Approved: 3/10/98
Date

MINUTES OF THE HOUSE COMMITTEE ON JUDICIARY.

The meeting was called to order by Chairperson Tim Carmody at 3:30 p.m. on January 26, 1998 in Room 313--S of the Capitol.

All members were present except: Representative Kline (excused)
Representative Gilmore (excused)
Representative Powell (excused)
Representative Ruff (excused)
Representative Adkins (excused)
Representative Wilk (excused)

Committee staff present: Jerry Ann Donaldson, Legislative Research Department
Mike Heim, Legislative Research Department
Jill Wolters, Revisor of Statutes
Jan Brasher, Committee Secretary

Conferees appearing before the committee: Nancy Lindberg, Attorney General's office
Wendy McFarland, ACLU
Greg Debacker, National Congress of Fathers and Children
Elwaine Pomeroy, Member of the National conference of Commissioners on Uniform State Laws (ULC)
Debra Perelman, ULC
Professor Webb Hecker, University of Kansas Law School
Mark Stafford, Kansas Board of Healing Arts

Others attending: See attached list

The Chair called the meeting to order.

Bill Introductions:

Representative Presta requested the introduction of a bill which contains the same provisions as **SB 87**, which was vetoed. Representative Presta stated that **SB 87** had provisions regarding cigarettes infractions, records on premises, tightening up the penalties for juvenile offenders and clarifying the provisions for a jury trial. The conferee stated that it was vetoed last year, because some of the language was ambiguous and some of parties were afraid it would remove the criminal and civil liability from the cigarette retailers. Representative Presta stated that the language has been changed to clarify the bill.

A motion was made by Representative Presta, second by Representative Dahl to introduce Representative Presta's request as a Committee bill. The motion carries.

Nancy Lindberg, Attorney General's Office, requested the introduction of four bills. The first request comes from the Violence Against Women Task Force. The conferee stated that the proposed bill will amend 1996 Supp. 60-3105, protection from abuse statute for emergency relief by deleting the language of 72 hours, to when the court is available. The second bill request provides that the "special D.U.I. sentencing rule include municipal court ordinance violations. The third request, Bill of Rights, would include municipal violations of DUI crashes when a victim is involved. The third request would also change current language to "all victims of DUI crash----", and the provision includes property damage as well. The fourth bill request concerns five items that would amend the Crime Victims Compensation statute. (Attachment 1)

The conferee requested hearings on behalf of the Attorney General on **SB 256** and **HB 2253**.

The Chair stated that the content of request number two is in **HB 2711** introduced by Representative Shultz. The Chair stated that there is a statute dealing with protection from abuse, but not in this form. The Chair suggested that each request be considered separately.

A motion was made by Representative Presta, second by Representative Shultz to introduce the Protection from Abuse request number one from the Attorney General's office. The motion carries.

A motion was made by Representative Mays, second by Representative Dahl to introduce as a Committee bill

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

request three, the Bill of Rights amendment. The motion carries.

A motion was made Representative Shriver, second by Representative Kirk to introduce as a Committee bill request four, amending the Crime Victims Act. The motion carries.

Wendy McFarland, ACLU, requested the introduction of a bill concerning bail bondsmen and their agents. (Attachment 2)

A motion was made by Representative Garner, second by Representative Haley to introduce as a Committee bill. The motion carries.

Greg Debacker, National Congress for Fathers and Children, requested the introduction of a bill to give equal rights to both parents in cases of divorce. The requested bill would change language referring to visitation, and shared physical custody. (Attachment 3)

A motion was made by Representative Pauls, second by Representative Presta to introduce as a committee bill. The motion carries.

SB 8 **Enacting the uniform fraudulent transfers act.**

Elwaine Pomeroy, Uniform Law Commissioners, testified in support of **SB 8**. The conferee related information about the National Conference of Commissioners on Uniform State Laws and discussed the need for **SB 8**. (Attachment 4)

Debra Perelman, ULC, testified in support of **SB 8.** The conferee related the history of the Uniform Fraudulent Transfer Act. The conferee stated that the bill overcomes significant problems. Lawyers can use the case law in other states to help construe the act and it changes our debtor-creditor laws to match more closely changes already existing in federal bankruptcy law. The conferee stated that the purpose of this bill is to provide a creditor with the capacity to procure assets a debtor has transferred to another person in an attempt to keep the assets from being used to satisfy the debt. (Attachment 5)

During Committee discussion with the conferee, the conferee stated that this law is comprehensive and provides one specific place to look. The conferee stated that ULC has been urging passage of bills like **SB 8** since 1984. The conferee stated that Kansas does have common law covering many provisions.

The Chair noted that the bill has the effective date of January 1, 1998 and that will need to be changed when the bill is worked in Committee. In response to a question, the conferee stated that to the best of her knowledge Kansas does not have any concise, comprehensive law on this subject. The conferee continued by stating that what Kansas has is a smattering of common law that covers issues on a section by section basis. Kansas may have a definition for fraudulent transfer and a remedy for that in piecemeal. The conferee stated that there are no repealers because there are not any statutes to be repealed, just case law. This law would supersede common law where it conflicts, but case law would be used.

Ron Smith, Kansas Bar Association, testified in support of **SB 8**.

The Chair closed the hearing on **SB 8**.

SB 9 **Enacting the uniform partnership act (1994)**

The Chair opened hearings on **SB 9**.

Debra Perelman, ULC, testified in support of the revised Uniform Partnership Act, **SB 9**. The conferee provided background information on the partnership statutes. The conferee stated that the revised uniform partnership act is based on the entity theory. The new act provides for a continuation of the business and offers more stability. The new act defines duties logically and due care. The conferee stated that the new act is more explicit. The conferee outlined certain provisions in **SB 9** as that bill compares to the current partnership act. (Attachment 6)

The Committee and conferee discussed how **SB 9** changes current law.

Professor Webb Hecker, University of Kansas School of Law, testified in support of **SB 9**. The conferee discussed the origins of the Uniform Partnership Act (UPA) and provided a general description of the Revised Uniform Partnership Act (RUPA). The conferee stated that **SB 9** is essentially RUPA(1994) with the 1996

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON Judiciary, Room 313-S Statehouse, at 3:30 p.m. on January 26, 1998.

Limited Liability Partnership amendments. The conferee stated that one of the most important features of **SB 9** was the default provision which takes away the leverage of the outgoing partner to leave the partnership in bad faith. The conferee stated that the bill creates a procedure for merging with other entities. The conferee discussed the Senate amendment referring to Section 56 and stated that they related to Limited Liability Partnership (LLP) provisions.(Attachment 7)
The conferee discussed the procedure created for partnerships to merge in Sections 49 through 52.

The conferee stated that there appears to be an omission in the bill. Any other form of organization that permits its members across the board full limited liability has a provision in it that restricts the organization from paying out money or assets to its members if the payout would leave the organization insolvent.

The committee members and conferee discussed the effective date of the provision in the bill. The conferee suggested changing section 67's effective date and section 64 which discusses the transition period. The conferee stated that he felt that the ULC would be okay with making the provisions of this bill prospective.

The conferee and committee members discussed full shield and partial shield statutes of other states.

Ron Smith, KBA, testified that the Kansas Bar Association endorses **SB 9.** (Attachment 8)

HB 2126 **Permitting a limited liability company to exercise the powers of a professional corporation or professional association.**

Mark Stafford, General Counsel, Kansas Board of Healing Arts, testified in support of **HB 2126**. The conferee stated that this bill was requested by the Board to address concerns which arise when certain regulated professionals practice as limited liability companies (LLCs). The conferee discussed each section of the bill. (Attachment 9)

During committee discussion the conferee agreed that this bill applies to anyone who now can form a professional association.

The Chair reminded the Committee members that tomorrow's meeting will be in room 519-S. The Chair stated that the Committee will meet on Wednesday.

The Chair adjourned the meeting at 4:55 p.m.

The next meeting is scheduled for January 27, 1998.

HOUSE JUDICIARY COMMITTEE
GUEST LIST

DATE: 1-26-98

NAME	REPRESENTING
Elwaine F Pomeroy	ULC
Debra Prideaux	ULC
Webb Hecker	KU Law School
GREG DEBACKER	National Congress for Fathers & Children
Shayla Johnston	KTLA
Heather Kendall	Whitney Damron, P.A.
Mark Stafford	Bd of Healing Arts
LARRY BUENING	BD OF HEALING ARTS
Martha Hodgesmith	Attorney General Office
Frank Henderson Jr	Ks. Attorney General
Ann Durkes	DOB
Pam Scott	KFDA
STEVE KEARNEY	KSTA
Eric Manning	Intern
Kathy Porter	OJA
Melissa Wangemann	Sec of State
Nancy Lindberg	AG
Julene Miller	AG

State of Kansas
Office of the Attorney General
301 S.W. 10th Avenue, Topeka 66612-1597

CARLA J. STOVALL
ATTORNEY GENERAL

MAIN PHONE: (785) 296-2215
FAX: 296-6296
TTY: 291-3767

MEMO

To: Rep. Tim Carmody, Chairman
House Judiciary Committee
From: Attorney General Carla Stovall CJS
Subject: Bill Introductions
Date: January 26, 1998

1. **Protection From Abuse Orders -** Amend 1996 Supp. 60-3105, protection from abuse statute for emergency relief by deleting the language of 72 hours, to when the court is available.

2. **DUI Aggravated Battery of DUI -** Amend 1996 Supp. 21-4711(c) "special D.U.I. sentencing rule" to include municipal court ordinance violations.

3. **Bill of Rights -** Amend 1996 Supp. 74-7333(c) to include municipal violations of DUI crashes when a victim is involved. In addition, amend 1996 Supp. 8-1019(b) to read, "all victims of a DUI crash whether physical injury or property damage. Current language reads serious bodily injury of death of a person.

4. **Crime Victims Compensation Amendments:**

A. **Sexual Predator Victims -** Amend K.S.A. 74-7305(b) to include, "compensation for mental health counseling may be awarded to a claimant who is required to testify in a sexual predator civil procedure of an offender who victimized the claimant or the victim on whose behalf the claim is made."

B. **Filing Deadline -** Amend K.S.A. 74-7305(b) by increasing the filing deadline for Crime Victims' Compensation from one year to two years.

House Judiciary
1-26-98
Attachment 1

C. **Wage Loss** - Amend K.S.A. 74-7305(h) by increasing the wage loss and dependent economic loss from $200 to $400.

D. **Funeral** - Amend K.S.A. 74-7301(a) by increasing the compensation allowed for funeral costs from $2,000 to $5,000.

E. **Clothing and Bedding** - Amend K.S.A. 74-7301(a) by including clothing and bedding seized as evidence as an allowance expense.

Request for hearings:

5. **Senate Bill 256 - University Law Enforcement Jurisdiction** (passed Senate Elections and Local Government and Senate; passed House Appropriations and remained on General Orders at end of 1997 session; has now been rereferred to House Judiciary) - Amend K.S.A. 76-726 and 22-2401a to authorize agreements to expand regent universities and Washburn police jurisdiction.

6. **House Bill 2253 - Mistreatment of a Dependent Adult** (House Judiciary) - Amend K.S.A. 21-3437 by adding a new subsection proscribing reckless behavior upon a dependent adult. The violation of a reckless act would be a severity level 6, person felony. Also, amend by increasing to a severity level 5, person felony the intentional mistreatment of a dependent adult.

2

American Civil Liberties Union of Kansas and Western Missouri

Wendy McFarland/Lobbyist (785) 233-9054 Bill Request to House Judiciary Jan. 26, 1998

Concerning Bail Bondsmen And Their Agents

Section 1. No surety or bonding company shall employ or contract with any person for the purpose of arresting, recapturing, returning to custody or surrendering any defendant or fugitive, except as provided in this section and subject to the restrictions of this section.

A. No surety or bonding company, or any of its employees or agents, shall be immune or exempt from any law or cause of action by virtue of their surety relationship to any defendant or fugitive except that such surety or bonding company, and its employees and agents, may use reasonable force to retake a defendant or fugitive for whom a warrant has been issued for the purpose of surrender on such warrant.

B. No employee or agent of a surety or bonding company shall forcibly enter or remain within any inhabited structure without valid consent, or use deadly force or the threat of deadly force, for the purpose of retaking a defendant or fugitive who is not charged with a felony violation, or when such acts are otherwise unreasonable.

C. A surety or bonding company shall be civilly liable to any person who sustains damages as a result of any act by its employee or agent, including punitive damages when allowed by law and reasonable attorney fees and expenses of litigation. Any surety or bonding company charging a fee for services shall maintain a minimum insurance insuring for such damages of $1,000.000.00 per occurrence, and otherwise shall not enter into any agreement with any person to insure, compensate or hold harmless such surety or bonding company for such liability.

D. Any surety or bonding company shall maintain a list of all employees and agents and file a copy of such list with the Sheriff in each county where it operates at least once every sixty days. No attempt shall be made to retake any defendant or fugitive until notice shall be given to the police department of the city where the defendant or fugitive is located (or, if not within a city, the sheriff of the county).

E. Any surety or bonding company which seeks to employ or contract with an agent (bounty hunter), shall be required to conduct a criminal background check prior to his or her employment and a discovery of any previous felony conviction(s) will disallow employment in the capacity of agent or bounty hunter.

House Judiciary
1-26-98
Attachment 2

3

National Congress for Fathers and Children
Topeka Chapter

PRESERVING THE PROMISE OF FATHERHOOD

851 Minnesota Avenue
Post Office Box 171675
Kansas City, KS 66117
(913) 281-9943
Hotline: (800) SEE-DADS
Fax: (913) 342-1414
E-mail: ncfc@primenet.com

OFFICERS
Travis Ballard, Esq.
President
Adrian, MI

Phillip Holman, JD
Vice-President
Detroit, MI

Cindy Falkner, P.I.A.
Secretary
Phoenix, AZ

Paul Rozeboom, CPA
Treasurer
Tulsa, OK

George R. McCasland
Operations Director
Kansas City, KS

Joseph McMillen, JD
Asst. Operations Director
Kansas City, KS

BOARD OF DIRECTORS
Bob Adams — *Hartford, CT*
Renet Bender, Ph.D. — *Bishop, GA*
Jean Bonhomme, MD — *Decatur, GA*
James Cook — *Los Angeles, CA*
Kent Earnhardt, JD, Ph.D. — *Atlanta, GA*
Warren Farrell, Ph.D. — *San Diego, CA*
Mike Geanoulis — *New Castle, NH*
Bill Harrington — *Washington, D.C.*
LaCretia Head — *Atlanta, GA*
Bob Hirschfeld, JD — *Phoenix, AZ*
George Kelly — *W. Springfield, MA*
Jeffery Leving, JD — *Chicago, IL*
Mike McKay, DDS — *Uncasville, CT*
Stuart Miller — *Washington, D.C.*
Ann Mitchell, JD — *Palo Alto, CA*
Leigh Travis, Ph.D. — *Ann Arbor, MI*

1/22/98

We request that legislation be introduced and passed, to guarantee both parents equal rights as defined by the 4th, 9th and 14th amendment of The Constitution of the United States of America, and also the Constitution of the State of Kansas, the Bill of Rights, 1st, "All men are possessed of equal and inalienable natural rights, among which are life, liberty, and the pursuit of happiness".

Shared parenting, or shared physical custody. The term, "joint custody", currently in use, does not guarantee parenting time. As close to equal time is of the greatest benefit for the children. They desire to be loved and nurtured by both parents. Two parents were needed to bring children into the world, both parents have a right and a duty to continue to nurture and support the children until the age of majority. Studies indicate that children's achievements are greater and delinquency is less when two parents are involved.

We also request that legislation be introduced and passed to replace the word "visitation" with the words "parenting time", in statutes and in the "Rules adopted by the Supreme Court of the State of Kansas". Visits are relegated to hospitals or zoos. Minor children do not visit their parents. Colorado passed a law in 1992.

Attached is a sample bill and a news article from the front page of The Des Moines Register and Governor Branstad's proposals for Iowa legislation.

Thank you for your consideration,

Buck Reidenbach, President Topeka Chapter
216 W. Lincoln
Burlingame, KS 66413
785-654-3199

Greg DeBacker, Chairman Topeka Chapter
2907 NW Topeka Blvd
Topeka, KS 66617-1111
home 785-286-3029 785-286-0809
work 785-232-2916 e-mail DeBackerG@aol.com

Children Need Fathers not Visitors

National Congress for Fathers and Children, Topeka Chapter
PO Box 750361 Topeka, KS 66675-0361

House Judiciary
1-26-98
Attachment 3

3. Each parent shall submit a parenting plan to the court with his or her moving or responsive papers. If the parents cannot agree to equal parenting plan, the judge shall select the parenting plan that best allows the child to have equal time with both parents. Each parent shall have the right to provide parenting time in preference to any other daycare placement.

The Court shall have the discretion to consider reasonable temporary unequal parenting time during the time the infant is breast-feeding. However, in recognition of the importance of the infant's early need to bond with both parents, the Court shall order regular, substantial parenting time to each parent during this period.

4. Parenting plans shall be detailed. Parenting plans shall be designated for minimum periods of two years for the benefit of the child's stability, and automatically renewed, absent a change of circumstances. Parenting time shall exclude actual school time, and shall also exclude time when the child is in daycare provided by someone other than one of the parents.

5. Upon a first violation of the court ordered time share provisions, the court shall order:

The offending parent to complete a private fee-paid class addressing shared parenting issues (at the offending party's expense), with proof of completion filed with the court within ninety days of such order. Upon subsequent violation(s) of the time share plan, the offending parent shall be ordered to perform community service equivalent to the time share hours denied, and the offended parent shall be entitled to make-up time for those hours denied. Repeated violation(s) of the parenting plan shall be considered Willful Cruelty , and shall be referred by the Court to the District Attorney for prosecution.

The court shall have the discretion to address situations relating to children where time share is occasionally interrupted due to emergency medical situations, temporary illness, injury, or rehabilitative care, documented by a physician. If a parent is determined to have substantially violated any provision of the parenting plan, the court shall award fees and costs for motion(s) brought by the offended parent.

3-2

6. In the event that a child is removed from physical custody of his or her parents, relatives/grandparents shall be first choice caretakers, primary to temporary or permanent protective care, foster care, or adoption. In the event that such state intervention occurs, the state shall be obligated to identify, locate, and provide appropriate notice to such relatives/grandparents under the same laws and policies as those affecting parents.

7. ~~Should the court order attorney's fees to be paid by one parent for the other parent's attorney in any custody or time share proceeding, those fees shall not exceed two thousand dollars total per calendar year for all such proceedings.~~ Delete

8. The establishment of this act constitutes a change of circumstances for the purpose of any modification of any child custody order entered into prior to this act's operative date.

9. If the provision or clause of this act or its application to any person or circumstances is held invalid, the invalidity does not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.

10. If (and it is not necessary by [illegible]) any child support is ordered ample resources shall be left with both parties to raise the children while with the parent. Larger expenses shall be split equally between the parties unless one side files an affidavit of poverty. In that event the Court would pro-rate the expenses according to income.

Children Need Fathers not Visitors

National Congress for Fathers and Children, Topeka Chapter
PO Box 750361 Topeka, KS 66675-0361

& N.A.F.F (FATHERS)

or her moving or responsive papers. If the parents cannot agree to an equal parenting plan, the judge shall select the parenting plan that best allows the child to have equal time with both parents. Each parent shall have the right to provide parenting time in preference to any other daycare placement.

The Court shall have the discretion to consider reasonable temporary unequal parenting time during the time the infant is breast-feeding. However, in recognition of the importance of the infant's early need to bond with both parents, the Court shall order regular, substantial parenting time to each parent during this period.

4. Parenting plans shall be detailed. Parenting plans shall be designated for minimum periods of two years for the benefit of the child's stability, and automatically renewed, absent a change of circumstances. Parenting time shall exclude actual school time, and shall also exclude time when the child is in daycare provided by someone other than one of the parents.

5. Upon a first violation of the court ordered time share provisions, the court shall order:

The offending parent to complete a private fee-paid class addressing shared parenting issues (at the offending party's expense), with proof of completion filed with the court within ninety days of such order. Upon subsequent violation(s) of the time share plan, the offending parent shall be ordered to perform community service equivalent to the time share hours denied, and the offended parent shall be entitled to make-up time for those hours denied. Repeated violation(s) of the parenting plan shall be considered Willful Cruelty , and shall be referred by the Court to the District Attorney for prosecution.

The court shall have the discretion to address situations relating to children where time share is occasionally interrupted due to emergency medical situations, temporary illness, injury, or rehabilitative care, documented by a physician. If a parent is determined to have substantially violated any provision of the parenting plan, the court shall award fees and costs for motion(s) brought by the offended parent.

6. In the event that a child is removed from physical custody of his or her parents, relatives/grandparents shall be first choice caretakers, primary to temporary or permanent protective care, foster care, or adoption. In the event that such state intervention occurs, the state shall he obligated to identify, locate, and provide appropriate notice to such relatives/grandparents under the same laws and policies as those affecting parents.

7. The establishment of this act constitutes a change of circumstances for the purpose of any modification of any child custody order entered into prior to this act's operative date.

8. If the provision or clause of this act or its application to any person or circumstances is held invalid, the invalidity does not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.

9. The use of the word "visitation" is offensive and degrading. The words "parenting time" shall be used to replace "visitation" in Kansas statutes and in the Rules Adopted by the Supreme Court of the State of Kansas.

Children Need Fathers not Visitors

National Congress for Fathers and Children, Topeka Chapter
PO Box 750361 Topeka, KS 66675-0361

3-3

#4

REMARKS CONCERNING SENATE BILL 8

HOUSE JUDICIARY COMMITTEE

JANUARY 26, 1998

Thank you for giving me the opportunity to appear as an individual member of the National Conference Of Commissioners on Uniform State Laws (ULC). The ULC is a unique institution created by state governments to consider state law and to determine in which areas of the law uniformity is important. It then drafts uniform and model acts for consideration by the states. The ULC began this work in 1892. The work of the ULC has been a valuable addition over time to the improvement of state laws in a great many subject areas, ranging from the Uniform Commercial Code to the Uniform Child Custody Jurisdiction Act. Even with acts that have not been uniformally adopted, the texts consistently contribute to the improvement of the law and have served as valuable references for the legislatures in their effort to improve the quality of state laws.

The procedures of the ULC insure meticulous consideration of each uniform act. The ULC spends a minimum of two years on each draft. Sometimes, the drafting work extends much longer. No individual state has the resources necessary to duplicate this meticulous, careful effort.

The ULC also permits the states to tap the skills and resources of the legal profession for very little cost. No Uniform Law Commissioner is paid for his or her services. He or she only receives reimbursement for actual expenses incurred. The ULC estimates that each commissioner devotes approximately 200 hours a year to ULC work, including work on various drafting committees and attendance at the annual meeting.

House Judiciary
1-26-98
Attachment 4

These are hours spent mainly on research and drafting work – solid, substantive hours. The cumulative value of this donated time in the development of uniform acts averages about six million dollars per year, at a conservative estimate.

The ULC constitutes an efficient voluntary institution for the benefit of state governments. This institution works because individual lawyers are willing to donate time to the effort, and because it is a genuine cooperative effort of the states. It seemed like a good idea when it began in 1892, and it continues to be a very good idea. The states have chosen to maintain it because it has been useful to them and because it strengthens the states in a federal system of government. Everybody recognizes a myriad of interstate problems in the law. Either the states solve them, or the issues are removed to Congress. Virtually the only institution the states have for solving these problems is the ULC. Without it, more and more legislative activity would shift from state capitols to Washington, D.C.

I have been privileged to be a member since 1979, when the Kansas law was changed to provide that the chairs of the House and Senate Judiciary Committees are ex-officio Commissioners. After I left the Kansas Senate in 1984, I was privileged to be appointed as one of the standing Kansas Commissioners. In Kansas, the Commissioners are appointed by the Interstate Cooperation Commission upon recommendation of the president of the Kansas Bar Association.

Debra Perelman, from the staff of ULC, is with us today to explain the details of SB 8 and also of SB 9.

5

UNIFORM FRAUDULENT TRANSFER ACT

CONTENTS

* *Fact Sheet* - The Uniform Fraudulent Transfer Act

* Summary of the Uniform Fraudulent Transfer Act

* Why states should adopt the Uniform Fraudulent Transfer Act

* "An analysis of the Uniform Fraudulent Transfer Act," by Fred Miller, Professor of Law at the University of Oklahoma

* A short comparison of the Uniform Fraudulent Transfer Act with the Uniform Fraudulent Conveyance Act

* *Durrett,* the Uniform Fraudulent Transfer Act, and Federal Bankruptcy Law

* *The National Conference of Commissioners on Uniform State Laws* - a brief history

House Judiciary
1-26-98
Attachment 5

A Few Facts About
THE UNIFORM FRAUDULENT TRANSFER ACT

PURPOSE: Providing a creditor with the capacity to procure assets a debtor has transferred to another person to keep them from being used to satisfy the debt.

ORIGIN: The Uniform Fraudulent Transfer Act, completed by the Uniform Law Commissioners in 1984, revises the Uniform Fraudulent Conveyance Act of 1918.

ENDORSED BY: American Bar Association

STATE ADOPTIONS:

Alabama
Arizona
Arkansas
California
Colorado
Connecticut
Delaware
District of Columbia
Florida
Hawaii
Idaho
Illinois
Indiana
Iowa
Maine
Massachusetts
Minnesota
Missouri
Montana
Nebraska
Nevada
New Hampshire
New Jersey
New Mexico
North Carolina
North Dakota
Ohio
Oklahoma
Oregon
Pennsylvania
Rhode Island
South Dakota
Texas
Utah
Vermont
Washington
West Virginia
Wisconsin

1998 INTRODUCTIONS: Kansas

For any further information regarding the Uniform Fraudulent Transfer Act, please contact John McCabe or Katie Robinson at 312-915-0195.

(1/1/98)

UNIFORM FRAUDULENT TRANSFER ACT

When we say a person "owns" something, we tend to think in all or nothing terms. Whatever a person owns is at that person's disposal - to sell, to give, to abandon, or to pledge as security for a debt. But relationships between people over property are never so simple or so unqualified. A creditor-debtor relationship, for example, may materially change an owner's power over the property owned. A mortgage, clearly, restricts what an owner may do with mortgaged property. The creditor has legally protected rights in the property securing the debt.

A less clear category, but important to the maintenance of credit, is that of the unsecured creditor-debtor relationship in which the debtor manipulates property to defeat the creditor's interest solely for that purpose and for no other. Perhaps the debtor foresees insolvency and tries to conceal property that a creditor might use to satisfy the debt. Perhaps the debtor never intends to satisfy the debt and manipulates property to make himself judgment-proof. Should the creditor be without recourse, and should the debtor's rights to deal with property be unrestricted in these kinds of cases?

The National Conference of Commissioners on Uniform State Laws (ULC) proposed the Uniform Fraudulent Conveyance Act in 1918 as an answer to that question. It created a class of transactions called fraudulent conveyances. A creditor has recourse against any debtor who makes such conveyances and against any person to whom property is transferred. Twenty-six states adopted this Act, and its provisions were then incorporated into the Federal Bankruptcy Act, which virtually made this Act the law of the land.

