

COMMENTS ON RECENT DEVELOPMENTS IN LIMITED PARTNERSHIP LAW*

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I. INTRODUCTION

In 1976 the Commissioners on Uniform State Laws approved a Revised Uniform Limited Partnership Act designed to replace the 1916 Act which is in effect in most states. Although no state has yet adopted the Revision,¹ it undoubtedly will receive widespread acceptance in the future. The 1976 Act makes significant changes in the 1916 version. This article discusses the functions that the limited partnership is designed to serve, developments in the law applicable to the limited partnership, problems that have arisen in the use of the limited partnership, and the extent to which the 1976 Revision meets those problems.

The limited partnership is a variation of the partnership. It is designed to allow passive investors in an enterprise to share profits without becoming responsible for losses or liabilities beyond the amount they invest in the business. To qualify as a limited partnership, a firm must have one or more "general" partners who control and manage the enterprise and who are subject to full liability to its creditors; but, if the limited partnership statute is complied with, limited liability can be achieved for the other investors (called "limited" or "special" partners).²

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This article is based on material from a treatise the author is writing on business corporations and other business associations. The author gratefully acknowledges the editorial assistance of Jill M. Brown and Paul R. De Muro, third-year law students at Washington University, in preparing this manuscript for publication.

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1. The 1976 Act recently received Internal Revenue Service approval, with some caveats, for the same favorable treatment under the tax classification rules, Treas. Regs. §§ 301.7701-1 to 7701-3, that the IRS now gives to limited partnerships formed under the 1916 Act. Telephone conversation with National Conference of Commissioners on Uniform Laws (Jan. 10, 1979).

2. A limited partnership is strictly a creature of statute, its object being to enable persons not desiring to engage in a particular business, to invest capital in it and to share in the profits which might be expected to result from its use, without becoming liable as

The first limited partnership statute in this country was adopted in New York in 1822.³ Shortly thereafter, similar legislation was enacted in most other commercial states. It was discovered, however, that the statutes, as interpreted by the courts, were filled with pitfalls for the supposed limited partner. The early tendency of the courts was to construe the statutes strictly as giving a privilege that was to be jealously guarded, *viz.*, limited liability without incorporation.⁴ The courts commonly took the view that the limited partner was essentially a general partner who achieved immunity from personal liability only on full and exact compliance with the requirements of the limited partnership statute.⁵

The first Uniform Limited Partnership Act was drafted by the Commissioners on Uniform State Laws in 1916 to establish a more satisfactory form of limited partnership. This statute has now been adopted in all but a few states.⁶ As has been pointed out, the Commissioners on Uniform State Laws adopted in 1976 a Revised Uniform Limited Part-

general partners for all partnership debts. In other words, it is a form of partnership in which the liability to third persons of one or more of its members is limited to a fixed amount.

Hoefer v. Hall, 75 N.M. 751, 755, 411 P.2d 230, 232 (1965). *But see* Brown v. Brown, 15 Ariz. App. 333, 488 P.2d 689 (1971) (in a limited partnership dissolution proceeding, persons who had contracted to form a limited partnership and had held themselves out to the community as limited partners were held to be estopped from asserting as between themselves that a limited partnership had not been formed, even though the limited partnership certificate had never been sworn to nor recorded as required by statute).

Partnership rules usually are applied to limited partnerships except to the extent that contrary rules are made applicable by statute. UNIFORM PARTNERSHIP ACT § 6(2), provides: "This Act shall apply to limited partnerships except insofar as the statutes of the jurisdiction relating to such partnerships are inconsistent herewith."

Thorough discussions of the history of the limited partnership in this country are contained in Rathke v. Griffith, 36 Wash.2d 394, 218 P.2d 757 (1950); TROUBAT, THE LAW OF COMMANDATARY AND LIMITED PARTNERSHIP IN THE UNITED STATES 34-112 (1953); Gladin, *Status of a Limited Partner: A Comparative Treatment of Georgia and New York Law*, 11 GA. B.J. 176 (1948).

3. 1882 N.Y. LAWS ch. 244.

4. *See* Note, *Partners and Limited Partners Under the Uniform Acts*, 36 HARV. L. REV. 1016 (1923).

5. Some courts held, for instance, that an affidavit filed in a public office with the certificate of partnership was false if it stated that the limited partners' contributions had been paid in cash when in fact they had been paid by checks that were uncashed at the time of the filing of the affidavit, and that therefore the limited partners were liable as general partners. *McGinnis v. Farrelly*, 27 F. 33 (S.D.N.Y. 1886); *Durant v. Abendroth*, 69 N.Y. 148 (1877). Some later cases, recognizing that payment by check was commonly accepted as payment in cash, relaxed this rule. *Chick v. Robinson*, 95 F. 619 (6th Cir. 1899) (noncertified check); *White v. Eisemen*, 134 N.Y. 101, 31 N.E. 276 (1892) (certified check).

6. *See generally* Lewis, *The Uniform Limited Partnership Act*, 65 U. PA. L. REV. 715 (1917); 45 YALE L.J. 895, 907 (1936).

nership Act to supersede the original Act and recommended it for enactment by the states. As of early 1979, it has not yet been enacted by any state, but undoubtedly in time most states will adopt it.

The 1916 version of the Act provides that in cases not covered by that Act, the rules of law and equity, including the law merchant, shall govern.⁷ However, the Uniform Partnership Act, which has been enacted in most jurisdictions to govern ordinary partnerships, states that it applies to limited partnerships "except insofar as the statutes relating to such partnerships are inconsistent herewith,"⁸ and the 1976 Revision of the Uniform Limited Partnership Act states that cases unprovided for in the 1976 Revision shall be governed by the provisions of the Uniform Partnership Act.⁹

II. FORMATION OF A LIMITED PARTNERSHIP

Unlike a general partnership, the formation of a limited partnership cannot be accomplished simply by an informal agreement. To form a limited partnership, statutory formalities similar to those required for creation of a corporation must be followed.¹⁰ Persons desiring to form a limited partnership can do so by signing and swearing to a certificate and filing it in the public office or offices designated by the limited partnership statute. The certificate must contain basic information about the limited partnership, such as its name, the character of its business, the name and residence of each general partner and each limited partner, the contributions of each limited partner, and the share of profits or other compensation that each limited partner is to receive.¹¹

Most of the existing limited partnership statutes provide that the cer-

7. UNIFORM LIMITED PARTNERSHIP ACT § 29 (1916).

8. UNIFORM PARTNERSHIP ACT § 6(2).

9. UNIFORM LIMITED PARTNERSHIP ACT § 1105.

10. UNIFORM LIMITED PARTNERSHIP ACT § 2 (1916). However, a limited partnership effective to govern relations among the members (general partners and limited partners) has been held to come into existence upon their executing a certificate of limited partnership even though the certificate is never recorded as provided by statute. *Hoefer v. Hall*, 75 N.M. 751, 411 P.2d 230 (1965).

