 207 expressly applies to a false statement appearing in the certificate of limited partnership, a certificate of amendment, or a certificate of cancellation. Section 6 applies to false statements appearing in “the certificate,” a term used in the 1916 Act to designate the certificate of limited partnership. Section 6 also indirectly covers false statements appearing in a certificate of amendment since the certificate, as amended, is deemed to be “the certificate.”¹³⁷ Thus, the only extension of coverage made by section 207 in the area of documents affected is the addition of the certificate of cancellation. Because of the narrow scope of a certificate of cancellation, this extension probably will not be significant in many cases.¹³⁸

With respect to statements false at the time a certificate is executed, section 207 continues the rule of section 6 that all parties executing the certificate are potentially liable. In this connection it is important to note that while section 204 requires all partners to execute the original certificate of limited partnership,¹³⁹ it does not con-

¹³⁶ *Id.* § 207.

¹³⁷ 1916 Act § 25(6).

¹³⁸ The certificate of cancellation contains (1) the name of the limited partnership, (2) the filing date of the certificate of limited partnership, (3) the reason for filing the certificate of cancellation, (4) the effective date of cancellation, and (5) any other information the general partners wish to include. 1976 Act § 203.

¹³⁹ *Id.* § 204(a)(1).

tain similar requirements for the other two types of certificates. A certificate of amendment need be executed by only a single general partner and any other partner designated as a new partner or whose contribution is described as having been increased, and a certificate of cancellation need be executed by only the general partners.¹⁴⁰ This is a major change from the 1916 Act, which required all partners to execute all certificates.¹⁴¹ Since limited partners are required to execute fewer certificates under the 1976 Act, the mathematical probability of their incurring liability under section 207 should be reduced. The extent of this reduction should not be overestimated, however, because they still must be parties to the statements that are the most likely source of liability—those relating to their contributions.

An ambiguity in drafting leaves the situation of general partners less clear. The issue, more specifically, is whether a general partner who does not join in execution of an amendment potentially is liable for a false statement appearing in the certificate of amendment.

Section 207(1) describes the class of potential defendants as “any person who executes the certificate . . . and knew, and any general partner who knew or should have known, the statement to be false at the time the certificate was executed.”¹⁴² The problem stems from use of the broad phrase, “any person who executes the certificate,” followed by the more specific reference to general partners. The specific reference could be construed merely as modifying the broader initial description. Under this construction section 207(1) would confine liability to those who execute the certificate of amendment, the specific reference being simply the imposition of a broader standard of culpability with respect to general partners—knowledge of the false statement or negligent failure to discover it.¹⁴³ If this is what was intended it would have been more logical to draft section 207(1) as follows: “any limited partner who executes the certificate and who knew, and any general partner who executes the certificate and who knew or should have known the statement to be false at the time the certificate was executed.”

Thus, it may be that the specific reference to general partners was intended not only to impose a broader standard of culpability but also to impose liability on all general partners who possess the requisite mental state regardless of whether they were parties to the certificate of amendment. The specific reference is to *any* general partner. Moreover, the initial reference to “any person” clearly includes *both* limited partners and general partners who executed the certificate of amendment and who *knew* of the false statement. If the subsequent reference specifically to general partners was intended merely to impose a broader standard of culpability than that applicable to limited partners, it would have been unnecessary to repeat the word “knew.” If, however, in addition to establishing an alternative standard of culpability, the reference was intended to impose liability on nonexecuting general partners, the use of “knew” is both logical and necessary since such general partners

¹⁴⁰ *Id.* § 204(a)(2)-(3).

¹⁴¹ 1916 Act §§ 2(1)(a), 25(1)(b), (2).

¹⁴² 1976 Act § 207(1).

¹⁴³ Several states, in their versions of § 6 of the 1916 Act, already have broadened the standard of culpability to include negligence. DEL. CODE ANN. tit. 6, § 1706 (1974) (“any party to the certificate who knew or should have known the statement to be false”); KAN. STAT. ANN. § 56-127 (1976) (“any party to the certificate who knew or, by the exercise of ordinary diligence, should have known the statement to be false”); MO. ANN. STAT. § 359.060 (Vernon 1968) (“any party to the certificate who knew, or by the exercise of ordinary diligence should have known, the statement to be false”).

are not included within the phrase "any person who executes the certificate." This reading also is supported by the duty of all general partners under section 202(c) to correct statements that were false when made.

Once again, however, the construction is not wholly satisfactory because it too involves some unnecessary overlap between the two phrases. If this latter construction is the intended one it would have been more logical to draft section 207(1) as follows: "any limited partner who executes the certificate and who knew, and any general partner, whether or not he or she executes the certificate, who knew or should have known the statement to be false at the time the certificate was executed."¹⁴⁴

A final constructional problem raised by section 207(1) relates to execution of a certificate by an attorney-in-fact, a method of execution expressly permitted by the 1976 Act.¹⁴⁵ Section 207(1) provides that a person who suffers loss by reliance on a false statement in a certificate may recover damages from "any person who executes the certificate, or causes another to execute it on his behalf," and who possesses the requisite mental state.¹⁴⁶ It seems clear from this language that a limited partner who knows of a false statement cannot avoid liability by appointing an agent to execute the certificate for him or her. Such a result is in accord with general agency law.

The question of the agent's liability remains. Although in many cases the agent will be a general partner who is potentially liable on a personal basis, this need not necessarily be the case. Does section 207(1) impose liability on a nonpartner agent who executes a certificate on behalf of a partner if the certificate contains a false statement? At first glance, section 207(1) would seem to indicate a negative answer, but the comment to that section states, "Section 207 changes Section 6 of the prior uniform law by providing explicitly for the liability of persons who sign a certificate as agent under a power of attorney"¹⁴⁷ This conclusion can be reached by a literal reading of the statutory language. The agent is a "person who executes the certificate" (even though not on his or her own behalf), and if the agent "knew" of the false statement he or she will be liable to one who suffers loss by reliance on the certificate.

It should be noted that this liability is not based on the concept of an agent who aids or abets a partner's fraud. Rather, it is wholly independent and will attach regardless of whether the principal knew of the falsehood.

Section 207(2) makes it clear, as it is not clear under the 1916 Act, that liability also may arise by reason of statements originally true but that become false through a change in circumstances. It confines the class of potential defendants to general partners and thus is roughly correlative to section 202(c). The language regarding changes of circumstances that create the duty to amend or cancel the certificate also is substantially identical to that contained in section 202(c).¹⁴⁸ The major differences between these two sections relate to the state of mind of the general partner and the degree of speed with which he or she must take corrective action.

As previously discussed, section 202(c) states that a general partner has a duty

¹⁴⁴ In many cases, in light of a general partner's personal liability for partnership obligations, the point may be academic. See text at notes 152-53 *infra*.

¹⁴⁵ 1976 Act § 204(b).

¹⁴⁶ *Id.* § 207(1).

¹⁴⁷ *Id.* § 207, Comment.

¹⁴⁸ Compare *id.* § 202(c) ("any arrangements or other facts described have changed, making the certificate inaccurate in any respect") with *id.* § 207(2) ("any arrangement or other fact described in the certificate has changed, making the statement inaccurate in any respect").

to amend the certificate of limited partnership promptly after becoming aware of a change of circumstances making a statement in the certificate inaccurate. Awareness would seem to be a subjective test substantially the same as actual knowledge. Section 207(2) imposes liability on a general partner who knew or should have known of the change within a reasonably sufficient time before the plaintiff relied on the statement to have enabled the general partner to have taken corrective action. While this time period may be roughly equivalent to acting "promptly," the requisite state of mind under section 207(2) is very different from that under section 202(c). "Should have known" means that negligent failure to know is sufficient to sustain a cause of action under section 207(2) and makes liability possible even though the general partner was not "aware" of the change in circumstances. Section 207(2) thus imposes an independent duty to keep informed concerning partnership affairs that is not imposed by section 202(c) and that easily could result in liability even though the general partner may not have breached his or her duty to amend under section 202(c). The result is that section 207(2) in large part supersedes and renders superfluous section 202(c).

If a general partner is not negligent and takes prompt corrective action upon learning of the change of circumstances he or she should incur no liability even though a third party may have relied on the inaccurate statement in the interim. Section 207(2) defines a class of defendants. The class consists of those general partners who knew or should have known of the change within a reasonably sufficient time before reliance to have enabled them to have taken corrective action. If a general partner is not negligent and acts promptly after gaining knowledge of the change of circumstances, he or she does not fall within the class defined because he or she did not have sufficient time to take action that would have prevented the third party's reliance. In this regard section 202(c) coincides with and supports section 207(2).

Sections 202 and 207 are related in another respect. As previously discussed, section 202(b) requires that an amendment reflecting a change in a partner's contribution or obligation to make a contribution, the admission of a new partner, the withdrawal of a partner, or the continuation of the business after withdrawal of a general partner be filed within thirty days of the occurrence of the event.¹⁴⁹ Section 202(e) provides that "[n]o person has any liability because an amendment to a certificate of limited partnership has not been filed to reflect the occurrence of any event referred to in subsection (b) of this Section if the amendment is filed within the 30-day period specified in subsection (b)."¹⁵⁰

Although section 202(e) speaks in terms of relief from liability, the remainder of section 202 does not purport to impose liability. Therefore, to have any meaning, section 202(e) must relate to the liability imposed by section 207(2). In effect, section 202(e) creates a statutory conclusive presumption that, with respect to the four enumerated events, any period less than thirty days after the event's occurrence is not a sufficient time to learn of the event and to take corrective action. If an amendment is not filed within the thirty day period section 202(e) will not apply, but the defendant still should be given the opportunity to prove nonnegligent conduct and lack of sufficient time to correct before reliance. The burden probably will be heavy,

¹⁴⁹ *Id.* § 202(b).

¹⁵⁰ *Id.* § 202(e).

however, because of the fundamental nature of the events involved and because the specific duty imposed by section 202(b) will have been breached.

Two more points concerning the relationship between sections 202(e) and 207(2) are worthy of mention. First, the very existence of section 202(e) supports the conclusion that, with respect to changes in circumstances other than the four events specifically covered, a general partner should not incur liability for interim reliance if he or she acts reasonably and takes prompt corrective action. That is, since there is a specific statutory grace period for the four most fundamental and important events,¹⁵¹ a general partner at least should be given an opportunity to avoid liability premised on less important events by showing reasonable and prompt action. Second, since section 202(e) provides a statutory "safe harbor" regarding the four types of events most likely to form the basis of a cause of action under section 207(2), it may alleviate the effect of that section's imposition of liability for negligent conduct—provided that the negligence does not extend for a period greater than thirty days.

Finally, it seems at least questionable whether section 207, as a practical matter, significantly extends the law prevailing under section 6 of the 1916 Act. The liability of limited partners is confined to statements that are false when made and is premised upon knowing conduct. The only real extension with respect to limited partners is the expansion of documents covered to include certificates of cancellation.

Liability based on negligent conduct and liability for failure to amend or cancel in light of changed circumstances both are confined to general partners. In any action under section 207 the plaintiff must have suffered loss by reliance on the false or inaccurate statement. This usually will occur when the partnership has become insolvent. But in such cases, general partners will be personally liable for partnership obligations in any event regardless of the presence or absence of falsehoods in a certificate. Thus, although in rare cases section 207 could provide an additional source for satisfaction of third party claims that is not available under the 1916 Act,¹⁵² in most cases it will not. It may, however, have an effect on the sharing of losses between or among general partners if there are more than one.¹⁵³

C. Criminal Liability for False Statements

In addition to civil liability, both the 1916 and 1976 Acts raise the spectre of po-

¹⁵¹ *Id.* § 202, Comment.

¹⁵² *See, e.g.*, text following note 47 *supra*. Liability under § 207 for failure to amend the certificate apparently also could accrue after a general partner had withdrawn from the partnership and had given notice of his or her withdrawal pursuant to § 35 of the UNIFORM PARTNERSHIP ACT. Since a general partner's duty under § 207 is to amend the certificate when he or she knew or should have known that the certificate was inaccurate in any respect, it seems reasonable to conclude that this duty continues with respect to any statements in the certificate that were false prior to the general partner's withdrawal from the partnership. The general partner should not be able to relieve himself or herself of the duty to amend (and thereby escape liability to third parties who suffer loss by reliance on the false statements) merely by withdrawing from the partnership and giving notice of that withdrawal. Thus, a general partner who breaches the duty to amend prior to his or her withdrawal from the partnership should be liable to any third party who thereafter suffers loss by reliance upon the false statement in the certificate.