In 1984, this 1918 Act has been substantially revised - and renamed as the Uniform Fraudulent Transfer Act. The intent of the new Act is the same as the old - classifying a category of transfers as fraudulent to creditors and providing defrauded creditors with a remedy. Why a new Act at this time? The terminology of the old Act had become considerably archaic, and needed to be modernized. The Bankruptcy Reform Act of 1978 changed the federal law on fraudulent transfers in significant ways, and made it imperative to reconsider state law. And creditor-debtor relationships have changed and become more complicated, basically, so that the whole issue of fraudulent transfers needed rethinking. In 1984, the Uniform Fraudulent Transfer Act is ready to promote the modernization of this subject area of law.

The basic format for the new Act is the same as that of the old. Both Acts create a right of action, a civil tort in essence, in any creditor against any debtor who engages in certain kinds of transfers. Sections 4 and 5 of the new Act create that right of action. There are three basic situations in which the right of action arises: (1) if a transfer is made intentionally "to hinder, delay, or defraud" any creditor of a debtor; (2) if the debtor transfers property "without receiving a reasonably equivalent value" while doing business with remaining assets too small to conduct the business or while intending to incur debts "beyond the debtor's ability to pay as they become due"; and, (3) if there is an existing creditor-debtor relationship, and the debtor makes transfers for less than equivalent value or to an "insider,"

An "insider" transfer is not considered at all in the old Act. But modern efforts to put assets beyond a creditor's reach require some response to such transactions. In part, the new Act picks up solutions from the Bankruptcy Reform Act of 1978. An "insider" has a special relationship to a debtor, such that a transfer to the "insider," coupled with inadequate value received and the debtor's insolvency, would indicate that the transaction was likely meant to defraud the creditor. An example of an "insider" is a person who is a relative of the debtor by blood or marriage. Another is a corporation for which the debtor is a director, officer, or person in control. Transactions with "insiders," when the debtor gets unreasonably low value and is insolvent, are considered fraudulent to creditors.

Another issue that the old Act does not address is the question of innocent transferees. In general, when a fraudulent transfer takes place, it is voidable by a creditor. But a transfer to a person who does give "reasonably equivalent value" and who is in good faith is not void when a preceding fraudulent transfer is an intentional one. However, the transferee may have to pay damages to the creditor. If the transfer is voidable, as it would be in all other cases of fraudulent transfer, the good-faith transferee for value may have a lien on the property or a right of enforcement of obligation against the debtor. Other specific transfers which do not quite fit into a system of fraudulent transfer are, also, not voidable. None of these issues is considered at all in the old Act.

The Uniform Fraudulent Transfer Act continues the concept of a civil action for transfers fraudulent to creditors first proposed in the Uniform Fraudulent Conveyance Act of 1918. It takes into account considerable development in both law and practice in creditor-debtor relationships. The ULC hopes that it will be adopted uniformly in all states.

THE UNIFORM FRAUDULENT TRANSFER ACT

by

FRED H. MILLER
Professor of Law at the University of Oklahoma

Section by Section Analysis of the Act

Section 1 contains definitions. Section 2 also contains the definition of "insolvent," and Section 3 the definition of "value." The definition of "asset" in Section 2(2), together with the latter definitions of "insolvent" and "value," in a general sense formulate the core concept of the act: the transfer of an asset (or incurring an obligation) for inadequate value by an insolvent debtor or one rendered insolvent by the transaction is a fraudulent transfer. Subsection 3(B) is worth particular note in this respect because it overrules for state law the controversial holding in Durrett v. Washington Nat. Ins. Co., 621 F.2d 201 (5th Cir. 1980), that a regularly conducted mortgage foreclosure that produces a price "too low" may be avoided as a fraudulent conveyance. By clouding property titles the Durrett rule virtually is a self-fulfilling prophecy.

Section 4 Subsection a(1) states the basic rule of the act: a transfer made or an obligation incurred with actual intent to hinder, delay or defraud creditors is actionable by creditors. How does a creditor prove the debtor's actual intent? Subsection b sets out "badges of fraud" if several of these appear it is strong evidence. Subsection a(2), on the other hand, sets out two cases where the law decrees the intent exists if the facts are as stated.

Section 5 states two further cases where the law decrees the transaction is fraudulent, but only as to present creditors and not also as to creditors arising later as is the case for transfers covered by Section 5.

Section 6 defines when a transaction occurs. It occurs when it can prejudice the rights of third parties, and not when it actually occurs between the parties to it. For example, a creditor does not need this act to set aside a fraudulent security interest that is never filed; the creditor can defeat that interest under the Uniform Commercial Code. Subsection 5 of this Section also states the time when an obligation is incurred.

Section 7 describes the remedies a creditor has to attack and avoid a fraudulent transfer or obligation.

Section 8, however, protects a good faith purchaser for reasonably equivalent value who did not share in the debtor's fraudulent purpose and subsequent good faith transferees for value who are sufficiently remote. Subsection (d) also gives a good faith transferee or obligee against whom the transaction can be avoided protection for any value given.

Subsection (e) is important as protecting lease terminations and security interest enforcement against "Durrett type" attacks, and Subsection (f) allows "workouts" and the like to occur.

Section 9 prescribes statutes of limitation specifically for the act.

Section 10 states the act is supplemented by other law and Section 11 specifies that in interpreting the act, precedent from other states that have enacted it should be used to maintain uniformity.

Section 12 provides the title.

Section 13 repeals the current statutes on the subject, including any old predecessor versions of this act.

A SHORT COMPARISON OF THE UNIFORM FRAUDULENT TRANSFER ACT

WITH THE UNIFORM FRAUDULENT CONVEYANCE ACT

The Uniform Fraudulent Transfer Act (UFTA) is a modernization of the Uniform Fraudulent Conveyance Act (UFCA) that was originally promulgated by the Uniform Law Commissioners in 1918. Since the rights and remedies between the earlier and later Acts are much the same, what are the differences, and what advantages accrue from adopting the UFTA over the UFCA? A short summary of the substantive differences follows[1]:

1. There are a number of more precisely defined terms in UFTA in Section 1 than are found in Section 1 of the UFCA. These new definitions include the words "affiliate," "claims," "debtor," "insider," "lien," "person," "property," "relative," "transfer," and "valid lien." The newly defined terms result in greater clarity throughout the UFTA and facilitate new provisions that will be discussed a little further on. Of the definitions, the one giving the UFTA its new title is "transfer." "Transfer" replaces the word "conveyance" as found in Section 1 of the UFCA. Both are comprehensive terms, but "transfer" comes from Section 101(48) of the Bankruptcy Code and is the more accepted modern term.

2. Both UFTA and UFCA define "insolvency" in Section 2, but UFTA establishes a rebuttable presumption of insolvency in Section 2(b) when a debtor is not generally paying his or her debts as they become due. Section 2(d) of UFTA prevents any fraudulently transferred property from being included in the debtor's assets when determining whether the debtor is insolvent or not. Section 2(e) of the UFTA prevents any obligation secured by a valid lien on the debtor's property, that is not an asset under Section 4, from being included as a debt for the purposes of determining insolvency. UFCA has no provisions similar to UFTA Sections 2(b), (d) or (e).

3. UFTA Section 3 replaces the term "reasonably equivalent value" for the term "fair consideration" as found in UFCA Section 3. "Reasonably equivalent value" is somewhat different from "fair consideration." "Good faith," which is an element in "fair consideration," is not an element in "value." "Good faith" becomes an element of defenses raisable under UFTA

[1] A complete overview of the UFTA is contained in the summary that accompanied this comparison.

Section 8. Also, "reasonably equivalent value" does not "include an unperformed promise made otherwise than in the ordinary course of the promisor's business to furnish support to the debtor or another person." "Fair consideration" under UFCA does not explicitly exclude such an unperformed promise, and there is a split in authorities as to whether such promises are or are not "fair consideration." Generally, under UFTA, "reasonably equivalent value" is to be considered from the point of view of the creditor. Would the value received in the transfer be available to satisfy the debt?

Section 3(b) of the UFTA deals specifically with the problem raised by Durrett v. Washington National Insurance Company, 621 F.2d 201 (5th Cir. 1980), in which a foreclosure sale of a debtor's property under a mortgage was held a fraudulent transfer when the sale resulted in a recovery of less than 70% of the property's value. Section 3(b) of UFTA provides that "reasonably equivalent value" results when a properly conducted foreclosure sale takes place, no matter the amount recovered. UFCA includes no comparable rule.

UFTA Section 3(c) defines "present value." No similar rule is included in the UFCA.

4. UFTA Section 4(a) combines Sections 5, 6 and 7 of UFCA with clarifications. Section 4(b) of UFTA is new. Section 4 of UFTA generally provides for those actions that are fraudulent to present and future creditors. A future creditor under this Section is, simply, one whose claim "arose . . . after the transfer was made or the obligation incurred."

Section 4(b) lists a series of factors that may be considered to determine the issue of intent under Section 4(a)(1). The list of factors includes most of the badges of fraud construed by courts over the history of the UFCA and predecessor legislation. The list is non-exclusive.

5. UFTA Section 5 provides for transfers fraudulent to creditors only. Section 5(a) is derived from Section 4 of the UFCA. Section 5(b) is new, and identifies a kind of transfer, the "insider" transfer, that is not specifically a fraudulent transfer in the UFCA. The "insider" transaction in Section 5(b) of the UFTA is derived from prior case law. An "insider" is defined in Section 1(7) of the UFTA and includes relatives or family members, partners, a corporate director, and the like.

In part, Section 8 of the UFCA is subsumed in

Section 5(b) of the UFTA. Section 8 of the UFCA deals with transactions between partners and with a person not a partner that results in the insolvency of the partnership. Although partners are "insiders" under the UFTA, liability occurs when an insider "had reasonable cause to believe that the debtor was insolvent." Under Section 8(a) of the UFCA, a partner was, per se, liable, a rule deemed unduly favorable to partnership creditors and unduly burdensome to a partner's creditors. UFTA has no specific sections dealing with partnership transfers such as Section 8 of the UFCA.

6. Section 6 of the UFTA is entirely new. It was created to eliminate questions about the time a transfer is made or an obligation is incurred.

7. Section 7 of the UFTA incorporates Sections 9 and 10 of the UFCA. The UFTA makes no distinction between claims of creditors that have matured as opposed to those that are unmatured, as the UFCA does. Remedies under Section 7 are available to all creditors. Section 7(a)(2) provides for attachment, subject to constitutional constraints. But attachment is offered as an alternative remedy in the UFTA because of the uncertainty over the constitutional problems. A jurisdiction may reject Section 7(a)(2) without impairing uniformity, therefore.

8. Section 8 of the UFTA is entirely new. The UFCA does not provide for transferee defenses and protection of transferee interests. Note that good faith is an element of the defense established in Section 8(a).

9. UFTA Section 9 is new. It establishes statutes of limitations, a subject not addressed at all in the UFCA.

WHY STATES SHOULD ADOPT

THE UNIFORM FRAUDULENT TRANSFER ACT

Are we only as good as the extent to which we honor our obligations? Many would argue for this proposition. And when our obligations are financial, the argument is reinforced by law. It is to this proposition that the Uniform Fraudulent Transfer Act is addressed. If we have acquired debt we should not be able to manipulate our assets so that creditors will be deprived of their value when we default on our debt. We should not be able to plan an artificial insolvency by transferring assets to others against the interests of our creditors.

The Uniform Fraudulent Transfer Act works as a deterrent, preventing such transgressions against obligations incurred, and provides creditors with a remedy when debtors transfer or hide assets that would otherwise be available to satisfy legitimate debts.

While the issue of obligation is preeminent, the economic issue is no less important. Credit is essential to the economic life of this country. Consumer credit, commercial credit, secured and unsecured credit enter into our lives, everyday. Credit remains available so long as those who extend it are given certain assurances about their rights at default. The Uniform Fraudulent Transfer Act provides assurances to creditors that help make credit available to all of us.

This economic issue leads directly to the issue of uniformity. The availability and the health of the credit mechanism require national standards. The principles of the old Uniform Fraudulent Conveyance Act became applicable to every person in every state because it was incorporated into the Federal Bankruptcy Act. Much of what is in the newer Fraudulent Transfer Act duplicates the Bankruptcy Reform Act of 1978. Uniformity has become not only a question of law between states, but also between state and federal law. Without uniformity, credit becomes less available, and the credit mechanism is less reliable. To avoid confusion and expense, the same rules must apply throughout the country. Public expectations are the same in every state and jurisdiction.

Associated with the issue of uniformity is the issue of modernity. The original Fraudulent Conveyance Act, which the Fraudulent Transfer Act replaces, was promulgated in 1918. Changes in federal bankruptcy law, in creditor-debtor relations in general, even in the rules governing the conduct of lawyers, make it clear that a modernization is overdue. The Uniform Fraudulent Transfers Act answers that immediate need.

DURRETT, THE UNIFORM FRAUDULENT TRANSFER ACT, AND FEDERAL BANKRUPTCY LAW - SORTING OUT CONFUSION

There has been much confusion over the relationship of mortgage foreclosures, however done, and fraudulent conveyance statutes, including the 1984 Uniform Fraudulent Transfer Act (UFTA). The confusion results from a single, now notorious case, Durrett v. Washington Nat. Ins. Co., 621 F.2d 201 (5th Cir. 1980). The Court, in Durrett, held a noncollusive mortgage foreclosure conducted pursuant to Texas law a constructively fraudulent transfer under Section 67d of the Bankruptcy Act. The Bankruptcy Act has fraudulent transfer provisions directly analogous to the UFTA.

Durrett has not been followed in all circuits of the federal courts. It has been directly rejected in the Sixth and Ninth Circuits, for example. Its influence on state law in the interpretation of the 1918 Uniform Fraudulent Conveyance Act (UFCA) and those states still following the common law is not yet clear. Much speculation attends the possibilities in that regard, however.

Why is Durrett so important? Its holding calls the validity of the bulk of mortgage foreclosure sales into question. Almost never do such sales realize the current market price for real estate bought and sold in the ordinary course. A key element in fraudulent conveyance analysis is the concept of "fair consideration" or "reasonably equivalent value." In Durrett, the foreclosure sale realized less than 70% of the alleged market value, and was a fraudulent transfer for that fact.

As a result of Durrett, buyers in foreclosure sales lose assurance of title. Lenders cannot be sure of lending practices. The uncertainty that Durrett forecasts has large economic impact in real estate markets.

UFTA attempts to alleviate the difficulties that Durrett suggests. In Section 3(b), value is "reasonably equivalent value" if given in "a regularly conducted, noncollusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement." Adoption of this provision would preclude a Durrett type of holding in any state adopting UFTA. Only private, non-public types of transfers, such as some kinds of deed in lieu of foreclosure, would be vulnerable. But these are exactly the kinds of transfers UFTA is designed to remedy anyway. UFTA Section 3(b) removes the uncertainty that Durrett has created, insofar as state law is concerned.

We must be clear, however, on the distinction between federal and state law, the Bankruptcy Act and state fraudulent conveyance law. Durrett still applies in federal bankruptcy law,

even when the UFTA applies in state actions. Indeed, in the 1984 amendments to the Bankruptcy Act, the holding in Durrett was reinforced. Durrett continues to be a problem in bankruptcy proceedings.

Why eliminate Durrett-type holdings? Durrett reflects dissatisfactions with the state of foreclosure procedures and perceived inequities that result from them. And that may be a legitimate concern. Using notions of fraudulent transfer to redress those inequities, however, is an oblique approach at best and a meat axe at the worst.

UFTA, its predecessor UFCA, and all fraudulent conveyance law preceding them primarily protect unsecured creditors (those for which no property acts as collateral) from certain actions of debtors that most everybody can agree are actually or constructively fraudulent. Durrett tends to turn that notion on its head. It would turn the remedy against secured creditors who are using accepted, legal procedures to recover loss after a default. This is not a role that fraudulent transfer law was ever designed to fill.

Not only does Durrett turn the remedy against an inappropriate defendant, it clouds every subsequent sale until the statute of limitations runs on any possible fraudulent transfer action. Every title examination after a foreclosure must inevitably result in exceptions for fraudulent transfer actions, leaving subsequent purchasers exposed. These are costs that are borne by sellers and buyers who are not involved in the foreclosure. If there are inequities in foreclosure actions, attacking them with fraudulent transfer theories merely spreads their burden to others. Nothing is really done to remedy them. UFTA Section 3(b) is an appropriate, timely response to the problem.

THE REVISED UNIFORM PARTNERSHIP ACT

Webb Hecker
Professor of Law
University of Kansas School of Law

June 6, 1997

I. INTRODUCTION

A. Origins.

1. The National Conference of Commissioners on Uniform State Laws ("NCCUSL") promulgated the original Uniform Partnership Act ("UPA") in 1914.

a. At its high-water mark it was the law in every state except Louisiana.

b. Kansas adopted the UPA in 1972. It is codified at K.S.A. 56-301 to -347.

2. In 1992 the NCCUSL promulgated the first Revised Uniform Partnership Act ("RUPA").

a. RUPA itself was revised in 1993 and again in 1994.

b. In 1996 the NCCUSL amended RUPA (1994) to integrate provisions governing limited liability partnerships ("LLPs").

3. Senate Bill No. 9 (1997)(see Appendix) essentially is RUPA (1994) with the 1996 LLP amendments.

a. It passed the Kansas Senate by a unanimous vote in February, 1997, but failed to pass the House.

(1) It will be carried over to the 1998 session in the House.

B. In general.

1. RUPA modernizes the UPA to reflect the changes in law and business that have occurred during the intervening 80 years.

House Judiciary
1-26-98
Attachment 6

2. RUPA carries over many of the concepts and rules that have withstood the test of time. E.g.,

   a. Partners as agents of the partnership.

   b. Default rules governing internal matters (profit-sharing, management rights, etc.).

3. It also repairs or replaces concepts and rules that have not worked well. E.g.,

   a. Ownership of partnership property.

   b. Dissolution rules.

4. Finally, it adds new concepts and provisions.

   a. Publicly-filed statements granting or limiting partners' authority.

   b. Statutory duties of care and loyalty.

   c. Extension of the protection afforded by LLPs.

   d. Procedures for conversions and mergers.

II. ENTITY THEORY

A. At common law and under the UPA, a partnership, unlike a corporation, is not considered to be an entity separate and distinct from its owners.

   1. From this so-called aggregate theory of partnership, a number of disadvantageous corollaries are logically derived. E.g.,

      a. A partnership technically can not own property. Rather, partnership property is owned by the partners as "tenants in partnership." K.S.A. 56-325.

      b. A partnership dissolves, at least technically, every time there is a change in membership of the firm. K.S.A. 56-329.

B. The conception of a partnership under RUPA is exactly the opposite -- a partnership <u>is</u> an entity, separate and distinct from the partners. S.B. 9 § 8(a).

   1. Consequently, partnership property is owned by the partnership and not by

the partners. S.B. 9 §§ 10, 26.

2. And, not every event that causes a partner to be dissociated from the partnership results in dissolution of the partnership. S.B. 9 §§ 30, 32(a), 33(a), 38. This point is discussed in greater detail infra.

III. PARTNERS AS AGENTS (THIRD PARTIES)

A. General rules.

1. Under the UPA, each partner is an agent of the partnership and has the ability to subject the partnership to liability in both contract and tort as to matters within the ordinary course of partnership business. K.S.A. 56-309, -313, -314.

2. RUPA continues these general rules with little change. S.B. 9 §§ 12, 16.

B. Statements granting or limiting authority.

1. In an attempt to add greater security to business dealings, RUPA creates a framework under which a partnership has the option to file written statements that either grant or limit the authority of a partner or partners to enter into certain transactions or kinds of transactions on behalf of the partnership. S.B. 9 § 14(a).

a. To be effective, such statements must be filed with the secretary of state, and, with respect to real estate, recorded with the register of deeds. S.B. 9 § 5(a), (b).

2. A duly filed, and, if necessary, recorded statement granting authority to a partner will protect innocent purchasers and others who give value from a later claim by the partnership that the acting partner lacked authority. S.B. 9 § 14(d).

3. A duly filed, and, if necessary, recorded statement limiting the authority of a partner:

a. Will protect the partnership from a partner who exceeds his or her authority with respect to real estate transactions. S.B. 9 § 14(e).

(1) I.e., if the statement has been recorded it will appear in the chain of title and third parties will be charged with knowledge.

b. But it will not conclusively protect the partnership in non-real estate transactions. S.B. 9 § 14(f).

(1) I.e., the mere fact that a limitation on authority is on file with the secretary of state was thought to be insufficient to charge an otherwise innocent third party with knowledge of the limitation. The burden of inquiry imposed would be too great.

(2) Such cases will be determined by whether the transaction was apparently within the ordinary course of business and, if so, whether the third party knew or had received actual notification that the partner lacked authority. S.B. 9 § 12.

(3) To the extent that the existence of a filing system fosters a climate in which third parties regularly verify partners' authority, a filed statement of limitation will serve as a source of actual knowledge and thus indirectly protect the partnership.

4. RUPA extends the concept of statements of authority to situations in which a partner is dissociated from the partnership, in which the partnership is dissolved, or in which the partnership is a party to a merger. S.B. 9 §§ 36, 42, 51.

IV. INTERNAL RELATIONS

A. Subject to certain specified exceptions, RUPA continues the proposition that internal relations among partners and between the partners and the partnership are governed by the partnership agreement. S.B. 9 § 3.

B. To the extent that the partnership agreement does not provide to the contrary, many of the default rules are similar to those presently in force under the UPA.

1. Partners share equally in profits and losses. S.B. 9 § 20(b).

2. Partners have equal rights in the management of the business. S.B. 9 § 20(f).

3. Admission of a new partner requires unanimous consent. S.B. 9 § 20(i).

4. Differences of opinion as to ordinary matters are decided by majority vote, but extraordinary matters require unanimity. S.B. 9 § 20(j).

C. Unlike the UPA, however, RUPA codifies partners' fiduciary duties of loyalty and care and provides that these statutory fiduciary duties are exclusive. S.B. 9 § 23(a).

1. The duty of loyalty is similar to the case law under the UPA and consists essentially of:

a. Refraining from using partnership property, including partnership opportunities, for personal benefit. S.B. 9 § 23(b)(1).

b. Refraining from entering into self-dealing transactions with the partnership. S.B. 9 § 23(b)(2).

c. Refraining from competing with the partnership. S.B. 9 § 23(b)(3).

2. The duty of care is framed in terms of conduct that amounts to gross negligence or worse. S.B. 9 § 23(c).

a. This brings partnership law into line with corporate law, in which directors' informed decisions are shielded by the business judgment rule unless they are at least grossly negligent.

D. RUPA also codifies the principle of good faith and fair dealing. S.B. 9 § 23(d).

1. This principle is derived from the Restatement (Second) of Contracts § 205.

E. Finally, RUPA abolishes the common law rule that the exclusive remedy for intrapartnership disputes is an accounting in the context of partnership dissolution. S.B. 9 § 24(b).

V. TRANSFERS OF PARTNERSHIP INTERESTS

A. RUPA continues the UPA rule that, absent agreement to the contrary, a partner may freely transfer his or her economic interest in the business. S.B. 9 § 28(a)(1), (b).

1. But the transferee does not thereby become a partner and has no right to participate in management, receive information concerning the business, or inspect the books. S.B. 9 § 28(a)(3).

B. RUPA also carries forward, with improved detail, the "charging order" procedure, by which a judgment creditor of an individual partner may acquire a lien on the partner's economic interest in the business, foreclose the lien, and sell the interest, if necessary. S.B. 9 § 29.

1. A purchaser of the interest at a foreclosure sale has the same rights as a transferee.

VI. DISSOCIATION/DISSOLUTION

A. Present law under the UPA.

1. A partnership is dissolved any time a partner ceases to be associated in carrying on partnership business. K.S.A. 56-329, -331.

a. The partners can agree in advance that the remaining partners, or some number of them, can continue the business. K.S.A. 56-338(a).

(1) If such an agreement is in place, the technical fact of dissolution often will have no practical significance.

b. But in the absence of such an agreement, any partner can insist on liquidation of the business as a consequence of dissolution. K.S.A. 56-338(a).

(1) This right can be used as leverage to achieve a higher buyout price for the interest of an outgoing partner.

(2) The only exception is in cases of wrongful dissolution -- usually premature withdrawal from a term partnership.

(a) In such cases, the other partners have a statutory right to continue the business, but exercise of this right is contingent on unanimous agreement among the nonbreaching partners. K.S.A. 56-338(b)(2).

B. The law under RUPA.

1. Not all events by which a partner becomes dissociated from the partnership will inevitably result in even technical dissolutions. Many will result instead in a mandatory buyout of the interest of the outgoing partner.

a. And, as under the UPA, the partners can agree in advance to a right to continue the business (with a few exceptions), even in situations that otherwise would result in dissolution. S.B. 9 § 3(a), (b)(8).

b. Thus, the most important changes made by RUPA are in cases in which there has been no advance planning and the statute itself

substitutes mandatory buyout for a dissolution/liquidation scenario.

c. These RUPA provisions are best understood by considering separately partnerships at will and partnerships for a definite term or for the accomplishment of a particular undertaking ("term partnerships").

2. Partnerships at will.

a. Withdrawal.

(1) RUPA continues the UPA rule that, absent agreement to the contrary, withdrawal causes dissolution, and the withdrawing partner has the right to force liquidation (and the bargaining leverage that goes with it). S.B. 9 §§ 30(a), 38(1).

b. Death, incapacity, the equivalent for nonhuman partners, and bankruptcy or similar financial exigency.

(1) Any of these events will result in a mandatory buyout of the dissociating partner's interest rather than in dissolution and winding up of the partnership. S.B. 9 §§ 30, 32(a), 33(a), 38.

(a) There is a provision for judicial appraisal if the parties cannot agree on price. S.B. 9 § 33(i).

3. Term partnerships.

a. Premature withdrawal, death, incapacity, the equivalent for nonhuman partners, and bankruptcy or similar financial exigency.

(1) Any of these events will result in a mandatory buyout of the dissociating partner's interest rather than in dissolution and winding up unless at least half of the remaining partners elect dissolution and winding up within 90 days after the dissociation. S.B. 9 §§ 30, 31(b), 33(a), 38(2)(i).

C. Other causes of dissolution.

1. In respects other than dissociation of a partner, RUPA's provisions regarding dissolution are similar to those of the UPA. See S.B. 9 § 38.

2. Thus, for example, a partnership is dissolved and its business must be wound

up upon:

a. Expiration of the term or completion of the undertaking for which it was formed;

b. The occurrence of an event specified in the partnership agreement;

c. Supervening illegality of the business; and

d. Judicial decree.

VII. LIMITED LIABILITY PARTNERSHIPS

A. Present law allows a general partnership to become an LLP by registering with the secretary of state. K.S.A. 56-345.

1. LLP status shields a partner from vicarious personal liability arising from professional malpractice or other tortious conduct committed by another partner or an employee or agent of the partnership. K.S.A. 56-315(b).