11. UNIFORM LIMITED PARTNERSHIP ACT § 2 (1916), provides:

(1) Two or more persons desiring to form a limited partnership shall (a) Sign and swear to a certificate, which shall state

- I. The name of the partnership,
- II. The character of the business,
- III. The location of the principal place of business,
- IV. The name and place of residence of each member; general and limited partners being respectively designated,
- V. The term for which the partnership is to exist,

tificate shall be filed with the county clerk, recorder, or other designated public official of the county in which the principal place of business is situated, and some statutes provide in addition that copies of the certificate shall be filed in other counties where the limited partnership has places of business. The 1976 Revision of the Uniform Act, apparently in an effort to bring the procedure for forming a limited partnership into line with that generally required for organizing a corporation, provides that a certificate of limited partnership shall be filed in the office of the Secretary of State rather than in some local office or offices.¹² Similar to the provisions of business corporation acts, which authorize the inclusion of "optional" provisions in a corporation's articles of incorporation, the Revised Uniform Limited Partnership Act permits the certificate of limited partnership to include any matters the partners may desire.¹³

The 1916 Uniform Limited Partnership Act does not refer to a "partnership agreement" or to "articles of partnership," apparently on the assumption that all important matters affecting a limited partnership

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- VI. The amount of cash and a description of and the agreed value of the other property contributed by each limited partner,
 - VII. The additional contributions, if any, agreed to be made by each limited partner and the times at which or events on the happening of which they shall be made,
 - VIII. The time, if agreed upon, when the contribution of each limited partner is to be returned,
 - IX. The share of the profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution,
 - X. The right, if given, of a limited partner to substitute an assignee as contributor in his place, and the terms and conditions of the substitution,
 - XI. The right, if given, of the partners to admit additional limited partners,
 - XII. The right, if given, of one or more of the limited partners to priority over other limited partners, as to contributions or as to compensation by way of income, and the nature of such priority,
 - XIII. The right, if given, of the remaining general partner or partners to continue the business on the death, retirement or insanity of a general partner, and
 - XIV. The right, if given, of a limited partner to demand and receive property other than cash in return for his contribution.
- (b) File for record the certificate in the office of [here designate the proper office].
 - (2) A limited partnership is formed if there has been substantial compliance in good faith with the requirements of paragraph (1).

12. UNIFORM LIMITED PARTNERSHIP ACT § 201(a). "The fact that a certificate of limited partnership is on file in the office of the Secretary of State is notice that the partnership is a limited partnership and the persons designated therein as limited partners are limited partners, but it is not notice of any other fact." *Id.* § 208. "While this section is designed to preserve the limited liability of limited partners, the constructive 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." Commissioners' Comment, *id.* § 208.

13. *Id.* § 201(a)(13).

and the limited partners will be set forth in the certificate of limited partnership. The practice has developed, however, for participants forming a limited partnership to enter into a comprehensive partnership agreement and to include in the certificate of limited partnership only a part of those matters covered in the agreement. Under the 1976 Revision, most of the items that must be included in the certificate of limited partnership are items concerning which firm creditors should be put on notice, *e.g.*, the addition or withdrawal of partners and capital. Other important matters can be covered in a separate partnership agreement.¹⁴

The Commissioners on Uniform State Laws, discussing provisions of the Revised Act governing the certificate, said:

In general, the certificate is intended to serve two functions: first, to place creditors on notice of the facts concerning the capital of the partnership and the rules regarding additional contributions to and withdrawals from the partnership; second, to clearly delineate the time at which persons

14. *Id.* § 201 provides:

- (a) In order to form a limited partnership two or more persons must execute a certificate of limited partnership. The certificate shall be filed in the office of the Secretary of State and set forth:
 - (1) the name of the limited partnership;
 - (2) the general character of its business;
 - (3) the address of the office and the name and address of the agent for service of process required to be maintained by Section 104;
 - (4) the name and the business address of each partner (specifying separately the general partners and limited partners);
 - (5) the amount of cash and a description and statement of the agreed value of the other property or services contributed by each partner and which each partner has agreed to contribute in the future;
 - (6) the times at which or events on the happening of which any additional contributions agreed to be made by each partner are to be made;
 - (7) any power of a limited partner to grant the right to become a limited partner to an assignee of any part of his partnership interest, and the terms and conditions of the powers;
 - (8) if agreed upon, the time at which or the events on the happening of which a partner may terminate his membership in the limited partnership and the amount of, or the method of determining, the distribution to which he may be entitled respecting his partnership interest, and the terms and conditions of the termination and distribution;
 - (9) any right of a partner to receive distributions of property, including cash from the limited partnership;
 - (10) any right of a partner to receive, or of a general partner to make, distributions to a partner which include a return of all or any part of the partner's contribution;
 - (11) any time at which or events upon the happening of which the limited partnership is to be dissolved and its affairs wound up;
 - (12) any right of the remaining general partners to continue the business on the happening of an event of withdrawal of a general partner; and
 - (13) any other matters the partners determine to include therein.

become general partners and limited partners.¹⁵

The Commissioners recognized that the basic document in a limited partnership is now the partnership agreement rather than the certificate of limited partnership, and pointed out that under the Revised Act the certificate of limited partnership "is not a constitutive document (except in the sense that it is a statutory prerequisite to the creation of the limited partnership), and merely reflects matters as to which creditors should be put on notice."¹⁶

III. PROTECTION OF A LIMITED PARTNER FROM UNLIMITED LIABILITY—PERMISSIBLE ACTIVITIES OF A LIMITED PARTNER

One of the most important tasks for the lawyer setting up a limited partnership is to protect the limited partners from potential liabilities. Under the 1916 Act, little danger exists that limited partners will lose the shield of limited liability if reasonable care is used to comply with statutory requirements in setting up the limited partnership and statutory limitations on the activities of limited partners are carefully observed. The draftsman of the 1916 Act commented as follows:

Practically all the differences between the new [1916] Uniform Act and the existing statutes are due to the desire of the Conference to present to the legislatures of the several states an act, under which a person willing to invest his money in a business for a share in the profits, may become a limited partner, with the same sense of security from any possibility of unlimited liability as the subscribers to the shares of a corporation.¹⁷

The Act limits the liability of a person who has attempted to become a limited partner if there has been substantial compliance with statutory

15. Commissioners' Comment, *id.* Under the 1976 Revision, the certificate of limited partnership is, at any time, supposed to be an accurate description of the facts to which it relates and does not speak merely as of the time it was executed. A general partner who learns of false statements in the certificate as filed, or of changes that make the certificate inaccurate, must promptly amend the certificate. *Id.* § 202(c). However, the Revision provides a "safe harbor" for a partner who amends the certificate within thirty days to reflect certain important events listed in the statute; no person can recover for damages sustained in the interim. *Id.* § 202(e). *See also id.* § 207 (imposing liability for false statements in the certificate).