¹⁵³ General partners must share partnership losses and, absent an agreement to the contrary, they must share them equally. UNIFORM PARTNERSHIP ACT §§ 18(a), 40(a)II, (d). If one is forced to pay more than his or her share of a third party's claim, because partnership assets are insufficient, he or she has a right to contribution from the others. *Id.* A third party may have a claim against the partnership and also a cause of action under § 207 based upon the same transaction. If some general partners are innocent with respect to the false statement and some are culpable, the loss should fall on the latter. To the extent the innocent general partners must pay the claim as a partnership obligation they should be able to recover from the culpable general partners on the theory that § 207 indicates the latter should bear the loss. *Cf.* 1 R. ROWLEY & D. SIVE, *supra* note 74, § 18(a), at 463 (partner who causes loss by his or her bad faith, wrongdoing, or gross negligence must, as between partners, bear entire loss).

tential criminal liability with respect to false statements appearing in the various certificates. Section 2(1)(a) of the 1916 Act requires that all partners “[s]ign and swear to” the original certificate of limited partnership.¹⁵⁴ Section 25(1)(b) imposes a similar requirement for amendments.¹⁵⁵ Certificates of cancellation, however, need only be “signed” by the partners.¹⁵⁶

The swearing requirement contemplates an actual affidavit which, unlike an acknowledgment, guarantees the truth of the matters recited.¹⁵⁷ Thus, under the 1916 Act, false statements appearing in the original certificate of limited partnership or an amendment thereto carry with them potential criminal liability for perjury.¹⁵⁸ The rationale presumably is to insure further the accuracy of the contents of the certificates for the protection of third parties. It is impossible to determine whether the imposition of criminal sanctions has a significant impact on the achievement of this goal, and, therefore, reasonable people will differ regarding the necessity for their imposition. The legislatures of a number of states have altered the 1916 Act’s swearing requirement,¹⁵⁹ and corporate law on the analogous question of execution of articles of incorporation varies widely.¹⁶⁰

Section 204(c) of the 1976 Act provides that “[t]he execution of a certificate by a general partner constitutes an affirmation under the penalties of perjury that the facts stated therein are true.”¹⁶¹ This provision applies to certificates of cancellation as well as the original certificate of limited partnership and any certificates of amendment. Unlike the 1916 Act, section 204(c) does not contemplate a formal oath or affirmation. Rather, for the convenience of the signatories the mere informal act of signing the certificate “under the penalties of perjury” is a legally effective substitute for the formal oath or affirmation.¹⁶²

Substitution of the informal statement under penalties of perjury for the formal oath introduces some practical problems not present under the 1916 Act. Many of these problems stem from the lack of uniformity in criminal law among the states. For example, in some criminal codes the offense of perjury expressly is defined to include unsworn statements made under penalty of perjury but in others it is not.¹⁶³ Also, some codes differentiate between the offenses of perjury and false swearing, the former being confined to false testimony in formal proceedings and the latter

¹⁵⁴ 1916 Act § 2(1)(a).

¹⁵⁵ *Id.* § 25(1)(b).

¹⁵⁶ *Id.* § 25(2).

¹⁵⁷ *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, ..., 80 A.2d 906, 911 (1951); *Kratovil & Werner*, *supra* note 58, at 53.

¹⁵⁸ *E.g.*, KAN. STAT. ANN. § 54-105 (1976).

¹⁵⁹ CAL. CORP. CODE §§ 15502(1)(a), 15525(1)(b) (West 1977) (acknowledgment); HAW. REV. STAT. §§ 425-22, -45(a)(2) (1976) (acknowledgment); MD. CORP. & ASS’NS CODE ANN. §§ 10-102(a), -124(a)(2) (1975) (acknowledgment of certificate of limited partnership, simple signing of certificates of amendment); N.Y. PARTNERSHIP LAW §§ 91(1)(a), 114(1)(b) (McKinney 1948) (acknowledgment or swearing); PA. CONS. STAT. ANN. tit. 59 app., §§ 512(a)(1), 543(a)(2) (Purdon Supp. 1978) (simple signing); S.D. COMPILED LAWS ANN. §§ 48-6-2, -53 (1967) (acknowledgment of certificate of limited partnership, swearing to certificates of amendment); WASH. REV. CODE ANN. §§ 25.08.020(1), .250(1)(b) (1969 & Supp. 1977) (acknowledgment of certificate of limited partnership, swearing to certificates of amendment).

¹⁶⁰ Compare ARK. STAT. ANN. §§ 64-117(A)(1), (2), -501 (1966) (simple signing) with CAL. CORP. CODE § 200(b) (West 1977) (acknowledgment) and CONN. GEN. STAT. ANN. §§ 33-285(a), -289(a)(1) (West Supp. 1978) (swearing or statement under penalties of false statement).

¹⁶¹ 1976 Act § 204(c).

¹⁶² R. PERKINS, CRIMINAL LAW 456 (2d ed. 1969).

¹⁶³ Compare CAL. PENAL CODE § 118 (West 1970) with ILL. ANN. STAT. ch. 38, § 32-2(a) (Smith-Hurd 1977). *But see* *People v. Coleson*, 25 Ill. App. 3d 43, 322 N.E.2d 600 (1975) (stating that unsworn declaration expressly made under penalty of perjury satisfies oath or affirmation requirement).

applying to false statements in sworn written documents.¹⁶⁴ While these problems are not insurmountable, they will require careful consideration by individual legislatures in integrating section 204(c) with their criminal codes.

In replacing the formal oath with an informal statement under penalty of perjury, section 204(c) may create a further problem. A brief survey of administrative practice under the 1916 Act indicates an apparent lack of any widespread requirement among the states that official forms be used for limited partnership filings.¹⁶⁵ If privately prepared forms also are to be used under the 1976 Act, there is a very real possibility that many will omit an express declaration that the statements contained therein are made under the penalties of perjury. Although the language of section 204(c) does not seem to require the inclusion of such an express declaration, its omission could vitiate the criminal offense under some statutes.¹⁶⁶ On the other hand, if the simple act of signing a form omitting such a declaration constitutes an affirmation under penalties of perjury, there would seem to be real issues concerning fairness and notice to the signer.

The major substantive change effected by section 204(c) is its restriction of criminal sanctions to general partners. Assuming, *arguendo*, that such sanctions are desirable as a matter of policy, the reason for this restriction is not immediately apparent. By way of explanation, the draftsmen state that "[t]he former requirement that all certificates be sworn has been confined to statements by the general partners, recognizing that the limited partner's role is a limited one."¹⁶⁷ Unlike the 1916 Act, however, the 1976 Act already has recognized this limited role by requiring limited partners to execute only the original certificate of limited partnership and any amendments having a direct, significant, and personal effect on them.¹⁶⁸ It could be argued, therefore, that section 204(c)'s limitation is overly generous. Although a limited partner's knowledge of the partnership's affairs may not be extensive, there seems to be no reason why he or she should escape responsibility for statements directly affecting him or her that are known to be untrue. A limited partner's act of signing these statements is no less reprehensible than similar conduct by a general partner. Moreover, extension of sanctions to limited partners for those certificates of which they are required signatories would promote the deterrence objective of section 204(c).

The foregoing argument may be persuasive with respect to certificates of amendment directly affecting only a particular limited partner. It is much less persuasive when applied to the original certificate of limited partnership. The original certificate will contain statements regarding many things about which a limited partner

¹⁶⁴ *E.g.*, CONN. GEN. STAT. ANN. §§ 53a-156(a), -157(a) (West 1972); MODEL PENAL CODE §§ 241.1(1), .2(2) (Prop. Off. Draft 1962).

¹⁶⁵ Telephone interview with Susan Coulbourne, Corporation Division, Secretary of State of Delaware (July 21, 1978); Telephone interview with Roberta Coulter, Corporation Division, Secretary of State of Kansas (July 20, 1978); Telephone interview with Lawrence McNeil, Corporation Division, Secretary of Commonwealth of Massachusetts (July 21, 1978); Telephone interview with Rosemarie Cole, Corporation Division, Department of Commerce of Oregon (July 21, 1978); Telephone interview with Anne Lassiter, Corporation Bureau, Department of State of Pennsylvania (July 21, 1978); Telephone interview with Lisa Alston, Corporation Division, Secretary of State of Texas (July 21, 1978).

¹⁶⁶ *E.g.*, MODEL PENAL CODE § 241.3(2) (Prop. Off. Draft 1962). "A person commits a petty misdemeanor if he makes a written false statement which he does not believe to be true, *on or pursuant to a form bearing notice*, authorized by law, *to the effect that false statements made therein are punishable.*" *Id.* (emphasis added).

¹⁶⁷ 1976 ACT § 204, Comment.

¹⁶⁸ *Id.* § 204(a).

cannot be expected to have knowledge.¹⁶⁹ If section 204(c) required a limited partner to verify such statements under penalty of perjury, it would impose an undue and unrealistic burden of investigation upon a person who essentially is a passive investor.¹⁷⁰ In this light, section 204(c) may be seen as a sensible contraction of the rule prevailing under the 1916 Act.

IV. PROVISIONS RELATING TO LIMITED PARTNERS

Article 3 of the 1976 Act contains two sections having a major impact on the status of limited partners vis-à-vis creditors of the limited partnership. Section 303 is a refinement of section 7 of the 1916 Act, which provides that a limited partner may become liable as a general partner if he or she "takes part in the control of the business."¹⁷¹ Section 304, the analogue of section 11 of the 1916 Act, permits a person erroneously believing himself or herself to be a limited partner to escape personal liability in certain circumstances.

The problems of one who erroneously believes himself or herself to be a limited partner are both logically and practically related to the requirements governing the filing and amendment of a certificate of limited partnership and to liability for false statements appearing in a certificate. This is so because, in order to achieve de jure status as a limited partner, a person must be designated as a limited partner in a properly filed certificate of limited partnership.¹⁷² For this reason, the following discussion will treat these problems first before proceeding to examine the problems relative to participation in control.

A. Person Erroneously Believing Himself or Herself to Be a Limited Partner

There are numerous reasons why one seeking to become a limited partner in a de jure limited partnership may fail to accomplish that goal. The most common may be failure to comply substantially with the filing requirements regarding the original certificate of limited partnership, with the result that the firm fails to achieve de jure existence as a limited partnership. Even if the original certificate is filed properly, the person may not be listed as a limited partner, either by mistake (as to original limited partners) or oversight (as to subsequently admitted limited partners). Even if the certificate is filed properly and the person is listed as a limited partner, the firm thereafter technically may be dissolved, by expiration of its stated term or by the death or withdrawal of a general partner. In all of these types of cases, section 11 of the 1916 Act provides a method by which the limited partner¹⁷³ may avoid being held liable as a general partner.¹⁷⁴ Section 11 states,

A person who has contributed to the capital of a business conducted by a person or partnership erroneously believing that he has become a limited partner in a

¹⁶⁹ See *id.* § 201(a).

¹⁷⁰ A person may be convicted of perjury, even with respect to a true statement, if the person has no idea whether the statement is true or false. R. PERKINS, *supra* note 162, at 459-60.

¹⁷¹ 1916 ACT § 7.

¹⁷² 1976 ACT §§ 101(6), 201, 202(b)(2), 301(b); 1916 ACT §§ 2, 19(5), 24(2)(b), (c); see note 106 *supra*.

¹⁷³ For ease of reference the term "limited partner" will be used to describe the person erroneously believing himself or herself to be a limited partner.

¹⁷⁴ *Graybar Elec. Co. v. Lowe*, 11 Ariz. App. 116, 462 P.2d 413 (1969) (section 11 applies not only to cases in which parties unsuccessfully attempt to create limited partnership but also to those in which partnership validly formed but subsequently loses status as such). *But see* *Vulcan Furniture Mfg. Corp. v. Vaughn*, 168 So. 2d 760 (Fla. Dist. Ct. App. 1964) (dictum).

limited partnership, is not, by reason of his exercise of the rights of a limited partner, a general partner with the person or in the partnership carrying on the business, or bound by the obligations of such person or partnership; provided that on ascertaining the mistake he promptly renounces his interest in the profits of the business, or other compensation by way of income.¹⁷⁵

It seems clear from both the language of the statute and the interpretive case law that existence of a de jure limited partnership formed under the 1916 Act is not a condition precedent to reliance on section 11.¹⁷⁶ If it were, the section would lose much of its utility because, as previously noted, many cases will involve failure to comply substantially with the filing provisions regarding the original certificate. A requirement that the erroneous belief on the part of the limited partner be in good faith, however, seems implicit in section 11. Some courts appear to have assumed the existence of such a requirement,¹⁷⁷ and the one opinion specifically addressing the issue holds good faith to be a necessary element.¹⁷⁸ A contrary rule would subvert unduly the filing provisions. Finally, section 11 will not provide relief if the limited partner has violated some other liability-producing section of the 1916 Act, such as section 7's prohibition against participation in control.¹⁷⁹

Section 11 provides that to escape liability as a general partner, the mistaken limited partner, on ascertaining his or her mistake, promptly must renounce his or her "interest in the profits of the business, or other compensation by way of income."¹⁸⁰ Promptness is measured from the time the limited partner ascertains the error, not from the time the error was committed,¹⁸¹ and it has been held that a six month delay in acting does not constitute prompt renunciation.¹⁸² Since section 11 specifies no procedure for renunciation, the courts have had to grapple with the problem. Clearly, a written notice delivered to a creditor is sufficient as to that creditor.¹⁸³ A bill of sale, formally filed with the proper county official, conveying the limited partner's interest to the general partners also has been held sufficient.¹⁸⁴ Renunciations contained in pleadings filed in the course of judicial proceedings instituted by creditors have even been upheld.¹⁸⁵ These cases, of course, may present an issue concerning promptness, but many times the institution of an action will be a limited partner's first notice that something is amiss.

A lack of clarity in the language of section 11 has caused some difficulty with respect to what, exactly, the limited partner must renounce. More specifically, the question is whether he or she may renounce merely the interest in future profits

¹⁷⁵ 1916 Act § 11.