2. It does not shield a partner from personal liability arising from professional malpractice or other tortious conduct committed personally by the partner or by an employee working under the partner's direct supervision and control. K.S.A. 56-315(c).

3. Nor does it shield a partner from personal liability arising from the partnership's general commercial, contractual relationships such as loans, leases, trade debts, wages and taxes. See K.S.A. 56-315(b).

B. RUPA dramatically expands the protection afforded by LLP status.

1. It provides that the obligations of an LLP, whether arising in contract, tort, or otherwise are solely obligations of the partnership; partners are not personally liable for such obligations solely by reason of being partners. S.B. 9 § 17(c).

a. Partners will, of course, continue to be liable for their own malpractice or other tortious conduct.

2. Thus, the liability status of a partner in an LLP under RUPA is essentially the same as that of a member of an LLC or a shareholder of a corporation.

VIII. CONVERSIONS AND MERGERS

A. RUPA provides a statutory framework under which a general partnership can convert into a limited partnership or vice versa without the necessity of dissolution and reformation. S.B. 9 §§ 46-48.

B. It also contains detailed provisions permitting, and governing the procedure for, mergers between general partnerships and between general and limited partnerships. S.B. 9 §§ 49-51.

UNIFORM PARTNERSHIP ACT

KIT CONTENTS

- *Factsheet* — Uniform Partnership Act

- *Summary* — Uniform Partnership Act

- Limited Liability Partnerships: The 1996 Amendments to the Uniform Partnership Act (1994)

- "Uniform Partnership Act Revised After 80 Years," by Francis J. Pavetti

- Section by Section Analysis of the Uniform Partnership Act, by Harry J. Haynsworth

- *Uniform Law Commissioners* - a brief history of the ULC

House Judiciary
1-26-98
Attachment 7

A Few Facts About
THE UNIFORM PARTNERSHIP ACT (1994)(1996)

PURPOSE: This act revises the Uniform Partnership Act of 1914. The 1994 act establishes a partnership as a separate legal entity, and not merely as an aggregate of partners. It recognizes the primacy of the partnership agreement over statutory rules, except for specific rules protecting specific partner interests in the partnership. The 1994 act explicitly addresses the fiduciary responsibilities of partners to each other, providing for express obligations of loyalty, due care, and good faith. The act was amended in 1996 to provide limited liability for partners in a limited liability partnership.

ORIGIN: Completed by the Uniform Law Commissioners in 1994, and amended in 1996.

APPROVED BY: American Bar Association

ADOPTIONS OF UPA (1992)(1994):

Alabama
Connecticut
Florida
West Virginia
Wyoming

ADOPTIONS OF UPA WITH 1996 AMENDMENTS:

Arizona **
California **
Colorado
District of Columbia
Maryland
Minnesota
Montana
Nebraska
New Mexico
North Dakota
Oklahoma
Oregon
Virginia **

1998 INTRODUCTIONS:

Alaska
Florida
Kansas
Vermont

For any further information regarding the Uniform Partnership Act (1994)(1996), please contact John McCabe or Katie Robinson at 312-915-0195.

** *Limited Liability Partnership Equivalent*

(1/1/98)

UNIFORM PARTNERSHIP ACT (1994)

Introduction

Partnership law in the United States has been derived from one source, the Uniform Partnership Act, since it was originally promulgated by the Uniform Law Commissioners in 1914. The Uniform Act is the law of partnership in the United States.

But 78 years is a long time in the reckonings of the law, and in 1992 the Uniform Law Commissioners promulgated the first revision of the Uniform Partnership Act. Some clarifying amendments were added in 1993 and 1994. The new Act reflects both continuity and change. On the one hand, it refurbishes a venerable form. Partnership as a form of business organization precedes corporations, limited partnerships, business trusts, and just about everything else except the most basic business organization of all, the sole proprietorship. And, in UPA (1994), a partnership retains its basic, historic character.

But, at the same time, the partnership form has to be adapted to the changes in the way business is done and the way it is expected to be done far into the next century. The change reflected in UPA (1994) is of an evolutionary sort. The distilled experience of the past 80 years is the basis for the new text.

A partnership is a form of business organization. It exists whenever more than one person associates for the purpose of doing business for profit. The notion is that the partners join their capital and share accordingly in profits and losses. They also share control over the enterprise and subsequent liabilities. Historically, every partner is equally able to transact business on behalf of the partnership. Creditors of the partnership are entitled to rely upon the assets of the partnership and those of every partner in the satisfaction of the partnership's debts. The character of any partnership depends upon the agreement of the partners.

A partnership may be as simple as two people meeting on a street corner and deciding to conduct some business together, arising from no more than verbal agreement and a handshake. A partnership may also be as complex as a large law firm, with tiers of partners and varying rights and obligations, memorialized in extensive written agreements. Partnership law must accommodate them all.

UPA governs the creation of a partnership, establishes what the nature of this business organization is, and provides some rules respecting the rights and obligations of partners among themselves, and those between partners and other parties that do business with the partnership and the partners. It provides the rules that govern the dissolution of a partnership when the appropriate time comes to dissolve it. The original Act did this, and UPA (1994) is designed to do the essential task much better. UPA (1994) adds, as well, concepts not ever contemplated in the 1914 Act, the concepts of merger and conversion.

This summary is an effort to highlight the essential differences between the 1914 Act and UPA (1994). It cannot be a comprehensive review, but is designed to point out to the reader the progress of 1994 over 1914.

Nature of a Partnership

The first essential change in UPA (1994) over the 1914 Act that must be discussed as a prelude to the rest of the revision concerns the nature of a partnership. There is age-long conflict in partnership law over the nature of the organization. Should a partnership be considered merely an aggregation of individuals or should it be regarded as an entity by itself? The answer to these questions considerably affects such matters as a partner's capacity to do business for the partnership, how property is to be held and treated in the partnership, and what constitutes dissolution of the partnership. The 1914 Act made no effort to settle the controversy by express language, and has rightly been characterized as a hybrid, encompassing aspects of both theories.

It is not necessary to go into the dispute with much detail here, because UPA (1994) makes a very clear choice that settles the controversy. To quote Section 201: "A partnership is an entity." All outcomes in UPA (1994) must be evaluated in light of that clearly articulated language.

What are some of the outcomes of this decision to treat a partnership as an entity in UPA (1994) that are not part of the hybrid 1914 Act? The 1914 Act expressly permits a partnership to hold property as a partnership. The difference is the interest that each partner holds. In the 1914 Act, a partner is treated "as a co-owner with his partners of specific partnership property holding as a tenant in partnership." In UPA (1994), a partner has his or her partnership interest, but is not a co-owner of specific partnership property. The entity holds the specific property. The partners have their interest in the entity.

The 1914 Act approach, which reflects the retention of aggregate theory in that hybrid Act, constitutes a serious impediment to transferring property to and from the partnership. The 1914 Act has to provide rules that carefully limit and restrict the transfer powers of partners so that individual partners cannot convey their ownership rights in ways to injure and inevitably defeat the partnership. Even so, subsequent cases have revealed the co-ownership aspect of partnership to be a serious weakness in partnership structure. That serious weakness is not continued into UPA (1994).

Dissolution of the partnership is another area in which selection of entity versus aggregate theory makes a big difference. Dissolution will be discussed a little later, but dissolution occurs whenever a partner disassociates under the 1914 Act, but not necessarily every time he or she dissociates from the entity under UPA (1994). Partnerships based upon aggregate theory are simply more fragile than partnerships based upon entity theory.

Creation of a Partnership

Creation of a partnership requires association of two or more persons to do business for profit. The concept is not materially different between the 1914 Act and UPA (1994). What UPA (1994) does is to put expressly what has been regarded as implied in the 1914 Act. By and large the rules of the 1914 Act have been regarded as default rules, rules that apply in the event that there is no express provision in the partnership agreement. The reliance upon implication leaves certain gray areas that have caused problems. How far can a partnership agreement go in abrogating the fiduciary responsibilities of a partner to other partners, for example?

UPA (1994) clearly expresses the primacy of the partnership agreement. The agreement applies, and the rules of UPA (1994) are regarded as default rules, with the exception of certain rules that protect partners. For example, a partner's duties of loyalty and good faith cannot be abrogated by agreement. The agreement cannot take away a partner's right of access to the partnership books. In general, however, the partnership agreement expressly controls over the language of the statute in UPA (1994).

Statement of Authority

A partnership is created anytime individuals associate together to do business. Under UPA (1994) the partnership formed is an entity, not an aggregation of individuals. UPA (1994) makes it clear the partnership is controlled by the agreement of the partners. But the partnership must function to do business, and the 1914 Act treats partners as co-equal in the conduct of that business. Any partner is an agent of the partnership. Any partner has the capacity to transfer property on the partnership's behalf. Any person doing business with a partnership is entitled to rely upon these basic rules to bind the partnership. To a large extent, these rules continue to apply in UPA (1994).

But UPA (1994) adds a new partnership capacity to the rules of the 1914 Act. The adoption of entity theory, again, provides some different perspective. Entities such as corporations and limited partnerships are founded upon the filing of a certificate in the appropriate state office. UPA (1994) does not require filing a certificate to found a partnership, preserving the availability of the partnership form of organization to both large and the small entities. However, it permits the filing of a statement of partnership authority. The statement can be used to limit the capacity of a partner to act as an agent of the partnership, and limit a partner's capacity to transfer property on behalf of the partnership. The statement is voluntary. No partnership need file such a statement, nor is the existence of the partnership dependent upon the filing of any statement. But the statement, if filed, has an impact upon a third party dealing with the partnership.

The main effect is to assure any third party that the business of the partnership can be conducted and the partnership will be bound, if the third party deals with a partner with

authority provided in a statement. Any limitation upon a partner's authority, however, does not affect any third party who does not know about the statement, except as to real estate transactions. If there is a limitation in a filed statement, that is also filed in the real property records of the locale, then a third party dealing with that partner in a real estate transaction is held to know of the limitation.

Other Statements Available

UPA (1994) provides for other statements that may be filed, as well, pertaining to the partnership. A partner may file a statement of denial respecting facts, including limitation upon partnership authority, found in a statement of partnership authority. A partner or the partnership may file a statement of dissociation for the partner. And there is a statement of dissolution that may be filed when a partnership is dissolving. Each of these statements has a notice function. Third parties are held to have knowledge of these last two statements 90 days after they are filed.

If there is a merger, a statement also may be filed. A merger statement establishes the property relationships of the new entity with respect to property of the merged entities.

Although these statements are not essential to either the creation or dissolution of a partnership, they have impact upon third parties transacting business with a partnership. They give necessary flexibility to the partnership in the conduct of business, and are important advances over the 1914 Act for that reason. They are also artifacts of the overall shift to entity theory in partnership law, the essential underlying shift in UPA (1994) over the 1914 Act.

Fiduciary Responsibilities

When a partnership is viewed as an aggregate of interests and an organization in which every partner is absolutely able to conduct the business of the partnership with third parties, and is able to conclude the partnership by any act of withdrawal, express treatment of partners' responsibilities to each other in the conduct of business may not be so important. All partners are assumed to be participating in the conduct of the business with knowledge of what other partners are doing on a daily basis.

The 1914 Act has very little to say about a partner's responsibilities to the other partners. A partner is a fiduciary who "must account to the partnership for any benefit, and hold as a trustee for it any profit derived by him without the consent of the other partners..." There is a full duty of disclosure between partners, but the 1914 Act is otherwise silent on the fiduciary responsibilities of each partner to the other partners.

UPA (1994) is not so silent. It articulates duties of loyalty and care to which each partner is to be held. There are baseline standards of conduct, therefore, that a partner has

to meet. No agreement can abrogate these baselines. In addition, there is an express good faith obligation to which each partner is subject.

The duty of loyalty includes the duty expressed in the 1914 Act, but adds to it. There is a duty not to do business on behalf of someone with an adverse interest to the partnership's. A partner must refrain from business in competition with the partnership.

The standard of care with respect to other partners is gross negligence or reckless conduct. A partner would be liable to another partner for such conduct, but not for ordinary negligence. The good faith obligation simply requires honest and fair dealing.

A partner may be sued more broadly in UPA (1994) than is the case in the 1914 Act. The earlier Act limited legal action to an action for an accounting.

Dissolution

A partnership dissolves under the 1914 Act upon the happening of specific events, either the end of the prescribed term of the partnership, as agreed by the partners, or when a partner dissociates, rightfully or wrongfully, from the partnership. At dissolution, the business of the partnership has to be wound up and fruits of the enterprise distributed to the partners – after the creditors are paid, of course.

Automatic dissolution of the partnership after dissociation of a partner does not take place under UPA (1994). In a partnership at will only a partner who dissociates with notice of "express will" to dissolve causes the dissolution of the partnership. Thus, if a partner is simply bought out, there is not automatic dissolution.

In a partnership for a term or for a particular purpose, dissolution and winding up are required unless a majority in interest of the remaining partners agree to continue the partnership within 90 days after a partner's triggering dissociation before the expected expiration of the term of the partnership. Again, a dissociation that triggers a buy out of the dissociating partner's interest does not imperil the partnership with dissolution.

Of the changes that UPA (1994) makes over the 1914 Act, these rules may be the most significant. The ordinary dissociation of a partner does not mean the dissolution of the entity. It takes something more under UPA (1994).

Dissociation normally entitles the partner to have his or her interest purchased by the partnership, and terminates his or her authority to act for the partnership and to participate with the partners in running the business. Otherwise the entity continues to do business without the dissociating partner. No other characteristic of a partnership under UPA (1994) better illustrates the adoption of entity theory.

Conversion and Merger

UPA (1994) has absolutely new provisions on "conversion" and "merger." A partnership may convert to a limited partnership or a limited partnership may convert to a

partnership under these new statutory rules. A partnership may merge with another partnership or limited partnership, forming an entirely new entity, under the new rules of UPA (1994).

Since a partnership is really a matter of agreement of the partners, there is no absolute barrier to either conversion or merger for a partnership under the 1914 Act. It would require unanimous consent of the partners, and a winding down process for the prior partnership or partnerships. What the statutory provisions of UPA (1994) do is to provide a process, and to permit agreement to less than unanimous consent of all partners to accomplish either conversion or merger. Under UPA (1994), a partnership agreement can specify that either conversion or merger can be accomplished with less than unanimous consent. The agreement controls.

Conclusion

These are some of the principal advances of UPA (1994) over the 1914 Act. Partnership, as a fundamental form of business organization, needs to be updated for the next century. UPA (1994) provides the needed update.

Founded in 1892, the National Conference of Commissioners on Uniform State Laws is a confederation of state commissioners on uniform laws. Its membership is comprised of 300 practicing lawyers, judges, and law professors who are appointed by each of the 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands to draft uniform and model state laws and work toward their enactment.

Limited Liability Partnerships:
The 1996 Amendments to the Uniform Partnership Act (1994)

The Uniform Partnership Act (UPA) was approved by the Uniform Law Commissioners in 1994. It is a complete revision of the Uniform Partnership Act of 1914, which was adopted in every state except Louisiana. UPA updates partnership law to meet the needs of modern business, clearly establishing that a partnership is an entity rather than an aggregate of partners.

The 1996 Amendments to UPA add a significant option to partnership law: limited liability for all partners in a partnership when the entity chooses the registered limited liability partnership form. A partner in a limited liability partnership has nearly the same level of limited liability as a shareholder in a business corporation.

One of the historic principles of general partnership law is that each individual partner is personally liable for all partnership obligations. This means that partners may be required to discharge partnership obligations from their own personal assets once partnership assets are exhausted.

However, limited liability for participants in a business organization can have an important economic impact. Whether an individual or entity invests in or participates in a business may very well depend upon the quality of limited liability – for obvious reasons. Much of the current development in unincorporated organization law has been devoted to combining the flexibility of a partnership with limited liability for the participants in the business. The limited liability company and certain kinds of business trusts are examples.

But there has continued to be a search for an even simpler form. Texas pioneered the concept of a limited liability partnership in 1991. The notion of a partnership that obtains limited liability for partners by a simple registration on the public record provides an even simpler form than a limited liability company, for example. The Texas experiment lead directly to the Amendments to UPA.

The 1996 Amendments to UPA provide for a limited liability partnership with complete limitation of liability. Some of the pioneer legislation posed limitation of liability only for professional malpractice. The UPA Amendments provide for immunity from

personal liability for any actionable wrong committed by the partnership. No partner is immune from liability for his or her own acts. A partner who commits an actionable wrong in the conduct of partnership business is fully liable for his or her own actions. Immunity is granted only for liability that is imputed simply because a partner is a partner, not for liability directly incurred.

Limited liability is an election that requires partners to register to become a limited liability partnership. Corporations, limited partnerships, and limited liability companies, which provide members or participants with some level of limitation of liability, all are registered entities. A limited liability partnership must also identify itself as an L.L.P. to those with whom it does business. The registration and identification requirements are to provide clear notice of its limited liability status to those who do business with a partnership. Creditors may and will adjust their assessments of credit-worthiness, accordingly.

The Amendments provide an option. The traditional partnership remains intact as the "residual" business organization for those who join to do business together. The continuity of partnership law that comes from the 1914 Uniform Partnership Act remains unsullied. A limited liability partnership is a partnership, and the rules that govern such matters as partners' obligations to each other, distributions, dissociation from the partnership, dissolution of the partnership, and the like, remain the same for limited liability partnerships as they do for traditional partnerships.

The objective of the 1996 Amendments to UPA is to increase choices for those who intend to do business together. This should have a positive impact on the formation of new businesses. Tax consequences have always been a major factor in decisions about which form of business organization to choose. This impact upon choice appears likely to become less important in the future with the promulgation of new regulations by the Internal Revenue Service. Therefore, the appearance of the Amendments to UPA could not come at a more propitious time.

Uniform Partnership Act Revised After 80 Years

By *Francis J. Pavetti*

The Uniform Partnership Act (UPA) is one of the most venerable of the assemblage of uniform acts. It originally was adopted 80 years ago in 1914 by the Uniform Law Commissioners as a uniform act. Since that time it has been adopted by 49 states including Connecticut. The National Conference of Commissioners on Uniform State Laws recently completed a major revision of the UPA. This constitutes the only revision to the UPA since the original 1914 promulgation by the Uniform Law Commissioners. The new Revised Uniform Partnership Act (RUPA) is the result of six years' work by the Uniform Law Commissioners' drafting committee and is now ready for adoption by the states.

RUPA is likely to be introduced to the Connecticut legislature during the 1995 session. If adopted, it would make substantial changes to the laws governing partnerships. This article covers some of the more significant changes.

If adopted, RUPA will bring the law of partnerships in line with modern practices and trends.

RUPA makes basic revisions to several subjects in the UPA. Partnership breakups under RUPA do not require a dissolution in every case and can be subject to a mandatory buy-out of the departing partner's interest. RUPA also establishes and defines the scope of the partners' duties of care and loyalty, and the obligation of good faith and fair dealing. The confusing concept of property ownership under a tenancy in partnership is also abolished, the rules on the nature and transfer of partnership property are clarified to better facilitate transactions, and the rights and remedies of creditors are clarified.

RUPA moves away from the aggregate approach to partnership law and instead adopts an entity approach. RUPA also provides a procedure for record notice of partnership information including the partners' agency authority. In addition, RUPA provides statutory authority for mergers and conversions to and with limited partnerships under the protection of "safe harbor" rules.

Effect of Partnership Agreement

A basic concept of RUPA is that it operates, for the most part, as a default statute for matters not covered by the partnership agreement. The partnership agreement is any agreement between the partners, whether written, oral or implied, concerning the partnership, including any amendments. The partnership agreement is controlling as to virtually all matters, even if they are covered by the provisions of RUPA, with certain exceptions. The most significant exceptions under RUPA are that the partnership agreement may not eliminate the partners' duty of loyalty or the obligation of good faith and fair dealing; may not unreasonably reduce the duty of care; may not restrict the rights of third parties dealing with the partnership; may not unreasonably restrict a partner's access to books and records; or may not vary the power of a partner to dissociate.

Entity Approach

An important feature of the RUPA revision is its adoption of the entity theory for a partnership. At the time of the original drafting of UPA in the early 1900's, the drafters, after considerable debate, decided to adopt the common law aggregate theory rather than the entity theory. Since the adoption of the UPA, it has been found that the aggregate approach often

(Please see next page)

militates against partnership stability. Section 201 of RUPA adopts the entity theory by stating that a partnership is an entity distinct from its partners — thus achieving greater partnership stability under this more modern approach. For example, the partnership is not always dissolved when a partner withdraws, a continuation of the partnership after a withdrawal does not result in a "new" partnership, and the partnership holds title to real property under the partnership entity and not through the partners under a tenancy in partnership.

Partnership Break-ups

The concept of dissolution under UPA has long been a confusing area of the law. Under UPA, a partnership dissolves every time a partner leaves. If the remaining partners decide to continue the same business, it must be under a new partnership. RUPA provides for a continuation of the partnership under certain situations through a buy-out of the departing partner's interest or by agreement of the partners to continue in the absence of a buy-out. Certain situations still bring about a dissolution of the partnership when a partner leaves, but the process is improved and clarified. The approach of RUPA creates a greater degree of stability and predictability, and it is more consistent with an entity approach.

RUPA applies the new term "dissociation" when a partner leaves the partnership. The right of a partner to withdraw and terminate the agency relationship is preserved. The events that cause a dissociation are defined in Section 601 and include voluntary withdrawal and such events as expulsion under the agreement or by judicial action, death, incapacity, bankruptcy and events specified in the partnership agreement. RUPA also defines a wrongful dissociation, and the consequences of dissociation when it is wrongful, including liability for any damages caused to the partnership.

Under Section 801 of RUPA, the following events or circumstances cause dissolution: withdrawal of a partner in a partnership-at-will; a partner's dissociation in a partnership formed for a definite term or a particular undertaking, upon the express will of at least half of the remaining partners; the express will of all the partners; expiration of the term or undertaking; illegality of the partnership business or upon judicial decree that it is not reasonably practical to continue the business; application of a transferee of a partner's transferable interest if winding up is found to be equitable; or if dissolution is agreed to in the partnership agreement.

Under RUPA, a partnership would continue after dissolution for the sole purpose of winding up. However, Section 802 of RUPA specifies that dissolution may be avoided during the winding-up phase if all the partners agree, including the dissociating partner who has not dissociated wrongfully. The partnership then would resume carrying on its business as if dissolution never occurred.

Another significant innovation of RUPA is the provisions requiring a buy-out of a dissociated partner's interest, if the dissociation has not caused a dissolution under Section 801. The buy-out price is defined as "the greater of liquidation value or value based on sale of the entire business as a going concern without the dissociating partner." The price also would be reduced by the dissociating partner's share of partnership liabilities, and an offset would be applied for any damages caused by a wrongful dissociation. If the parties cannot agree on the buy-out price the dissociating partner would be able to maintain a court action to determine price, if a required tender of a price from the partnership is rejected.

Rights and Duties of Partners

RUPA clearly identifies the duties between and among the partnership and the individual partners. The defined fiduciary duties owed by a partner to the partnership and the individual partners are the duties of loyalty and due care as defined in RUPA. The duty of loyalty is limited to the obligation to account for benefits derived by a partner from the partnership business or the use of partnership property, including appropriation of a partnership opportunity; to refrain from dealing with the partnership on behalf of a party having an adverse interest; and not to compete with the partnership. The partnership agreement cannot eliminate the duty of loyalty, but the agreement may identify activities that do not violate the duty, if they are not manifestly unreasonable; and the partners, after full disclosure of the facts, may authorize or ratify an act or transaction that would otherwise violate the duty.

The duty of care is limited to refraining from gross negligence, reckless conduct, intentional misconduct, or a knowing violation of law. The partnership agreement cannot eliminate the duty of care, but it can reduce the duty, provided it is reasonable. The partners must discharge their duties and exercise their rights consistent with the obligation of good faith and fair dealing. This obligation may not be eliminated, but the partnership agreement may prescribe standards to measure the obligation of good faith and fair dealing if not manifestly unreasonable.

Under RUPA, the partnership has the duty to provide the partners with access to books, records and information. Information concerning the partnership's business and affairs must be furnished to a partner without demand, if the information is reasonably required for the proper exercise of the partner's rights, and must be furnished on demand, unless the de-

CLIENT NEWSLETTER SERVICE

For as little as $275 per year, you will receive four issues of *Report From Counsel* (100 copies of each issue), printed with your firm's letterhead, folded, and ready to be mailed to your clients and prospective clients.

Call or write for a free sample and more information.

Toll Free: 800-727-6574

Miles B. Weiss • N.L.R.G. • P.O. Box 7187 • Charlottesville, VA 22906

mand or the information demanded is unreasonable or improper.

Creditors' Rights and Partnership Property

RUPA makes some changes and clarifications with respect to creditors' rights. Partners are jointly and severally liable for obligations of the partnership. A partnership may be sued in the name of the partnership, and an action may be brought against the partnership with the joinder of any, or all, of the partners in the same action or in separate actions. A judgment creditor of the partnership and a partner may not levy against the assets of the partner unless the assets of the partnership have first been exhausted. Partnership property is owned by the partnership, not by the individual partners, and there is no tenancy in partnership.

Clear and precise rules also are established for the transfer of property to and from the partnership. A partner may not transfer the partner's rights as a partner, but may transfer what is known as the partner's "transferable interest," an interest limited to the partner's share of profits and losses, and the right to distributions. A transfer of the partner's transferable interest does not cause a dissolution of the partnership, and does not give the transferee the rights of a partner.

Statement of Authority

RUPA also introduces an optional record-notice procedure to facilitate transactions. It also protects third parties, as well as the partnership, from unauthorized acts of partners. A statement of authority may be filed with the Secretary of State. It may grant, or limit, the authority of designated partners to act for the partnership. For real estate transactions, the statement must also be filed in the land records, and may be conclusively relied upon by a bona fide purchaser. This will facilitate real estate transactions by not requiring the signatures of all partners for every transaction. Procedures are also established for the optional filing of a statement of dissociation of a partner, and of dissolution of the partnership.

Conclusion

If adopted, RUPA will bring the law of partnerships in line with modern practices and trends, while retaining many of the valuable provisions originally contained in UPA. This article addresses the major changes, but not all of the provisions and technical rules. In addition to the modernization of partnership law, RUPA provides for partnership stability and a greater level of predictability for practitioners and clients.

Francis Pavetti is a partner in the New London law firm of Pavetti & Freeman. He also is a Uniform Law Commissioner and co-drafted the Revised Uniform Partnership Act as a member of the Drafting Committee.

HAVE YOU ACCOUNTED FOR ALL THE HEIRS?

you can by calling...