16. Prefatory Note, *id.*

17. Lewis, *supra* note 6, at 723. "The limited partner is in 'a position analogous to that of a corporate shareholder,' an investor who likewise has limited liability and no voice in the operation of an enterprise." *Lichtyger v. Franchard Corp.*, 18 N.Y.2d 528, 536, 223 N.E.2d 869, 873, 277 N.Y.S.2d 377, 383 (1966). *See also Grynberg v. B.B.L. Assocs.*, 436 F. Supp. 564, 568 (D. Colo. 1977) ("a limited partnership is basically an association of individuals . . . that . . . has some quasi-corporate characteristics"); *Lynn v. Cohen*, 359 F. Supp. 565, 567 (S.D.N.Y. 1973) (under New York law, a limited partnership more closely resembles a corporation than an ordinary partnership).

requirements.¹⁸ Furthermore, failure to comply with the requirements of the Act does not make a person who believed he was a limited partner liable as a general partner. Even in the absence of substantial compliance with statutory requirements, the Act gives blanket protection to a person who in good faith believes he is a limited partner by providing:

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 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.¹⁹

18. UNIFORM LIMITED PARTNERSHIP ACT §§ 2, 7 (1916). *Compare id.*, with *Bisno v. Hyde*, 290 F.2d 560 (9th Cir. 1961) (defendant held liable to creditors as general partner where there was a failure to record certificate of limited partnership).

19. UNIFORM LIMITED PARTNERSHIP ACT § 11 (1916).

Section 11 is broad and highly remedial. The existence of a partnership—limited or general—is not essential in order that it shall apply. . . . It ought to be construed liberally, and with appropriate regard for the legislative purpose to relieve . . . the strictness of the earlier statutes and decisions. . . . Its application should not be restricted to cases where there was an attempt to organize a limited partnership under that act.

Giles v. Vette, 263 U.S. 553, 563 (1924) (construing Illinois legislation to protect limited partners in a limited partnership formed under pre-Uniform Act limited partnership act and engaged in a business—securities brokerage—prohibited by the Uniform Act) (citations omitted). *See also Rathke v. Griffith*, 36 Wash. 2d 394, 218 P.2d 757 (1950) (§ 11 held to protect all persons who believe they are limited partners, either in a limited partnership under the Uniform Act or in one under the earlier statutes).

For the protection provided a limited partner in a foreign limited partnership doing business in a state without having registered, see notes 70-79 *infra*.

There are certain exceptions to this so-called "escape provision," such as where the limited partner exercises control over the business, . . . or made false statements in the certificate where reliance is had on such false statements and loss is thereby suffered, . . . or where the surname of a limited partner appears in the partnership name.

J.C. Wattenbarger & Sons v. Sanders, 191 Cal. App. 2d 857, 862, 13 Cal. Rptr. 92, 94 (1961) (court emphasized that provision was designed to protect one who acts mistakenly but in good faith). *See also Russell v. Warner*, 96 Cal. App. 2d 986, 217 P.2d 43 (1950) (held that evidence supported a finding that neither the general partner nor the limited partner had substantially complied in good faith with requirements for formation of a limited partnership: an abbreviation of the limited partner's surname appeared in the partnership name, the limited partner was an authorized co-signer of partnership checks, and the certificate of limited partnership had not been filed in either of two required public offices; further, the court held that irrespective of whether the person claiming to be a limited partner was in fact a limited partner, he was liable to plaintiff, who fraudulently had been induced by the general partner to invest in the partnership, because the person claiming to be a partner had later ratified the general partner's acts).

In *Giles v. Vette*, 263 U.S. 553 (1924), upon finding that a limited partnership had not been properly organized, persons who believed themselves to be limited partners returned all the divi-

The 1976 Revision contains a somewhat clumsily worded section which perhaps weakens the overall protection afforded a person who erroneously believes himself to be a limited partner. The section provides that to enjoy the protection afforded by the statute, a person must not be a general partner, must "in good faith" believe that he has become a limited partner in the enterprise and must, on ascertaining the mistake, (1) cause an appropriate certificate of limited partnership or a certificate of amendment to be executed and filed, or (2) withdraw from future equity participation in the enterprise.²⁰ The "good faith" language does not seem to make a substantive change in the protection provided the limited partner by the 1916 Act. The section does add somewhat to the limited partner's protection in that it eliminates an ambiguity in the 1916 Act by providing that if a person who erroneously had believed himself a limited partner chooses to protect himself by withdrawing from the enterprise, he is not required to renounce any of his then current interest in the enterprise. This current interest presumably includes his portion of profits earned by the enterprise before he learned of the mistake; he simply must not continue as an equity participant.²¹ Alternatively, the Revision apparently tries to safeguard the interests of a party who deals with an enterprise thinking that a person is a general partner when that person believes himself to be a limited partner. In such a situation, the Revision seemingly imposes liability as a general partner on the person who erroneously believes himself to be a limited partner for transactions entered into before the filing of an appropriate certificate or before the person withdraws from the enterprise.²²

dends they had received during the course of the business. In exonerating them under § 11, the Court did not have to decide whether such a return of back profits was necessary. This question was answered in part in *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, 80 A.2d 906 (1951), where the court held that a person erroneously believing himself to be a limited partner does not have to return profits received from the business before the creditor who is seeking to impose personal liability on him became a creditor of the business. Left open is the question whether a person believing himself a limited partner must return profits received after the challenging creditor became a creditor.

20. UNIFORM LIMITED PARTNERSHIP ACT § 304(a).

21. Commissioners' Comment, *id.* § 304.

22. The relevant section of the Revision reads:

A person who makes a contribution of the kind described in subsection (a) [*i.e.*, 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 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 the 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

Both the 1916 and the 1976 versions of the Act vest general control of the limited partnership in the general partners, stating that subject to certain exceptions a general partner has "all the rights and powers" and is subject to "all the restrictions and liabilities of a partner in a partnership without limited partners."²³ The 1916 and 1976 versions differ from each other considerably, however, in their statements on the powers that limited partners have or may be given.

Under the 1916 Act, a limited partner may lose his personal immunity and become generally liable for the partnership's obligations if "in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business."²⁴ That Act and the relatively few decisions discussing the control test are not very helpful "on the critical question of how much review, advisory, management selection, or veto power a limited partner may have without being regarded as taking part in control."²⁵ The resulting uncertainty has undoubtedly

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.

Id. § 304(b).

23. UNIFORM LIMITED PARTNERSHIP ACT § 9(1) (1916) (subject to the exception that without the written consent or ratification of the specific act by all the limited partners, a general partner or all the general partners have no authority to do the following: (a) any act in contravention of the certificate of limited partnership; (b) any act which would make it impossible to carry on the partnership's ordinary business; (c) confess a judgment against the partnership; (d) possess partnership property, or assign their rights in specific partnership property, for other than partnership property, for other than a partnership purpose; (e) admit a person as a general partner; (f) admit a person as a limited partner, unless the right so to do is given in the certificate; (g) continue the business with partnership property on the death, retirement, or insanity of a general partner, unless the right so to do is given in the certificate). *See* UNIFORM LIMITED PARTNERSHIP ACT § 403 (except as provided in the Act or in the partnership agreement).