¹⁷⁶ *Giles v. Vette*, 263 U.S. 553 (1924); *Rathke v. Griffith*, 36 Wash. 2d 394, 218 P.2d 757 (1950).

¹⁷⁷ *In re Marcuse & Co.*, 281 F. 928, 936 (7th Cir. 1922), *aff'd sub nom. Giles v. Vette*, 263 U.S. 553 (1924). See *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, ..., 80 A.2d 906, 910 (1951).

¹⁷⁸ *J.C. Wattenbarger & Sons v. Sanders*, 191 Cal. App. 2d 857, ..., 13 Cal. Rptr. 92, 95 (1961).

¹⁷⁹ 1916 Act § 11 states, "A person who has contributed to the capital of a business . . . erroneously believing that he has become a limited partner in a limited partnership, is not, *by reason of his exercise of the rights of a limited partner*, a general partner . . ." (Emphasis added). *J.C. Wattenbarger & Sons v. Sanders*, 191 Cal. App. 2d 857, ..., 13 Cal. Rptr. 92, 94-95 (1961). See *Giles v. Vette*, 263 U.S. 553 (1924).

¹⁸⁰ 1916 Act § 11.

¹⁸¹ *Id.*; *In re Marcuse & Co.*, 281 F. 928, 936 (7th Cir. 1922), *aff'd sub nom. Giles v. Vette*, 263 U.S. 553 (1924).

¹⁸² *Vidricksen v. Grover*, 363 F.2d 372 (9th Cir. 1966).

¹⁸³ *Graybar Elec. Co. v. Lowe*, 11 Ariz. App. 116, ..., 462 P.2d 413, 416 (1969).

¹⁸⁴ *Rathke v. Griffith*, 36 Wash. 2d 394, ..., 218 P.2d 757, 764 (1950).

¹⁸⁵ *In re Marcuse & Co.*, 281 F. 928, 932, 935 (7th Cir. 1922), *aff'd sub nom. Giles v. Vette*, 263 U.S. 553 (1924); *J.C. Wattenbarger & Sons v. Sanders*, 216 Cal. App. 2d 495, ..., 30 Cal. Rptr. 910, 914 (1963).

or whether he or she also must forego or repay past profits already accrued or distributed. This question was noted by the Supreme Court in the leading case of *Giles v. Vette*,¹⁸⁶ but expressly was reserved because the limited partners voluntarily had undertaken the latter course of action.¹⁸⁷ It can be argued that section 11's use of the terms "renounce" and "interest" indicates an intent to look only to the future rather than to require a disgorging of profits already received.¹⁸⁸ One court has adopted this rationale, although under fairly limited circumstances.¹⁸⁹

The retroactive effect of a renunciation finally must be considered. Although section 11 does not speak directly to the point, the idea of retroactivity seems inherent in it. In view of the relative ease with which partners may correct defects in the filing or content of the certificate, section 11 would be of little value if its relief were prospective only.

Virtually all decisions under section 11 support the proposition that renunciation *may* displace accrued claims.¹⁹⁰ This is not to say, however, the renunciation always *must* displace such claims. A distinction easily could be made between plaintiffs who extended credit to the firm in reliance on the belief that the limited partner was a general partner and those who did not so rely.¹⁹¹ The cases to date appear to be making this distinction, although they all ultimately involve creditors of the second type.¹⁹² Such a distinction seems proper because section 11 essentially is an equitable relief provision. If a creditor does not rely on the belief that a limited partner is a general partner, a renunciation that is given retroactive effect merely prevents the creditor from receiving a windfall.¹⁹³ On the other hand, if the creditor believed the limited partner was a general partner and acted in reliance on that belief, the equities are not so clearly on the side of the limited partner. This construction of section 11 not only seems equitable but also harmonizes it with the law

¹⁸⁶ 263 U.S. 553 (1924).

¹⁸⁷ *Id.* at 563.

¹⁸⁸ 71 U. PA. L. REV. 150, 151 (1923).

¹⁸⁹ *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, ..., 80 A.2d 906, 910-11 (1951). In *Gilman*, a valid and current certificate of limited partnership was in effect at the time the limited partner withdrew profits from the firm. It was also more than four years before the plaintiff's extension of credit. The court concluded, "Under these circumstances at least, the appellee was not obliged to return the profits so received in order to claim the benefits of Section 11." *Id.* at ..., 80 A.2d at 911. The court expressly reserved the question of the effect of withdrawing profits after an extension of credit. *Id.* at ..., 80 A.2d at 910.

¹⁹⁰ See *In re Marcuse & Co.*, 281 F. 928 (7th Cir. 1922), *aff'd sub nom. Giles v. Vette*, 263 U.S. 553 (1924); *Graybar Elec. Co. v. Lowe*, 11 Ariz. App. 116, 462 P.2d 413 (1969); *J.C. Wattenbarger & Sons v. Sanders*, 216 Cal. App. 2d 495, 30 Cal. Rptr. 910 (1963); *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, 80 A.2d 906 (1951); *Rathke v. Griffith*, 36 Wash. 2d 394, 218 P.2d 757 (1950).

¹⁹¹ This distinction is supported by 1916 Acr § 1, Comment at 564 which states, "No public policy requires a person who contributes to the capital of a business . . . to become bound for the obligations of the business; provided creditors have no reason to believe at the times their credits were extended that such person was so bound."

¹⁹² See cases cited note 190 *supra*. *J.C. Wattenbarger & Sons v. Sanders*, 191 Cal. App. 2d 857, 13 Cal. Rptr. 92 (1961), involved an appeal by plaintiff from an order granting summary judgment for the defendant limited partner. Plaintiff's affidavit in opposition to summary judgment averred reliance on the belief that defendant was a general partner. The court held that factual issues were presented involving the good faith of defendant's belief in his status as a limited partner. It therefore reversed and remanded for trial. *Id.* at ..., 13 Cal. Rptr. at 92-93. Although the factual issues ultimately were resolved in favor of defendant, *J.C. Wattenbarger & Sons v. Sanders*, 216 Cal. App. 2d 495, 30 Cal. Rptr. 910 (1963), the case seems to indicate that had reliance been established as a fact, plaintiff might have prevailed, notwithstanding defendant's renunciation.

¹⁹³ *Giles v. Vette*, 263 U.S. 553, 561 (1924). "To hold them liable as general partners would give creditors what they are not entitled to have, and would impose on Hecht and Finn burdens that are not theirs to bear." *Id.*

of partnership by estoppel.¹⁹⁴ The two areas are obviously closely related and both may be involved in a given case.¹⁹⁵ If section 11 would not be a defense to an express claim of partnership by estoppel,¹⁹⁶ the renunciation should be given retroactive effect only in cases in which the plaintiff did not act in reliance on the belief that the limited partner was a general partner.

The 1976 Act, in section 304, retains the general scheme of section 11, but provides greater detail in the hope of resolving some of the problems discussed above. Section 304 provides,

(a) Except as provided in subsection (b), a person who makes a contribution to a business enterprise and erroneously but in good faith believes that he has become a limited partner in the enterprise is not a general partner in the enterprise and is not bound by its obligations by reason of making the contribution, receiving distributions from the enterprise, or exercising any rights of a limited partner, if, on ascertaining the mistake, he:

(1) causes an appropriate certificate of limited partnership or a certificate of amendment to be executed and filed; or

(2) withdraws from future equity participation in the enterprise.

(b) A person who makes a contribution of the kind described in subsection (a) is liable as a general partner to any third party who transacts business with the enterprise (i) before the person withdraws and an appropriate certificate is filed to show withdrawal, or (ii) before an appropriate certificate is filed to show his status as a limited partner and, in the case of an amendment, after expiration of the 30-day period for filing an amendment relating to the person as a limited partner under Section 202, but in either case only if the third party actually believed in good faith that the person was a general partner at the time of the transaction.¹⁹⁷

Section 304(a) essentially refines section 11 and adds an alternative means to escape unrestricted liability as a general partner. Use of the phraseology "business enterprise" should make it clear that section 304 potentially will apply to a person who believes he or she has become a limited partner in a limited partnership, regardless of the actual form of organization. The element of good faith, implicit in section 11, has been made explicit. The past versus future profits problem has been resolved, since a person will not be liable as a general partner "by reason of . . . receiving distributions from the enterprise," provided he or she "withdraws from future equity participation in the enterprise."¹⁹⁸ By retaining section 11's reference to exercising the rights of a limited partner, section 304 also limits its applicability to liability based solely on failure to become a *de jure* limited partner. Although section 304(a) omits section 11's promptness requirement, the potential for liability under section 304(b) ought to insure relatively speedy action.

¹⁹⁴ UNIFORM PARTNERSHIP ACT § 16.

¹⁹⁵ See *Giles v. Vette*, 263 U.S. 553 (1924); *Graybar Elec. Co. v. Lowe*, 11 Ariz. App. 116, 462 P.2d 413 (1969); *J.C. Wattenbarger & Sons v. Sanders*, 216 Cal. App. 2d 495, 30 Cal. Rptr. 910 (1963). If the limited partnership is defective and the limited partner fails to renounce, he or she will be liable as a general partner regardless of whether the elements of partnership by estoppel are present. *But see* *Vulcan Furniture Mfg. Corp. v. Vaughn*, 168 So. 2d 760 (Fla. Dist. Ct. App. 1964).

¹⁹⁶ *J.C. Wattenbarger & Sons v. Sanders*, 191 Cal. App. 2d 857,, 13 Cal. Rptr. 92, 94-95 (1961); see *Giles v. Vette*, 263 U.S. 553, 561 (1924).

¹⁹⁷ 1976 Act § 304.

¹⁹⁸ *Id.* § 304(a)(2). It should be noted that § 304, by permitting a person to receive distributions from the enterprise and still avoid general partner liability, goes further than the existing case law under the 1916 Act. See note 189 *supra*.

As previously discussed, section 11 of the 1916 Act is silent with respect to the procedure to be followed in renouncing one's interest. Section 304 attempts to cure this defect by substituting "withdraws" for "renounces." Since section 202 specifies withdrawal of a partner as one of the events requiring amendment of the certificate of limited partnership,¹⁹⁹ and since section 304(b) expressly refers to a certificate showing withdrawal, this simple change in terminology appears to provide a definite procedure for the limited partner who chooses this avenue of escape.

In order to assess the value of this procedure, it first is necessary to note that section 304(a) provides an alternative means of escape from general liability. Rather than withdrawing, the limited partner may "[cause] an appropriate certificate of limited partnership or a certificate of amendment to be executed and filed."²⁰⁰ The orientation of section 304 is thus very different than that of section 11. While section 11 "is not designed to amend or correct or perfect the limited partnership organization, so that it may thereafter continue as such, but looks rather to termination of the relation,"²⁰¹ section 304 looks either to perfection or termination, at the option of the limited partner.

In light of this new ability to correct defects and continue in the business without incurring unrestricted liability as a general partner, it would seem that withdrawal would be a more attractive alternative only in relatively few types of cases, principally those in which the business is defunct, or nearly so, at the time the limited partner discovers the defect. In addition, if the defect consists of either failure to file the certificate of limited partnership or, if properly filed, failure to name the limited partner in any capacity whatsoever, filing an amendment to reflect withdrawal would not seem to make sense. In the first case there will be no document of record to which the amendment relates, and in the second there will be no indication of record that the person purporting to withdraw ever was a participant in the business. In these cases, the more logical course would be to take corrective action under section 304(a)(1). If the defect consists of the limited partner's being listed in a properly filed certificate as a general partner, or of continuing the business after a technical dissolution of the firm, an amendment evidencing withdrawal at least can be integrated sensibly with previously filed documents. Again, however, unless the business is failing, action under section 304(a)(1) would seem the logical choice.

These kinds of problems could cause one to question the validity of the original premise—that section 304(a) contemplates the filing of a certificate of amendment to effectuate withdrawal. It could be argued that, on the contrary, a literal reading of the section indicates that effective withdrawal is not conditioned upon such an amendment. The argument is that section 304(a)(2) simply speaks of withdrawal, making no mention of an amendment. Section 304(a)(1), of course, does refer to amendments as a form of corrective action, but the disjunctive, "or," connecting the two subsections clearly indicates they are to be alternatives. Although section 304(b) requires the filing of a certificate evidencing withdrawal, this section, unlike section 304(a), applies only to a restricted class of creditors to whom the limited partner may be liable—those who, at the time of extending credit, actually believed in good

¹⁹⁹ 1976 ACT § 202(b)(3).

²⁰⁰ *Id.* § 304(a)(1).

²⁰¹ *In re Marcuse & Co.*, 281 F. 928, 936 (7th Cir. 1922), *aff'd sub nom.* *Giles v. Vette*, 263 U.S. 553 (1924).

faith that the limited partner was a general partner.²⁰² As to third parties potentially within this more restricted class, requiring an amendment to reflect withdrawal may make somewhat more sense.²⁰³ Thus, it could be concluded that, with the exception of cases falling within subsection (b), section 304 prescribes no definite procedure to be followed by a limited partner seeking to withdraw.

Section 304(b), alluded to in the previous discussion, attempts to resolve a question left open by section 11 of the 1916 Act—the retroactive effect of remedial action taken by a person erroneously believing himself or herself to be a limited partner. The following discussion will focus on two major points—first, the class of creditors affected; and second, the time frame within which the limited partner must take remedial action.