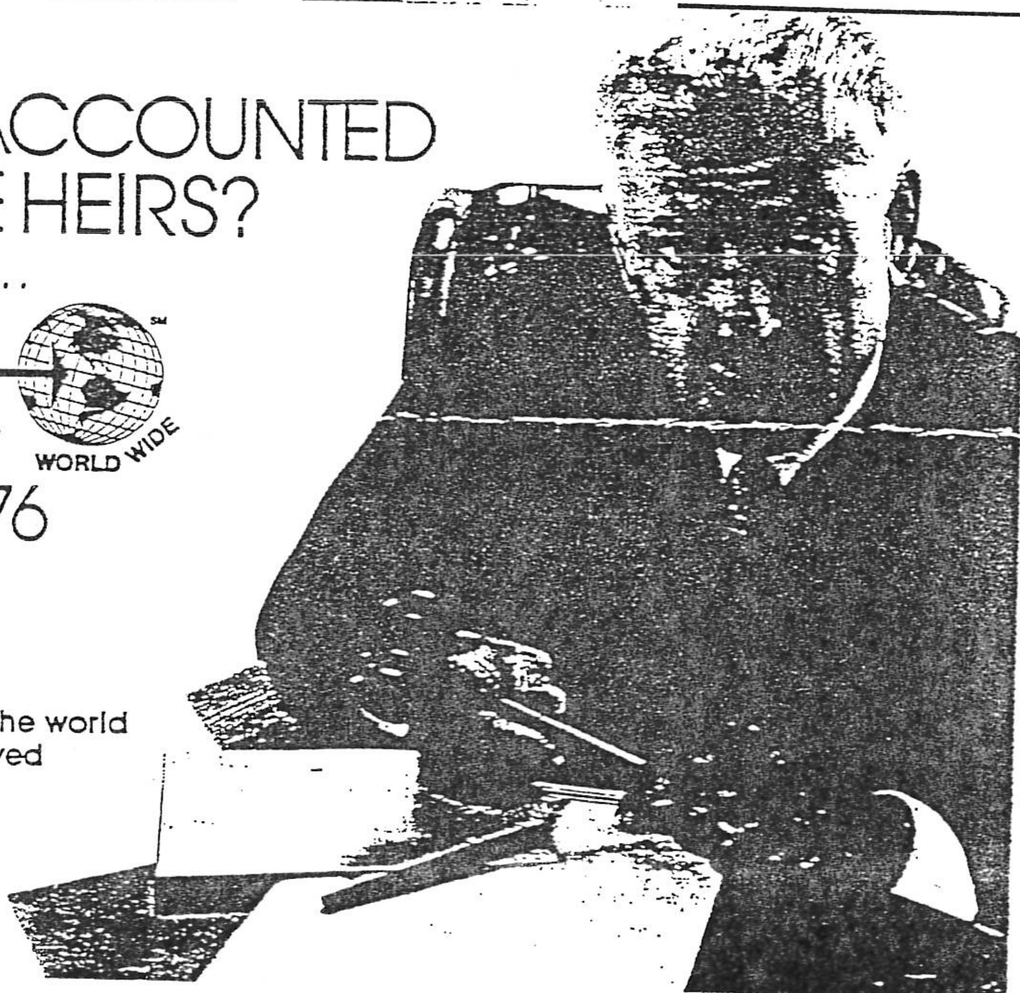
1-800-522-7276

8686 W. 96th Street, Suite 204
Overland Park, Kansas 66212
Fax 913-381-7710

- No expense to the estate
- Heirs located anywhere in the world
- The most difficult cases solved

Please call for free brochure and genealogical charts

© Copyright 1992, National Locators Inc., Overland Park, Kansas



SUMMARY OF THE REVISED UNIFORM PARTNERSHIP ACT*

RUPA SECTION	TITLE	PARALLEL §UPA	RUPA vs UPA
§101	Definitions	§2	RUPA deletes one definition in UPA (real property), expands on three UPA definitions (bankruptcy, conveyance (which is "transfer" in RUPA) and person) and contains seven new definitions (distribution, partnership, partnership, partnership agreement, partnership at will, property, state and statement (referring to various types of documents that may be filed by a partnership).
§102	Knowledge and Notice	§ 3	RUPA's formulation, which is based principally on UCC §1-201 (25) to (27), is more elaborate than UPA §3, but no major substantive change is intended.
§103	Effect of Partnership Agreement; Non-waivable Provisions	None	Subsection (a) sets forth the guiding principle that with respect to the rights of the partners between themselves and the partnership, RUPA contains default rules, which with limited exceptions, can be varied or restricted by the partnership agreement. This principle is contained in UPA, but the provisions where it is explicitly stated are spread throughout UPA. There are also several provisions in UPA dealing with the rights of partners qua partners and the partnership where the UPA is silent on the right to vary the statutory default rule, e.g., variation of fiduciary duties (§21) and the obligations to provide information about the partnership (§20). Subsection (b) lists nine exceptions to the default rule. The most significant is subsection (b)(9) which prohibits a partnership agreement from restricting the rights of third parties against the partnership or the partners. Several of the exceptions, which restrict but do not prohibit altogether variation by the partnership agreement of the default rule, are controversial. The formulation in RUPA represents a carefully worked out and extensively debated compromise between these persons who advocated no exception or a narrower exception than was approved by NCCUSL and those persons who thought the exceptions should be broader, thereby decreasing the number of situations where partnership agreement could override the default rule. The three most controversial exemptions are: 1. (b)(3) which does not allow the partnership agreement to "eliminate" a partner's duty of loyalty; 2. (b)(4) which does not allow the partnership agreement to "unreasonably reduce" a partner's duty of care; and

* Prepared by Dean Harry J. Haynsworth, Southern Illinois University School of Law, Carbondale, Illinois

			3. (b)(5) which does not allow the partnership agreement to "eliminate" a partner's obligation of good faith and fair dealing.
§104	Supplemental Principles of Law	§5	Subsection (a) is the same as UPA §5. Subsection (b) which specifies the state statute that determines the interest rate on obligations created under the act, is new
§105	Execution, Filing and Recording of Statements	None	This section, which has no counterpart in UPA, sets forth the requirements for filing, amending and canceling partnership statements. Centralized filing in the Secretary of State's office is required; and in the case of real estate, local filing in the office for recording transfers of real property is authorized in order to facilitate transfers of real property from a partnership. All authorized filings are optional and can be made by any partnership regardless of where it is formed. There are five types of authorized statements: (1) a statement of partnership authority (§303) which, although it applies to all transfers of property from a partnership, will be used most frequently with respect to real estate transactions because the grant of authority to convey partnership real property contained in the statement is conclusive as to BFPs; (2) a statement of denial of partnership authority (§304), which is designed to protect a partner or any person named as a partner in a partnership statement from being bound by any grant of authority or liability as a result of being named as a partner in the filed statement; (3) a statement of dissociation (§704), which protects a former or a partner from personal liability for obligations of the partnership incurred more than 90 days after the statement is filed; (4) a statement of dissolution (§805), which is effective as constructive notice to third parties of the partnership's dissolution 90 days after the filing; and (5) a statement of merger (§907), which is required to be filed by the surviving partnership in a merger of a general partnership with another general partnership or with a limited partnership.
§106	Law Governing Internal Affairs	None	This section is similar to RULPA §901; but: (1) RUPA substitutes the laws of the state where the partnership has its chief executive office (cf. UCC 9-103(3)(d))for the state of the partnership's organization on the grounds that because of the informality with which a general partnership can be created, it is often impossible to determine where the partnership was organized but it will always have a chief executive office; and (2) unlike RULPA, RUPA allows the partnership agreement to specify the state whose partnership statute will govern its internal affairs.

§107	Partnership Subject to Amendment or Repeal	None	This section, which is adapted from §1.02 of the 1984 Revised Model Business Corporation Act, makes it clear that future amendments in RUPA may affect partnership agreements drafted on the basis of RUPA provisions at the time the partnership is formed; i.e., there can be no claim of vested rights in the statutory language of RUPA.
§201	Partnership as Entity	None	The section makes explicitly clear one of the most significant changes made by RUPA: a general partnership is a legal entity that can own and convey property and sue and be sued in its own name and continues in existence even though one or more partners may leave. RUPA eschews the dichotomy between the aggregate and entity theories of UPA and is much closer to the general partnership model of civil law countries than UPA.
§202	Formation of Partnership	§§6 and 7	RUPA makes two changes: (1) the list of profit sharing arrangements that do not per se create a partnership in UPA §7(4) has been modernized to specifically include shared appreciation and other types of equity participation loans (§202 (c) (3) (v)); and (2) the language in UPA §6(2) stating that the UPA applies to limited partnerships to the extent there is no inconsistent provision in the applicable limited partnership act has been deleted. The effect of the second change could be very significant. Although §1105 of RULPA currently states that the UPA governs "in any case not provided for" in RULPA, it is possible that a decision could be made to delink the two partnership acts entirely. This could be done simply by deleting §1105 of RULPA and adding to RULPA any provisions thought to be necessary to make RULPA a free standing statute. This issue is currently being studied by NCCUSL and the ABA Partnership Committee.
§203	Partnership Property	§§8(1) and 25	RUPA §203 states simply and affirmatively the principle that since a partnership is a separate entity, its property, however acquired, belongs to it and not to the partners. Because of the entity theory incorporated into RUPA, it is no longer necessary to use artificial concepts like tenancy in partnership (See UPA §25), which is an outgrowth of the compromise between the aggregate and entity concepts of partnership built into RUPA, to describe the legal status of a partnership.
§204	When Property is Partnership Property	§8(2), (3), (4)	This most significant substantive change made by this section is in subsection (b) which defines how property is acquired in the partnership name. This concept is undefined in UPA.

§301	Partner Agent of Partnership	§9	RUPA makes two significant changes: (1) language has been added to both subsections (1) and (2) ("or business of the kind carried on by the partnership") to make it clear that the apparent authority of a partner includes both the usual way the particular partnership conducts its business and the way other partnerships in the same business conduct their affairs; and (2) the laundry list of events in UPA §9(3) requiring unanimous consent for approval has been deleted on the grounds that it was incomplete, unnecessary and a potential trap for unwary third-parties doing business with the partnership.
§302	Transfer of Partnership Property	§10	There are two significant substantive changes made in this section by RUPA: (1) it covers transfers of all property vs § 10 of UPA, which only covers transfers of real property; and (2) new subsection (c) provides a mechanism for a sole surviving partner or a sole successor in interest of a partnership's assets to execute and file documents in the name of the partnership to transfer title to the surviving partner or successor in interest.
§303	Statement of Partnership Authority	None	The statement of partnership authority is designed to facilitate transfers of property from a partnership. The statement, which is not mandatory, must contain: the names of the partnership, the street address of its chief executive office and also of one office in this state, if there is one; the names and mailing addresses of all the partners, or alternatively the name and mailing address of an agent who has a list containing the names and addresses of all the partners; the names of persons who have authority to execute deeds and other instruments transferring interests in real property from the partnership and may contain a special grant or limitation on the authority of any partner or deal with any other matter relating to the partnership. If properly filed, the statement is conclusive as to BFP's with respect to the authority of partners to transfer property from the partnership. A limitation on authority in a filed statement, however, is only binding on non-partners who do not have actual notice of the limitation, and in the case of real estate transfers is binding on those partners only in circumstances where the limitation on authority is in a copy of the statement that is filed both in the Secretary of State's office and in the real estate records of the county where the real property is located. A statement of partnership is automatically canceled at the end of five years but can be renewed by amendment or a new filing that is effective on the date of filing and can be canceled by the partnership at anytime.

			A statement of partnership can be filed by a partnership formed in another state and will be effective to protect transferees of property from the partnership made within the state where it is filed. Whether a creditor or other third party can challenge the transfer in an action against a partnership formed in another state that has transferred property located in a state where a partnership statement is filed will depend on the conflict of laws rules of the state where the partnership is deemed to have been formed or is located.
§304	Statement of Denial	None	This section provides a mechanism whereby a person who is not a partner may file a statement of denial which operates as a limitation of authority. A statement of denial can also be filed by a partner or former partner who wants to correct an error or update a filed partnership statement. The person filing the statement of denial should, of course, notify all the partners and partnership creditors of the statement of denial and also in appropriate circumstances file a statement of dissociation (§704) and a statement of dissolution §806).
§305	Partnership Liable for Partner's Actionable Conduct	§§13 & 14	The three significant changes made by RUPA are: (1) to broaden the scope of the section to cover all actionable misconduct by a partner (the language in UPA §13 could be interpreted as not encompassing certain types of no-fault torts and other actions); (2) deleting language in UPA §13 ("not being a partner in the partnership") that has been interpreted as prohibiting a partner who has been harmed by a tort committed by the partnership or by another partner acting as an agent of the partnership from recovering in an action against the partnership; and (3) adding language making it clearer than under the UPA that the partnership is liable for property belong to a third party that is taken improperly by a partner even if the property is never actually received by the partnership.
§306	Partner's Liability	§15, §17 47(7)	Subsection (a) is the successor to RUPA §15. Under UPA partners are jointly and severally liable for torts committed while acting on behalf of the partnership, but are only severally liable for debts of the partnership. Under RUPA, partners are jointly and severally liable for all partnership obligations "unless otherwise agreed to by the claimant or provided by law." Several states have already amended their version of UPA to incorporate this change. Subsection (b), which provides that an incoming partner is not personally liable for partnership obligations incurred before that person's admission as a partner, is the same as UPA §17. See also UPA §41(7).

§307	Action Against Partnership and Partners	None	This section of RUPA makes two major changes: (1) it specifically authorizes a partnership to sue and be sued in the partnership name (many states have implemented this concept in recent years either in their codes of civil procedure or as amendments to UPA); and (2) a creditor with a judgment against the partnership and the partners cannot collect the judgement against the partner's individual assets until the creditor has unsuccessfully attempted to satisfy the judgment against the partnership. There are several exceptions to this basic rule, which in effect makes partners guarantors of payment for partnership obligations: (1) the partnership is a party to a bankruptcy proceeding, and in the case of an involuntary case, the proceeding has not been dismissed within 90 days of filing; (2) a court gives permission to proceed against the partners after finding that the partnership's assets are clearly insufficient or otherwise unavailable to satisfy the judgment; (3) a partner has agreed that the creditor need not first exhaust partnership assets; or (4) individual partner liability is imposed by law (e.g. CERCLA environmental clean up liability). This may well be the most significant substantive change made by RUPA.
§308	Liability of Purported Partner	§16	This section, which deals with the liability of a person who is deemed to be a partner because of his or her conduct or consent, is essentially the same as UPA §16.
§401	Partner's Rights and Duties	§18	With minor modifications, RUPA carries forward the default rules in UPA §18, which sets forth the basic rights and duties of partners <u>inter se</u>. The modifications are: (1) an explicit provision describing debits and credits to a partner's capital account (subsection (a)); (2) expanding UPA §19(f) to allow all liquidating partners and not merely the "surviving partner" compensation for services rendered in winding up the partnership (see subsection (h); and (3) adding specific language to UPA §18(h) making it clear that all acts outside the ordinary course of the partnership's business and all amendments to the partnership agreement must be approved by unanimous consent of the partners.(See Subsection (j)).
§402	Distribution In Kind	38(1)	RUPA continues the rule in the UPA that in the absence of a contrary agreement, a partner cannot be required to accept an in kind distribution from a partnership. See also §808(a), which has the same rule with respect to liquidating distributions to partners.
§403	Partner's Information Rights and Duties	§§19 & 20	RUPA makes several significant change and clarifications: (1) subsection (a) makes it clear that a partnership has no mandatory duty to have any books and records; (2) the

7-19

partnership books and records are to be kept at the partnership's "chief executive office" vs its "principal place of business"; (3) subsection (b) explicitly states that agents and attorneys of a partner have the same rights as the partner to inspect the partnership's books and records; (4) subsection (b) also contains an explicit provision allowing former partners access to the partnership books and records for the period in which they were partners (UPA §19 was silent on this point); (5) the right to access and copy books and records is limited to "ordinary business hours" whereas under UPA §19 a partner can have access and copy the partnership books and records "at all times"; (6) subsection (b) of RUPA also adds a specific provision allowing the partnership to impose a reasonable charge for copies of documents furnished to a partner or a former partner; (7) the obligation of partners to furnish information about the partnership is to furnish without demand "any information concerning the partnership's business and affairs reasonably required for the proper exercise of the partner's rights and duties under the partnership agreement" or RUPA and with demand "any other information concerning the partnership's business and affairs, except to the extent the demand or the information demanded is unreasonable or otherwise improper under the circumstances", which gives partners and courts a basis for refusing burdensome and unreasonable demands for this nonessential information (UPA §20, which does not distinguish between the two types of information, requires "true and full" information about the partnership on demand and contains no unreasonable demand limitation); and (8) RUPA §103 allows the partnership agreement (a) to restrict the statutory rules on access to books and records, so long as the restrictions are not "unreasonable" (§103(b)(2)) and (b) to eliminate altogether the obligation to provide information about the partnership business UPA contains no specific authorization for restrictions on access and the duty to provide information).

RUPA	Subject	UPA	Comment
§404	General Standard of Partner's Conduct	§21	This section, which is perhaps the most controversial section in RUPA, basically states two propositions: (1) a partner has two fiduciary duties to the other partners and the partnership: a duty of loyalty and a duty of care, which is "limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law"; and (2) a partner has an obligation of good faith and fair dealing to the other partners and the partnership in discharging the partner's duties and exercising any rights under RUPA and the partnership agreement. The fiduciary duties of loyalty and due care and the obligation of good faith and fair dealing can be modified but the parameters of the modifications are different: the partnership agreement may not eliminate the

duty of loyalty but may "identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable"; the partnership agreement cannot"unreasonably reduce" the duty of due care; and the partnership agreement cannot eliminate the obligation of good faith and fair dealing but it may "determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable".

Under UPA, the fiduciary duties of a partner apply to the "formation, conduct, or liquidation" of a partnership. RUPA makes two significant changes in the scope of a partner's fiduciary duties: (1) under RUPA fiduciary duties of a partner only apply "in the conduct and winding up of the partnership business" and not to the "formation" of the partnership, a term that could be interpreted as making fiduciary duties applicable at the negotiation stage prior to the time an agreement to form a partnership has been reached; and (2) under RUPA, absent an agreement to the contrary, a disassociated partner can compete with the partnership after dissociation and the remaining duties of loyalty and the duty of care only apply to matters arising before the dissociation, exceptions that at best are only implicit in UPA.

There are several reasons why §404 is controversial. First, the section specifies that the duty of loyalty and due care are fiduciary duties; UPA, however, does not specifically state that the duty of loyalty is a fiduciary duty, a term that can be construed as requiring the same strict duty of loyalty as a trustee of a trust, (but the title to UPA §21 is "Partner Accountable as a Fiduciary" and virtually every partnership case since the seminal case of Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928) has characterized the duty of loyalty as a fiduciary duty). In addition UPA does not have any provision specifying a duty of care (but several cases have held that a duty of care does apply to partnerships). Third, there is no specific mention of an obligations of good faith and fair dealing in UPA (but cases have applied this contract principal to partnerships). Fourth, the section has been criticized because the formulations of the limitations on the partnership agreement being able to vary the statutory duties of loyalty and care and the obligation of good faith and fair dealing (See §103(b)) are said to be confusing and there is insufficient case law and examples in the comments to §404 on these limitations to provide a reasonable level of comfort to lawyers who draft partnership agreements.

§405	Actions by Partnership and Partners	§§13 and 22 and 43	Subsection (a), which is new, gives the partnership a right of action against a partner for breach of the partnership agreement or for violation of any other duty owed to the partnership. Subsection (b), which sets forth the remedies of partners against the partnership or another partner, makes two major substantive changes: (1) the language in UPA §13 which prohibits a partner from suing the partnership or another partner for torts and the like (the partnership is bound only for injuries to a "person not being a partner in the partnership") has been eliminated and new subsection (3) reinforces this change by specifically stating that a partner can sue the partnership and any partner for any cause of action" including rights and interests arising independently of the partnership relationship"; and (2) a partner may have relief against the partnership or another partner without the requirement of a formal accounting, as required by many courts interpreting UPA §21. Subsection (c), which states that the statute of limitations for an action brought by the partnership against a partner or by a partner against the partnership or another partner is the state's applicable statute of limitations for that particular cause of action, is new. This rule also applies to an accounting action brought at the time of liquidation. Any cause of action involved in the accounting that is barred by the applicable state statute of limitation can not be considered in the accounting action, however.
§406	Continuation of Partnership Beyond Definite Term	§23	This section continues the UPA rule that a term or single purpose partnership becomes a partnership at will if it continues after the term or completion of the undertaking, absent agreement to the contrary.
§501	Partner Not Co-Owner of Partnership Property	§§24 & 25	RUPA, as part of the implementation of the entity concept, eliminates the UPA concept in §§24 and 25 that partners own property belonging to a partnership as tenants-in-partnership, a unique form of co-ownership. One important legal consequence of eliminating the co-ownership theory is that a partner can now be held liable for embezzlement for misappropriating partnership property. Under UPA many courts held that partners could not be guilty for embezzlement since you cannot steal money or other property you own.
§502	Partner's Transferable Interest in the Partnership	§24, 26	This section makes it much clearer than under UPA that the only transferable interest of a partner is the right to transfer the partners profits and losses and right to distributions.

§503	Transfer of Partner's Transferable Interest	§§27, 32(2)	This section essentially carries forward the rules in UPA. The following changes are worth noting: (1) because of RUPA §103 it is now clear that a provision restricting or prohibiting a transfer would be enforceable as between the partners and the partnership (UPA §27(1) authorized variations in the rule that a transferee had no right to participate in the management of the partnership but was silent as to the right to restrict an assignment); (2) subsection (a)(3), which states that the transferring partner remains a partner for management and liability purposes, is new; subsection (e), which states that the partnership has no obligation to make distributions or otherwise recognize the rights of a transferee until after receiving notice of the transfer, is new; and subsection (f), which makes a transfer in violation of a restriction on transfer invalid as to transferees with notice of the transfer, is also new.
§504	Partner's Transferable Interest Subject to Charging Order	§28	This section carries forward the charging order rules in UPA §28, with the following modifications: (1) RUPA authorizes a judgment creditor of a partner's transferee, as well as a judgment creditor of a partner, to obtain a charging order against a partner's interest in distributions from the partnership; (2) subsection (b), which specifically states that a charging order is a lien on the debtor partner's right to distributions and can be foreclosed upon at any time, is new; and (3) subsection (e), which states that a charging order is the exclusive method of satisfying a judgment against a partner's right to distributions, is also new but is consistent with the majority of cases on this issue.
§601	Events Causing Partner's Dissociation	§§ 29,31 and 32	Under UPA the withdrawal of a partner cause a dissolution of the partnership, thereby automatically triggering the liquidation process; and if the partnership continues, it is legally a new partnership. Under RUPA, if the partnership continues in business after the dissociation of a partner, it is legally the same partnership as before the dissociation. Dissolution and liquidation occur only if the partnership is not continued. Thus, dissolution under RUPA has basically the same meaning as it has in corporate statutes. This separation of withdrawal ("dissociation") and dissolution reflects the adoption of the entity concept in RUPA and is one of the most fundamental changes made by RUPA. Section 601 rearranges and modifies, but does not fundamentally change the composite list of events of dissociation in UPA §§31 and 32. The major changes are: (1) a specific requirement that when a partner dissociates by express will, the dissociation is effective only upon

			receipt of the notice by the partnership, or at a later date specified in the notice; (2) a specific provision authorizing the partnership agreement to require that the notice of "express will" dissociation be in writing (§103(b)(6); (3) an express provision allowing the partnership agreement to define dissociation events other than those in §601; (4) a provision, modeled on RULPA 402(9), which authorizes expulsion of a corporate partner that has filed a certificate of dissolution, had its charter revoked or its right to conduct its business suspended, unless the problem is cured within 90 days after notice of expulsion from the partnership; (5) use of a new defined term ("debtor in bankruptcy") that makes it clear a partner against whom an order has been entered in an involuntary bankruptcy proceeding is, as of the time of the order, dissociated; (6) the addition of specific language making the execution of an assignment for the benefit of creditors, or the appointment of a trustee, receiver or liquidator of all or substantially all of a partner's property (and in the case of the appointment without consent of the partner, the failure to have the appointment vacated within 90 days of the appointment or within 90 days after the expiration of a stay to have the appointment vacated) are events that cause a dissociation; (7) the addition of detailed provisions based on equivalent provisions in RULPA defining what is meant by death of a partner in the case of a partner that is an entity, e.g., a corporation, partnership or trust; and (8) elimination of all the events in UPA §§31 and 32 that relate to termination of the partnership as opposed to withdrawal of a partner from the partnership.
§602	Partner's Power to Dissociate Wrongful Dissociation	§31(2), 38(2)	RUPA defines more precisely than UPA the circumstances in which a dissociation by a partner is wrongful. Subsection (b)(2)(iii), which makes bankruptcy a wrongful dissociation in a partnership for a term or definite undertaking is new. RUPA also eliminates the rule in UPA §38(2)(c) that prevents a wrongfully dissociating partner from receiving any good will value of the partnership if that partner's interest is purchased by the partnership or the other partners. The right of the partnership and the other partners to recover damages caused by the wrongful dissociation is, however, retained.
§603	Effect of Partner's Dissociation	New	This section accomplishes two purposes: (1) subsection (a) sets out the basic principle that upon dissociation Article 7 of RUPA applies if the dissociating partner's interest is to be purchased and Article 8 applies if the partnership is to be liquidated; and (2) subsection (b) provides that a dissociated partner "cannot participate in the management of the partnership unless and until the partnership is legally dissolved and begins liquidating (in which event only

dissociated partners who have not wrongfully dissolved can participate in the management of the partnership) but the dissociated partner can go into competition with the partnership with respect to new transactions but continues to have a duty of loyalty and due care to the partnership for matters arising before the dissociation.

§701	Purchase of Dissociated Partner's Interest	§38	This section, which can be varied by the partnership agreement, makes six major changes in the UPA buyout provisions: (1) perhaps the most significant and certainly the most controversial is the detailed formula for determining the buyout price of a dissociated partner's interest in subsection (a), which in essence sets out a willing buyer-willing seller model whereas UPA uses the term "value" with no elaboration of the criteria to determine value; (2) a partner who wrongfully dissociates from a term or single purpose partnership can be paid the discounted present value of his interest at the time of dissociation only if the court determines early payment "will not cause undue hardship to the business of the partnership" whereas under UPA the wrongfully dissociated partner has the right to immediate payment is secured by a bond approved by the court; (3) under RUPA the deferred payment to the wrongfully dissociating partner from a term or single purpose partnership must be secured by security authorized by the court as a bond; (4) as previously mentioned under RUPA but not UPA the good will value of the partnership can be taken into account when determining the value of a wrongfully dissociated partner's interest in the partnership; (5) RUPA adopts a procedure similar to the Revised Model Business Corporation Act for determining the value of a dissociated partner's interest when the dissociated partner and the partnership cannot agree (the partnership must pay the estimated value within 120 days of demand (or in the case of a term or single purpose partnership offer to pay) accompanied by a notice stating how the value was determined and the dissociated partner has 120 days after the tender to file suit (or one year after demand for payment if the partnership makes no tender) and if suit is filed the court will determine the value and can assess attorneys fees and expenses against any party found to have acted "arbitrarily, vexatiously, or not in good faith);" and (6) RUPA does not have the equivalent of UPA §42 which allows a dissociated partner who has not been paid the value of his or her interest the election to receive either interest on the value or a share of the profits of the partnership attributable to the use of that partner's capital by the partnership--under RUPA the dissociated partner is only entitled to interest on the unpaid value from the date of dissociation to the date of payment.