24. "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." UNIFORM LIMITED PARTNERSHIP ACT § 7 (1916). *See, e.g.,* Van Arsdale v. Claxton, 391 F. Supp. 538 (S.D. Cal. 1975); Donroy, Ltd. v. United States, 196 F. Supp. 54 (N.D. Cal. 1961), *aff'd*, 301 F.2d 200 (9th Cir. 1962).

If a certificate of limited partnership contains a false statement, anyone who suffers loss by reliance on such statement may hold liable any party to the certificate who knew the statement to be false at the time he signed the certificate or, subsequently, within a sufficient time before the statement was relied upon to enable him to cancel or amend the certificate. UNIFORM LIMITED PARTNERSHIP ACT § 6 (1916). In some states, the limited partnership statute imposes liability if the party to the certificate should have known the statement to be false. *See, e.g.,* DEL. CODE ANN. tit. 6, § 1706 (1975).

25. J. CRANE & A. BROMBERG, PARTNERSHIPS 147 (1968). *See also* Feld, *The "Control" Test for Limited Partnerships*, 82 HARV. L. REV. 1471, 1477-83 (1969) (suggesting three possible standards that courts may use in determining the permissible scope of a limited partner's participation in the enterprise); Feldman, *The Limited Partner's Participation in the Control of the Partnership Business*, 50 CONN. B.J. 168 (1976).

been one of the greatest drawbacks to the use of the limited partnership form.²⁶

Although some authorities indicate that the limited partner is privileged to give advice to the general partners,²⁷ control of the partnership affairs must be vested solely or largely in general partners, who are unlimitedly liable for obligations of the enterprise.²⁸ However, the courts have generally been liberal in permitting some participation in the business by a limited partner, in a number of instances considerable participation, without imposing the liability of a general partner on him. For example, they have not imposed such liability on a limited partner for serving as the partnership's sales manager or as foreman of its automobile repair shop, advising the general partner on some partnership transactions, or negotiating or signing some partnership

26. See Feld, *supra* note 25, at 176-79.

27. See *Plasteel Prods. Corp. v. Helman*, 271 F.2d 354 (1st Cir. 1959); 2 R. ROWLEY, PARTNERSHIP ch. 53 (2d ed. 1960). However, as Feld, *supra* note 25, at 1477, points out, a decision on whether a limited partner is exercising control is a factual determination and "advice" of limited partners may carry great weight with general partners, especially if the limited partners have large investments in the limited partnership and are "carrying" the general partners' interest. "Certainly in the absence of any standard for determining control, counsel could not confidently permit a regular practice of 'advice.'" *Id.*

Some of the early limited partnership statutes specifically authorized the limited partner to give advice concerning the limited partnership's management. *Id.* at 1478.

28. See generally Feld, *supra* note 25.

In *Holzman v. De Escamilla*, 86 Cal. App. 2d 858, 195 P.2d 833 (1948), limited partners in a limited partnership engaged in vegetable and truck crop farming controlled the firm's bank accounts; they were active in determining what crops were planted, in some instances dictating the planting of certain vegetables against the wishes of the general partner; and they eventually required the general partner to resign as manager of the farm and selected his successor. The court affirmed the trial judge's decision that they were liable to the firm's creditors as general partners.

"The control test . . . presents substantial interpretative problems in cases falling between the extremes of the wholly passive investor and the partner who manages the business on a day-to-day basis." Feld, *supra* note 25, at 1473.

The control test creates, for example, special difficulty when the limited partnership is used for large real estate investment.

The promoters of such ventures, whether for the construction of new facilities or the purchase of old, customarily act as general partners; the passive investors buy certificates of limited partnership, which are essentially securities. Such investors should be allowed to participate in basic organizational decisions; e.g., the election of management and its discharge for cause. Indeed some regulatory authorities insisted upon such protective clauses as a prerequisite to permitting the sale of these interests. As a result, however, the limited liability status of the investors was subject to such doubt, because of section 7, that the use of the partnership device was hampered, despite the fact that the limited partnership form offers the most satisfactory combination of tax and business advantages for the typical real estate syndicate.

N. LATTIN, R. JENNINGS, & R. BUXBAUM, CORPORATIONS CASES AND MATERIALS 45-46 (4th ed. 1968). California has amended its version of § 7 of the UNIFORM LIMITED PARTNERSHIP ACT in an effort to deal with this problem. See CAL. CORP. CODE § 15507 (Deering Supp. 1978).

contracts.²⁹

The 1976 Revision of the Uniform Act retains the “control” test³⁰ but gives the limited partners greater protection than the 1916 Act. The

29. As to how far a limited partner can go without incurring liability as a general partner, see *Grainger v. Antoyan*, 48 Cal. 2d 805, 313 P.2d 848 (1957) (limited partner was sales manager for firm, made loan against chattel mortgage to firm, leased its building to the firm, and purchased certain assets for fair market value when firm became insolvent, but he had no control over employment, wages, salaries, purchases, prices, the extension of credit, or the funds of the firm and in no way took part in the control of the firm; the court sustained the finding by the lower court that the limited partner was never a general copartner in the firm), *noted in* 56 MICH. L. REV. 285 (1957); *Silvola v. Rowlett*, 129 Colo. 522, 272 P.2d 287 (1954) (limited partner was foreman in automobile repair shop, purchased parts for the firm only when available locally, extended credit to certain classes of persons as predetermined by the general partner, and when asked by the general partner gave his opinion on certain proposed transactions, but the general partner made all non-local and major purchases, approved credit extensions, had sole and exclusive control of the partnership bank account, and exercised control and direction over all aspects of the firm's business; further, the plaintiff, as the firm's accountant, had actual knowledge of the terms of the certificate of limited partnership; thus neither the limited partner's rendition of services after the formation of the limited partnership nor his expressions upon the advisability of transactions when sought by the general partner operated to deprive him of protection as a limited partner); *Rathke v. Griffith*, 36 Wash. 2d 394, 218 P.2d 757 (1950) (bylaws named limited partner as member of three-man board of directors, but he never functioned as such; two deeds were made out to him and the general partners as doing business in the firm name; he signed some leases and other agreements for the firm, in most cases along with the general partners; he accompanied the managing partner on a trip to negotiate a loan for the firm and negotiated with a contractor for the construction of a building; the court held that he was not liable as a general partner, at least where firm creditors had not relied on his being a general partner or even understood him to be anything other than a limited partner).

In *Plasteel Prods. Corp. v. Eisenberg*, 170 F. Supp. 100 (D. Mass. 1959), the partnership agreement described the limited partners as trustees of a designated trust, and it provided that the son of one of the trustees would act as general sales manager with extensive power over the fiscal operations of the business. The court, thinking of the son as a possible agent for that particular trustee refused, on a motion for summary judgment, to hold as a matter of law that the father-trustee was protected by the state's limited partnership act. However, the motion for summary judgment by the other trustees was allowed on the ground that they were limited partners only. On appeal, the creditor contended that the other trustees should also be held liable since they participated in the control of the business by selecting the general sales manager and by providing that he and the general partner should jointly control the financial aspects of the business. The Court of Appeals for the First Circuit, however, affirmed the decision of the court below, commenting that the general partner could have discharged the general sales manager at any time, that joint signing by the manager and the general partner would then have become unnecessary, and that therefore the action of the trustees in agreeing to the arrangement did not constitute “taking part in the control of the business” within the meaning of the Act. *Plasteel Prods. Corp. v. Helman*, 271 F.2d 354, 356 (1st Cir. 1959). *But see* *Holzman v. De Escamilla*, 86 Cal. App. 2d 858, 195 P.2d 833 (1948) (consent of the purported limited partners was necessary to issue checks and they could issue checks without the general partner's approval; general liability was imposed on the purported limited partners).