Section 304(a) states a general rule—that a person erroneously believing himself or herself to be a limited partner will not be liable as a general partner if he or she causes a certificate of limited partnership or a certificate of amendment to be executed and filed, or, alternatively, withdraws from future equity participation in the enterprise. If the limited partner²⁰⁴ undertakes neither of these actions he or she potentially will be liable to all firm creditors, past, present, and future, regardless of whether they knew of the existence of the limited partner or relied on the belief that he or she was a general partner. Section 304(b) is a direct limitation on section 304(a).²⁰⁵ It provides that, notwithstanding any corrective action taken by a limited partner, he or she will remain liable as a general partner with respect to any third party who transacted business with the enterprise, prior to the corrective action, actually believing in good faith that the limited partner was a general partner.²⁰⁶

The test of section 304(b) regarding the type of creditor whose accrued claim is protected closely approximates the test previously discussed in connection with the 1916 Act.²⁰⁷ Unlike both that test and the law of partnership by estoppel, however, section 304(b) does not require explicitly that the creditor act in reliance on the belief that the limited partner is a general partner. The absence of such a requirement probably is an improvement. In the partnership by estoppel area, for example, it is not clear whether the reliance element necessitates proof by the plaintiff that he or she would not have extended credit but for the belief that the defendant was a general partner. Because of the difficulties of proof involved in such “but for” causation, it has been suggested that a rebuttable presumption of reliance should arise upon a showing that the defendant was held out to the plaintiff as a partner and that the plaintiff, with knowledge of the holding out, extended credit to the enterprise.²⁰⁸ This essentially is what section 304(b) does, although the presumption does not appear to be rebuttable. If the creditor actually believes in good faith that the limited partner is a general partner and if this belief coincides with the transac-

²⁰² 1976 Act § 304(b).

²⁰³ Even in these cases the intended notice to be provided by the amendment often may be illusory. For example, if a third party who is considering extending credit to the firm believes the limited partner is a general partner in a general partnership and the defect consists of a total failure to file a certificate of limited partnership, an amendment reflecting withdrawal of the limited partner will be of little value.

²⁰⁴ See note 173 *supra*.

²⁰⁵ Section 304(a) begins by stating, “Except as provided in subsection (b) . . .” 1976 Act § 304(a).

²⁰⁶ *Id.* § 304(b). The timing of the corrective action in relation to the transaction of business is subject to some intricate refinements discussed in the text at notes 214-34 *infra*.

²⁰⁷ See text at notes 190-96 *supra*.

²⁰⁸ Painter, *Partnership by Estoppel*, 16 VAND. L. REV. 327, 333-35 (1963).

tion of business, it seems probable that the creditor is to some extent relying on the limited partner's association with the enterprise.²⁰⁹

It is interesting to note that in this respect section 304(b) seems more lenient from the plaintiff's point of view than section 207. Under the latter, in order to recover on the basis of a false statement in a certificate, the plaintiff must prove a loss suffered by reliance on the statement.²¹⁰ Since the two sections are somewhat related and may even overlap in certain factual patterns, the difference in standards seems incongruous. For example, assume that a limited partner is listed erroneously as a general partner in a properly filed certificate of limited partnership and that a creditor institutes litigation seeking to impose personal liability on the limited partner. To rely on the affirmative defense of section 304, the defendant must establish that he or she made a good faith error²¹¹ and that he or she took remedial action under section 304. The plaintiff then will have the burden of proving merely that he or she extended credit, before the remedial action was taken, in the good faith belief that the limited partner was a general partner. To succeed under section 207, however, the plaintiff must show that he or she suffered a loss by reliance on the listing of the limited partner as a general partner, which necessarily will involve an extension of credit prior to any remedial action,²¹² and that the defendant knew of the erroneous listing at the time the certificate was executed.²¹³ It would appear, then, that the plaintiff's case is more burdensome under section 207 (in which the limited partner is more culpable) than under section 304 (in which the limited partner is less culpable).

To this point, section 304(b)'s most difficult constructional problems have been finessed by use of the phraseology "remedial action" or "corrective action." The problems involve the two types of remedial action a limited partner may take, and the relationship between the time at which such action is taken and the time at which the third party transacts business with the enterprise. It further involves interplay between sections 202 and 304(b).

Section 304(b) states that the limited partner will remain liable to a third party who transacts business with the enterprise believing in good faith that the limited partner is a general partner, provided that the transaction occurs

- (i) before the person [limited partner] withdraws and an appropriate certificate is filed to show withdrawal, or
- (ii) before an appropriate certificate is filed to show his status as a limited partner and, in the case of an amendment,

²⁰⁹ *Id.* at 335.

²¹⁰ 1976 ACT § 207.

²¹¹ Since "good faith" is a subjective standard, it would seem possible to comply with § 304(a) even though the limited partner is a required signatory of the certificate of limited partnership.

²¹² It would be possible for a third party to rely on the erroneous listing even after it had been corrected if he or she were aware of the original listing but unaware of the correction. While the situation is not completely free of doubt, such reliance might be insufficient to form the basis of a cause of action under § 207. First, depending upon the length of time between each of the three critical events (examination of the original certificate, correction, and extension of credit), such reliance might not be reasonable. In addition, § 208 provides, "The fact that a certificate of limited partnership is on file in the office of the Secretary of State is notice that the partnership is a limited partnership and the persons designated therein as limited partners are limited partners . . ." 1976 Act § 208. *But see id.* § 208, Comment, which states, "[T]he notice provided is not intended to change any liability of a limited partner which may be created by his action or inaction under the law of estoppel, agency, fraud, or the like." Perhaps the question ultimately will be resolved by concluding reliance is legally possible notwithstanding correction but that the reliance must be reasonable, reasonableness being a question of fact in each case. Fortunately, resolution is not necessary to the point discussed in the text.

²¹³ *Id.* § 207(1).

after expiration of the 30-day period for filing an amendment relating to the person as a limited partner under Section 202²¹⁴

The problems raised by this rather tortured language derive chiefly from its ambiguous reference to the thirty day period of section 202. It will be recalled that section 202(b) requires an amendment reflecting a change in a contribution or an obligation to make a contribution, the admission of a new partner, the withdrawal of a partner, or the continuation of the business after withdrawal of a general partner to be filed within thirty days of the occurrence of the event.²¹⁵ Section 202(e) further provides that "[n]o person has any liability because an amendment to a certificate of limited partnership has not been filed to reflect the occurrence of any event referred to in subsection (b) of this Section if the amendment is filed within the 30-day period specified in subsection (b)."²¹⁶ The construction of section 304(b), and its interplay with sections 202(b) and (e) best can be discussed by a series of examples. In each example, the question, of course, is whether the limited partner can avoid liability to a third party transacting business with the enterprise under the good faith belief that the limited partner is a general partner.

EXAMPLE 1

The enterprise is a de jure limited partnership formed by the proper filing of a certificate of limited partnership. L is a new, incoming limited partner. She is admitted to the firm on day 1, and an amendment to the certificate of limited partnership to reflect L's admission and status is filed on day 25. X, a third party, extends credit to the firm on day 35, believing in good faith that L is a general partner.

It is clear that L is not liable to X. In fact, the case does not even fall under section 304 because at the time X extended credit, L was a de jure limited partner.²¹⁷ Even if this were not true, L would be protected by section 304(b)(ii) because X did not transact business before the certificate of amendment was filed indicating L's status as a limited partner. The same result would be reached for the same reasons if the amendment were filed on day 35 and X extended credit on day 40.

EXAMPLE 2

The enterprise is a de jure limited partnership formed by the proper filing of a certificate of limited partnership. L is a new, incoming limited partner. She is admitted to the firm on day 1, and an amendment to the certificate of limited partnership to reflect L's admission and status is filed on day 40. In the interim, X, a third party, extends credit to the firm on day 35, believing in good faith that L is a general partner.

It is clear that L is liable to X. At the time X extended credit, L was not a de jure limited partner. L is not protected by section 304(b)(ii) because X transacted business before the certificate of amendment was filed and after expiration of the thirty day period of section 202(b).

EXAMPLE 3

The enterprise is a de jure limited partnership formed by the proper filing of a certificate of limited partnership. L is a new, incoming limited partner. She is admitted to the

²¹⁴ *Id.* § 304(b).

²¹⁵ *Id.* § 202(b).

²¹⁶ *Id.* § 202(e).

²¹⁷ *Id.* § 101(6).

firm on day 1, and an amendment to the certificate of limited partnership to reflect L's admission and status is filed on day 25. In the interim, X, a third party, extends credit to the firm on day 15, believing in good faith that L is a general partner.

It is clear that L is not liable to X. Although L was not a de jure limited partner at the time X extended credit, she is protected by section 304(b)(ii). While X transacted business before the certificate of amendment was filed, such transaction was not after expiration of the thirty day period of section 202(b). This would seem to be the paradigm case contemplated by section 304(b)(ii). The membership of a modern, commercial limited partnership may change with some frequency, and it is impossible to keep the certificate of limited partnership current on a daily basis. Section 202(b) recognizes this impossibility and reaches a compromise between it and the interest of third parties in the make-up of the firm by mandating that amendments reflecting changes in membership be filed within thirty days of the change. This compromise is reinforced by section 202(e)'s provision that no person shall be liable on the basis of failure to file such an amendment if the amendment, in fact, is filed within the thirty day period. As previously discussed, section 202(e) seems to be referring to liability asserted against general partners under section 207(2) for failure to keep the certificate current.²¹⁸ This delicate balance would be upset, however, if a third party, rather than proceeding under section 207(2), could impose liability on the incoming limited partner by claiming that he or she did not have de jure status at the time credit was extended. Thus, section 304(b)(ii) preserves the compromise by providing that a limited partner will not be vulnerable to such a claim unless credit was extended prior to the filing of the amendment and after expiration of section 202's thirty day period.²¹⁹

EXAMPLE 4

The enterprise is a de jure limited partnership formed by the proper filing of a certificate of limited partnership. L is a new, incoming limited partner. She is admitted to the firm on day 1, and an amendment to the certificate of limited partnership to reflect L's admission and status is filed on day 35. In the interim, X, a third party, extends credit to the firm on day 15, believing in good faith that L is a general partner.

It is not clear whether L is liable to X. At the time X extended credit, L was not a de jure limited partner, but L may be protected by a literal reading of section 304(b)(ii). This section essentially is a description of a class of creditors to whom a person who erroneously believes himself or herself to be a limited partner will remain liable, notwithstanding any corrective action taken. The description relevant to the facts of this example is

any third party who transacts business with the enterprise . . . before an appropriate certificate is filed to show [the limited partner's] status as a limited partner and, in the case of an amendment, after expiration of the 30-day period for filing an amendment relating to the person as a limited partner under Section 202²²⁰

X literally does not fall within this description because he transacted business with

²¹⁸ See text at notes 149-51 *supra*.

²¹⁹ Because § 202(e) states that "[n]o person" shall have "any liability" it seems broad enough to repel a claim of the type discussed in the text. In this respect, § 304(b)(ii) may be just a cautious redundancy, at least in this context.

²²⁰ 1976 Acr § 304(b)(ii).

the enterprise before expiration of the thirty day period rather than after it. Stated differently, section 304(b)(ii), unlike section 202(e), does not require expressly that the amendment be filed within the thirty day period.

It is impossible to determine whether this omission is intentional. In terms of policy considerations, the question, in effect, is whether this example is more like Example 2 or Example 3. On the one hand, it can be argued that if a thirty day filing period is a reasonable compromise between the competing interests of partners and outsiders, allowing L to escape liability here would violate the terms of the compromise. In other words, this example is more like Example 2 than Example 3, the only difference being the purely fortuitous early extension of credit by X. In Example 3, X's interest was sacrificed on grounds of practicality and fairness to incoming limited partners. Those considerations by definition are absent in the present case, as is the necessity for sacrifice. On the other hand, it can be argued that the partners' late filing in this example is just as fortuitous as the time at which X extended credit. Since both events are equally fortuitous, and since section 304(b)(ii) literally does not require filing of the amendment within thirty days, any doubts in construing this remedial provision should be resolved in favor of the limited partner.

On balance, it is submitted that L should not be able to avoid liability to X. There seems to be no reason why filing within thirty days should be a condition precedent to relief under section 202(e) and not under section 304(b)(ii). Perhaps this result could be reached by construing the reference to section 202 as including the requirement that the amendment be filed within thirty days.

EXAMPLE 5

The enterprise is a de jure limited partnership formed by the proper filing of a certificate of limited partnership. L is an original limited partner but is not listed as such in the certificate.²²¹ L discovers the error and withdraws from the firm on day 1. An amendment to the certificate of limited partnership to reflect L's withdrawal is filed on day 25. In the interim, X, a third party, extends credit to the firm on day 15, believing in good faith that L is a general partner.

L probably is liable to X, but the result is not certain. At the time X extended credit, L was not a de jure limited partner. Whether L is protected by section 304(b) depends upon whether the thirty day grace period for filing an amendment relates to amendments reflecting withdrawal of a partner as well as those reflecting admission of a partner. It is clear that section 304(b)(i), standing alone, will not insulate L because X's transaction, while after withdrawal, occurred "before . . . an appropriate certificate [was] filed to show withdrawal."²²² If, however, X's transaction must also occur "after expiration of the 30-day period for filing an amendment relating to the person as a limited partner under Section 202,"²²³ L will be protected.