§702	Dissociated Partner's Power to Bind and Liability to Partnership	§§33 and 35	RUPA radically alters the UPA rules regarding the lingering apparent authority of a dissociated partner whose interest is purchased to bind the partnership following dissociation. Under UPA, the apparent authority extends without any time limit to any creditor who did not have actual notice or constructive notice by means of a newspaper notice published in all places where the partnership business "was regularly carried on." Under RUPA the apparent authority of the dissociated partner extends for a maximum of two years following dissociation and is terminated prior to that time by actual notice to a creditor or 90 days after the filing of a notice of dissociation under §704. Even if there is no actual or constructive notice, only a creditor who can prove reliance on the dissociated partner's status as a partner when extending credit to the partnership can recover the debt from the partnership.
§703	Dissociated Partner's Liability to Other Persons	§§35(2), 36	This section sets out two basic principles: (1) a dissociated partner whose interest is purchased remains liable for pre-dissociation liabilities of the partnership unless released from them voluntarily or by operation of law (but has a right of indemnification for all liabilities from the partnership and the continuing partners); and (2) a dissociated partner whose interest is purchased is not personally liable for post-dissolution liabilities of the partnership unless the dissociating partner's wrongful acts are responsible for the partnership being bound by the liability pursuant to §702. The first is basically a restatement of the same principal in UPA. The second represents a significant reduction in the possible exposure of the dissociated partner for post-dissociation partnership liabilities. See the comments to §702.
§704	Statement of Dissociation	None	The closest counterpart of this section in UPA is the provision in §35(b)(II) authorizing newspaper notice in all places where a partnership regularly carries on business as a means of cutting off the apparent agency power of a dissociated partner to bind the partnership to creditors who had not previously extended credit to the partnership prior to the dissociation. The statement of dissociation cuts off the apparent authority of the dissociated partner with respect to all creditors 90 days after the filing and not merely as to those creditors who have not previously granted credit to the partnership, and therefore is broader in scope and effect than UPA §35(b)(II). The statement of dissociation can be filed by either the dissociated partner or the partnership. It should be filed

routinely in every case even though actual notice is made to all known creditors.

§705	Continued Use of Partnership Name	§41(10)	This section carries forward the rule in §41(10) that the continued use of the name of the partnership, even if it contains the name of a dissociated partner, will not by itself make the dissociated partner liable for the post dissociation liabilities of the partnership. This section and section 306(b), which carries forward the rule in UPA 41(7) that an incoming partner is not personally liable for partnership liabilities incurred before he or she became a partner, are all that are left of UPA §41.
§801	Events Causing Dissolution and Winding Up of Partnership Business	§§31 and 32	Section 801 lists the events, including certain types of dissociation, that can result in a dissolution and winding up of the partnership business. The "other than dissociation" events listed are basically the same as UPA, with the following modifications: (1) subsection (4) of RUPA gives a partnership a 90 day right to cure any event that makes it unlawful for all or substantially all the partnership's business to be conducted; (2) the language in UPA §32 (e) giving a court the right to dissolve a partnership when its business "can only be carried on at a loss" has been changed in RUPA subsection (5)(i) to "the economic purpose of the partnership is likely to be unreasonably frustrated" in order to make it clear that a partnership that has tax losses but is otherwise a viable business is not subject to judicial dissolution merely because of the losses; (3) the right of a transferee of a partner's interest in the partnership to have the partnership liquidated (See Subsection (6)) is made subject to a judicial determination that it is "equitable to wind up the partnership business"; and (4) RUPA does not carry forward the rule in UPA §32(f) that a court may decree a dissolution in any circumstances that it determines to be equitable--rather the list of dissolution events in §801 is intended to be exclusive. RUPA makes three major changes in the RUPA dissolution rules: (1) as previously noted in the comments to §601, if the partnership continues in business it is organically the same partnership rather than a new partnership as is the case under UPA; (2) in a partnership for a definite term or specific undertaking, where a partner has wrongfully dissociated, or a partner dies (including "death" of a partner that is an entity) or becomes bankrupt or incompetent or makes an assignment for the benefit of creditors or has a receiver or liquidator appointed over all or substantially all of that partner's property, the partnership is dissolved unless within 90 days of the dissociation, a "majority in interest" (See Rev. Proc. 94-46) of the remaining partners agree that the partnership business should be continued,

7-21

			whereas under UPA, any partner who had not wrongfully dissociated could force a liquidation; and (3) even if the partnership is dissolved and starts liquidating, the dissolution can be retroactively revoked by agreement of all the partners, other than a wrongfully withdrawing partner, at any time before the liquidation process is completed (under UPA it is possible to revoke the decision to liquidate but legally, the business is considered a new partnership).
§802	Partnership Continues After Dissolution	§30	RUPA incorporates the rule in UPA §30 that a partnership is not terminated by reason of its dissolution but rather continues until the liquidation is completed but adds an important new twist -- all the partners, including a dissociated partner who has not wrongfully dissociated, can agree to revoke the dissolution, and if they do so, the partnership business continues as if dissolution had never occurred. This revocation concept is an adaptation of §14.04 of the Model Business Corporation Act. If revocation occurs, the dissociated partner is entitled to be paid the fair value of his or her interest. Moreover, the rights of third parties who act in reliance on the dissolution and before receiving notification of the revocation, are not adversely affected. This will protect third parties who, for example, enter into a transaction with the partnership that is proper if the partnership is liquidating but that would not be enforceable against the partnership if it had not been dissolved. This section is merely a default rule and can be modified by the partnership agreement. Thus the partnership agreement can provide that in an at-will partnership the dissociated partner does not have the right to force a liquidation of the partnership, but instead the majority of the remaining partners shall decide whether the partnership will continue or be liquidated.
§803	Right to Wind Up Partnership Business	§37	This section, which is basically the same as UPA §37, provides that any partner other than a wrongfully dissociating partners may participate in the management of the partnership during the dissolution phase. The only major change made in UPA is the addition of specific language authorizing the liquidating partners to engage in activities not ordinarily incident to liquidating the partnership in order to preserve the partnership's business of property "as a going concern for a reasonable time."
§804	Partner's Power to Bind Partnership After Dissolution	§§33 and 35	This section provides a much less complex rule than the equivalent provisions in UPA: after dissolution, the partnership is bound by any acts by the partners that are appropriate for liquidation and also for any obligations not

			appropriate for liquidation entered into with a non-partner who does not have actual or constructive notice of the dissolution.
§805	Statement of Dissolution	None	The Statement of Dissolution serves two purposes: (1) it provides constructive notice to the world that the partnership is dissolving, thereby cutting off after 90 days the apparent authority of a partner to bind the partnership for acts other than those reasonably necessary to liquidate the business; and (2) terminates authority to convey partnership real estate pursuant to section 303(d).
§806	Partner's Liability to Other Partners After Dissolution	§34	This section, which specifies how the partners share liabilities incurred during the liquidation process, is less complex than the equivalent UPA provisions. RUPA does not have different rules dependent on the cause of dissolution. In addition, pursuant to §103, it is possible for the partnership agreement to modify the rules in this section. There is no such authorization in UPA.
§807	Settlement of Accounts and Contributions Among Partners	§40	This section, which sets out the rules for liquidating distribution to the partners and the rules for contributions by partners necessary to wipe out a negative capital account and to pay partnership obligations in excess of its assets, makes the following changes in UPA §40: (1) partners who are creditors of the partnership are treated the same as other creditors "to the extent permitted by law", rather than being automatically subordinated to outside creditors; (2) the distinction between capital and profits in UPA §40(b)(II)-(IV) has been deleted as unnecessary because profits are part of capital under the definition of "distribution" in RUPA §101(3); (3) language in UPA §40 that could be interpreted to automatically make the amount of negative balance in a partner's capital account a debt to the partnership even if that is not the partners' intent, has been eliminated; and (4) the "jingle rule" in §§40 (h) and (i) giving creditors of a partner priority over partnership creditors in the assets of a bankrupt partner has been deleted as being inconsistent with §723(c) of the Bankruptcy code.
§901	Definitions	None	This section contains four definitions ("general partner," "limited partner," "limited partnership" and "partner" that apply to Article 9 of RUPA, which deals with conversions and mergers of partnerships.
§902	Conversion of Partnership to Limited Partnership	None	This section, which has no counterpart in the UPA, authorizes a non-exclusive safe harbor method of converting a general partnership into a limited partnership

			and specifies the responsibility of a general partner who becomes a limited partner for partnership liabilities before and after the conversion.
§903	Conversion of Limited Partnership to Partnership	None	This section, which has no counterpart in the UPA, authorizes as non-exclusive safe harbor method of converting a limited partnership into a general partnership and specifies the responsibility of a limited partner who becomes a general partner for partnership liabilities before and after the conversion.
§904	Effect of Conversion; Entity Unchanged	None	This section, which has no counterpart in the UPA, states that a partnership which has converted under §§902 or 903 is the exact same partnership before and after the conversion.
§905	Merger of Partnerships	None	This section, which has no counterpart in the UPA, authorizes a non-exclusive safe harbor method of merging a general partnership with one or more general or limited partnerships. The statutory format is similar to that for corporate mergers.
§906	Effect of Merger	None	This section, which basically follows the corporate merger statutes, sets out the legal effects of the merger, including the liability of a partner of the surviving partnership for the obligation of the merging and the surviving partnerships and the rights and liabilities of a non-continuing partner.
§907	Statement of Merger	None	This section, which has no UPA counterpart, sets out the requirements for a statement of merger as well as the legal consequences of filing the statement. The format is similar to the statement required to be filed by the surviving corporation under corporate merger statutes.
§908	Nonexclusive	None	This section makes it clear that partnerships can convert or merge in any other manner authorized by law.
§1001	Uniformity of Application and Construction	None	This section is a standard provision found in all recently drafted uniform acts.
§1002	Short Title	§1	This section sets out the official name of the act.

§..03	Severability Clause	None	This section is a standard provision found in all recently drafted uniform acts.
§1004	Effective Date	§44	Because of the number of changes made by RUPA, state legislatures will probably want to have a delayed effective date in order to allow sufficient time for the various partnership statement forms to be prepared and filed and to educate lawyers and their clients about the changes.
§1005	Applicability	None	This section provides for a phased-in applicability of RUPA depending on whether a partnership is formed before or after the effective date of the Act. RUPA applies to partnerships formed before its effective date at a time certain specified by the state legislature (until that time they are governed by UPA); but such partnerships can elect to be governed by RUPA before this date. RUPA applies to all partnerships formed after its effective date. These rules should minimize transition problems.
§1007	Savings Clause	None	This Section, which parallels RULPA §1106, sets forth two standard rules: (1) the provisions of RUPA do not impair contract obligations existing on the effective date; (2) the changes in RUPA do not affect any action or proceeding commenced or any right accrued before the effective date.

\hayn\rupa\rupa3
January 12, 1995

DRAFT

FOR APPROVAL

AMENDMENTS TO
UNIFORM PARTNERSHIP ACT (1996)

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

MEETING IN ITS ONE-HUNDRED-AND-SIXTH YEAR
SACRAMENTO, CALIFORNIA

JULY 25-AUGUST 1, 1997

AMENDMENTS TO
UNIFORM PARTNERSHIP ACT (1996)

Copyright 1996
By
NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

The ideas and conclusions herein set forth, including drafts of proposed legislation, have not been passed on by the National Conference of Commissioners on Uniform State Laws. They do not necessarily reflect the views of the Committee, Reporters or Commissioners. Proposed statutory language, if any, may not be used to ascertain legislative meaning of any promulgated final law.

7-32

AMENDMENTS TO
UNIFORM PARTNERSHIP ACT (1994)

SECTION 801. EVENTS CAUSING DISSOLUTION AND WINDING UP OF PARTNERSHIP BUSINESS. A partnership is dissolved, and its business must be wound up, only upon the occurrence of any of the following events:

(1) in a partnership at will, the partnership's having notice from a partner, other than a partner who is dissociated under Section 601(2) through (10), of that partner's express will to withdraw as a partner, or on a later date specified by the partner;

(2) in a partnership for a definite term or particular undertaking:

(i) ~~the expiration of~~ within 90 days after a partner's dissociation by death or otherwise under Section 601(6) through (10) or wrongful dissociation under Section 602(b), ~~unless before that time a majority in interest of the remaining partners, including partners who have rightfully dissociated pursuant to Section 602(b)(2)(i), agree to continue the partnership~~ the express will of at least half of the remaining partners to wind up the partnership business, for which purpose a partner's rightful dissociation pursuant to Section 602(b)(2)(i) constitutes the expression of that partner's will to wind up the partnership business;

(ii) the express will of all of the partners to wind up the partnership business; or

(iii) the expiration of the term or the completion of the undertaking;

1 (3) an event agreed to in the partnership agreement resulting in the winding
2 up of the partnership business;
3 (4) an event that makes it unlawful for all or substantially all of the business
4 of the partnership to be continued, but a cure of illegality within 90 days after notice
5 to the partnership of the event is effective retroactively to the date of the event for
6 purposes of this section;
7 (5) on application by a partner, a judicial determination that:
8 (i) the economic purpose of the partnership is likely to be unreasonably
9 frustrated;
10 (ii) another partner has engaged in conduct relating to the partnership
11 business which makes it not reasonably practicable to carry on the business in
12 partnership with that partner, or
13 (iii) it is not otherwise reasonably practicable to carry on the partnership
14 business in conformity with the partnership agreement; or
15 (6) on application by a transferee of a partner's transferable interest, a
16 judicial determination that it is equitable to wind up the partnership business:
17 (i) after the expiration of the term or completion of the undertaking, if
18 the partnership was for a definite term or particular undertaking at the time of the
19 transfer or entry of the charging order that gave rise to the transfer; or
20 (ii) at any time, if the partnership was a partnership at will at the time of
21 the transfer or entry of the charging order that gave rise to the transfer.

UNIFORM PARTNERSHIP ACT (1996)

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-FIFTH YEAR
SAN ANTONIO, TEXAS
JULY 12 - JULY 19, 1996

WITH PREFATORY NOTE AND COMMENTS

COPYRIGHT 1994, 1996
By
NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

Approved by the American Bar Association
San Antonio, Texas, February 4, 1997

4/21/97

LIMITED LIABILITY PARTNERSHIP
AMENDMENTS TO UNIFORM PARTNERSHIP ACT (1994)

The Committee that acted for the National Conference of Commissioners on Uniform State Laws in preparing the Uniform Partnership Act (1996) was as follows:

HARRY J. HAYNSWORTH, IV, William Mitchell College of Law, 875 Summit Avenue, St. Paul, MN 55105, *Chair*
ANN E. CONAWAY ANKER, Widener University, School of Law, P.O. Box 7474, Wilmington, DE 19803
REX BLACKBURN, Suite 200, 1101 W. River Street, P.O. Box 959, Boise, ID 83701
STANLEY M. FISHER, 1100 Huntington Building, Cleveland, OH 44115
REED L. MARTINEAU, P.O. Box 45000, 10 Exchange Place, Salt Lake City, UT 84145
JOHN M. SPANGLER, Legislative Research Commission, Room 409, State Capitol, Frankfort, KY 40601
HOWARD J. SWIBEL, Suite 1200, 120 South Riverside Plaza, Chicago, IL 60606
JUSTIN L. VIGDOR, 2400 Chase Square, Rochester, NY 14604
CARTER G. BISHOP, Suffolk University Law School, 41 Temple Street, Boston, MA 02114, *Reporter*

EX OFFICIO

BION M. GREGORY, Office of Legislative Counsel, State Capitol, Suite 3021, Sacramento, CA 95814-4996, *President*
HENRY M. KITTLESON, P.O. Box 32092, 92 Lake Wire Drive, Lakeland, FL 33802, *Chair, Division E*

EXECUTIVE DIRECTOR

FRED H. MILLER, University of Oklahoma, College of Law, 300 Timberdell Road, Norman, OK 73019, *Executive Director*
WILLIAM J. PIERCE, 1505 Roxbury Road, Ann Arbor, MI 48104, *Executive Director Emeritus*

ABA ADVISORS TO DRAFTING COMMITTEE

ELIZABETH G. HESTER, *ABA*, Richmond, VA
LOU CONTI, *ABA Section of Business Law*, Orlando, FL
STEVEN G. FROST, *ABA Section of Taxation*, Chicago, IL
PROFESSOR THOMAS E. GEU, *ABA Section of Real Property, Probate and Trust*, University of South Dakota School of Law
SANFORD J. LIEBSCHUTZ, *ABA Section of Real Property, Probate and Trust* and *American College of Real Estate Lawyers*, Rochester, NY

UNIFORM PARTNERSHIP ACT (1994)

Approved and Recommended, Chicago, Illinois, July 29-August 5, 1994
Approved by the American Bar Association, August 10, 1994

Succeeded by the Uniform Partnership Act (1996)

The Committee that acted for the National Conference of Commissioners on Uniform State Laws in preparing the Uniform Partnership Act (1994) was as follows:

H. LANE KNEEDLER, Suite 600, 411 East Franklin Street, P.O. Box 3-K, Richmond, VA 23206, *Chair*
GEORGE H. BUXTON, III, P.O. Box 5389, Oak Ridge, TN 37831
ROBERT H. CORNELL, 34th Floor, 101 California Street, San Francisco, CA 94111
WILLIAM C. GARDNER, 4366 Argyle Terrace, N.W., Washington, DC 20011
HARRY J. HAYNSWORTH, IV, Southern Illinois University, School of Law, Lesar Law Building, Douglas Drive, Carbondale, IL 62901
MENDES HERSHMAN, 20th Floor, 575 Madison Avenue, New York, NY 10022
THOMAS L. JONES, University of Alabama, School of Law, P.O. Box 5557, University Station, Tuscaloosa, AL 35486
MORRIS W. MACEY, Suite 700, 133 Carnegie Way, N.W., Atlanta, GA 30303
FRANCIS J. PAVETTI, P.O. Box 829, Court House Square Building, New London, CT 06320
HAROLD E. READ, JR., 5631 East Desert Vista Trail, Cave Creek, AZ 85331
HOWARD J. SWIBEL, Suite 1200, 120 South Riverside Plaza, Chicago, IL 60606
M. GAY TAYLOR, Office of Legislative Research, 436 State Capitol, Salt Lake City, UT 84114
DONALD J. WEIDNER, Florida State University, College of Law, 425 West Jefferson Street, Tallahassee, FL 32306, *Reporter*
JOHN W. LARSON, Florida State University, College of Law, 425 West Jefferson Street, Tallahassee, FL 32306, *Assistant Reporter*

EX OFFICIO

RICHARD C. HITE, 200 West Douglas Avenue, Suite 630, Wichita, KS 67202, *President*
K. KING BURNETT, P.O. Box 910, 115 Broad Street, Salisbury, MD 21803, *Chair, Division A*

EXECUTIVE DIRECTOR

FRED H. MILLER, University of Oklahoma, College of Law, 300 Timberdell Road, Norman, OK 73019, *Executive Director*
WILLIAM J. PIERCE, 1505 Roxbury Road, Ann Arbor, MI 48104, *Executive Director Emeritus*

REVIEW COMMITTEE

JOHN FOX ARNOLD, 714 Locust Street, St. Louis, MO 63101, *Chair*
L. S. JERRY KURTZ, JR., 810 N Street, Anchorage, AK 99501
ROGER P. MORGAN, P.O. Box 588, Mystic, CT 06355

ABA ADVISORS TO DRAFTING COMMITTEE

ALLAN G. DONN, *American Bar Association*
S. STACY EASTLAND, *American Bar Association, Section of Real Property, Probate and Trust Law, Probate and Trust Division*
CARYL B. WELBORN, *American Bar Association, Section of Real Property, Probate and Trust Law, Real Property Division*

UNIFORM PARTNERSHIP ACT – QUICK CHRONOLOGY

1914 – Original Uniform Partnership Act

1992 – Promulgation of Uniform Partnership Act (1992) by Uniform Law Commissioners

1993 – Amendments to Uniform Partnership Act (1992)
Becomes Uniform Partnership Act (1993)

1994 – Amendments to Uniform Partnership Act (1993)
Becomes Uniform Partnership Act (1994)

1996 – Amendments to Uniform Partnership Act (1994)
Adds Limited Liability Partnership. Becomes **Uniform Partnership Act (1996)**

Copies of this Act may be obtained from:

NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS
676 North St. Clair Street, Suite 1700
Chicago, Illinois 60611
312/915-0195

UNIFORM PARTNERSHIP ACT (1996)

PREFATORY NOTE

The National Conference of Commissioners on Uniform State Laws first considered a uniform law of partnership in 1902. Although early drafts had proceeded along the mercantile or "entity" theory of partnerships, later drafts were based on the common-law "aggregate" theory. The resulting Uniform Partnership Act ("UPA"), which embodied certain aspects of each theory, was finally approved by the Conference in 1914. The UPA governs general partnerships, and also governs limited partnerships except where the limited partnership statute is inconsistent. The UPA has been adopted in every State other than Louisiana and has been the subject of remarkably few amendments in those States over the past 80 years.

In January of 1986, an American Bar Association subcommittee issued a detailed report that recommended extensive revisions to the UPA. *See* UPA Revision Subcommittee of the Committee on Partnerships and Unincorporated Business Organizations, Section of Business Law, American Bar Association, *Should the Uniform Partnership Act be Revised?*, 43 Bus. Law. 121 (1987) ("ABA Report"). The ABA Report recommended that the entity theory "should be incorporated into any revision of the UPA whenever possible." *Id.* at 124.

In 1987, the Conference appointed a Drafting Committee to Revise the Uniform Partnership Act and named a Reporter. The Committee held its initial meeting in January of 1988 and a first reading of the Committee's draft was begun at the Conference's 1989 Annual Meeting in Kauai, Hawaii. The first reading was completed at the 1990 Annual Meeting in Milwaukee. The second reading was begun at Naples, Florida, in 1991 and completed at San Francisco in 1992. The Revised Uniform Partnership Act (1992) was adopted unanimously by a vote of the States on August 6, 1992. The following year, in response to suggestions from various groups, including an American Bar Association subcommittee and several state bar associations, the Drafting Committee recommended numerous revisions to the Act. Those were adopted at the Charleston, South Carolina, Annual Meeting in 1993, and the Act was restyled as the Uniform Partnership Act (1993). Subsequently, a final round of changes was incorporated, and the Conference unanimously adopted the Uniform Partnership Act (1994) at its 1994 Annual Meeting in Chicago. The Revised Act was approved by the American Bar Association House of Delegates in August, 1994.

The Uniform Partnership Act (1994) ("Revised Act" or "RUPA") gives supremacy to the partnership agreement in almost all situations. The Revised Act is,

therefore, largely a series of "default rules" that govern the relations among partners in situations they have not addressed in a partnership agreement. The primary focus of RUPA is the small, often informal, partnership. Larger partnerships generally have a partnership agreement addressing, and often modifying, many of the provisions of the partnership act.

The Revised Act enhances the entity treatment of partnerships to achieve simplicity for state law purposes, particularly in matters concerning title to partnership property. RUPA does not, however, relentlessly apply the entity approach. The aggregate approach is retained for some purposes, such as partners' joint and several liability.

The Drafting Committee spent significant effort on the rules governing partnership breakups. RUPA's basic thrust is to provide stability for partnerships that have continuation agreements. Under the UPA, a partnership is dissolved every time a member leaves. The Revised Act provides that there are many departures or "dissociations" that do not result in a dissolution.

Under the Revised Act, the withdrawal of a partner is a "dissociation" that results in a dissolution of the partnership only in certain limited circumstances. Many dissociations result merely in a buyout of the withdrawing partner's interest rather than a winding up of the partnership's business. RUPA defines both the substance and procedure of the buyout right.

Article 6 of the Revised Act covers partner dissociations; Article 7 covers buyouts; and Article 8 covers dissolution and the winding up of the partnership business. *See generally* Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 Bus. Law. 1 (1993).

The Revised Act also includes a more extensive treatment of the fiduciary duties of partners. Although RUPA continues the traditional rule that a partner is a fiduciary, it also makes clear that a partner is not required to be a disinterested trustee. Provision is made for the legitimate pursuit of self-interest, with a counterbalancing irreducible core of fiduciary duties.

Another significant change introduced by RUPA is provision for the public filing of statements containing basic information about a partnership, such as the agency authority of its partners. Because of the informality of many partnerships, and the inadvertence of some, mandatory filings were eschewed in favor of a voluntary regime. It was the Drafting Committee's belief, however, that filings would become routine for sophisticated partnerships and would be required by lenders and others for major transactions.

Another innovation is found in Article 9. For the first time, the merger of two or more partnerships and the conversion of partnerships to limited partnerships (and the reverse) is expressly authorized, and a "safe harbor" procedure for effecting such transactions is provided.

One final change deserves mention. Partnership law no longer governs limited partnerships pursuant to the provisions of RUPA itself. First, limited partnerships are not "partnerships" within the RUPA definition. Second, UPA Section 6(2), which provides that the UPA governs limited partnerships in cases not provided for in the Uniform Limited Partnership Act (1976) (1985) ("RULPA") has been deleted. No substantive change in result is intended, however. Section 1105 of RULPA already provides that the UPA governs in any case not provided for in RULPA, and thus the express linkage in RUPA is unnecessary. Structurally, it is more appropriately left to RULPA to determine the applicability of RUPA to limited partnerships. It is contemplated that the Conference will review the linkage question carefully, although no changes in RULPA may be necessary despite the many changes in RUPA.

Finally, the Drafting Committee wishes to express its deep appreciation for the extraordinary time and effort that has been devoted to this project by its Reporter, Donald J. Weidner, Dean of the Florida State University College of Law; by its Assistant Reporter, Professor John W. Larson of the Florida State University College of Law; by its American Bar Association Advisors Allan G. Donn, of Norfolk, Virginia (ABA Section of Taxation and later the ABA Advisor, and a member of the original ABA subcommittee that recommended revising the UPA), Harry J. Haynsworth, Dean of the Southern Illinois University School of Law (the original ABA Advisor until he became a Commissioner and member of the Drafting Committee in 1992 and who was also a member of the original ABA subcommittee), S. Stacy Eastland, of Houston, Texas (Probate and Trust Division of the ABA Section of Real Property, Probate and Trust Law), and Caryl B. Welborn, of San Francisco, California (Real Property Division of the ABA Section of Real Property, Probate and Trust Law); and by a number of other advisors and observers without whose assistance the successful completion of this project would not have been possible: Edward S. Merrill of Walnut Creek, California, Gregory P.L. Pierce of Chicago, Illinois, Paul L. Lion, III, of San Jose, California, Professor Robert W. Hillman of the University of California at Davis School of Law, John Goode of Richmond, Virginia, Ronald H. Wilcomes of New York, New York, Professor Gary S. Rosin of the South Texas College of Law, James F. Fotenos of San Francisco, California, and Joel S. Adelman of Detroit, Michigan (who also was a member of the original ABA subcommittee). The Drafting Committee also would like to express its appreciation to the members of the ABA Committee on Partnerships and Unincorporated Business Organizations, and its chairs, Thurston R. Moore of Richmond, Virginia, and John H. Small of Wilmington, Delaware, for all the time

and effort they devoted to this project, and to that Committee's special Subcommittee on the Revised Uniform Partnership Act, the chairs of that subcommittee, Lauris G.L. Rall of New York, New York, and Gerald V. Niesar of San Francisco, California, and its members, in particular, Robert R. Keatinge of Denver, Colorado, Professor Larry E. Ribstein of the George Mason University School of Law, and Anthony van Westrum of Denver, Colorado. Each of these individuals added immeasurably to the Drafting Committee's discussion and consideration of both the major policy issues and the technical drafting issues raised by the Act.