30. The Commissioners commented that the Revision “carries over the basic test from former Section 7 [UNIFORM LIMITED PARTNERSHIP ACT § 7 (1916)]—whether the limited partner ‘takes part in the control of the business’—in order to insure that judicial decisions under the prior

1976 Revision provides that even a limited partner who participates in control, as long as he is not also a general partner and his participation in control is not substantially the same as the exercise of the powers of a general partner, is liable only to persons who have transacted business with the limited partnership with actual knowledge of his participation in control.³¹ Furthermore, the 1976 Revision sanctions the common practice in partnership agreements of giving voting power to limited partners by specifically providing that "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."³² Finally, the 1976 Revision provides "safe harbors" for limited partners by enumerating certain activities in which a limited partner may engage, including voting on specified matters, without being considered to have taken part in the control of the business. The Revision provides that a limited partner does not participate in control solely by one or more of the following:

- (1) being a contractor for or an agent or employee of the limited partnership or of a general partner;
- (2) consulting with and advising a general partner with respect to the business of the limited partnership;
- (3) acting

uniform law remain applicable to the extent not expressly changed." Commissioners' Comment, UNIFORM LIMITED PARTNERSHIP ACT § 303.

31. *Id.* § 303(a). The Commissioners commented on this section as follows:

The second sentence of Section 303(a) reflects a wholly new concept. 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 dealings with third parties, the "is not substantially the same as" test was introduced.

Commissioners' Comment, *id.*

32. *Id.* § 302. Commissioners' Comment, *id.* reads:

Section 302 is new, and must be read together with subdivision (b)(5) of Section 303. Although the prior uniform law did not speak specifically of the voting powers of limited partners, it is not uncommon for partnership agreements to grant such power to limited partners. Section 302 is designed only to make it clear that the partnership agreement may grant such power to limited partners. If such powers are granted to limited partners beyond the "safe harbor" of Section 303(b)(5), a court may hold that, under the circumstances, the limited partners have participated in "control of the business" within the meaning of Section 303(a). Section 303(c) simply means that the exercise of powers beyond the ambit of Section 303(b) is not ipso facto to be taken as taking part in the control of the business.

See also id. § 405, which provides: "The partnership agreement may grant to all or certain identified general partners the right to vote (on a per capita or any other basis), separately or with all or any class of the limited partners, on any matter." The Commissioners on Uniform State Laws comment: "Section 405 is new and is intended to make it clear that the Act does not require that the limited partners have any right to vote on matters as a separate class." Commissioners' Comment, *id.*

as surety for the limited partnership; (4) approving or disapproving an amendment to the partnership agreement; or (5) voting on one or more of the following matters: (i) the dissolution and winding up of the limited partnership; (ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership other than in the ordinary course of its business; (iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business; (iv) a change in the nature of the business; or (v) the removal of a general partner.³³

In the following comments, the Commissioners on Uniform Laws sum up in somewhat reverse order the changes that the 1976 Revision makes in order to provide greater protection to limited partners:

[The Revision] lists a number of activities in which a limited partner may engage without being held to have so participated in the control of the business that he assumes the liability of a general partner. Moreover, it goes on to confine the liability of a limited partner who merely steps over the line of participation in control to persons who actually know of that participation in control. General liability for partnership debts is imposed only on those limited partners who are, in effect, "silent general partners." With that exception, 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.³⁴

Under the 1916 Act, if a limited partner's name appears in the partnership name, he is liable as a general partner to partnership creditors who extend credit to the partnership without actual knowledge that he is not a general partner, unless: (1) the limited partner's name is also the name of a general partner, or (2) before the time the limited partner became such, the business had been carried on under a name in which his surname appeared.³⁵ The 1976 Revision modifies these provisions by imposing liability on the limited partner if he *knowingly* permits his name to be used in the name of the limited partnership, except in the two enumerated circumstances.³⁶

33. *Id.* § 303(b). "The enumeration in subsection (b) [of § 303] 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." *Id.* § 303(c).

34. Prefatory Note, UNIFORM LIMITED PARTNERSHIP ACT.

35. UNIFORM LIMITED PARTNERSHIP ACT § 5 (1916).

36. UNIFORM LIMITED PARTNERSHIP ACT §§ 102(2), 303(d). Under the 1976 Revision, the name of a limited partnership must contain without abbreviation the words "limited partnership" and may not be the same as, or deceptively similar to, the name of any corporation or limited partnership organized under the laws of the state or licensed or registered as a foreign corporation or limited partnership in the state. *Id.* §§ 102(1), (4). A limited partnership name may be reserved

Even if a limited partner participates in the control of the partnership, he may still be able to escape liability by bringing himself within an exception to the control test that is recognized in both the 1916 and the 1976 versions of the Act. This exception permits a limited partner to exercise his "rights and powers as a limited partner."³⁷ No cases have been found that apply or interpret this exception.

Under the 1916 version of the Act, a limited partner is privileged to lend money to, and transact other business with, the partnership and, unless he is also a general partner, he may receive, along with general partnership creditors, a pro rata share of the partnership's assets for claims he has against the partnership resulting from such loans or transactions.³⁸ The 1916 Act, however, contains what, in effect, is a special fraudulent conveyance provision. It provides that with respect to a claim arising out of a limited partner's loan to the partnership or a business transaction with it, the limited partner shall not: (1) receive or hold as collateral security any partnership property, or (2) receive from a general partner or the partnership any payment, conveyance, or release from liability, if at the time partnership assets are not sufficient to discharge partnership liabilities to persons not claiming as general or limited partners.³⁹ The Act goes on to say that a limited partner's receipt of collateral security or a payment, conveyance, or release in violation of this provision is a fraud on partnership creditors.⁴⁰ The 1976 Revision omits this special fraudulent conveyance provision. The Revision simply reads:

Except as provided in the partnership agreement, a partner [which by definition means a general partner or a limited partner]⁴¹ 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.⁴²

Thus, the Revision apparently permits a general partner, as well as a limited partner, who makes a loan to the partnership or transacts business with it to share pro rata in partnership assets along with general

by filing an application with the Secretary of State. *Id.* § 103. The Revision contemplates that the registration of limited partnership names and corporate names will be integrated.

37. See UNIFORM LIMITED PARTNERSHIP ACT § 303; UNIFORM LIMITED PARTNERSHIP ACT § 7 (1916). For several possible constructions of the exception as it appears in the 1916 version of the Act, see Feld, *supra* note 25, at 477-83.