Although the reference to section 202 appears to be a part of section 304(b)(ii), the spacing and punctuation are not so obvious as to require absolutely the conclusion that it cannot also relate to section 304(b)(i). Further, section 202(b) speaks specifically to amendments reflecting withdrawal as well as those reflecting admis-

²²¹ For purposes of this example it is irrelevant whether the certificate lists L as a general partner or totally omits mention of her.

²²² 1976 Acr § 304(b)(i).

²²³ *Id.* § 304(b).

sion,²²⁴ and section 202(e)'s broad exculpation applies to amendments covering "any event referred to in subsection (b)."²²⁵ Failure to apply the thirty day grace period in this case, it can be argued, not only would result in inequality of treatment as between subsections (i) and (ii) of section 304(b), but also would subvert the policy of section 202(b) and the express provisions of section 202(e). Finally, support for this view may be drawn from the rather cryptic comment to section 304, which states, "Paragraph (b) preserves the liability of the equity participant prior to withdrawal (and after the time for appropriate amendment in the case of a limited partnership)"²²⁶

A number of arguments can be made in opposition to this reading of section 304(b). The most obvious is that the reference to section 202's thirty day grace period visually and grammatically appears to relate exclusively to subsection (ii). The reference also contains a significant modifying phrase—the amendment must be one "relating to the person as a limited partner."²²⁷ The amendment in Example 5 does not fit this description since it concerns the withdrawal of a person who never had and never will have the status of an actual limited partner. While the argument concerning section 202(e) could be countered by the maxim of statutory construction that specific provisions control more general ones, a more telling point can be made. Section 202(b) imposes a duty to amend the certificate within thirty days of the occurrence of any of the four events there listed. This, obviously, is a duty to amend because of changing circumstances. Section 202(e)'s exculpation is from liability that otherwise would be imposed "because an amendment to a certificate of limited partnership has not been filed to reflect the occurrence of any event referred to in subsection (b)"²²⁸ Section 202(e)'s whole orientation is toward liability under section 207(2), for failure to keep the certificate of limited partnership current, rather than toward section 207(1), which imposes liability for statements originally false. If there were any doubt, the clause from section 202(e) quoted above should make this clear. The analogy in a case arising under section 304 is apparent. In Example 3, there was no defect in the content or filing of the certificate of limited partnership; there simply was a change in circumstances—the admission of L as an additional limited partner. Application of the thirty day grace period in Example 3 merely served to reinforce the notion that no partner should be liable on the basis of interim reliance if the certificate is amended with reasonable promptness to reflect such changes. The facts in Example 5 are in sharp contrast. It is not a case in which the interest of third parties necessarily must be sacrificed in fairness to partners who are conducting their business with complete regularity. There was a defect in the content of the original certificate. The amendment reflecting L's withdrawal was filed not to indicate a change in circumstances but to avoid the effect of the original defect. Thus, the correct analogy is to section 207(1) rather than to section 207(2), and any reference to section 202(e) is specious. There is no practical necessity requiring a grace period for defects originally appearing in a certificate of limited partnership, and neither section 202 nor section 207 provides one. It is submitted, therefore, that imposition of liability on L under the facts of Example 5 not only

²²⁴ *Id.* § 202(b)(3).

²²⁵ *Id.* § 202(e).

²²⁶ *Id.* § 304, Comment.

²²⁷ *Id.* § 304(b).

²²⁸ *Id.* § 202(e).

complies with the more natural reading of section 304(b) but also harmonizes it with sound policy and the analogous provisions of sections 202 and 207.

EXAMPLE 6

The enterprise is a de jure limited partnership formed by the proper filing of a certificate of limited partnership. L is an original limited partner but is not listed as such in the certificate.²²⁰ L discovers the error on day 1, and an amendment to the certificate of limited partnership reflecting L's status as a limited partner is filed on day 25. In the interim, X, a third party, extends credit to the firm on day 15, believing in good faith that L is a general partner.

L should be liable to X, but the result is less certain than the result in Example 5. The only factual difference between this example and Example 5 is with respect to the type of amendment filed. Here, rather than withdrawing, L is seeking to perfect her status as a limited partner. Although L was not a de jure limited partner at the time X extended credit, the language of section 304(b)(ii), at first glance, would appear to be broad enough to protect her. While X extended credit "before an appropriate certificate [was] filed to show [L's] status as a limited partner" such extension was not "after expiration of the 30-day period for filing an amendment relating to [L] as a limited partner under Section 202"²³⁰ It is submitted, however, that L should not be afforded the protection of section 304(b)(ii). All of the policy reasons for not permitting a thirty day grace period in Example 5 apply with equal force here. If the interpretation of section 304(b) submitted in Example 5 is correct, it would be totally irrational to distinguish Example 6 on the basis that L filed an amendment indicating her status as a limited partner rather than one indicating her withdrawal from the firm. A closer reading of section 304(b)(ii) lends support to the proposition that such a distinction should not be made. The reference is not to a thirty day period in general, but to "*the 30-day period for filing an amendment relating to the person as a limited partner under Section 202*"²³¹ The only possible object of this reference is section 202(b)(2), requiring an amendment within thirty days of the admission of a new partner.²³² Since L was not admitted as a new partner, her case is not the object of the reference and she should not be permitted to claim its benefit. Moreover, section 202(b)'s thirty day period begins to run only on occurrence of one of the four events listed therein. It seems almost impossible to consider the application of that period in a case, such as the present one, in which none of the four events that will trigger it has occurred. For all of these reasons, it is submitted that the thirty day grace period should not apply and that L should remain liable to the interim creditor, X.

EXAMPLE 7

The enterprise is not a de jure limited partnership because no certificate of limited partnership was filed upon formation of the firm. L is an original limited partner. She discovers the error on day 1, and causes a certificate of limited partnership listing her as a limited partner to be filed on day 25. In the interim, X, a third party, extends credit to the firm on day 15, believing in good faith that L is a general partner.

²²⁰ See note 221 *supra*.

²³⁰ 1976 Act § 304(b)(ii).

²³¹ *Id.* (emphasis added).

²³² *Id.* § 202(b)(2). As previously discussed, the reference cannot be to § 202(b)(3) (withdrawal of a partner) because, in the context of Examples 5 and 6, such an amendment would not fit § 304(b)'s description of an amendment "relating to the person as a limited partner."

This example was placed last not only for ease of discussion but also on the theory that it is good practice to begin and end on easy notes. L clearly is liable to X. At the time X extended credit, L was not a de jure limited partner. L is not protected by section 304(b)(ii) because X transacted business before "an appropriate certificate [was] filed to show [L's] status as a limited partner."²³³ The thirty day grace period is inapplicable for all of the reasons discussed in Examples 5 and 6, and, more importantly, because section 304(b) limits its application to cases of "amendment."²³⁴

In conclusion, it can be stated that section 304 constitutes an improvement over section 11 of the 1916 Act. It addresses specifically many of the problems that are still in the process of case by case evolution under the latter section. The policy choices it makes appear to be wise ones. The major fault that can be found with section 304 is a lack of clarity in drafting, particularly in subsection (b). The ambiguities in this subsection raise a host of constructional problems, the most important of which have been illustrated by the foregoing examples. The discussion following each example has attempted to set forth a sound and consistent construction of section 304(b). It is hoped that it is the one the draftsmen intended.

B. Liability for Participation in Control

It is neither unusual nor unreasonable for persons investing money in a business enterprise to desire some control over that business. The legitimacy of this desire in the context of a limited partnership is recognized by the introductory comment to the 1916 Act, as follows:

No public policy requires a person who contributes to the capital of a business, acquires an interest in the profits, and some degree of control over the conduct of the business, to become bound for the obligations of the business; provided creditors have no reason to believe at the time their credits were extended that such person was so bound.²³⁵

Section 7 of the 1916 Act, however, creates a tension, if not outright conflict, with this recognition by means of a single sentence, stating, "A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business."²³⁶

The problem, of course, is to determine when the legitimate control envisioned by the comment ends and the prohibited control begins. This problem is aggravated by the lack of any explicit theoretical basis for the liability imposed by section 7. The result has been a body of case law that proceeds largely on an ad hoc basis and fails to articulate any comprehensive guiding principle by which section 7 liability may be predicted.²³⁷

In spite of this, it is possible to make certain generalizations about the present state of the law under section 7. The first is that there is a definite split of authority

²³³ *Id.* § 304(b)(ii).

²³⁴ *Id.* § 304(b); *see id.* § 304, Comment.

²³⁵ 1916 ACT § 1, Comment at 564.

²³⁶ *Id.* § 7.

²³⁷ *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, ..., 323 A.2d 371, 375 (1974); *Delaney v. Fidelity Lease Ltd.*, 517 S.W.2d 420, 425 (Tex. Ct. App. 1974), *rev'd*, 526 S.W.2d 543 (Tex. 1975); *Feld, The "Control" Test for Limited Partnerships*, 82 HARV. L. REV. 1471, 1474 (1969); *Feldman, The Limited Partner's Participation in the Control of the Partnership Business*, 50 CONN. B.J. 168, 190 (1976).

regarding whether reliance is a necessary element under section 7. This split is occasioned by an underlying difference of opinion concerning the theoretical basis for liability. Some courts and commentators, focusing on the proviso in the introductory comment quoted above, believe that section 7 essentially is an estoppel provision and consequently that a limited partner should not be liable unless his or her participation in control is of such a nature that it would cause third parties reasonably to rely on the mistaken belief that the limited partner is a general partner.²³⁸ Others have read section 7 literally. Since it does not contain an express reliance requirement, unlike sections 5 and 6,²³⁹ it has been held that none should be supplied by the courts.²⁴⁰ The recent case of *Delaney v. Fidelity Lease Ltd.*²⁴¹ is indicative of this view. There, the Texas Supreme Court unequivocally rejected the argument that reliance was necessary to recovery, in the following language:

[Section 7] simply provides that a limited partner who takes part in the control of the business subjects himself to personal liability as a general partner. The statute makes no mention of any requirement of reliance on the part of the party attempting to hold the limited partner personally liable.²⁴²

The court did not hazard a guess as to what the proper theoretical basis for liability is. It was sufficient, apparently, that section 7 proscribed participation in control and that defendants' conduct fell within the proscription.

A second generalization about section 7 may be drawn from the facts of the cases in which a violation actually was found. In all cases the limited partner's participation in control was substantially the equivalent of that of a general partner.²⁴³ For this reason, some observers have concluded that extensive, day-to-day participation in the conduct of the business is necessary to violate section 7's prohibition.²⁴⁴ While falling short of a guiding principle, this conclusion has been some solace to limited partners and their counsel. It also is interesting to note that, for the most part, the cases finding violations on the basis of significant and pervasive acts of control by limited partners tend to be the same ones that either ignore or reject the element of third party reliance.²⁴⁵

²³⁸ *Western Camps, Inc. v. Riverway Ranch Enterprises*, 70 Cal. App. 3d 714, 728-30, 138 Cal. Rptr. 918, 926-27 (1977); *Delaney v. Fidelity Lease Ltd.*, 517 S.W.2d 420, 425 (Tex. Ct. App. 1974), *rev'd*, 526 S.W.2d 543 (Tex. 1975); *Frigidaire Sales Corp. v. Union Properties, Inc.*, 88 Wash. 2d 400, ..., 562 P.2d 244, 247 (1977), *aff'g* 14 Wash. App. 634, ..., 544 P.2d 781, 785 (1975); *Rathke v. Griffith*, 36 Wash. 2d 394, ..., 218 P.2d 757, 764 (1950); *Feld*, *supra* note 237, at 1479-80; *Feldman*, *supra* note 237, at 171-74, 181; *see* *Silvola v. Rowlett*, 129 Colo. 522, ..., 272 P.2d 287, 289 (1954). Alabama, in its unique version of § 7, makes belief by the creditor that he or she was dealing with a general partner an express element. ALA. CODE tit. 10, § 10-9-41(b) (1975).

²³⁹ 1916 Acr §§ 5(2), 6.

²⁴⁰ *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543, 545 (Tex. 1975), *rev'g* 517 S.W.2d 420 (Tex. Ct. App. 1974); *see* *Holzman v. De Escamilla*, 86 Cal. App. 2d 858, 195 P.2d 833 (1948).

²⁴¹ 526 S.W.2d 543 (Tex. 1975).

²⁴² *Id.* at 545.

²⁴³ *Filesi v. United States*, 352 F.2d 339 (4th Cir. 1965) (dictum); *Plasteel Prods. Corp. v. Eisenberg*, 170 F. Supp. 100 (D. Mass. 1959), *aff'd on other grounds sub nom. Plasteel Prods. Corp. v. Helman*, 271 F.2d 354 (1st Cir. 1959); *Bergeson v. Life Ins. Corp. of America*, 170 F. Supp. 150 (D. Utah 1958) (dictum), *aff'd in part and rev'd in part on other grounds*, 265 F.2d 227 (10th Cir.), *cert. denied*, 360 U.S. 932 (1959); *Holzman v. De Escamilla*, 86 Cal. App. 2d 858, 195 P.2d 833 (1948); *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, 323 A.2d 371 (1974); *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543 (Tex. 1975).