Addendum

In 1995, the Conference appointed a Drafting Committee to add provisions to RUPA authorizing the creation of a new form of general partnership called a limited liability partnership (LLP). At the time RUPA was first approved in 1992, only two states had adopted limited liability partnership legislation. By the time the LLP amendments to RUPA were approved by the Conference at the 1996 Annual Meeting, over forty states had adopted limited liability partnership provisions to their general partnership statutes.

The LLP amendments to RUPA deal with four major issues: (1) scope of a partner's liability shield; (2) the voting requirement to become an LLP; (3) the effect of becoming an LLP on the partnership agreement; and (4) the annual filing requirement.

1. Scope of a Partner's Liability Shield

The amendments to add LLP provisions to RUPA include a new Section 306(c) providing for a corporate-styled liability shield which protects partners from vicarious personal liability for all partnership obligations incurred while a partnership is a limited liability partnership. The complete liability shield comports with the modern trend among the states. Most states, however, have adopted a partial liability shield protecting the partners only from vicarious personal liability for all partnership obligations arising from negligence, wrongful acts or misconduct, whether characterized as tort, contract or otherwise, committed while the partnership is an LLP. The Act does not alter a partner's liability for personal misconduct and does not alter the normal partnership rules regarding a partner's right to indemnification from the partnership (Section 401(c)). Therefore, the primary effect of the new liability shield is to sever a partner's personal liability to make contributions to the partnership when partnership assets are insufficient to cover its indemnification obligation to a partner who incurs a partnership obligation in the ordinary course of the partnership's business.

2. **Voting Requirement to Become an LLP**

The Act includes a new Section 1001(b) which provides that the decision to become an LLP is a major partnership event equivalent to an amendment of the partnership agreement. Therefore, the required vote equals the vote required to amend the partnership agreement. When the agreement is silent on these matters, the required vote would be unanimous. Where the agreement includes several amendment votes depending on the nature of the amendment, the required vote is that which considers contribution obligations since those obligations are the most affected by the amendments. Most states currently consider the required vote to become a limited liability partnership to be an ordinary partnership decision requiring only a majority consent.

In becoming an LLP, each partner should consider a personal liability calculus. Where partnership assets are insufficient to indemnify a partner for an LLP obligation, each partner forfeits a right to receive contributions from other partners in exchange for being relieved of the obligation to contribute to the personal liability of other partners. This calculus will be different for each partner and will vary, for example, depending on the size and business of the partnership, the number of partners, the amount of insurance, and the relative risk of each partner's business practice compared to fellow partners. To adequately consider these varying interests, the Act adopts the vote required to amend the partnership agreement in special and general cases.

3. **Effect of Becoming an LLP on the Partnership Agreement**

The last sentence in new Section 306(c) provides that when a partnership becomes an LLP, the resulting liability shield applies notwithstanding inconsistent provisions of the partnership agreement existing immediately before the vote to become an LLP was taken. When the partners vote to become an LLP, they obviously intend to sever their personal responsibility to make contributions to the partnership when partnership assets are insufficient to cover partnership indemnification obligations to a partner. A partner's contribution obligation may be enforced not only by a partner (Sections 401 and 405) but also by a partner's creditors (Section 807(f)). In essence, the new Section 306(c) automatically "amends" the partnership agreement to remove personal liability for contribution obligations that may exist under the terms of the partnership agreement as it exists immediately before the vote. However, the partners are not prohibited from thereafter amending the partnership agreement again to reestablish contribution obligations (see Section 103(b)).

4. **Annual Filing Requirement**

The Act includes new Section 1001(d) which provides that a partnership's status as an LLP remains effective until it is revoked by a vote of the partners or is

canceled by the Secretary of State under new Section 1003(c) for the failure to file an annual report or pay the required annual fees. Most states provide that unless an LLP timely files an annual registration statement, its LLP status is "automatically" terminated but may be resurrected prospectively only with a subsequent corrective filing. Under this view, an operating partnership may have significant "gaps" in its shield which is further complicated by sourcing rules necessary to determine when a partnership obligation belongs to the shielded LLP or the unshielded partnership. As with corporations and limited liability companies, the Act preserves the LLP status and the partners' liability shield unless the LLP status is revoked by the partners or canceled by the Secretary of State. In the latter case, potential gaps in the liability shield are cured with a retroactive resurrection of the LLP status if a corrective filing is made within two years (Section 1003(e)).

The LLP Drafting Committee wishes to express its gratitude to the Reporter for this project, Professor Carter G. Bishop of Suffolk University Law School. Professor Bishop's comprehensive knowledge of partnership law and tax and his drafting expertise were instrumental in enabling the Drafting Committee to complete this project in one year. The Drafting Committee also wishes to thank the following advisors and observers, whose expertise and advice were very important to the success of this project: Elizabeth G. Hester of Richmond, Virginia (ABA Advisor); Lou Conti of Orlando, Florida (ABA Section of Business Law Advisor); Steven G. Frost of Chicago, Illinois (ABA Section of Taxation Advisor); Professor Thomas E. Geu of the University of South Dakota School of Law (ABA Section of Real Property, Probate and Trust Advisor); Sanford J. Liebschutz of Rochester, New York (ABA Section of Real Property, Probate and Trust Advisor and American College of Real Estate Lawyers Advisor); Robert A. Creamer of Chicago, Illinois (Attorneys' Liability Assurance Society, Inc.); R. Michael Duffy of Washington, D.C. (The Accountant's Coalition); Professor Philip Hablutzel of Chicago, Illinois (Illinois Secretary of State's Corporation Law Advisory Committee; Robert R. Keatinge of Denver, Colorado (ABA Business Law Section); Mark Lubin of San Francisco, California (California Bar Association); Professor Sandra Miller of Chester, Pennsylvania; and William R. Stein of Washington, D.C. (The Accountant's Coalition); and Ronald H. Wilcomes of Paramus, New Jersey (American College of Real Estate Lawyers).

UNIFORM PARTNERSHIP ACT (1996)

[ARTICLE] 1

GENERAL PROVISIONS

SECTION 101. DEFINITIONS. In this [Act]:

(1) "Business" includes every trade, occupation, and profession.

(2) "Debtor in bankruptcy" means a person who is the subject of:

(i) an order for relief under Title 11 of the United States Code or a comparable order under a successor statute of general application; or

(ii) a comparable order under federal, state, or foreign law governing insolvency.

(3) "Distribution" means a transfer of money or other property from a partnership to a partner in the partner's capacity as a partner or to the partner's transferee.

(4) "Foreign limited liability partnership" means a partnership that:

(i) is formed under laws other than the laws of this State; and

(ii) has the status of a limited liability partnership under those laws.

(5) "Limited liability partnership" means a partnership that has filed a statement of qualification under Section 1001 and does not have a similar statement in effect in any other jurisdiction.

(6) "Partnership" means an association of two or more persons to carry on as co-owners a business for profit formed under Section 202, predecessor law, or comparable law of another jurisdiction.

(7) "Partnership agreement" means the agreement, whether written, oral, or implied, among the partners concerning the partnership, including amendments to the partnership agreement.

(8) "Partnership at will" means a partnership in which the partners have not agreed to remain partners until the expiration of a definite term or the completion of a particular undertaking.

(9) "Partnership interest" or "partner's interest in the partnership" means all of a partner's interests in the partnership, including the partner's transferable interest and all management and other rights.

(10) "Person" means an individual, corporation, business trust, estate, trust, partnership, association, joint venture, government, governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

(11) "Property" means all property, real, personal, or mixed, tangible or intangible, or any interest therein.

(12) "State" means a State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or insular possession subject to the jurisdiction of the United States.

(13) "Statement" means a statement of partnership authority under Section 303, a statement of denial under Section 304, a statement of dissociation under

Section 704, a statement of dissolution under Section 805, a statement of merger under Section 907, a statement of qualification under Section 1001, a statement of foreign qualification under Section 1102, or an amendment or cancellation of any of the foregoing.

(14) "Transfer" includes an assignment, conveyance, lease, mortgage, deed, and encumbrance.

Comment

These Comments include the original Comments to the Revised Uniform Partnership Act (RUPA or the Act) and the new Comments to the Limited Liability Partnership Act Amendments to the Uniform Partnership Act (1994). The new Comments regarding limited liability partnerships are integrated into the RUPA Comments.

The RUPA continues the definition of "business" from Section 2 of the Uniform Partnership Act (UPA).

RUPA uses the more contemporary term "debtor in bankruptcy" instead of "bankrupt." The definition is adapted from the new Georgia Partnership Act, Ga. Code Ann. § 14-8-2(1). The definition does not distinguish between a debtor whose estate is being liquidated under Chapter 7 of the Bankruptcy Code and a debtor who is being rehabilitated under Chapter 11, 12, or 13 and includes both. The filing of a voluntary petition under Section 301 of the Bankruptcy Code constitutes an order for relief, but the debtor is entitled to notice and an opportunity to be heard before the entry of an order for relief in an involuntary case under Section 303 of the Code. The term also includes a debtor who is the subject of a comparable order under state or foreign law.

The definition of "distribution" is new and adds precision to the accounting rules established in Sections 401 and 807 and related sections. Transfers to a partner in the partner's capacity as a creditor, lessor, or employee of the partnership, for example, are not "distributions."

The definition of a "foreign limited liability partnership" includes a partnership formed under the laws of another State, foreign country, or other jurisdiction provided it has the status of a limited liability partnership in the other jurisdiction. Since the scope and nature of foreign limited liability partnership liability shields may vary in different jurisdictions, the definition avoids reference to

similar or comparable laws. Rather, the definition incorporates the concept of a limited liability partnership in the foreign jurisdiction, however defined in that jurisdiction. The reference to formation "under laws other than the laws of this State" makes clear that the definition includes partnerships formed in foreign countries as well as in another State.

The definition of a "limited liability partnership" makes clear that a partnership may adopt the special liability shield characteristics of a limited liability partnership simply by filing a statement of qualification under Section 1001. A partnership may file the statement in this State regardless of where formed. When coupled with the governing law provisions of Section 106(b), this definition simplifies the choice of law issues applicable to partnerships with multi-state activities and contacts. Once a statement of qualification is filed, a partnership's internal affairs and the liability of its partners are determined by the law of the State where the statement is filed. See Section 106(b). The partnership may not vary this particular requirement. See Section 103(b)(9).

The reference to a "partnership" in the definition of a limited liability partnership makes clear that the RUPA definition of the term rather than the UPA concept controls for purposes of a limited liability partnership. Section 101(6) defines a "partnership" as "an association of two or more persons to carry on as co-owners a business for profit formed under Section 202, predecessor law, or comparable law of another jurisdiction." Section 202(b) further provides that "an association formed under a statute other than this [Act], a predecessor statute, or a comparable statute of another jurisdiction is not a partnership under this [Act]." This language was intended to clarify that a limited partnership is not a RUPA general partnership. It was not intended to preclude the application of any RUPA general partnership rules to limited partnerships where limited partnership law otherwise adopts the RUPA rules. See Comments to Section 202(b) and Prefatory Note.

The effect of these definitions leaves the scope and applicability of RUPA to limited partnerships to limited partnership law, not to sever the linkage between the two Acts in all cases. Certain provisions of RUPA will continue to govern limited partnerships by virtue of Revised Uniform Limited Partnership Act (RULPA) Section 1105 which provides that "in any case not provided for in this [Act] the provisions of the Uniform Partnership Act govern." The RUPA partnership definition includes partnerships formed under the UPA. Therefore, the limited liability partnership rules will govern limited partnerships "in any case not provided for" in RULPA. Since RULPA does not provide for any rules applicable to a limited partnership becoming a limited liability partnership, the limited liability partnership rules should apply to limited partnerships that file a statement of qualification.

Partner liability deserves special mention. RULPA Section 403(b) provides that a general partner of a limited partnership "has the liabilities of a partner in a partnership without limited partners." Thus limited partnership law expressly references general partnership law for general partner liability and does not separately consider the liability of such partners. The liability of a general partner of a limited partnership that becomes a LLLP would therefore be the liability of a general partner in an LLP and would be governed by Section 306. The liability of a limited partner in a LLLP is a more complicated matter. RULPA Section 303(a) separately considers the liability of a limited partner. Unless also a general partner, a limited partner is not liable for the obligations of a limited partnership unless the partner participates in the control of the business and then only to persons reasonably believing the limited partner is a general partner. Therefore, arguably limited partners in a LLLP will have the specific RULPA Section 303(c) liability shield while general partners will have a superior Section 306(c) liability shield. In order to clarify limited partner liability and other linkage issues, States that have adopted RUPA, these limited liability partnership rules, and RULPA may wish to consider an amendment to RULPA. A suggested form of such an amendment is:

SECTION 1107. LIMITED LIABILITY LIMITED PARTNERSHIP.

(a) A limited partnership may become a limited liability partnership by:

(1) obtaining approval of the terms and conditions of the limited partnership becoming a limited liability limited partnership by the vote necessary to amend the limited partnership agreement except, in the case of a limited partnership agreement that expressly considers contribution obligations, the vote necessary to amend those provisions;

(2) filing a statement of qualification under Section 1001(c) of the Uniform Partnership Act (1994); and

(3) complying with the name requirements of Section 1002 of the Uniform Partnership Act (1994).

(b) A limited liability limited partnership continues to be the same entity that existed before the filing of a statement of qualification under Section 1001(c) of the Uniform Partnership Act (1994).

(c) Sections 306(c) and 307(f) of the Uniform Partnership Act (1994) apply to both general and limited partners of a limited liability limited partnership.

"Partnership" is defined to mean an association of two or more persons to carry on as co-owners a business for profit formed under Section 202 (or predecessor law or comparable law of another jurisdiction), that is, a general partnership. Thus, as used in RUPA, the term "partnership" does not encompass limited partnerships, contrary to the use of the term in the UPA. Section 901(3) defines "limited partnership" for the purpose of Article 9, which deals with conversions and mergers of general and limited partnerships.

The definition of "partnership agreement" is adapted from Section 101(9) of RULPA. The RUPA definition is intended to include the agreement among the partners, including amendments, concerning either the affairs of the partnership or the conduct of its business. It does not include other agreements between some or all of the partners, such as a lease or loan agreement. The partnership agreement need not be written; it may be oral or inferred from the conduct of the parties.

Any partnership in which the partners have not agreed to remain partners until the expiration of a definite term or the completion of a particular undertaking is a "partnership at will." The distinction between an "at-will" partnership and a partnership for "a definite term or the completion of a particular undertaking" is important in determining the rights of dissociating and continuing partners following the dissociation of a partner. See Sections 601, 602, 701(b), 801(a), 802(b), and 803.

It is sometimes difficult to determine whether a partnership is at will or is for a definite term or the completion of a particular undertaking. Presumptively, every partnership is an at-will partnership. *See, e.g.*, *Stone v. Stone*, 292 So. 2d 686 (La. 1974); *Frey v. Hauke*, 171 Neb. 852, 108 N.W.2d 228 (1961). To constitute a partnership for a term or a particular undertaking, the partners must agree (i) that the partnership will continue for a definite term or until a particular undertaking is completed **and** (ii) that they will remain partners until the expiration of the term or the completion of the undertaking. Both are necessary for a term partnership; if the partners have the unrestricted right, as distinguished from the power, to withdraw from a partnership formed for a term or particular undertaking, the partnership is one at will, rather than a term partnership.

To find that the partnership is formed for a definite term or a particular undertaking, there must be clear evidence of an agreement among the partners that the partnership (i) has a minimum or maximum duration or (ii) terminates at the conclusion of a particular venture whose time is indefinite but certain to occur. *See, e.g.*, *Stainton v. Tarantino*, 637 F. Supp. 1051 (E.D. Pa. 1986) (partnership to dissolve no later than December 30, 2020); *Abel v. American Art Analog, Inc.*, 838 F.2d 691 (3d Cir. 1988) (partnership purpose to market an art book); *68th Street Apts., Inc. v. Lauricella*, 362 A.2d 78 (N.J. Super. Ct. 1976) (partnership purpose to construct an apartment building). A partnership to conduct a business which may last indefinitely, however, is an at-will partnership, even though there may be an obligation of the partnership, such as a mortgage, which must be repaid by a certain date, absent a specific agreement that no partner can rightfully withdraw until the obligation is repaid. *See, e.g.*, *Page v. Page*, 55 Cal. 2d. 192, 359 P.2d 41 (1961) (partnership purpose to operate a linen supply business); *Frey v. Hauke*, *supra* (partnership purpose to contract and operate a bowling alley); *Girard Bank v.*

Haley, 460 Pa. 237, 332 A.2d 443 (1975) (partnership purpose to maintain and lease buildings).

"Partnership interest" or "partner's interest in the partnership" is defined to mean all of a partner's interests in the partnership, including the partner's transferable interest and all management and other rights. A partner's "transferable interest" is a more limited concept and means only his share of the profits and losses and right to receive distributions, that is, the partner's economic interests. See Section 502 and Comment. Compare RULPA § 101(10) ("partnership interest" includes partner's economic interests only).

The definition of "person" is the usual definition used by the National Conference of Commissioners on Uniform State Laws (NCCUSL or the Conference). The definition includes other legal or commercial entities such as limited liability companies.

"Property" is defined broadly to include all types of property, as well as any interest in property.

The definition of "State" is the Conference's usual definition.

The definition of "statement" is new and refers to one of the various statements authorized by RUPA to enhance or limit the agency authority of a partner, to deny the authority or status of a partner, or to give notice of certain events, such as the dissociation of a partner or the dissolution of the partnership. See Sections 303, 304, 704, 805, and 907. Generally, Section 105 governs the execution, filing, and recording of all statements. The definition also makes clear that a statement of qualification under Section 1001 and a statement of foreign qualification under Section 1102 are considered statements. Both qualification statements are therefore subject to the execution, filing, and recordation rules of Section 105.

"Transfer" is defined broadly to include all manner of conveyances, including leases and encumbrances.

SECTION 102. KNOWLEDGE AND NOTICE.

(a) A person knows a fact if the person has actual knowledge of it.

(b) A person has notice of a fact if the person:

(1) knows of it;

(2) has received a notification of it; or

(3) has reason to know it exists from all of the facts known to the person at the time in question.

(c) A person notifies or gives a notification to another by taking steps reasonably required to inform the other person in ordinary course, whether or not the other person learns of it.

(d) A person receives a notification when the notification:

(1) comes to the person's attention; or

(2) is duly delivered at the person's place of business or at any other place held out by the person as a place for receiving communications.

(e) Except as otherwise provided in subsection (f), a person other than an individual knows, has notice, or receives a notification of a fact for purposes of a particular transaction when the individual conducting the transaction knows, has notice, or receives a notification of the fact, or in any event when the fact would have been brought to the individual's attention if the person had exercised reasonable diligence. The person exercises reasonable diligence if it maintains reasonable routines for communicating significant information to the individual conducting the transaction and there is reasonable compliance with the routines. Reasonable diligence does not require an individual acting for the person to communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

(f) A partner's knowledge, notice, or receipt of a notification of a fact relating to the partnership is effective immediately as knowledge by, notice to, or receipt of a notification by the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

Comment

The concepts and definitions of "knowledge," "notice," and "notification" draw heavily on Section 1-201(25) to (27) of the Uniform Commercial Code (UCC). The UCC text has been altered somewhat to improve clarity and style, but in general no substantive changes are intended from the UCC concepts. "A notification" replaces the UCC's redundant phrase, "a notice or notification," throughout the Act.

A person "knows" a fact only if that person has actual knowledge of it. Knowledge is cognitive awareness. That is solely an issue of fact. This is a change from the UPA Section 3(1) definition of "knowledge" which included the concept of "bad faith" knowledge arising from other known facts.

"Notice" is a lesser degree of awareness than "knows" and is based on a person's: (i) actual knowledge; (ii) receipt of a notification; or (iii) reason to know based on actual knowledge of other facts and the circumstances at the time. The latter is the traditional concept of inquiry notice.

Generally, under RUPA, statements filed pursuant to Section 105 do not constitute constructive knowledge or notice, except as expressly provided in the Act. *See* Section 301(1) (generally requiring knowledge of limitations on partner's apparent authority). Properly recorded statements of limitation on a partner's authority, on the other hand, generally constitute constructive knowledge with respect to the transfer of real property held in the partnership name. *See* Sections 303(d)(1), 303(e), 704(b), and 805(b). The other exceptions are Sections 704(c) (statement of dissociation effective 90 days after filing) and 805(c) (statement of dissolution effective 90 days after filing).

A person "receives" a notification when (i) the notification is delivered to the person's place of business (or other place for receiving communications) or (ii) the recipient otherwise actually learns of its existence.

The sender "notifies" or gives a notification by making an effort to inform the recipient, which is reasonably calculated to do so in ordinary course, even if the recipient does not actually learn of it.

The Official Comment to UCC Section 1-201(26), on which this subsection is based, explains that "notifies" is the word used when the essential fact is the proper dispatch of the notice, not its receipt. When the essential fact is the other party's receipt of the notice, that is stated.

A notification is not required to be in writing. That is a change from UPA Section 3(2)(b). As under the UCC, the time and circumstances under which a notification may cease to be effective are not determined by RUPA.

Subsection (e) determines when an agent's knowledge or notice is imputed to an organization, such as a corporation. In general, only the knowledge or notice of the agent conducting the particular transaction is imputed to the organization. Organizations are expected to maintain reasonable internal routines to insure that important information reaches the individual agent handling a transaction. If, in the exercise of reasonable diligence on the part of the organization, the agent should have known or had notice of a fact, or received a notification of it, the organization is bound. The Official Comment to UCC Section 1-201(27) explains:

> This makes clear that reason to know, knowledge, or a notification, although "received" for instance by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction.

Subsection (e) uses the phrase "person other than an individual" in lieu of the UCC term "organization."

Subsection (f) continues the rule in UPA Section 12 that a partner's knowledge or notice of a fact relating to the partnership is imputed to the partnership, except in the case of fraud on the partnership. Limited partners, however, are not "partners" within the meaning of RUPA. *See* Comment 4 to Section 202. It is anticipated that RULPA will address the issue of whether notice to a limited partner is imputed to a limited partnership.

SECTION 103. EFFECT OF PARTNERSHIP AGREEMENT; NONWAIVABLE PROVISIONS.

(a) Except as otherwise provided in subsection (b), relations among the partners and between the partners and the partnership are governed by the

partnership agreement. To the extent the partnership agreement does not otherwise provide, this [Act] governs relations among the partners and between the partners and the partnership.

(b) The partnership agreement may not:

(1) vary the rights and duties under Section 105 except to eliminate the duty to provide copies of statements to all of the partners;

(2) unreasonably restrict the right of access to books and records under Section 403(b);

(3) eliminate the duty of loyalty under Section 404(b) or 603(b)(3), but:

(i) the partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; or

(ii) all of the partners or a number or percentage specified in the partnership agreement may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty;

(4) unreasonably reduce the duty of care under Section 404(c) or 603(b)(3);

(5) eliminate the obligation of good faith and fair dealing under Section 404(d), but the partnership agreement may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable;

(6) vary the power to dissociate as a partner under Section 602(a), except to require the notice under Section 601(1) to be in writing;

(7) vary the right of a court to expel a partner in the events specified in Section 601(5);

(8) vary the requirement to wind up the partnership business in cases specified in Section 801(4), (5), or (6);

(9) vary the law applicable to a limited liability partnership under Section 106(b); or

(10) restrict rights of third parties under this [Act].

Comment

1. The general rule under Section 103(a) is that relations among the partners and between the partners and the partnership are governed by the partnership agreement. *See* Section 101(5). To the extent that the partners fail to agree upon a contrary rule, RUPA provides the default rule. Only the rights and duties listed in Section 103(b), and implicitly the corresponding liabilities and remedies under Section 405, are mandatory and cannot be waived or varied by agreement beyond what is authorized. Those are the only exceptions to the general principle that the provisions of RUPA with respect to the rights of the partners *inter se* are merely default rules, subject to modification by the partners. All modifications must also, of course, satisfy the general standards of contract validity. See Section 104.

2. Under subsection (b)(1), the partnership agreement may not vary the requirements for executing, filing, and recording statements under Section 105, except the duty to provide copies to all the partners. A statement that is not executed, filed, and recorded in accordance with the statutory requirements will not be accorded the effect prescribed in the Act, except as provided in Section 303(d).

3. Subsection (b)(2) provides that the partnership agreement may not unreasonably restrict a partner or former partner's access rights to books and records under Section 403(b). It is left to the courts to determine what restrictions are reasonable. See Comment 2 to Section 403. Other information rights in Section 403 can be varied or even eliminated by agreement.

4. Subsection (b)(3) through (5) are intended to ensure a fundamental core of fiduciary responsibility. Neither the fiduciary duties of loyalty or care, nor the obligation of good faith and fair dealing, may be eliminated entirely. However, the statutory requirements of each can be modified by agreement, subject to the limitation stated in subsection (b)(3) through (5).

There has always been a tension regarding the extent to which a partner's fiduciary duty of loyalty can be varied by agreement, as contrasted with the other partners' consent to a particular and known breach of duty. On the one hand, courts have been loathe to enforce agreements broadly "waiving" in advance a partner's fiduciary duty of loyalty, especially where there is unequal bargaining power, information, or sophistication. For this reason, a very broad provision in a partnership agreement in effect negating any duty of loyalty, such as a provision giving a managing partner complete discretion to manage the business with no liability except for acts and omissions that constitute willful misconduct, will not likely be enforced. *See, e.g.*, *Labovitz v. Dolan*, 189 Ill. App. 3d 403, 136 Ill. Dec. 780, 545 N.E.2d 304 (1989). On the other hand, it is clear that the remaining partners can "consent" to a particular conflicting interest transaction or other breach of duty, after the fact, provided there is full disclosure.

RUPA attempts to provide a standard that partners can rely upon in drafting exculpatory agreements. It is not necessary that the agreement be restricted to a particular transaction. That would require bargaining over every transaction or opportunity, which would be excessively burdensome. The agreement may be drafted in terms of types or categories of activities or transactions, but it should be reasonably specific.

A provision in a real estate partnership agreement authorizing a partner who is a real estate agent to retain commissions on partnership property bought and sold by that partner would be an example of a "type or category" of activity that is not manifestly unreasonable and thus should be enforceable under the Act. Likewise, a provision authorizing that partner to buy or sell real property for his own account without prior disclosure to the other partners or without first offering it to the partnership would be enforceable as a valid category of partnership activity.