38. UNIFORM LIMITED PARTNERSHIP ACT § 13(1) (1916).

39. *Id.*

40. *Id.* § 13(2).

41. UNIFORM LIMITED PARTNERSHIP ACT § 101(8).

42. *Id.* § 107.

creditors on claims he holds against the partnership arising from such loan or transaction.⁴³ Of course, in some circumstances, a state's general fraudulent conveyance statute may require setting aside a transfer of partnership property to a partner. Similarly, doctrines developed under the bankruptcy or insolvency laws may require that claims based on loans made by a partner to the partnership be subordinated to claims of outside partnership creditors.

IV. LIMITED PARTNERSHIP WITH CORPORATE GENERAL PARTNER

Though a limited partner can, through careful planning and strict observance of statutory requirements, shield himself from potential liability beyond his investment in the firm, a general partner is subject to unlimited liability for firm debts and obligations. This risk often deters an individual investor from assuming the role of a general partner. Hence, it has become a common practice to form limited partnerships with a corporation as the only general partner. Any one of the following kinds of situations may occur: (1) an established corporation engaged in regular business operations enters a limited partnership as the general partner; (2) promoters of a venture, *e.g.*, a real estate syndicate, desiring to retain control while shielding themselves from unlimited liability, cast the venture in the form of a limited partnership; they organize a corporation, in which they hold all or most of the shares, to serve as general partner and bring in outside investors as limited partners; they themselves do not become limited partners; and (3) persons who want to set up an enterprise as a limited partnership and become limited partners for most or some of their investment organize a corporation in which they become principal shareholders, directors, and officers, to act as the limited partnership's sole general partner, thus shielding themselves from liability while retaining effective control of the enterprise.

The legislators who enacted the early limited partnership statutes in this country probably did not contemplate that a corporation would become a general partner, perhaps not even that a corporation would become a limited partner. They apparently assumed that a limited partnership would have at least one individual partner who would be unlimitedly liable for firm obligations. Furthermore, some courts very early laid down the rule that a corporation lacks the power to enter a partnership of any kind, ordinary or limited, absent authorization by

43. See Commissioners' Comment, *id.*

statute or the corporation's charter.⁴⁴ However, present statutory law clearly indicates that a corporation can become a partner. The corporate law rule denying a corporation's capacity to enter into a partnership was showing signs of breaking down even in the absence of statute. It has now been repudiated by modern business corporation acts, which expressly authorize a corporation to enter partnerships and joint ventures.⁴⁵ Furthermore, the Uniform Partnership Act and the 1976 Revision of the Uniform Limited Partnership Act define the "persons" who may form partnerships and limited partnerships to include "corporations."⁴⁶ Moreover, the 1976 Revision clearly contemplates that a corporation can become the general partner in a limited partnership.⁴⁷ Nothing in the 1916 version of the Uniform Limited Partnership Act disqualifies a corporation from becoming either a limited or a general partner, and the Uniform Partnership Act states that its provisions (which presumably include its definition of "person") apply to limited partnerships except where inconsistent with limited partnership provisions.⁴⁸

A question that has been recently litigated is whether in a limited partnership a limited partner who is a shareholder, director, or officer of the incorporated general partner and who exercises control of the limited partnership through the incorporated general partner becomes liable as a general partner because of such exercise of control. A decision by the Texas Supreme Court holds that limited partners cannot escape personal liability when they take part in the control of the business even though they exercise that control through a corporation.⁴⁹ In

44. *People v. North River Sugar Ref. Co.*, 121 N.Y. 582, 24 N.E. 834 (1890); *Luling Oil & Gas Co. v. Humble Oil & Ref. Co.*, 144 Tex. 475, 191 S.W.2d 716 (1945); W. FLETCHER, CORPORATIONS § 2520 (rev. ed. 1968); Annot., 60 A.L.R.2d 917, 920 (1958). However, this rule seems to have been designed to protect shareholders and not to prohibit some violation of public policy concerning the partnership arrangement. Comment, *The Limited Partnership with a Corporate General Partner—Federal Taxation—Partnership or Association?* 24 Sw. L.J. 285, 288 (1970).

45. See, e.g., DEL. CODE ANN. tit. 8, § 122(11) (1953); N.Y. BUS. CORP. LAW § 202(a)(15) (McKinney 1963); MODEL BUS. CORP. ACT § 4(g) (1969).

46. UNIFORM PARTNERSHIP ACT § 2; UNIFORM LIMITED PARTNERSHIP ACT § 101(11).

47. See UNIFORM LIMITED PARTNERSHIP ACT § 204(a).

48. UNIFORM PARTNERSHIP ACT § 6(2). See also *Port Arthur Trust Co. v. Muldrow*, 155 Tex. 612, 291 S.W.2d 312 (1956) (a corporation may become a limited partner in a limited partnership; a corporation is a "person" within the meaning of the Uniform Act). Cf. *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543 (Tex. 1975) (limited partners who take part in the control of a limited partnership, whether within or outside their capacity as officers of the incorporated general partner, are personally liable as general partners; decision was reserved on whether *Muldrow* should be extended to permit a corporation to become a general partner in a limited partnership).

49. *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543 (Tex. 1975), noted in 29 Sw. L.J. 791

that case, plaintiffs sought to hold the limited partners, who were officers of the general partner, liable on a lease that the incorporated general partner had entered on behalf of the limited partnership. Plaintiffs knew at the time of the lease that the general partner was a corporation. The limited partners argued that to impose liability on a limited partner two elements must exist: (1) the limited partner must take part in the control of the business, and (2) the limited partner must have held himself out as being a general partner to the extent that the limited partnership creditor or other plaintiff relied upon the limited partner's personal liability. The court rejected this argument, saying that liability could be imposed without the second element. It pointed out that the Uniform Limited Partnership Act provides that a limited partner who takes part in the control of the business subjects himself to personal liability as a general partner without any mention of a requirement of reliance by the party attempting to hold the limited partner liable. The court expressed concern that if limited partners were permitted to operate a limited partnership through a corporation with minimum capitalization, the statutory requirement that a limited partnership have at least one general partner with general liability could be circumvented.⁵⁰

Rejecting the reasoning of the Texas decision, other jurisdictions have held that the dominant consideration in imposing personal liability on a limited partner is not the exercise of control by the limited partner, but rather the plaintiff's reliance on the appearance of general partnership status which the exercise of control may create.⁵¹ Under these decisions, a limited partner does not become liable as a general partner by taking part in the control of the limited partnership business while acting as an officer or agent of the corporation that is the limited partnership's sole general partner, provided: (1) the limited partnership's creditors deal with it with full awareness of its general partner's corporate status, and (2) the general partner is adequately capitalized

(1975). For a detailed discussion of the *Delaney* case, see Hamilton, *Corporations*, 30 Sw. L.J. 153 (1976).

50. *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543, 546 (Tex. 1975).