²⁴⁴ *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, ..., 323 A.2d 371, 375 (1974); *Augustine, Fass, Lester & Robinson, The Liability of Limited Partners Having Certain Statutory Voting Rights Affecting the Basic Structure of the Partnership*, 31 Bus. Law. 2087, 2104 (1976); *Feld*, *supra* note 237, at 1474-75.

²⁴⁵ *See* cases cited note 243 *supra*. It also is true that some cases adopting the reliance element and finding no violation involved extensive control by limited partners. In these cases, however, the limited

Section 303 of the 1976 Act carries over section 7's prohibition against participation in control, but with a number of refinements. Its two main features are a general rule with a dual standard of liability and a "safe harbor" list of activities that will not constitute participation in the control of the business.²⁴⁶ Its major failing relates to its general rule and its continued ambiguity as to the theoretical basis for imposing personal liability on a limited partner who takes part in control.

Section 303(a) states the 1976 Act's prohibition as follows:

Except as provided in subsection (d), a limited partner is not liable for the obligations of a limited partnership unless he is also a general partner or, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business. However, if the limited partner's participation in the control of the business is not substantially the same as the exercise of the powers of a general partner, he is liable only to persons who transact business with the limited partnership with actual knowledge of his participation in control.²⁴⁷

The first sentence simply restates the rule of section 7, although in a slightly more refined way. The intent is "to insure that judicial decisions under the prior uniform law remain applicable to the extent not expressly changed."²⁴⁸ The real difficulties are caused by the second sentence. It contemplates two different sorts of participation in control—that which is substantially the same as a general partner's exercise of powers and that which is not. As to the latter, the limited partner will be personally liable only to persons transacting business with actual knowledge of the limited partner's participation in control. As to the former, by clear negative implication, the limited partner will be liable regardless of the third party's knowledge or lack thereof.

The institution of this bifurcated standard raises a number of interrelated questions, including—why it was thought necessary to institute such a standard; why third party knowledge is required under one part of the standard but not under the other; why the draftsmen specifically chose knowledge of the limited partner's participation in control rather than some other test such as good faith belief that the limited partner was a general partner; what third party interest is being protected by the standard applicable to conduct substantially equivalent to that of a general partner, with respect to which there is no requirement of third party knowledge; and on what basis the determination is to be made whether a limited partner's acts of control are substantially the same as a general partner's exercise of powers.

In answer to the first question, the draftsmen state,

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

partners were not acting in their individual capacities. See *Western Camps, Inc. v. Riverway Ranch Enterprises*, 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (1977); *Frigidaire Sales Corp. v. Union Properties, Inc.*, 88 Wash. 2d 400, 562 P.2d 244 (1977).

²⁴⁶ 1976 Act § 303(a), (b). Section 303(d) imposes liability on a separate basis—use of a limited partner's name in the firm name. For a discussion of § 303(d), see text at note 16 *supra*.

²⁴⁷ 1976 Act § 303(a).

²⁴⁸ *Id.* § 303, Comment.

dealings with third parties, the "is not substantially the same as" test was introduced.²⁴⁹

The statement indicates that the new dual test is an attempt to accommodate once again the competing interests of limited partners and third parties dealing with the partnership. The interest of the limited partner seems fairly clear—the desire to achieve limited liability while exercising "some degree of control" over the business. The specific interest of the third party that is sought to be protected is somewhat harder to identify. Those advocating adoption of a reliance element under section 7 of the 1916 Act appear to believe that the third party's primary concern is the identity of those who will incur general liability on a partnership obligation.²⁵⁰ Thus, they conclude, only those acts of control that would cause a third party reasonably to believe that the limited partner is a general partner should give rise to liability. Anything else would be giving the third party an undeserved windfall.²⁵¹

Protection of this sort of reliance interest, however, does not appear to be the aim of section 303(a). The most obvious support for this conclusion is the intentional omission of any requirement of third party knowledge or reliance in a case in which the limited partner's participation in control is the substantial equivalent of a general partner's exercise of powers. Even if it could be argued that reliance simply is presumed in such flagrant cases, the specific knowledge requirement with respect to conduct not substantially equivalent to that of a general partner still must be considered. Simple knowledge of the limited partner's participation in control is sufficient to satisfy this requirement. Since this knowledge is completely compatible with knowledge that the limited partner is a limited partner, it seems clear that section 303(a) does not seek to protect only those creditors who have been misled into believing the limited partner is a general partner.²⁵² Moreover, liability may be asserted under section 303(a) even though the limited partner is designated as such in a certificate of limited partnership substantially complying with section 201. The presence of this factor reinforces the above conclusion because, in such a case, all third parties would appear to be charged with constructive notice that the limited partners are, in fact, limited partners.²⁵³ It therefore may be that good faith reliance on the belief that the limited partner is a general partner legally is impossible in this context.²⁵⁴

²⁴⁹ *Id.*

²⁵⁰ See authorities cited note 238 *supra*.

²⁵¹ *Giles v. Vette*, 263 U.S. 553, 561 (1924).

²⁵² *Feldman*, *supra* note 237, at 188. The draftsmen appear to believe that they are protecting only those creditors who have been misled into thinking the limited partner is a general partner. They state that, with the exception of conduct substantially equivalent to that of a general partner, "the provisions of the new Act that impose liability on a limited partner who has somehow permitted third parties to be misled to their detriment as to the limited partner's true status confine that liability to those who have actually been misled." 1976 Act, Prefatory Note. Although this may have been the draftsmen's intent, the language of § 303(a) simply does not accomplish the intended result. Nor could the draftsmen have feared that it would be too difficult for a plaintiff to prove the existence of a mistaken belief that the limited partner was a general partner, and so created a conclusive presumption of such a belief based on knowledge of the limited partner's participation in control. Section 304(b) of the 1976 Act specifically requires that a plaintiff proceeding thereunder prove an actual belief that the limited partner was a general partner. If proof of such a belief is not thought to be too great a burden for a plaintiff proceeding under § 304(b), there is no apparent reason why it should be thought too great a burden for a plaintiff proceeding under § 303(a).

²⁵³ 1976 Act § 208.

²⁵⁴ *Feldman*, *supra* note 237, at 209. *But see* 1976 Act § 208, Comment, which states "[T]he notice provided is not intended to change any liability of a limited partner which may be created by his action

If section 303(a) is not an attempt to protect creditors who rely on the good faith belief that a limited partner is a general partner, it may be an effort to protect those who rely on the business expertise of the actual general partner and on the belief that he or she controls, and will continue to control, the business decisions of the partnership. This view, it is submitted, would be incorrect, since such expectations on the part of creditors are undercut almost completely by other sections of the 1976 Act. The most notable of these is the provision in section 303(b) permitting limited partners to remove a general partner without being deemed to have participated in control.²⁵⁵ In addition, the rule regarding limited partners who participate in control to an extent less than exercising the powers of a general partner flatly contradicts this interpretation. If the intent is to protect third parties who extend credit in reliance on the general partner's business expertise, the limited partner should be liable to those who transact business *without* knowledge of the limited partner's participation rather than to those with knowledge.²⁵⁶

Finally, it may be that, rather than an attempt to protect third parties who have been misled in some way, section 303(a) merely is a device to make personal liability roughly correspondent to decision-making power. In other words, personal liability of a limited partner usually will be important only when the partnership assets are insufficient to satisfy creditors' claims. Section 303(a) may be just a judgment that a limited partner who participates in control is at least partially responsible for the loss or dissipation of the assets on which the creditor relied and that he or she ought to bear the burden of that responsibility.²⁵⁷ The bifurcation of the control standard by section 303(a) lends support to this analysis. Assuming, *arguendo*, that the liability-responsibility postulate is sufficient justification for an exception to the 1976 Act's policy favoring limited liability, a limited partner whose conduct is substantially the same as that of a general partner could be deemed equally responsible for the failure of the business and ought to be equally liable. The general rule of section 303(a) achieves this result. On the other hand, a limited partner whose acts of control are less significant and extensive than those of a general partner, while still possibly partially responsible, cannot be deemed equally responsible for the failure. Thus, his or her personal liability ought to extend only to a limited class of creditors.

The question, of course, is whether section 303(a) selects the correct class. Three possibilities come readily to mind. The first is that the limited partner should be liable only with respect to transactions upon which he or she committed the partnership and which resulted in losses to the partnership. Limiting personal liability in this way, however, is subject to a number of objections. It not only involves serious problems of judging business decisions by hindsight but also presupposes that the other parties to these transactions will be the ones pressing claims, a contrary to fact assumption in many cases. It also effectively restricts the definition of participation in control to the limited partner's personal transaction of business on behalf of the

or inaction under the law of estoppel" Feld, *supra* note 237, at 1480, states, "[T]he control test depends on notions of estoppel"

²⁵⁵ 1976 Act § 303(b)(5)(v). Also significant are *id.* §§ 401 (requiring the consent of all partners to the admission of an additional general partner), 602 (permitting a general partner to withdraw from the partnership), and 801(3) (permitting all partners to agree to carry on the business and appoint additional general partners upon withdrawal of a general partner). Feldman, *supra* note 237, at 184.

²⁵⁶ Feldman, *supra* note 237, at 188-89 n.44.

²⁵⁷ For an argument that this, in fact, is the approach the courts have taken under § 7 of the 1916 Act, see 26 OKLA. L. REV. 289, 293 (1973).

partnership, a result seemingly at odds with the draftsmen's intent. A second possibility would restrict the limited partner's liability to transactions upon which he or she committed the partnership without regard to the profitability of the particular venture. This possibility is open to the same objection regarding restriction of the definition of participation in control, and also fails to take into account a class of creditors whose loss may have been caused by the limited partner in a very real sense. This class consists of those who knew of the limited partner's participation in control and who extended credit to the limited partnership not in reliance on the limited partner's personal liability but in reliance on his or her business acumen. It is this class that section 303(a) attempts to protect and, based on rough notions of justice, it may be the most rational choice. It should be remembered, however, that it is an approximation only and that actual reliance need not be shown.

Probably of greater interest to the limited partner and his or her counsel than extended discussions of the theoretical basis for liability is the litigation-oriented problem of which standard a court will apply to a given fact situation. Once it is determined that a limited partner has taken part in the control of the business, the question becomes whether his or her conduct has been "substantially the same as the exercise of the powers of a general partner." The logical point to begin looking for an answer would be to ascertain precisely what the powers of a general partner are.

Section 403 states that, except as otherwise provided by the 1976 Act or by the partnership agreement, a general partner has all the rights and powers and is subject to all the liabilities and restrictions of a partner in a general partnership.²⁵⁸ The Uniform Partnership Act contains several provisions bearing on those rights and powers that are relevant to the present discussion. Each partner is an agent of the partnership for the purpose of carrying on the business of the partnership in the usual way,²⁵⁹ and each may convey property in the partnership name.²⁶⁰ Also, subject to any contrary provision in the partnership agreement, each partner has an equal right in the management and conduct of the business,²⁶¹ any differences of opinion regarding ordinary business matters being decided by majority vote.²⁶² Of these rights and powers the management rights are the most significant. This is so because "control of the business" is the focus of section 303. Section 303(b) expressly permits a limited partner to be an agent or employee of the limited partnership.²⁶³ This exception has been recognized by the case law under section 7 of the 1916 Act²⁶⁴ and theoretically is correct. If one is an agent, by definition, one is *subject to* the right of control of the principal.²⁶⁵ Any acts performed in the conduct of the business, even discretionary acts, are subject to this overriding right of control. Although each partner of a general partnership may be an agent of the partnership, his or her actions are subject to the right of control of the other partners. This control is codified as the partners' equal rights in management, which are exercised by majority vote. Thus, while partners in a general partnership are both principals

²⁵⁸ 1976 ACT § 403.

²⁵⁹ UNIFORM PARTNERSHIP ACT § 9(1).

²⁶⁰ *Id.* § 10(1).

²⁶¹ *Id.* §§ 18(e), 24(3).

²⁶² *Id.* § 18(h).

²⁶³ 1976 ACT § 303(b)(1).

²⁶⁴ See *Grainger v. Antoyan*, 48 Cal. 2d 805, 313 P.2d 848 (1957); *Silvola v. Rowlett*, 129 Colo. 522, 272 P.2d 287 (1954); *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, 323 A.2d 371 (1974).

²⁶⁵ RESTATEMENT (SECOND) OF AGENCY § 1(1)-(3) (1958).

and agents, the latter status should be irrelevant for purposes of section 303(a). Its concern is participation in control of the business, not participation in the business subject to the control of others.