Ultimately, the courts must decide the outer limits of validity of such agreements, and context may be significant. It is intended that the risk of judicial refusal to enforce manifestly unreasonable exculpatory clauses will discourage sharp practices while accommodating the legitimate needs of the parties in structuring their relationship.

5. Subsection (b)(3)(i) permits the partners, in their partnership agreement, to identify specific types or categories of partnership activities that do not violate the

duty of loyalty. A modification of the statutory standard must not, however, be manifestly unreasonable. This is intended to discourage overreaching by a partner with superior bargaining power since the courts may refuse to enforce an overly broad exculpatory clause. *See, e.g.*, *Vlases v. Montgomery Ward & Co.*, 377 F.2d 846, 850 (3d Cir. 1967) (limitation prohibits unconscionable agreements); *PPG Industries, Inc. v. Shell Oil Co.*, 919 F.2d 17, 19 (5th Cir. 1990) (apply limitation deferentially to agreements of sophisticated parties).

Subsection (b)(3)(ii) is intended to clarify the right of partners, recognized under general law, to consent to a known past or anticipated violation of duty and to waive their legal remedies for redress of that violation. This is intended to cover situations where the conduct in question is not specifically authorized by the partnership agreement. It can also be used to validate conduct that might otherwise not satisfy the "manifestly unreasonable" standard. Clause (ii) provides that, after full disclosure of all material facts regarding a specific act or transaction that otherwise would violate the duty of loyalty, it may be authorized or ratified by the partners. That authorization or ratification must be unanimous unless a lesser number or percentage is specified for this purpose in the partnership agreement.

6. Under subsection (b)(4), the partners' duty of care may not be unreasonably reduced below the statutory standard set forth in Section 404(d), that is, to refrain from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

For example, partnership agreements frequently contain provisions releasing a partner from liability for actions taken in good faith and in the honest belief that the actions are in the best interests of the partnership and indemnifying the partner against any liability incurred in connection with the business of the partnership if the partner acts in a good faith belief that he has authority to act. Many partnership agreements reach this same result by listing various activities and stating that the performance of these activities is deemed not to constitute gross negligence or willful misconduct. These types of provisions are intended to come within the modifications authorized by subsection (b)(4). On the other hand, absolving partners of intentional misconduct is probably unreasonable. As with contractual standards of loyalty, determining the outer limit in reducing the standard of care is left to the courts.

The standard may, of course, be increased by agreement to one of ordinary care or an even higher standard of care.

7. Subsection (b)(5) authorizes the partners to determine the standards by which the performance of the obligation of good faith and fair dealing is to be measured. The language of subsection (b)(5) is based on UCC Section 1-102(3).

The partners can negotiate and draft specific contract provisions tailored to their particular needs (*e.g.*, five days notice of a partners' meeting is adequate notice), but blanket waivers of the obligation are unenforceable. *See, e.g., PPG Indus., Inc. v. Shell Oil Co.*, 919 F.2d 17 (5th Cir. 1990); *First Security Bank v. Mountain View Equip. Co.*, 112 Idaho 158, 730 P.2d 1078 (Ct. App. 1986), *aff'd*, 112 Idaho 1078, 739 P.2d 377 (1987); *American Bank of Commerce v. Covolo*, 88 N.M. 405, 540 P.2d 1294 (1975).

8. Section 602(a) continues the traditional UPA Section 31(2) rule that every partner has the power to withdraw from the partnership at any time, which power can not be bargained away. Section 103(b)(6) provides that the partnership agreement may not vary the power to dissociate as a partner under Section 602(a), except to require that the notice of withdrawal under Section 601(1) be in writing. The UPA was silent with respect to requiring a written notice of withdrawal.

9. Under subsection (b)(7), the right of a partner to seek court expulsion of another partner under Section 601(5) can not be waived or varied (e.g., requiring a 90-day notice) by agreement. Section 601(5) refers to judicial expulsion on such grounds as misconduct, breach of duty, or impracticability.

10. Under subsection (b)(8), the partnership agreement may not vary the right of partners to have the partnership dissolved and its business wound up under Section 801(4), (5), or (6). Section 801(4) provides that the partnership must be wound up if its business is unlawful. Section 801(5) provides for judicial winding up in such circumstances as frustration of the firm's economic purpose, partner misconduct, or impracticability. Section 801(6) accords standing to transferees of an interest in the partnership to seek judicial dissolution of the partnership in specified circumstances.

11. Subsection (b)(9) makes clear that a limited liability partnership may not designate the law of a State other than the State where it filed its statement of qualification to govern its internal affairs and the liability of its partners. See Sections 101(5), 106(b), and 202(a). Therefore, the selection of a State within which to file a statement of qualification has important choice of law ramifications, particularly where the partnership was formed in another State. See Comments to Section 106(b).

12. Although stating the obvious, subsection(b)(10) provides expressly that the rights of a third party under the Act may not be restricted by an agreement among the partners to which the third party has not agreed. A non-partner who is a party to an agreement among the partners is, of course, bound. *Cf.* Section 703(c) (creditor joins release).

13. The Article 9 rules regarding conversions and mergers are not listed in Section 103(b) as mandatory. Indeed, Section 907 states expressly that partnerships may be converted and merged in any other manner provided by law. The effect of compliance with Article 9 is to provide a "safe harbor" assuring the legal validity of such conversions and mergers. Although not immune from variation in the partnership agreement, noncompliance with the requirements of Article 9 in effecting a conversion or merger is to deny that "safe harbor" validity to the transaction. In this regard, Sections 903(b) and 905(c)(2) require that the conversion or merger of a limited partnership be approved by all of the partners, notwithstanding a contrary provision in the limited partnership agreement. Thus, in effect, the agreement can not vary the voting requirement without sacrificing the benefits of the "safe harbor."

SECTION 104. SUPPLEMENTAL PRINCIPLES OF LAW.

(a) Unless displaced by particular provisions of this [Act], the principles of law and equity supplement this [Act].

(b) If an obligation to pay interest arises under this [Act] and the rate is not specified, the rate is that specified in [applicable statute].

Comment

The principles of law and equity supplement RUPA unless displaced by a particular provision of the Act. This broad statement combines the separate rules contained in UPA Sections 4(2), 4(3), and 5. These supplementary principles encompass not only the law of agency and estoppel and the law merchant mentioned in the UPA, but all of the other principles listed in UCC Section 1-103: the law relative to capacity to contract, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other common law validating or invalidating causes, such as unconscionability. No substantive change from either the UPA or the UCC is intended.

It was thought unnecessary to repeat the UPA Section 4(1) admonition that statutes in derogation of the common law are not to be strictly construed. This principle is now so well established that it is not necessary to so state in the Act. No change in the law is intended. See the Comment to RUPA Section 1101.

7-60

Subsection (b) is new. It is based on the definition of "interest" in Section 14-8-2(5) of the Georgia act and establishes the applicable rate of interest in the absence of an agreement among the partners. Adopting States can select the State's legal rate of interest or other statutory interest rate, such as the rate for judgments.

SECTION 105. EXECUTION, FILING, AND RECORDING OF STATEMENTS.

(a) A statement may be filed in the office of [the Secretary of State]. A certified copy of a statement that is filed in an office in another State may be filed in the office of [the Secretary of State]. Either filing has the effect provided in this [Act] with respect to partnership property located in or transactions that occur in this State.

(b) A certified copy of a statement that has been filed in the office of the [Secretary of State] and recorded in the office for recording transfers of real property has the effect provided for recorded statements in this [Act]. A recorded statement that is not a certified copy of a statement filed in the office of the [Secretary of State] does not have the effect provided for recorded statements in this [Act].

(c) A statement filed by a partnership must be executed by at least two partners. Other statements must be executed by a partner or other person authorized by this [Act]. An individual who executes a statement as, or on behalf of, a partner or other person named as a partner in a statement shall personally declare under penalty of perjury that the contents of the statement are accurate.

(d) A person authorized by this [Act] to file a statement may amend or cancel the statement by filing an amendment or cancellation that names the partnership, identifies the statement, and states the substance of the amendment or cancellation.

(e) A person who files a statement pursuant to this section shall promptly send a copy of the statement to every nonfiling partner and to any other person named as a partner in the statement. Failure to send a copy of a statement to a partner or other person does not limit the effectiveness of the statement as to a person not a partner.

(f) The [Secretary of State] may collect a fee for filing or providing a certified copy of a statement. The [officer responsible for recording transfers of real property] may collect a fee for recording a statement.

Comment

1. Section 105 is new. It mandates the procedural rules for the execution, filing, and recording of the various "statements" (see Section 101(11)) authorized by RUPA. Section 101(13) makes clear that a statement of qualification filed by a partnership to become a limited liability partnership is included in the definition of a statement. Therefore, the execution, filing, and recording rules of this section must be followed except that the decision to file the statement of qualification must be approved by the vote of the partners necessary to amend the partnership agreement as to contribution requirements. See Section 1001(b) and Comments.

No filings are mandatory under RUPA. In all cases, the filing of a statement is optional and voluntary. A system of mandatory filing and disclosure for partnerships, similar to that required for corporations and limited partnerships, was rejected for several reasons. First, RUPA is designed to accommodate the needs of small partnerships, which often have unwritten or sketchy agreements and limited resources. Furthermore, inadvertent partnerships are also governed by the Act, as the default form of business organization, in which case filing would be unlikely.

The RUPA filing provisions are, however, likely to encourage the voluntary use of partnership statements. There are a number of strong incentives for the partnership or the partners to file statements or for third parties, such as lenders or transferees of partnership property, to compel them to do so.

Only statements that are executed, filed, and, if appropriate (such as the authority to transfer real property), recorded in conformity with Section 105 have the legal consequences accorded statements by RUPA. The requirements of Section 105 cannot be varied in the partnership agreement, except the duty to provide copies of statements to all the partners. *See* Section 103(b)(1).

In most States today, the filing and recording of statements requires written documents. As technology advances, alternatives suitable for filing and recording may be developed. RUPA itself does not impose any requirement that statements be in writing. It is intended that the form or medium for filing and recording be left to the general law of adopting States.

2. Section 105(a) provides for a single, central filing of all statements, as is the case with corporations, limited partnerships, and limited liability companies. The expectation is that most States will assign to the Secretary of State the responsibility of maintaining the filing system for partnership statements. Since a partnership is an entity under RUPA, all statements should be indexed by partnership name, not by the names of the individual partners.

Partnerships transacting business in more than one State will want to file copies of statements in each State because subsection (a) limits the legal effect of filed statements to property located or transactions occurring within the State. The filing of a certified copy of a statement originally filed in another State is permitted, and indeed encouraged, in order to avoid inconsistencies between statements filed in different States.

3. Subsection (b), in effect, mandates the use of certified copies of filed statements for local recording in the real estate records by limiting the legal effect of recorded statements under the Act to those copies. The reason for recording only certified copies of filed statements is to eliminate the possibility of inconsistencies affecting the title to real property.

Subsection (c) requires that statements filed on behalf of a partnership, that is, the entity, be executed by at least two partners. Individual partners and other persons authorized by the Act to file a statement may execute it on their own behalf. To protect the partners and the partnership from unauthorized or improper filings, an individual who executes a statement as a partner must personally declare under penalty of perjury that the statement is accurate.

The amendment or cancellation of statements is authorized by subsection (d).

As a further safeguard against inaccurate or unauthorized filings, subsection (e) requires that a copy of every statement filed be sent to each partner, although the failure to do so does not limit the effectiveness of the statement. This requirement may, however, be eliminated in the partnership agreement. *See* Section 103(b)(1). Partners may also file a statement of denial under Section 304.

4. A filed statement may be amended or canceled by any person authorized by the Act to file an original statement. The amendment or cancellation must state the name of the partnership so that it can be properly indexed and found, identify the statement being amended or canceled, and the substance of the amendment or cancellation. An amendment generally has the same operative effect as an original statement. A cancellation of extraordinary authority terminates that authority. A cancellation of a limitation on authority revives a previous grant of authority. *See* Section 303(d). The subsequent filing of a statement similar in kind to a statement already of record is treated as an amendment, even if not so denominated. Any substantive conflict between filed statements operates as a cancellation of authority under Section 303.

SECTION 106. GOVERNING LAW.

(a) Except as otherwise provided in subsection (b), the law of the jurisdiction in which a partnership has its chief executive office governs relations among the partners and between the partners and the partnership.

(b) The law of this State governs relations among the partners and between the partners and the partnership and the liability of partners for an obligation of a limited liability partnership.

Comment

The subsection (a) internal relations rule is new. *Cf.* RULPA § 901 (internal affairs governed by law of State in which limited partnership organized).

RUPA looks to the jurisdiction in which a partnership's chief executive office is located to provide the law governing the internal relations among the partners and between the partners and the partnership. The concept of the

partnership's "chief executive office" is drawn from UCC Section 9-103(3)(d). It was chosen in lieu of the State of organization because no filing is necessary to form a general partnership, and thus the situs of its organization is not always clear, unlike a limited partnership, which is organized in the State where its certificate is filed.

The term "chief executive office" is not defined in the Act, nor is it defined in the UCC. Paragraph 5 of the Official Comment to UCC Section 9-103(3)(d) explains:

> "Chief executive office" . . . means the place from which in fact the debtor manages the main part of his business operations. . . . Doubt may arise as to which is the "chief executive office" of a multi-state enterprise, but it would be rare that there could be more than two possibilities. . . . [The rule] will be simple to apply in most cases. . . .

In the absence of any other clear rule for determining a partnership's legal situs, it seems convenient to use that rule for choice of law purposes as well.

The choice-of-law rule provided by subsection (a) is only a default rule, and the partners may by agreement select the law of another State to govern their internal affairs, subject to generally applicable conflict of laws requirements. For example, where the partners may not resolve a particular issue by an explicit provision of the partnership agreement, such as the rights and duties set forth in Section 103(b), the law chosen will not be applied if the partners or the partnership have no substantial relationship to the chosen State or other reasonable basis for their choice or if application of the law of the chosen State would be contrary to a fundamental policy of a State that has a materially greater interest than the chosen State. *See* Restatement (Second) of Conflict of Laws § 187(2) (1971). The partners must, however, select only one State to govern their internal relations. They cannot select one State for some aspects of their internal relations and another State for others.

Contrasted with the variable choice-of-law rule provided by subsection (a), the law of the State where a limited liability partnership files its statement of qualification applies to such a partnership and may not be varied by the agreement of the partners. See Section 103(b)(9). Also, a partnership that files a statement of qualification in another State is not defined as a limited liability partnership in this State. See Section 101(5). Unlike a general partnership which may be formed without any filing, a partnership may only become a limited liability partnership by filing a statement of qualification. Therefore, the situs of its organization is clear. Because it is often unclear where a general partnership is actually formed, the decision to file a statement of qualification in a particular State constitutes a choice-of-law for the partnership which cannot be altered by the partnership agreement.

See Comments to Section 103(b)(9). If the partnership agreement of an existing partnership specifies the law of a particular State as its governing law, and the partnership thereafter files a statement of qualification in another State, the partnership agreement choice is no longer controlling. In such cases, the filing of a statement of qualification "amends" the partnership agreement on this limited matter. Accordingly, if a statement of qualification is revoked or canceled for a limited liability partnership, the law of the State of filing would continue to apply unless the partnership agreement thereafter altered the applicable law rule.

SECTION 107. PARTNERSHIP SUBJECT TO AMENDMENT OR REPEAL OF [ACT]. A partnership governed by this [Act] is subject to any amendment to or repeal of this [Act].

Comment

The reservation of power provision is new. It is adapted from Section 1.02 of the Revised Model Business Corporation Act (RMBCA) and Section 1106 of RULPA.

As explained in the Official Comment to the RMBCA, the genesis of those provisions is *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat) 518 (1819), which held that the United States Constitution prohibits the application of newly enacted statutes to existing corporations, while suggesting the efficacy of a reservation of power provision. Its purpose is to avoid any possible argument that a legal entity created pursuant to statute or its members have a contractual or vested right in any specific statutory provision and to ensure that the State may in the future modify its enabling statute as it deems appropriate and require existing entities to comply with the statutes as modified.

[ARTICLE] 2

NATURE OF PARTNERSHIP

SECTION 201. PARTNERSHIP AS ENTITY.

(a) A partnership is an entity distinct from its partners.

(b) A limited liability partnership continues to be the same entity that existed before the filing of a statement of qualification under Section 1001.

Comment

RUPA embraces the entity theory of the partnership. In light of the UPA's ambivalence on the nature of partnerships, the explicit statement provided by subsection (a) is deemed appropriate as an expression of the increased emphasis on the entity theory as the dominant model. *But see* Section 306 (partners' liability joint and several unless the partnership has filed a statement of qualification to become a limited liability partnership).

Giving clear expression to the entity nature of a partnership is intended to allay previous concerns stemming from the aggregate theory, such as the necessity of a deed to convey title from the "old" partnership to the "new" partnership every time there is a change of cast among the partners. Under RUPA, there is no "new" partnership just because of membership changes. That will avoid the result in cases such as *Fairway Development Co. v. Title Insurance Co.*, 621 F. Supp. 120 (N.D. Ohio 1985), which held that the "new" partnership resulting from a partner's death did not have standing to enforce a title insurance policy issued to the "old" partnership.

Subsection (b) makes clear that the explicit entity theory provided by subsection (a) applies to a partnership both before and after it files a statement of qualification to become a limited liability partnership. Thus, just as there is no "new" partnership resulting from membership changes, the filing of a statement of qualification does not create a "new" partnership. The filing partnership continues to be the same partnership entity that existed before the filing. Similarly, the amendment or cancellation of a statement of qualification under Section 105(d) or the revocation of a statement of qualification under Section 1003(c) does not terminate the partnership and create a "new" partnership. See Section 1003(d).

7-67

Accordingly, a partnership remains the same entity regardless of a filing, cancellation, or revocation of a statement of qualification.

SECTION 202. FORMATION OF PARTNERSHIP.

(a) Except as otherwise provided in subsection (b), the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership.

(b) An association formed under a statute other than this [Act], a predecessor statute, or a comparable statute of another jurisdiction is not a partnership under this [Act].

(c) In determining whether a partnership is formed, the following rules apply:

(1) Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not by itself establish a partnership, even if the co-owners share profits made by the use of the property.

(2) The sharing of gross returns does not by itself establish a partnership, even if the persons sharing them have a joint or common right or interest in property from which the returns are derived.

(3) A person who receives a share of the profits of a business is presumed to be a partner in the business, unless the profits were received in payment:

(i) of a debt by installments or otherwise;

(ii) for services as an independent contractor or of wages or other compensation to an employee;

(iii) of rent;

(iv) of an annuity or other retirement or health benefit to a beneficiary, representative, or designee of a deceased or retired partner;

(v) of interest or other charge on a loan, even if the amount of payment varies with the profits of the business, including a direct or indirect present or future ownership of the collateral, or rights to income, proceeds, or increase in value derived from the collateral; or

(vi) for the sale of the goodwill of a business or other property by installments or otherwise.

Comment

1. Section 202 combines UPA Sections 6 and 7. The traditional UPA Section 6(1) "definition" of a partnership is recast as an operative rule of law. No substantive change in the law is intended. The UPA "definition" has always been understood as an operative rule, as well as a definition. The addition of the phrase, "whether or not the persons intend to form a partnership," merely codifies the universal judicial construction of UPA Section 6(1) that a partnership is created by the association of persons whose intent is to carry on as co-owners a business for profit, regardless of their subjective intention to be "partners." Indeed, they may inadvertently create a partnership despite their expressed subjective intention not to do so. The new language alerts readers to this possibility.

As under the UPA, the attribute of co-ownership distinguishes a partnership from a mere agency relationship. A business is a series of acts directed toward an end. Ownership involves the power of ultimate control. To state that partners are co-owners of a business is to state that they each have the power of ultimate control. See Official Comment to UPA § 6(1). On the other hand, as subsection (c)(1) makes clear, passive co-ownership of property by itself, as distinguished from the carrying on of a business, does not establish a partnership.

2. Subsection (b) provides that business associations organized under other statutes are not partnerships. Those statutory associations include corporations, limited partnerships, and limited liability companies. That continues the UPA concept that general partnership is the residual form of for profit business association, existing only if another form does not.

A limited partnership is not a partnership under this definition. Nevertheless, certain provisions of RUPA will continue to govern limited partnerships because RULPA itself, in Section 1105, so requires "in any case not provided for" in RULPA. For example, the rules applicable to a limited liability partnership will generally apply to limited partnerships. See Comment to Section 101(5) (definition of a limited liability partnership). In light of that RULPA Section 1105, UPA Section 6(2), which provides that limited partnerships are governed by the UPA, is redundant and has not been carried over to RUPA. It is also more appropriate that the applicability of RUPA to limited partnerships be governed exclusively by RULPA. For example, a RULPA amendment may clarify certain linkage questions regarding the application of the limited liability partnership rules to limited partnerships. See Comment to Section 101(5) for a suggested form of such an amendment.

It is not intended that RUPA change any common law rules concerning special types of associations, such as mining partnerships, which in some jurisdictions are not governed by the UPA.

Relationships that are called "joint ventures" are partnerships if they otherwise fit the definition of a partnership. An association is not classified as a partnership, however, simply because it is called a "joint venture."

An unincorporated nonprofit organization is not a partnership under RUPA, even if it qualifies as a business, because it is not a "for profit" organization.

3. Subsection (c) provides three rules of construction that apply in determining whether a partnership has been formed under subsection (a). They are largely derived from UPA Section 7, and to that extent no substantive change is intended. The sharing of profits is recast as a rebuttable presumption of a partnership, a more contemporary construction, rather than as prima facie evidence thereof. The protected categories, in which receipt of a share of the profits is not presumed to create a partnership, apply whether the profit share is a single flat percentage or a ratio which varies, for example, after reaching a dollar floor or different levels of profits.

Like its predecessor, RUPA makes no attempt to answer in every case whether a partnership is formed. Whether a relationship is more properly

characterized as that of borrower and lender, employer and employee, or landlord and tenant is left to the trier of fact. As under the UPA, a person may function in both partner and nonpartner capacities.

Paragraph (3)(v) adds a new protected category to the list. It shields from the presumption a share of the profits received in payment of interest or other charges on a loan, "including a direct or indirect present or future ownership in the collateral, or rights to income, proceeds, or increase in value derived from the collateral." The quoted language is taken from Section 211 of the Uniform Land Security Interest Act. The purpose of the new language is to protect shared-appreciation mortgages, contingent or other variable or performance-related mortgages, and other equity participation arrangements by clarifying that contingent payments do not presumptively convert lending arrangements into partnerships.

4. Section 202(e) of the 1993 Act stated that partnerships formed under RUPA are general partnerships and that the partners are general partners. That section has been deleted as unnecessary. Limited partners are not "partners" within the meaning of RUPA, however.

SECTION 203. PARTNERSHIP PROPERTY. Property acquired by a partnership is property of the partnership and not of the partners individually.

Comment

All property acquired by a partnership, by transfer or otherwise, becomes partnership property and belongs to the partnership as an entity, rather than to the individual partners. This expresses the substantive result of UPA Sections 8(1) and 25.

Neither UPA Section 8(1) nor RUPA Section 203 provides any guidance concerning when property is "acquired by" the partnership. That problem is dealt with in Section 204.

UPA Sections 25(2)(c) and (e) also provide that partnership property is not subject to exemptions, allowances, or rights of a partner's spouse, heirs, or next of kin. Those provisions have been omitted as unnecessary. No substantive change is intended. Those exemptions and rights inure to the property of the partners, and not to partnership property.

SECTION 204. WHEN PROPERTY IS PARTNERSHIP PROPERTY.

(a) Property is partnership property if acquired in the name of:

(1) the partnership; or

(2) one or more partners with an indication in the instrument transferring title to the property of the person's capacity as a partner or of the existence of a partnership but without an indication of the name of the partnership.

(b) Property is acquired in the name of the partnership by a transfer to:

(1) the partnership in its name; or

(2) one or more partners in their capacity as partners in the partnership, if the name of the partnership is indicated in the instrument transferring title to the property.

(c) Property is presumed to be partnership property if purchased with partnership assets, even if not acquired in the name of the partnership or of one or more partners with an indication in the instrument transferring title to the property of the person's capacity as a partner or of the existence of a partnership.

(d) Property acquired in the name of one or more of the partners, without an indication in the instrument transferring title to the property of the person's capacity as a partner or of the existence of a partnership and without use of partnership assets, is presumed to be separate property, even if used for partnership purposes.

Comment

1. Section 204 sets forth the rules for determining when property is acquired by the partnership and, hence, becomes partnership property. It is based

on UPA Section 8(3), as influenced by the recent Alabama and Georgia modifications. The rules govern the acquisition of personal property, as well as real property, that is held in the partnership name. *See* Section 101(9).

2. Subsection (a) governs the circumstances under which property becomes "partnership property," and subsection (b) clarifies the circumstances under which property is acquired "in the name of the partnership." The concept of record title is emphasized, although the term itself is not used. Titled personal property, as well as all transferable interests in real property acquired in the name of the partnership, are covered by this section.

Property becomes partnership property if acquired (1) in the name of the partnership or (2) in the name of one or more of the partners with an indication in the instrument transferring title of either (i) their capacity as partners or (ii) of the existence of a partnership, even if the name of the partnership is not indicated. Property acquired "in the name of the partnership" includes property acquired in the name of one or more partners in their capacity as partners, but only if the name of the partnership is indicated in the instrument transferring title.

Property transferred to a partner is partnership property, even though the name of the partnership is not indicated, if the instrument transferring title indicates either (i) the partner's capacity as a partner or (ii) the existence of a partnership. This is consonant with the entity theory of partnership and resolves the troublesome issue of a conveyance to fewer than all the partners but which nevertheless indicates their partner status.

3. Ultimately, it is the intention of the partners that controls whether property belongs to the partnership or to one or more of the partners in their individual capacities, at least as among the partners themselves. RUPA sets forth two rebuttable presumptions that apply when the partners have failed to express their intent.

First, under subsection (c), property purchased with partnership funds is presumed to be partnership property, notwithstanding the name in which title is held. The presumption is intended to apply if partnership credit is used to obtain financing, as well as the use of partnership cash or property for payment. Unlike the rule in subsection (b), under which property is **deemed** to be partnership property if the partnership's name or the partner's capacity as a partner is disclosed in the instrument of conveyance, subsection (c) raises only a **presumption** that the property is partnership property if it is purchased with partnership assets.

That presumption is also subject to an important caveat. Under Section 302(b), partnership property held in the name of individual partners, without an

indication of their capacity as partners or of the existence of a partnership, that is transferred by the partners in whose name title is held to a purchaser without knowledge that it is partnership property is free of any claims of the partnership.

Second, under subsection (d), property acquired in the name of one or more of the partners, without an indication of their capacity as partners and without use of partnership funds or credit, is presumed to be the partners' separate property, even if used for partnership purposes. In effect, it is presumed in that case that only the use of the property is contributed to the partnership.

4. Generally, under RUPA, partners and third parties dealing with partnerships will be able to rely on the record to determine whether property is owned by the partnership. The exception is property purchased with partnership funds without any reference to the partnership in the title documents. The inference concerning the partners' intent from the use of partnership funds outweighs any inference from the State of the title, subject to the overriding reliance interest in the case of a purchaser without notice of the partnership's interest. This allocation of risk should encourage the partnership to eliminate doubt about ownership by putting title in the partnership.