51. *Western Camps, Inc. v. Riverway Ranch Enterprises*, 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (1977); *Frigidaire Sales Corp. v. Union Properties, Inc.*, 14 Wash. App. 634, 544 P.2d 781 (1976). See also UNIFORM LIMITED PARTNERSHIP ACT § 303, which provides in pertinent part: "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."

and no other equitable reason exists for disregarding the general partner's separate corporate personality. These decisions emphasize that if a corporate general partner in a limited partnership is organized without sufficient capitalization, making it foreseeable that the general partner would not have sufficient assets to meet its obligations, the corporate entity can be disregarded to avoid injustice.⁵² In appropriate cases, the separate corporate personality of an incorporated general partner in a limited partnership can be disregarded, thereby imposing personal liability on the general partner's shareholders, directors, and officers even if those persons are not also limited partners in the limited partnership.⁵³

V. LIMITED PARTNERSHIP: PARTNERS' RIGHTS AND MISCELLANEOUS RULES

The 1976 Revision of the Uniform Limited Partnership Act requires a limited partnership to maintain an office in the state of its organization, have a resident agent there for the service of process, and keep at the office the following records: (1) a list of the names and last known business addresses of the partners, (2) a copy of the limited partnership certificate, amendments thereto, and executed copies of any powers of attorney pursuant to which any certificate has been executed, (3) copies of the firm's federal, state, and local income tax returns and reports for the last three years, and (4) copies of any effective written partnership agreements and of any financial statements of the firm for the three most recent years.⁵⁴ A limited partner, as well as a general partner, has a right to inspect these records. In a rather backhanded way, the Revision provides that the records "are subject to inspection and copying at the reasonable request, and at the expense, of any partner during ordinary business hours."⁵⁵ Note that the Revision requires the retention only of tax returns and other financial statements that have been prepared. It does not require preparation of financial statements or a standard form of financial report.⁵⁶

Under the 1916 Uniform Limited Partnership Act, a limited part-

52. *Western Camps, Inc. v. Riverway Ranch Enterprises*, 70 Cal. App. 3d 714, 729, 138 Cal. Rptr. 918, 926 (1977); *Frigidaire Sales Corp. v. Union Properties, Inc.*, 14 Wash. App. 634, 640, 544 P.2d 781, 784-85 (1975).

53. See notes 49-50 *supra*.

54. UNIFORM LIMITED PARTNERSHIP ACT §§ 104, 105.

55. *Id.* § 105.

56. *Id.*

ner's contributions to the firm must be in cash or other property, not in services.⁵⁷ General partners, however, may make their contributions in whole or in part in services.⁵⁸ The 1976 Revision explicitly provides that the contribution of a partner, either a general partner or a limited partner, may be "in cash, property, or services rendered, or a promissory note or other obligation to contribute cash or property or to perform services."⁵⁹ Thus, a present contribution of services or a promise to make a payment in cash, contribute property, or perform services is a clearly permissible form of contribution.

For the protection of creditors, the 1916 version of the Uniform Limited Partnership Act restrains withdrawal of capital and preserves a kind of trust fund of partnership assets. This is analogous to corporate law provisions prohibiting dividends and other distributions to shareholders that would impair capital. Upon the winding up of a limited partnership, a limited partner's right to share in profits and to the repayment of capital contributions is subordinated to the rights of creditors, but he has priority over distributions to general partners both of profits and capital contributions.⁶⁰ The 1976 Revision modifies prior law by providing: (1) to the extent that partners are also creditors, other than in respect to their interests in the partnership, they share with other creditors, and (2) general partners and limited partners rank on the same level in the distribution of partnership assets except as is otherwise provided in the partnership agreement.⁶¹

A limited partner has the right to bring a derivative action on behalf of the firm whenever the general partners "have disabled themselves or wrongfully refused" to bring the action.⁶² The judicial holdings grant-

57. UNIFORM LIMITED PARTNERSHIP ACT § 4 (1916).

58. See Commissioners' Comment, UNIFORM LIMITED PARTNERSHIP ACT § 101.

59. *Id.* § 501. See also *id.* § 101(2). The certificate of limited partnership must set forth the value assigned the services or promise of services. *Id.* § 201(5). The value assigned a promise may determine the liability of a partner who fails to carry out his agreement. *Id.* § 502.

60. UNIFORM LIMITED PARTNERSHIP ACT § 23 (1916); *Chalmers v. Weed*, 175 Misc. 740, 25 N.Y.S.2d 195 (Sup. Ct. 1941).

61. UNIFORM LIMITED PARTNERSHIP ACT § 804.

62. *Klebanow v. New York Produce Exch.*, 344 F.2d 294 (2d Cir. 1965); *Riviera Congress Assocs. v. Yassky*, 18 N.Y.2d 540, 223 N.E.2d 876, 277 N.Y.S.2d 386 (1966). But see *Millard v. Newmark & Co.*, 24 App. Div. 2d 333, 266 N.Y.S.2d 254 (1966). See generally Comment, *Standing of Limited Partners to Sue Derivatively*, 65 COLUM. L. REV. 1463 (1965).

In *Wallace v. Sinclair*, 114 Cal. App. 2d 220, 250 P.2d 154 (1953), the court held that if a limited partner can establish that the business of the limited partnership can only be carried on at a loss, he is entitled to dissolution of the limited partnership.

As to the power of a limited partner to bring a class action, see *Lichtyger v. Franchard Corp.*, 18

ing this right were decided under statutes based on the 1916 version of the Uniform Act. The 1976 Revision confirms the right by specifically providing that a limited partner "may bring an action in the right of a limited partnership to recover a judgment in its favor if general partners with authority to do so have refused to bring the action or if an effort to cause those general partners to bring the action is not likely to succeed."⁶³

VI. KINDS OF ENTERPRISES USING THE LIMITED PARTNERSHIP FORM

The limited partnership was employed extensively during the nineteenth century for small-scale manufacturing, wholesaling, and retailing concerns. Today it is frequently used in real estate syndications, in the development and holding of residential property, especially low-income housing, and in such widely diverse enterprises as oil and gas, patents and inventions, and motion pictures. It is the basic business form for the production of Broadway shows, with the producer serving as general partner and investors ("angels") becoming limited partners.

The limited partnership device enables the proprietor of a business to obtain funds without increasing his indebtedness, while retaining control of his business as the general partner. This arrangement may also have advantages for the limited partner: He may expect a more active

N.Y.2d 528, 223 N.E.2d 869, 277 N.Y.S.2d 377 (1966) (limited partners held privileged to bring a class action for damages on behalf of all limited partners even though some limited partners indicated disagreement with position of those bringing the lawsuit).

By bringing a derivative action or class action, a limited partner conceivably subjects himself to some risk of being held to have so participated in the control of the business as to be liable for its obligations as a general partner.