This analysis of the Uniform Partnership Act leads to the conclusion that if a limited partner exercises at least an equal voice in all or most management decisions he or she will be participating in control in a manner "substantially the same as the exercise of the powers of a general partner." The conclusion is supported by the thesis that section 303(a) is an attempt to equate general liability with responsibility for loss or dissipation of the partnership's assets. It also is borne out by the case law under the 1916 Act. Those few cases that attempt to define participation in control do so in terms of managing the affairs of the firm, initiating and controlling the execution of policy, or possessing decision-making authority that the general partner is unable to check or nullify.²⁶⁶ While these cases purport to be defining mere participation in control, it is clear from the facts of cases in which violations actually were found that the standard under section 7 for mere participation is the equivalent of section 303(a)'s "substantially the same as" a general partner standard.²⁶⁷

If this latter conclusion is correct, then section 303(a) could be viewed as restricting a limited partner's latitude, in comparison to that available under the 1916 Act, by imposing liability to a particular class of creditors for participation in control that is not substantially equivalent to a general partner's exercise of power. This view certainly is not that of the draftsmen,²⁶⁸ and probably is incorrect in any event. Since both standards in section 303(a) involve participation in control, the difference must be quantitative rather than qualitative. As previously noted, the cases finding violations of section 7's standard involved factual situations in which the limited partners virtually controlled the partnership business. These cases also do not seem to require any reliance by the creditor as a condition to recovery. In cases involving less obtrusive conduct by the limited partner no violation was found either because the conduct qualitatively did not constitute control²⁶⁹ or because there was no reliance by the creditor.²⁷⁰ In an analogous situation under section 303(a), the inquiry would be whether the limited partner's acts related to managerial decision-making (albeit not on an equal basis with the general partner or partners), and, if so, whether the creditor had knowledge of the limited partner's participation. If such knowledge could not be shown recovery would be denied. The freedom of action of a limited partner under section 303(a), therefore, would appear to track relatively closely with that under section 7. In addition, the safe harbor of section 303(b) greatly increases the limited partner's freedom from even the fear of potential liability.

Before proceeding to section 303(b), however, a final question involving section 303(a) remains to be considered. It concerns the relationship between the time a third party transacts business with the partnership and the time at which the limited partner participates in control. Referring to section 7 of the 1916 Act, one com-

²⁶⁶ *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, ..., 323 A.2d 371, 375 (1974); *Rathke v. Griffith*, 36 Wash. 2d 394, ..., 218 P.2d 757, 764 (1950).

²⁶⁷ See cases cited note 243 *supra*.

²⁶⁸ See 1976 Act § 303, Comment.

²⁶⁹ See *Plasteel Prods. Corp. v. Helman*, 271 F.2d 354 (1st Cir. 1959); *Grainger v. Antoyan*, 48 Cal. 2d 805, 313 P.2d 848 (1957); *Silvola v. Rowlett*, 129 Colo. 522, 272 P.2d 287 (1954); *Trans-Am Builders, Inc. v. Woods Mill, Ltd.*, 133 Ga. App. 411, 210 S.E.2d 866 (1974); *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, 323 A.2d 371 (1974).

²⁷⁰ *Rathke v. Griffith*, 36 Wash. 2d 394, ..., 218 P.2d 757, 764 (1950).

mentator has raised the question whether the limited partner who takes part in control on a less than continual basis becomes liable (1) for all past, present, and future obligations of the partnership, (2) for obligations based on transactions occurring during his or her participation in control and all future obligations, or (3) only for obligations based on transactions occurring during his or her participation in control.²⁷¹ Unfortunately, and in contrast to section 304, the draftsmen did not attempt to address this timing problem under section 303.

It seems fairly clear that alternative (1) is not correct. Although participation in control does not cause a limited partner to become a general partner in all respects, the liability incurred is similar to that of a general partner if the participation in control is substantially the same as that of a general partner.²⁷² As such, the case of a limited partner who first takes part in control sometime after the business is begun seems closely analogous to the case of an incoming general partner. Section 17 of the Uniform Partnership Act provides that the liability of an incoming general partner with respect to obligations arising before his or her admission shall be satisfied only out of partnership property.²⁷³ That is, as to such transactions his or her liability is limited, and the same should be true of a limited partner who takes part in control.²⁷⁴ In addition, in the case of a limited partner whose participation in control is not substantially equivalent to that of a general partner, a third party extending credit prior to the participation could not have done so with knowledge of the participation.²⁷⁵

The choice between alternatives (2) and (3) is more difficult. The thesis that section 303(a) is an attempt to equate general liability with responsibility for loss or dissipation of the partnership's assets would appear to weigh in favor of alternative (2), which holds the limited partner liable for all transactions occurring during his or her participation in control and all future obligations. Even if a limited partner has ceased participating in control, his or her prior activity could be a substantial contributing factor to the decline or failure of the business. Moreover, with respect to a limited partner whose activity was not substantially the same as that of a general partner, a third party could transact business with knowledge of such activity but without knowledge that it had ceased.

In reference to section 7 of the 1916 Act, a strong argument has been made that alternative (3) is the only proper choice.²⁷⁶ The argument is based on a continuation

²⁷¹ Feldman, *supra* note 237, at 174-75.

²⁷² 1916 ACT § 7 states that the limited partner shall become "liable as a general partner." 1976 ACT § 303(a) abandons this terminology in favor of "liable for the obligations of a limited partnership." This change in language probably was felt necessary to accommodate the new bifurcated control standard.

²⁷³ UNIFORM PARTNERSHIP ACT § 17. *Id.* § 41(7) is similar.

²⁷⁴ Feldman, *supra* note 237, at 175-76.

²⁷⁵ Although the intent of § 303(a) appears to be to protect creditors only with respect to transactions in which knowledge of the limited partner's participation was contemporaneous with the extension of credit, the language used may be susceptible of a broader interpretation. The section states that the limited partner is liable "to persons who transact business with the limited partnership with actual knowledge of his participation in control." In a case in which a limited partner began participating in control and the third party acquired knowledge of it in the middle of a series of transactions, it could be argued that the limited partner is liable with respect to the prior transactions as well as the subsequent ones. The third party would appear to be a person "who transact[ed] business . . . with actual knowledge of his [the limited partner's] participation in control." Compare 1976 ACT § 304(b), which makes a person erroneously believing himself or herself to be a limited partner liable (notwithstanding corrective action) "to any third party who transacts business with the enterprise . . . if the third party actually believed in good faith that the person was a general partner at the time of the transaction."

²⁷⁶ Feldman, *supra* note 237, at 176-79.

of the comparison between a limited partner who takes part in control and a partner in a general partnership. After admission the latter will be liable for all partnership obligations incurred during his or her continued association with the firm. The partner can withdraw from the firm at any time, however.²⁷⁷ This will work a dissolution of the partnership²⁷⁸ and, with certain exceptions,²⁷⁹ will provide the partner with protection from future liabilities. Because of the inability of a limited partner to extricate himself or herself effectively from a limited partnership,²⁸⁰ it is argued that the analogy fails and fairness requires that the limited partner not be bound personally with respect to obligations incurred after he or she ceases taking part in control. The selection of alternative (3) is buttressed by reference to the element of reliance. If a creditor must establish that the limited partner's participation in control caused him or her to believe the limited partner was a general partner and to extend credit in reliance on that belief, then the limited partner should be vulnerable only with respect to transactions occurring contemporaneously with the participation in control.²⁸¹

This argument retains much of its force when applied to section 303(a). Even though the 1976 Act contains a provision expressly permitting a limited partner to withdraw, it falls far short of the kind of easy withdrawal at will available to a general partner.²⁸² Thus, the rule that a general partner remains liable for partnership obligations incurred during his or her continued association with the firm, even if he or she becomes dormant,²⁸³ would appear to work an undue hardship if applied to a limited partner who ceases his or her participation in control.

On balance, alternative (3) may be the best choice. In the absence of any clear and express policy underlying the imposition of liability, the rule that most nearly equates liability with the duration of the prohibited conduct would seem least objectionable.

In comparison to the obscurities of section 303(a), section 303(b) is a model of clarity. From the point of view of a limited partner it undoubtedly is one of the most significant provisions in the 1976 Act. In contrast to the vague, single sentence prohibition of section 7 of the 1916 Act, section 303(b) contains an extensive list of activities that conclusively will *not* be deemed participation in control. It provides,

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

(1) being a contractor for or an agent or employee of the limited partnership or of a general partner;

²⁷⁷ UNIFORM PARTNERSHIP ACT § 31(1)(b), (2).

²⁷⁸ *Id.*

²⁷⁹ *Id.* §§ 34-35.

²⁸⁰ Feldman, *supra* note 237, at 178-79.

²⁸¹ *Id.* at 179-82. This argument fails to consider that a future extension of credit may be in reliance on past acts of control.

²⁸² 1976 ACT § 603. This section permits withdrawal at will only if the certificate of limited partnership is silent regarding the time for dissolution or the time at which or events upon the occurrence of which a limited partner may withdraw. Even then a limited partner may withdraw only upon six month's prior written notice to the general partners. As such, § 603 does not seem to be significantly more lenient than § 16 of the 1916 Act. See 1916 ACT § 16(2). Compare 1976 ACT § 602, which states, "A general partner may withdraw from a limited partnership at any time by giving written notice to the other partners" See UNIFORM PARTNERSHIP ACT § 31(1)(b), (2). The relationship between § 603 and 1976 ACT § 702, which provides that upon assignment of all of his or her partnership interest a partner ceases to be a partner, is unclear.

²⁸³ A. BROMBERG, *supra* note 15, § 24A, at 141-42.

- (2) consulting with and advising a general partner with respect to the business of the limited partnership;
- (3) acting as a surety for the limited partnership;
- (4) approving or disapproving an amendment to the partnership agreement; or
- (5) voting on one or more of the following matters:
 - (i) the dissolution and winding up of the limited partnership;
 - (ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership other than in the ordinary course of its business;
 - (iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business;
 - (iv) a change in the nature of the business; or
 - (v) the removal of a general partner.²⁸⁴

Before proceeding to a consideration of these various activities it should be stressed that they do not have a cumulative effect. This is demonstrated by the introductory language permitting limited partners to engage in "one or more" of the types of conduct listed. Additionally, section 303(c) makes it clear that section 303(b)'s failure to mention a particular activity is not determinative of the question whether that activity constitutes participation in control.²⁸⁵

In general, it may be said that section 303(b) is not really an attempt to restrict the definition of participation in control as much as it is an attempt to give limited partners greater freedom from uncertainty and doubt. The activities listed, with the reservations to be discussed subsequently, are qualitatively different from acts of control and most already have received approbation from the courts or commentators.

Section 303(b)(1) permits a limited partner to be a contractor for or agent or employee of the partnership or general partner. As previously discussed, it is correct as a matter of theory to conclude that a limited partner who acts as agent or employee of the limited partnership is not taking part in control of the partnership's business. The relationship is rather the reverse; he or she is subject to the control of the partnership in the form of the general partner or partners.²⁸⁶ In cases in which this relationship has been found to exist in fact as well as in theory the courts correctly have refused to impose liability.²⁸⁷ The same should be true of a limited partner employed by a general partner.

A number of recent cases involving a specialized version of this latter factual pattern, however, have reached varying results.²⁸⁸ In each, certain limited partners were the sole or controlling shareholders, directors, and officers of the corporate

²⁸⁴ 1976 ACT § 303(b).

²⁸⁵ *Id.* § 303(c) states, "The enumeration in subsection (b) does not mean that the possession or exercise of any other powers by a limited partner constitutes participation by him in the business of the limited partnership."

²⁸⁶ See text at notes 263-65 *supra*.

²⁸⁷ See cases cited note 264 *supra*. Acting as an independent contractor for the partnership also would not seem to be an act of control. Although such a contractor would not be subject to the partnership's control, RESTATEMENT (SECOND) OF AGENCY § 2(3) (1958), neither would the partnership be subject to his or her control. *But see* *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, ..., 323 A.2d 371, 374-75 (1974) (reversing summary judgment for two limited partners who acted as "independent consultants" for the partnership on the ground that there was a factual issue whether their technical advice influenced or controlled the decisions of the general partner).

²⁸⁸ *Western Camps, Inc. v. Riverway Ranch Enterprises*, 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (1977); *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543 (Tex. 1975), *rev'g* 517 S.W.2d 420 (Tex. Ct. App. 1974); *Frigidaire Sales Corp. v. Union Properties, Inc.*, 14 Wash. App. 634, 544 P.2d 781 (1975), *aff'd*, 88 Wash. 2d 400, 562 P.2d 244 (1977).

general partner of a limited partnership. In their capacity as directors and officers of the general partner, the limited partners assumed full control of the partnership business. In two cases, *Frigidaire Sales Corp. v. Union Properties, Inc.*²⁸⁹ and *Western Camps, Inc. v. Riverway Ranch Enterprises*,²⁹⁰ the courts upheld the limited liability of the limited partners. Each court adopted reliance as a necessary element under section 7 and found the necessary reliance lacking because it was clear to the creditors at all times that the limited partners were acting as agents of the corporate general partners.²⁹¹ In addition, both courts felt that imposition of liability would amount to a disregard of the corporate entity of the general partner without an adequate factual basis.²⁹² The third case, *Delaney v. Fidelity Lease Ltd.*,²⁹³ imposed liability. The court in *Delaney* expressly rejected the proposition that section 7 requires a third party to be misled into believing a limited partner is a general partner.²⁹⁴ It felt that failure to impose liability would permit easy evasion of section 7's prohibition and also would allow circumvention of the requirement that a limited partnership have at least one general partner with unlimited liability.²⁹⁵ By finding a violation of section 7 the court, in effect, was piercing the veil of the corporate general partner, and it appeared to recognize this.²⁹⁶

These varying results clearly demonstrate the divergence of views concerning the theory for imposing liability on a limited partner who takes part in control. If one accepts the reliance theory, *Frigidaire* and *Western Camps* are correct. Because the limited partners were acting in a fully disclosed representative capacity the third parties could not have relied on their actions as indicative of individual general partner status. If, however, one believes the responsibility theory is the underlying basis of section 7, then *Delaney* reaches the proper result, although some damage, of course, is done to corporate dogma. Unfortunately, the theoretical uncertainty surrounding section 7 has been carried over to section 303(a). While these cases fall literally within section 303(b)(1), the language is so broad and general that a court strongly adhering to the responsibility theory conceivably could reach the same result as *Delaney* on the basis that they do not fall within the spirit of the section. That is, arguably the employee-agent exception presupposes an independent general partner, not one owned and controlled by the limited partners. If the general partner is not independent it still would seem possible to conclude that "[t]ruly 'the corporate fiction' [is] in this instance a fiction."²⁹⁷ Thus, there may be shoals in the safe harbor.