63. UNIFORM LIMITED PARTNERSHIP ACT § 1001. Following the so-called "contemporaneous ownership" rule, which most jurisdictions apply in a derivative action brought in the right of a corporation, the Revision provides that in a derivative action in the right of a limited partnership, "the plaintiff must be a partner at the time of bringing the action and (1) at the time of the transaction of which he complains or (2) his status as a partner had devolved upon him by operation of law or pursuant to the terms of the partnership agreement from a person who was a partner at the time of the transaction." *Id.* § 1002. Similarly, the Revision lays down a rule analogous to the one prevailing in most jurisdictions for a corporate derivative action; it provides that in a derivative action in the right of a limited partnership, "the complaint shall set forth with particularity the effort of the plaintiff to secure initiation of the action by a general partner or the reasons for not making the effort." *Id.* § 1003. Finally, the Revision empowers a court to award a derivative plaintiff reasonable expenses, including attorney's fees, if the derivative action is successful or if the plaintiff receives anything as a result of a judgment, compromise, or settlement. *Id.* § 1004.

Sections 1001-04 of the 1976 Act apparently were patterned on a 1953 Delaware statute. *See* DEL. CODE ANN. tit. 6, § 1732 (1953).

interest on the part of the general partner because the general partner who manages the business is subject to full liability. The limited partner also avoids some of the dangers of other profit-sharing schemes, such as a loan for a share of the profits, which may result in the lender's becoming liable as a partner.⁶⁴ If one lending money to the proprietor of a business assumes any voice in the management or control of the business, he may find himself subject to the unlimited liability of a partner even though he expressly stipulated against it.⁶⁵

Tax considerations most often cause participants in a business enterprise to select the limited partnership form.⁶⁶ A limited partnership provides the participants in an enterprise with the tax treatment of a partnership while insulating a limited partner's personal assets from the firm's liabilities. Assets that the limited partners invest in the enterprise, however, are not protected from the firm's liabilities. In contrast to the "double" federal income tax imposed on corporate income paid out as dividends, limited partnership gains are passed through to the partners without change of character and are not taxed at the partnership level.⁶⁷ For federal income tax purposes, limited partnership profits and losses are allocated to the partners pro rata as individuals.⁶⁸ The pass-through of partnership losses to the partners is especially advantageous in enterprises that generate large write-offs through accelerated depreciation and in oil and gas operations, where intangible drilling cost write-offs and percentage depletion are available.⁶⁹

64. On the dangers of a loan for a share of the profits, see, e.g., *Minute Maid Corp. v. United Foods, Inc.*, 291 F.2d 577 (5th Cir. 1961).

65. See generally Painter, *Partnership by Estoppel*, 16 VAND. L. REV. 327 (1963).

66. See Aslanides, Cardinali, Haynsworth, Lane, & Niesar, *Limited Partnerships—What's Next and What's Left?*, 34 BUS. LAW. 257, 280-304 (1978); Taubman, *Limited Partnerships*, 3 CORP. PRAC. COM. 15, 26-38 (1962). See generally J. BARRETT & E. SEAGO, PARTNERS AND PARTNERSHIPS LAW AND TAXATION ch. 13, § 3 (1956); Wiesner, *Tax Shelters—A Survey of the Impact of the Tax Reform Act of 1976*, 33 TAX. L. REV. 5 (1977); Note, *Tax Classification of Limited Partnerships: Opportunity For Reform*, 30 RUTGERS L. REV. 1260 (1977). See also Epstein, *The Application of the Crane Doctrine to Limited Partnerships*, 45 S. CAL. L. REV. 100 (1972); Stein, *Partnership Taxation for the Limited Partnership with a Corporate General Partner*, 25 U. MIAMI L. REV. 435 (1971); Note, *Death and Taxes: An Analysis of 1014, 743, 236, and the Limited Partnership*, 59 VA. L. REV. 122 (1973).

67. See I.R.C. §§ 702(a), (b) (1954).

68. *Id.* § 701.

69. By using the limited partnership, investors in oil and gas properties gain: (1) limited liability, *id.* § 613, (2) percentage depletion, *id.*, and (3) individual tax write-off of intangible drilling costs. *Id.* § 263(c). This combination of advantages appears to be unavailable under any other business form.

VII. FOREIGN LIMITED PARTNERSHIP

Although the vast majority of states recognize some form of limited partnership,⁷⁰ the status of a limited partnership in states other than its state of organization remains an open question. Neither case law nor administrative practice gives a clear answer concerning, for example, what law governs a limited partnership doing business in a number of states, and whether a limited partner in a limited partnership doing business in other states becomes subject to liability in those other states as though he were a general partner.⁷¹ The 1916 version of the Uniform Limited Partnership Act seems to assume that a limited partnership is to be used only in a small, purely local business and is silent on what a limited partnership should do if it engages in business in other states.⁷²

The 1976 Revision of the Uniform Act deals with the problem of a limited partnership that does business in states other than its state of organization by specifying choice of law rules and providing for registration of out-of-state limited partnerships doing business within the state.⁷³ The Revision provides that the laws of the state under which a foreign limited partnership is organized govern its organization, internal affairs, and the liability of its limited partners, and that a foreign limited partnership may not be denied registration to do business in a state because of differences between the laws of that state and the laws of the state under which it is organized.⁷⁴ The Revision requires a foreign limited partnership to register with the secretary of state of the jurisdiction before doing business there⁷⁵ and sets forth the consequences of a foreign corporation's transacting business within the jurisdiction without registration.⁷⁶ Two such consequences are: the foreign

70. See note 5 *supra* and accompanying text.

71. Prefatory Note, UNIFORM LIMITED PARTNERSHIP ACT.

72. See R. HAMILTON, CASES AND MATERIALS ON CORPORATIONS—INCLUDING PARTNERSHIPS AND LIMITED PARTNERSHIPS 20 n.1(b) (1976).

73. UNIFORM LIMITED PARTNERSHIP ACT §§ 901-08. The 1976 Revision deals only with "foreign limited partnerships" organized under the laws of another state. The Revision defines a "foreign limited partnership" as "a partnership formed under the laws of any State other than this State and having as partners one or more general partners and one or more limited partners." *Id.* § 101(4). See also *id.* § 101(12). Any state that adopts the Revision and desires to regulate by statute the status of limited partnerships or their equivalents, organized under the laws of a foreign country should make appropriate changes in the Revision before adopting it. See Commissioners' Comment, *id.* § 101.

74. *Id.* § 901.

75. *Id.* § 902. For cancellation of registration, see *id.* § 906.

76. *Id.* § 907.

corporation may not maintain an action or proceeding in any court of the state until it has registered, and it is deemed to have appointed the secretary of state as its agent for service of process on claims arising out of its transaction of business within the state.⁷⁷ However, failure to register does not impair the validity of any of its contracts or acts nor prevent it from defending any action or proceeding in a court of the state.⁷⁸ Perhaps most important, a limited partner in an unregistered foreign limited partnership doing business within a state is not liable as a general partner solely because the limited partnership is conducting business without registration.⁷⁹

77. *Id.* §§ 907(a), (d). An appropriate state official may bring an action to restrain an unregistered foreign limited partnership from transacting business in the state. *Id.* § 908.

78. *Id.* § 907(b).

79. *Id.* § 907(c).