Section 303(b)(2) provides that a limited partner may consult with or advise the general partner regarding the partnership business without being deemed to have participated in control. Since consulting and advising denote giving information and making recommendations but do not connote the actual making of decisions, the provision is not only correct but also in accord with prior case law.²⁹⁸ There is,

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

²⁹⁰ 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (1977).

²⁹¹ *Id.* at 728-30, 138 Cal. Rptr. at 926-27; 88 Wash. 2d at ..., 562 P.2d at 247.

²⁹² 70 Cal. App. 3d at 730, 138 Cal. Rptr. at 927; 88 Wash. 2d at ..., 562 P.2d at 246-47.

²⁹³ 526 S.W.2d 543 (Tex. 1975).

²⁹⁴ *Id.* at 545.

²⁹⁵ *Id.* at 545-46.

²⁹⁶ *Id.* at 546.

²⁹⁷ *Delaney v. Fidelity Lease Ltd.*, 517 S.W.2d 420, 426-27 (Tex. Ct. App. 1974) (dissenting opinion).

²⁹⁸ *Silvola v. Rowlett*, 129 Colo. 522, ..., 272 P.2d 287, 289, 290-91 (1954); *Trans-Am Builders, Inc. v. Woods Mill, Ltd.*, 133 Ga. App. 411, ..., 210 S.E.2d 866, 868-69 (1974).

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however, authority for the proposition that if because of financial leverage, superior technical knowledge, or for any other reason the limited partner's advice is unduly influential on the general partner's decisions, the limited partner will be participating in control.²⁹⁹ This view presumably will continue under the 1976 Act. Since whether the limited partner's advice truly is advice will be a factual question in each case, the safe harbor once again may not be completely safe.

Section 303(b)(3)'s permission for a limited partner to act as surety for the limited partnership seems potentially less troublesome. This type of conduct involves no real managerial authority. Moreover, it may not be completely voluntary since wary creditors often insist upon a personal guarantee by those with limited liability. In light of judicial suggestions that creditors secure such guarantees,³⁰⁰ it hardly would be sportsmanlike for a court later to hold that suretyship with respect to creditor A constituted participation in control of the business with respect to creditor B.

Approving or disapproving an amendment to the partnership agreement, covered by section 303(b)(4), also would appear not to raise any significant problems. The focus of section 303(a) is on control of the *business* and thus, necessarily, on the power to make or have a voice in managerial decisions. As the partnership agreement primarily and directly affects only the relationship of the partners among themselves, the power to amend it is a power to make decisions concerning internal matters. This sort of power is distinguishable from the power to make decisions affecting the external business of the limited partnership and its relationships with third parties.³⁰¹ Although an amendment might have some effect on external business matters, the effect generally would be caused by the content of the amendment and subsequent action taken under it rather than by the mere act of amending. For example, if an amendment made a limited partner general manager of the business, that limited partner may be held to have participated in control on the basis of subsequent conduct in his or her capacity as general manager. The mere act of approving such an amendment, however, should not constitute participation in control on the part of the other limited partners.³⁰²

Section 303(b)(5), permitting limited partners to have voting rights with respect to dissolution of the partnership, disposition of all or substantially all of the partnership's assets other than in the ordinary course of business, incurrence of indebtedness by the partnership other than in the ordinary course of business, change in the nature of the partnership business, and removal of a general partner, represents the culmination of a long chain of events. With the rapid growth of large, public limited partnerships designed to take advantage of various tax shelter opportunities, it was inevitable that some general partners would abuse their positions of control, often

²⁹⁹ *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, ..., 323 A.2d 371, 374-75 (1974); Feld, *supra* note 237, at 1477.

³⁰⁰ *Frigidaire Sales Corp. v. Union Properties, Inc.*, 88 Wash. 2d 400, ..., 562 P.2d 244, 247 (1977); *Delaney v. Fidelity Lease Ltd.*, 517 S.W.2d 420, 427 (Tex. Ct. App. 1974) (concurring opinion), *rev'd*, 526 S.W.2d 543 (Tex. 1975).

³⁰¹ *Gast v. Petsinger*, 228 Pa. Super. Ct. 394, ..., 323 A.2d 371, 373-74, 375 (1974) (affirming summary judgment for limited partners who had, *inter alia*, attended meetings for the purpose of amending the partnership agreement).

³⁰² See *Rathke v. Griffith*, 36 Wash. 2d 394, ..., 218 P.2d 757, 764 (1950). Compare *Plasteel Prods. Corp. v. Eisenberg*, 170 F. Supp. 100 (D. Mass. 1959) with *Plasteel Prods. Corp. v. Helman*, 271 F.2d 354 (1st Cir. 1959).

to the detriment of the partnership and the limited partners.³⁰³ As a result, the securities administrators of some states have required that limited partners be given certain protective voting rights.³⁰⁴ This requirement caused observers to question whether the possession or exercise of such voting rights by limited partners would constitute participation in control under section 7 of the 1916 Act.³⁰⁵ In response to this concern, the legislatures of several states amended their versions of section 7 specifically to provide that the possession or exercise of such voting rights would not constitute participation in control.³⁰⁶ Because the vast majority of states did not take such action, however, there still remained a potentially serious problem. If a limited partnership organized in a state authorizing such voting rights had contacts in a state not having such statutory authority and suit was brought in the latter jurisdiction, the possibility always existed that the forum state's choice of law rules would dictate application of its own version of section 7.³⁰⁷ Section 303(b)(5) is an attempt to remedy this problem by authorizing such voting rights on a uniform basis.³⁰⁸

The draftsmen have made a policy decision that the matters encompassed by section 303(b)(5) should not constitute participation in control. The choice has much to recommend it. Not only does it resolve the conflict between state securities regulations and the law of limited partnership, but it is supportable theoretically as well. All of the matters covered by section 303(b)(5) relate to fundamental changes in the basic structure or make-up of the limited partnership itself rather than to management of its day-to-day business. Corporate law, in allocating powers between shareholders and directors, long has recognized this basic distinction. While directors generally are entrusted with management of the business,³⁰⁹ items of the sort listed in section 303(b)(5) ordinarily must be submitted to a shareholder vote.³¹⁰ As one group of commentators has concluded with reference to section 7 of the 1916 Act,

An overall reading of the ULPA and a consideration of the policies behind it make it apparent that the forbidden participation in the control of the partnership business which is contemplated by section 7 of the ULPA is a taking part in the day-to-day business of the partnership, as opposed to the ability to influence the partnership's

³⁰³ See, e.g., *Executive Hotel Assocs. v. Elm Hotel Corp.*, 41 Misc. 2d 354, 245 N.Y.S.2d 929 (Civ. Ct. N.Y.), *aff'd mem.*, 43 Misc. 2d 153, 250 N.Y.S.2d 351 (App. Term 1964).

³⁰⁴ E.g., CENTRAL SECURITIES ADMINISTRATORS COUNCIL, GUIDELINES FOR THE REGISTRATION OF COMMODITY POOL PROGRAMS ¶ V B (January 24, 1978), 1 BLUE SKY L. REP. (CCH) ¶ 4877; NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, GUIDELINES FOR THE REGISTRATION OF OIL AND GAS PROGRAMS ¶ VIII F (September 22, 1976, amended, October 12, 1977), 1 BLUE SKY L. REP. (CCH) ¶ 4589; MIDWEST SECURITIES COMMISSIONERS ASSOCIATION, STATEMENT OF POLICY REGARDING REAL ESTATE PROGRAMS ¶ VII B (February 28, 1973, amended, February 26, 1974, July 22, 1975), 1 BLUE SKY L. REP. (CCH) ¶ 4821.

³⁰⁵ E.g., 26 OKLA. L. REV. 289 (1973).

³⁰⁶ CAL. CORP. CODE § 15507 (West 1977); DEL. CODE tit. 6, § 1707 (1974); NEV. REV. STAT. § 88.080 (1973); OR. REV. STAT. § 69.280 (1977); WASH. REV. CODE ANN. § 25.08.070 (Supp. 1977); cf. NEB. REV. STAT. §§ 67-207, -210(3) (1943 & Supp. 1977) (authorizing voting rights required by the Investment Company Act of 1940); N.Y. PARTNERSHIP LAW §§ 96, 99(3) (McKinney Supp. 1977) (to the same effect).

³⁰⁷ Augustine, Fass, Lester & Robinson, *supra* note 244, at 2089-99.

³⁰⁸ Section 303(b)(5) is not a statutory grant of voting rights to limited partners. It merely provides that possession or exercise of the right to vote on any or all of the matters enumerated does not constitute participation in control. The right to vote, itself, must be granted by the certificate of limited partnership or the partnership agreement.

³⁰⁹ E.g., DEL. CODE tit. 8, § 141(a) (Supp. 1977).

³¹⁰ E.g., *id.* §§ 102(a)(3), 141(k), 242(a)(2), (c), 271, 275 (1974 & Supp. 1977).

basic structure which the statutory voting rights provide. Arguably, this is why section 7, in effect, forbids a "tak[ing] part in the control of the *business* of the partnership," rather than an ability to influence management or the partnership's basic structure.³¹¹

Before concluding, note should be taken of section 302, also dealing with voting rights of limited partners. It provides, "*Subject to Section 303*, the partnership agreement may grant to all or a specified group of the limited partners the right to vote (on a per capita or other basis) upon any matter."³¹² The emphasized portion of the preceding statement is its most important feature. Section 302 is not intended to validate voting rights in general but simply to give partners permission to include them in their agreement, subject to the dangers of section 303(a) if the rights extend beyond the safe harbor of section 303(b)(5).³¹³ Why the draftsmen felt it necessary to include such a provision is a mystery. Unlike corporate law, partnership law has never purported to engage in comprehensive regulation of the affairs of partners *inter se*,³¹⁴ and no one ever seemed to doubt that, but for the possibility of loss of limited liability, voting rights could be given to limited partners.³¹⁵ At best, then, section 302 is a superfluity. At worst it is a trap for the unwary since it is possible to overlook the effect of the introductory phrase.

V. CONCLUSION

This article has attempted to explore the most significant provisions of the 1976 Act affecting the relationship of the limited partnership and its members to third parties.³¹⁶ At the outset it was noted that the draftsmen intended to modernize the law, to clarify ambiguities by adding more detailed language and mechanics, and to make some important substantive changes and additions.³¹⁷ With respect to matters within the scope of this article, it must be concluded that the draftsmen met with only limited success in their pursuit of these goals.

The major achievement in terms of modernization is the streamlining of the requirements for execution of the various certificates and the integration of corporate and limited partnership filings. The practical importance of these changes should not be underestimated. The results with respect to the other two goals, however, are more mixed. The addition of the list of activities in which a limited partner may engage without fear of incurring liability for participation in control probably is the most significant advancement in the area of substantive additions and changes. Many of the other provisions appearing to introduce substantive changes work only superficial alterations in the law. Section 207 may be the leading example in this category. While it clearly imposes a duty to keep the certificate of limited partnership current in light of changing circumstances and lowers the standard of culpa-

³¹¹ Augustine, Fass, Lester & Robinson, *supra* note 244, at 2101 (emphasis in original).

³¹² 1976 Act § 302 (emphasis added).

³¹³ *Id.* § 302, Comment.

³¹⁴ *E.g.*, Lanier v. Bowdoin, 282 N.Y. 32, ..., 24 N.E.2d 732, 735 (1939) (as between themselves, partners may agree on anything they wish, as long as not barred by statute, common law, or public policy).

³¹⁵ *See, e.g.*, the partnership agreement in Weil v. Diversified Properties, 319 F. Supp. 778, 781-82 (D.D.C. 1970).

³¹⁶ Provisions such as §§ 502 and 608 have been omitted from consideration because they deal with internal problems of finance that are beyond the scope of the present article and because the liability imposed runs primarily to the partnership.

³¹⁷ 1976 Act, Prefatory Note.

bility to include negligence, these innovations are confined to general partners, who remain personally liable for partnership obligations in any event.

The failure to make sweeping substantive changes does not appear to be a major defect since the 1916 Act does a relatively good job of balancing the competing interests of the partners and third parties. Unfortunately, the same cannot be said of the 1976 Act's deficiencies in the area of clarity. Sixty years' experience with the rather skeletal provisions of the 1916 Act pointed out a number of questions that had to be answered on a case by case basis if at all. It is here that the 1976 Act could have made its greatest contribution, and it is here that we find its greatest failing. Although it attempts to address some of these questions, such as the retroactive effect of withdrawal by a person erroneously believing himself or herself to be a limited partner, it often does so in a way that creates as many problems as it solves. Provisions such as section 304(b) are ample proof that more is not always better.