5. UPA Section 8(4) provides, "A transfer to a partnership in the partnership name, even without words of inheritance, passes the entire estate or interest of the grantor unless a contrary intent appears." It has been omitted from RUPA as unnecessary because modern conveyancing law deems all transfers to pass the entire estate or interest of the grantor unless a contrary intent appears.

[ARTICLE] 3

RELATIONS OF PARTNERS TO PERSONS DEALING WITH PARTNERSHIP

SECTION 301. PARTNER AGENT OF PARTNERSHIP. Subject to the effect of a statement of partnership authority under Section 303:

(1) Each partner is an agent of the partnership for the purpose of its business. An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership, unless the partner had no authority to act for the partnership in the particular matter and the person with whom the partner was dealing knew or had received a notification that the partner lacked authority.

(2) An act of a partner which is not apparently for carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership only if the act was authorized by the other partners.

Comment

1. Section 301 sets forth a partner's power, as an agent of the firm, to bind the partnership entity to third parties. The rights of the partners among themselves, including the right to restrict a partner's authority, are governed by the partnership agreement and by Section 401.

The agency rules set forth in Section 301 are subject to an important qualification. They may be affected by the filing or recording of a statement of

partnership authority. The legal effect of filing or recording a statement of partnership authority is set forth in Section 303.

2. Section 301(1) retains the basic principles reflected in UPA Section 9(1). It declares that each partner is an agent of the partnership and that, by virtue of partnership status, each partner has apparent authority to bind the partnership in ordinary course transactions. The effect of Section 301(1) is to characterize a partner as a general managerial agent having both actual and apparent authority co-extensive in scope with the firm's ordinary business, at least in the absence of a contrary partnership agreement.

Section 301(1) effects two changes from UPA Section 9(1). First, it clarifies that a partner's apparent authority includes acts for carrying on in the ordinary course "business of the kind carried on by the partnership," not just the business of the particular partnership in question. The UPA is ambiguous on this point, but there is some authority for an expanded construction in accordance with the so-called English rule. *See, e.g.*, *Burns v. Gonzalez*, 439 S.W.2d 128, 131 (Tex. Civ. App. 1969) (dictum); *Commercial Hotel Co. v. Weeks*, 254 S.W. 521 (Tex. Civ. App. 1923). No substantive change is intended by use of the more customary phrase "carrying on in the ordinary course" in lieu of the UPA phrase "in the usual way." The UPA and the case law use both terms without apparent distinction.

The other change from the UPA concerns the allocation of risk of a partner's lack of authority. RUPA draws the line somewhat differently from the UPA.

Under UPA Section 9(1) and (4), only a person with knowledge of a restriction on a partner's authority is bound by it. Section 301(1) provides that a person who has received a notification of a partner's lack of authority is also bound. The meaning of "receives a notification" is explained in Section 102(d). Thus, the partnership may protect itself from unauthorized acts by giving a notification of a restriction on a partner's authority to a person dealing with that partner. A notification may be effective upon delivery, whether or not it actually comes to the other person's attention. To that extent, the risk of lack of authority is shifted to those dealing with partners.

On the other hand, as used in the UPA, the term "knowledge" embodies the concept of "bad faith" knowledge arising from other known facts. As used in RUPA, however, "knowledge" is limited to actual knowledge. *See* Section 102(a). Thus, RUPA does not expose persons dealing with a partner to the greater risk of being bound by a restriction based on their purported reason to know of the partner's lack of authority from all the facts they did know. Compare Section 102(b)(3) (notice).

With one exception, this result is not affected even if the partnership files a statement of partnership authority containing a limitation on a partner's authority. Section 303(f) makes clear that a person dealing with a partner is not deemed to know of such a limitation merely because it is contained in a filed statement of authority. Under Section 303(e), however, all persons are deemed to know of a limitation on the authority of a partner to transfer real property contained in a recorded statement. Thus, a recorded limitation on authority concerning real property constitutes constructive knowledge of the limitation to the whole world.

3. Section 301(2) is drawn directly from UPA Section 9(2), with conforming changes to mirror the new language of subsection (1). Subsection (2) makes it clear that the partnership is bound by a partner's actual authority, even if the partner has no apparent authority. Section 401(j) requires the unanimous consent of the partners for a grant of authority outside the ordinary course of business, unless the partnership agreement provides otherwise. Under general agency principles, the partners can subsequently ratify a partner's unauthorized act. See Section 104(a).

4. UPA Section 9(3) contains a list of five extraordinary acts that require unanimous consent of the partners before the partnership is bound. RUPA omits that section. That leaves it to the courts to decide the outer limits of the agency power of a partner. Most of the acts listed in UPA Section 9(3) probably remain outside the apparent authority of a partner under RUPA, such as disposing of the goodwill of the business, but elimination of a statutory rule will afford more flexibility in some situations specified in UPA Section 9(3). In particular, it seems archaic that the submission of a partnership claim to arbitration always requires unanimous consent. *See* UPA § 9(3)(e).

5. Section 301(1) fully reflects the principle embodied in UPA Section 9(4) that the partnership is not bound by an act of a partner in contravention of a restriction on his authority known to the other party.

SECTION 302. TRANSFER OF PARTNERSHIP PROPERTY.

(a) Partnership property may be transferred as follows:

(1) Subject to the effect of a statement of partnership authority under Section 303, partnership property held in the name of the partnership may be

transferred by an instrument of transfer executed by a partner in the partnership name.

(2) Partnership property held in the name of one or more partners with an indication in the instrument transferring the property to them of their capacity as partners or of the existence of a partnership, but without an indication of the name of the partnership, may be transferred by an instrument of transfer executed by the persons in whose name the property is held.

(3) Partnership property held in the name of one or more persons other than the partnership, without an indication in the instrument transferring the property to them of their capacity as partners or of the existence of a partnership, may be transferred by an instrument of transfer executed by the persons in whose name the property is held.

(b) A partnership may recover partnership property from a transferee only if it proves that execution of the instrument of initial transfer did not bind the partnership under Section 301 and:

(1) as to a subsequent transferee who gave value for property transferred under subsection (a)(1) and (2), proves that the subsequent transferee knew or had received a notification that the person who executed the instrument of initial transfer lacked authority to bind the partnership; or

(2) as to a transferee who gave value for property transferred under subsection (a)(3), proves that the transferee knew or had received a notification that

the property was partnership property and that the person who executed the instrument of initial transfer lacked authority to bind the partnership.

(c) A partnership may not recover partnership property from a subsequent transferee if the partnership would not have been entitled to recover the property, under subsection (b), from any earlier transferee of the property.

(d) If a person holds all of the partners' interests in the partnership, all of the partnership property vests in that person. The person may execute a document in the name of the partnership to evidence vesting of the property in that person and may file or record the document.

Comment

1. Section 302 replaces UPA Section 10 and provides rules for the transfer and recovery of partnership property. The language is adapted in part from Section 14-8-10 of the Georgia partnership statute.

2. Subsection (a)(1) deals with the transfer of partnership property held in the name of the partnership and subsection (a)(2) with property held in the name of one or more of the partners with an indication either of their capacity as partners or of the existence of a partnership. Subsection (a)(3) deals with partnership property held in the name of one or more of the partners without an indication of their capacity as partners or of the existence of a partnership. Like the general agency rules in Section 301, the power of a partner to transfer partnership property under subsection (a)(1) is subject to the effect under Section 303 of the filing or recording of a statement of partnership authority. These rules are intended to foster reliance on record title.

UPA Section 10 covers only real property. Section 302, however, also governs the transfer of partnership personal property acquired by instrument and held in the name of the partnership or one or more of the partners.

3. Subsection (b) deals with the right of the partnership to recover partnership property transferred by a partner without authority. Subsection (b)(1) deals with the recovery of property held in either the name of the partnership or the name of one or more of the partners with an indication of their capacity as partners or of the existence of a partnership, while subsection (b)(2) deals with the recovery

of property held in the name of one or more persons without an indication of their capacity as partners or of the existence of a partnership.

In either case, a transfer of partnership property may be avoided only if the partnership proves that it was not bound under Section 301 by the execution of the instrument of initial transfer. Under Section 301, the partnership is bound by a transfer in the ordinary course of business, unless the transferee actually knew or had received a notification of the partner's lack of authority. See Section 102(a) and (d). The reference to Section 301, rather than Section 301(1), is intended to clarify that a partner's actual authority is not revoked by Section 302. Compare UPA § 10(1) (refers to partner's authority under Section 9(1)).

The burden of proof is on the partnership to prove the partner's lack of authority and, in the case of a subsequent transferee, the transferee's knowledge or notification thereof. Thus, even if the transfer to the initial transferee could be avoided, the partnership may not recover the property from a subsequent purchaser or other transferee for value unless it also proves that the subsequent transferee knew or had received a notification of the partner's lack of authority with respect to the initial transfer. Since knowledge is required, rather than notice, a remote purchaser has no duty to inquire as to the authority for the initial transfer, even if he knows it was partnership property.

The burden of proof is on the transferee to show that value was given. Value, as used in this context, is synonymous with valuable consideration and means any consideration sufficient to support a simple contract.

The burden of proof on all other issues is allocated to the partnership because it is generally in a better position than the transferee to produce the evidence. Moreover, the partnership may protect itself against unauthorized transfers by ensuring that partnership real property is held in the name of the partnership and that a statement of partnership authority is recorded specifying any limitations on the partners' authority to convey real property. Under Section 303(e), transferees of real property held in the partnership name are conclusively bound by those limitations. On the other hand, transferees can protect themselves by insisting that the partnership record a statement specifying who is authorized to transfer partnership property. Under Section 303(d), transferees for value, without actual knowledge to the contrary, may rely on that grant of authority.

4. Subsection (b)(2) replaces UPA Section 10(3) and provides that partners who hold partnership property in their own names, without an indication in the record of their capacity as partners or of the existence of a partnership, may transfer good title to a transferee for value without knowledge or a notification that it was partnership property. To recover the property under this subsection, the

partnership has the burden of proving that the transferee knew or had received a notification of the partnership's interest in the property, as well as of the partner's lack of authority for the initial transfer.

5. Subsection (c) is new and provides that property may not be recovered by the partnership from a remote transferee if any intermediate transferee of the property would have prevailed against the partnership. *Cf.* Uniform Fraudulent Transfer Act, §§ 8(a) (subsequent transferee from bona fide purchaser protected), 8(b)(2) (same).

6. Subsection (d) is new. The UPA does not have a provision dealing with the situation in which all of the partners' interests in the partnership are held by one person, such as a surviving partner or a purchaser of all the other partners' interests. Subsection (d) allows for clear record title, even though the partnership no longer exists as a technical matter. When a partnership becomes a sole proprietorship by reason of the dissociation of all but one of the partners, title vests in the remaining "partner," although there is no "transfer" of the property. The remaining "partner" may execute a deed or other transfer of record in the name of the non-existent partnership to evidence vesting of the property in that person's individual capacity.

7. UPA Section 10(2) provides that, where title to real property is in the partnership name, a conveyance by a partner in his own name transfers the partnership's equitable interest in the property. It has been omitted as was done in Georgia and Florida. In this situation, the conveyance is clearly outside the chain of title and so should not pass title or any interest in the property. UPA Section 10(2) dilutes, albeit slightly, the effect of record title and is, therefore, inconsistent with RUPA's broad policy of fostering reliance on the record.

UPA Section 10(4) and (5) have also been omitted. Those situations are now adequately covered by Section 302(a).

SECTION 303. STATEMENT OF PARTNERSHIP AUTHORITY.

(a) A partnership may file a statement of partnership authority, which:

(1) must include:

(i) the name of the partnership;

(ii) the street address of its chief executive office and of one office in this State, if there is one;

7-81

(iii) the names and mailing addresses of all of the partners or of an agent appointed and maintained by the partnership for the purpose of subsection (b); and

(iv) the names of the partners authorized to execute an instrument transferring real property held in the name of the partnership; and

(2) may state the authority, or limitations on the authority, of some or all of the partners to enter into other transactions on behalf of the partnership and any other matter.

(b) If a statement of partnership authority names an agent, the agent shall maintain a list of the names and mailing addresses of all of the partners and make it available to any person on request for good cause shown.

(c) If a filed statement of partnership authority is executed pursuant to Section 105(c) and states the name of the partnership but does not contain all of the other information required by subsection (a), the statement nevertheless operates with respect to a person not a partner as provided in subsections (d) and (e).

(d) Except as otherwise provided in subsection (g), a filed statement of partnership authority supplements the authority of a partner to enter into transactions on behalf of the partnership as follows:

(1) Except for transfers of real property, a grant of authority contained in a filed statement of partnership authority is conclusive in favor of a person who gives value without knowledge to the contrary, so long as and to the extent that a limitation on that authority is not then contained in another filed

statement. A filed cancellation of a limitation on authority revives the previous grant of authority.

(2) A grant of authority to transfer real property held in the name of the partnership contained in a certified copy of a filed statement of partnership authority recorded in the office for recording transfers of that real property is conclusive in favor of a person who gives value without knowledge to the contrary, so long as and to the extent that a certified copy of a filed statement containing a limitation on that authority is not then of record in the office for recording transfers of that real property. The recording in the office for recording transfers of that real property of a certified copy of a filed cancellation of a limitation on authority revives the previous grant of authority.

(e) A person not a partner is deemed to know of a limitation on the authority of a partner to transfer real property held in the name of the partnership if a certified copy of the filed statement containing the limitation on authority is of record in the office for recording transfers of that real property.

(f) Except as otherwise provided in subsections (d) and (e) and Sections 704 and 805, a person not a partner is not deemed to know of a limitation on the authority of a partner merely because the limitation is contained in a filed statement.

(g) Unless earlier canceled, a filed statement of partnership authority is canceled by operation of law five years after the date on which the statement, or the most recent amendment, was filed with the [Secretary of State].

Comment

1. Section 303 is new. It provides for an optional statement of partnership authority specifying the names of the partners authorized to execute instruments transferring real property held in the name of the partnership. It may also grant supplementary authority to partners, or limit their authority, to enter into other transactions on behalf of the partnership. The execution, filing, and recording of statements is governed by Section 105.

RUPA follows the lead of California and Georgia in authorizing the optional filing of statements of authority. Filing a statement of partnership authority may be deemed to satisfy the disclosure required by a State's fictitious name statute, if the State so chooses.

Section 105 provides for the central filing of statements, rather than local filing. However, to be effective in connection with the transfer of real property, a statement of partnership authority must also be recorded locally with the land records.

2. The most important goal of the statement of authority is to facilitate the transfer of real property held in the name of the partnership. A statement must specify the names of the partners authorized to execute an instrument transferring that property.

Under subsection (d)(2), a recorded grant of authority to transfer real property held in the name of the partnership is conclusive in favor of a transferee for value without actual knowledge to the contrary. A partner's authority to transfer partnership real property is affected by a recorded statement only if the property is held in the name of the partnership. A recorded statement has no effect on the partners' authority to transfer partnership real property that is held other than in the name of the partnership. In that case, by definition, the record will not indicate the name of the partnership, and thus the partnership's interest would not be disclosed by a title search. *See* Section 204. To be effective, the statement recorded with the land records must be a certified copy of the original statement filed with the Secretary of State. *See* Section 105(b).

The presumption of authority created by subsection (d)(2) operates only so long as and to the extent that a limitation on the partner's authority is not contained in another recorded statement. This is intended to condition reliance on the record to situations where there is no conflict among recorded statements, amendments, or denials of authority. See Section 304. If the record is in conflict regarding a partner's authority, transferees must go outside the record to determine the partners' actual authority. This rule is modified slightly in the case of a cancellation

of a limitation on a partner's authority, which revives the previous grant of authority.

Under subsection (e), third parties are deemed to know of a recorded limitation on the authority of a partner to transfer real property held in the partnership name. Since transferees are bound under Section 301 by knowledge of a limitation on a partner's authority, they are bound by such a recorded limitation. Of course, a transferee with actual knowledge of a limitation on a partner's authority is bound under Section 301, whether or not there is a recorded statement of limitation.

3. A statement of partnership authority may have effect beyond the transfer of real property held in the name of the partnership. Under subsection (a)(2), a statement of authority may contain any other matter the partnership chooses, including a grant of authority, or a limitation on the authority, of some or all of the partners to enter into other transactions on behalf of the partnership. Since Section 301 confers authority on all partners to act for the partnership in ordinary matters, the real import of such a provision is to grant extraordinary authority, or to limit the ordinary authority, of some or all of the partners.

The effect given to such a provision is different from that accorded a provision regarding the transfer of real property. Under subsection (d)(1), a filed grant of authority is binding on the partnership, in favor of a person who gives value without actual knowledge to the contrary, unless limited by another filed statement. That is the same rule as for statements involving real property under subsection 301(d)(2). There is, however, no counterpart to subsection (e) regarding a filed limitation of authority. To the contrary, subsection (f) makes clear that filing a limitation of authority does **not** operate as constructive knowledge of a partner's lack of authority with respect to non-real property transactions.

Under Section 301, only a third party who knows or has received a notification of a partner's lack of authority in an ordinary course transaction is bound. Thus, a limitation on a partner's authority to transfer personal property or to enter into other non-real property transactions on behalf of the partnership, contained in a filed statement of partnership authority, is effective only against a third party who knows or has received a notification of it. The fact of the statement being filed has no legal significance in those transactions, although the filed statement is a potential source of actual knowledge to third parties.

4. It should be emphasized that Section 303 concerns the authority of partners to bind the partnership to third persons. As among the partners, the authority of a partner to take any action is governed by the partnership agreement, or by the provisions of RUPA governing the relations among partners, and is not affected by the filing or recording of a statement of partnership authority.

5. The exercise of the option to file a statement of partnership authority imposes a further disclosure obligation on the partnership. Under subsection (a)(1), a filed statement must include the street address of its chief executive office and of an office in the State (if any), as well as the names and mailing addresses of all of the partners or, alternatively, of an agent appointed and maintained by the partnership for the purpose of maintaining such a list. If an agent is appointed, subsection (b) provides that the agent shall maintain a list of all of the partners and make it available to any person on request for good cause shown. Under subsection (c), the failure to make all of the required disclosures does not affect the statement's operative effect, however.

6. Under subsection (g), a statement of authority is canceled by operation of law five years after the date on which the statement, or the most recent amendment, was filed.

7. Section 308(c) makes clear that a person does not become a partner solely because he is named as a partner in a statement of partnership authority filed by another person. See also Section 304 ("person named as a partner" may file statement of denial).

8. Under certain circumstances a statement of authority can potentially affect the tax status of a partnership. Under the classification regulations in the Internal Revenue Code, centralization of management may exist if there is any limitation on the normal agency authority of partners. *See* Treas. Reg. § 301.7701-2(c). A statement of authority that simply names the partners who are authorized to execute deeds or other instruments transferring partnership real property, pursuant to Section 303(a)(1)(iv), does not create a tax classification problem because that designation has no effect on the agency power of the partners to bind the partnership by entering into the transaction. The mere execution of the instruments transferring partnership property is essentially a ministerial act and presupposes that the underlying transaction has already been approved and is binding on the partnership. If the statement of authority goes further and grants some partners more power than other partners to bind the partnership or limits the normal agency authority of one or more partners, however, a potential centralization of management issue exists. The distinction is between saying "Partner John Smith is authorized to sign deeds and other instruments conveying interests in the partnership's real property" and "Partner John Smith has the exclusive power to enter into transactions on behalf of this partnership" or "Partner John Smith cannot enter into any transaction exceeding $5,000."

Even if the statement of partnership authority contains a special grant or limitation of authority, the potential adverse tax consequences are minimal for two reasons. First, whether the particular partnership will be held to have centralized

management depends on all the facts and circumstances. The statement of authority is merely one factor in the analysis. Second, even if there is centralized management, the partnership will still be taxed under Subchapter K of the Internal Revenue Code unless it also possess at least two of the three other corporate characteristics deemed important by the Regulations: (1) continuity of life, (2) limited liability, and (3) free transferability of interests; that will rarely be the case.

SECTION 304. STATEMENT OF DENIAL. A partner or other person named as a partner in a filed statement of partnership authority or in a list maintained by an agent pursuant to Section 303(b) may file a statement of denial stating the name of the partnership and the fact that is being denied, which may include denial of a person's authority or status as a partner. A statement of denial is a limitation on authority as provided in Section 303(d) and (e).

Comment

Section 304 is new and complements Section 303. It provides partners (and persons named as partners) an opportunity to deny any fact asserted in a statement of partnership authority, including denial of a person's status as a partner or of another person's authority as a partner. A statement of denial must be executed, filed, and recorded pursuant to the requirements of Section 105.

Section 304 does not address the consequences of a denial of partnership. No adverse inference should be drawn from the failure of a person named as a partner to deny such status, however. See Section 308(c) (person not liable as a partner merely because named in statement as a partner).

A statement of denial operates as a limitation on a partner's authority to the extent provided in Section 303. Section 303(d) provides that a filed or recorded statement of partnership authority is conclusive, in favor of purchasers without knowledge to the contrary, so long as and to the extent that a limitation on that authority is not contained in another filed or recorded statement. A filed or recorded statement of denial operates as such a limitation on authority, thereby precluding reliance on an inconsistent grant of authority. Under Section 303(d), a filed or recorded cancellation of a statement of denial that operates as a limitation on authority revives the previous grant of authority.

Under Section 303(e), a recorded statement of denial of a partner's authority to transfer partnership real property held in the partnership name constitutes constructive knowledge of that limitation.

SECTION 305. PARTNERSHIP LIABLE FOR PARTNER'S ACTIONABLE CONDUCT.

(a) A partnership is liable for loss or injury caused to a person, or for a penalty incurred, as a result of a wrongful act or omission, or other actionable conduct, of a partner acting in the ordinary course of business of the partnership or with authority of the partnership.

(b) If, in the course of the partnership's business or while acting with authority of the partnership, a partner receives or causes the partnership to receive money or property of a person not a partner, and the money or property is misapplied by a partner, the partnership is liable for the loss.

Comment

Section 305(a), which is derived from UPA Section 13, imposes liability on the partnership for the wrongful acts of a partner acting in the ordinary course of the partnership's business or otherwise within the partner's authority. The scope of the section has been expanded by deleting from UPA Section 13, "not being a partner in the partnership." This is intended to permit a partner to sue the partnership on a tort or other theory during the term of the partnership, rather than being limited to the remedies of dissolution and an accounting. See also Comment 2 to Section 405.

The section has also been broadened to cover no-fault torts by the addition of the phrase, "or other actionable conduct."

The partnership is liable for the actionable conduct or omission of a partner acting in the ordinary course of its business or "with the authority of the partnership." This is intended to include a partner's apparent, as well as actual, authority, thereby bringing within Section 305(a) the situation covered in UPA Section 14(a).

The phrase in UPA Section 13, "to the same extent as the partner so acting or omitting to act," has been deleted to prevent a partnership from asserting a partner's immunity from liability. This is consistent with the general agency rule that a principal is not entitled to its agent's immunities. *See* Restatement (Second) of Agency § 217(b) (1957). The deletion is not intended to limit a partnership's contractual rights.

Section 305(b) is drawn from UPA Section 14(b), but has been edited to improve clarity. It imposes strict liability on the partnership for the misapplication of money or property received by a partner in the course of the partnership's business or otherwise within the scope of the partner's actual authority.

SECTION 306. PARTNER'S LIABILITY.

(a) Except as otherwise provided in subsections (b) and (c), all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law.

(b) A person admitted as a partner into an existing partnership is not personally liable for any partnership obligation incurred before the person's admission as a partner.

(c) An obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership. A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or so acting as a partner. This subsection applies notwithstanding anything inconsistent in the partnership agreement that existed immediately before the vote required to become a limited liability partnership under Section 1001(b).

Comment

1. Section 306(a) changes the UPA rule by imposing joint and several liability on the partners for all partnership obligations where the partnership is not a limited liability partnership. Under UPA Section 15, partners' liability for torts is joint and several, while their liability for contracts is joint but not several. About ten States that have adopted the UPA already provide for joint and several liability. The UPA reference to "debts and obligations" is redundant, and no change is intended by RUPA's reference solely to "obligations."

Joint and several liability under RUPA differs, however, from the classic model, which permits a judgment creditor to proceed immediately against any of the joint and several judgment debtors. Generally, Section 307(d) requires the judgment creditor to exhaust the partnership's assets before enforcing a judgment against the separate assets of a partner.

2. RUPA continues the UPA scheme of liability with respect to an incoming partner, but states the rule more clearly and simply. Under Section 306(a), an incoming partner becomes jointly and severally liable, as a partner, for all partnership obligations, except as otherwise provided in subsection (b). That subsection eliminates an incoming partner's personal liability for partnership obligations incurred before his admission as a partner. In effect, a new partner has no personal liability to existing creditors of the partnership, and only his investment in the firm is at risk for the satisfaction of existing partnership debts. That is presently the rule under UPA Sections 17 and 41(7), and no substantive change is intended. As under the UPA, a new partner's personal assets are at risk with respect to partnership liabilities incurred after his admission as a partner.

3. Subsection (c) alters classic joint and several liability of general partners for obligations of a partnership that is a limited liability partnership. Like shareholders of a corporation and members of a limited liability company, partners of a limited liability partnership are not personally liable for partnership obligations incurred while the partnership liability shield is in place solely because they are partners. As with shareholders of a corporation and members of a limited liability company, partners remain personally liable for their personal misconduct.

In cases of partner misconduct, Section 401(c) sets forth a partnership's obligation to indemnify the culpable partner where the partner's liability was incurred in the ordinary course of the partnership's business. When indemnification occurs, the assets of both the partnership and the culpable partner are available to a creditor. However, Sections 306(c), 401(b), and 807(b) make clear that a partner who is not otherwise liable under Section 306(c) is not obligated to contribute assets to the partnership in excess of agreed contributions to share the loss with the culpable partner. (See Comments to Sections 401(b) and 807(b). regarding a slight

1-90

variation in the context of priority of payment of partnership obligations.) Accordingly, Section 306(c) makes clear that an innocent partner is not personally liable for specified partnership obligations, directly or indirectly, by way of contribution or otherwise.

Although the liability shield protections of Section 306(c) may be modified in part or in full in a partnership agreement (and by way of private contractual guarantees), the modifications must constitute an intentional waiver of the liability protections. See Sections 103(b), 104(a), and 902(b). Since the mere act of filing a statement of qualification reflects the assumption that the partners intend to modify the otherwise applicable partner liability rules, the final sentence of subsection (c) makes clear that the filing negates inconsistent aspects of the partnership agreement that existed immediately before the vote to approve becoming a limited liability partnership. The negation only applies to a partner's personal liability for future partnership obligations. The filing however has no effect as to previously created partner obligations to the partnership in the form of specific capital contribution requirements.

Inter se contribution agreements may erode part or all of the effects of the liability shield. For example, Section 807(f) provides that an assignee for the benefit of creditors of a partnership or a partner may enforce a partner's obligation to contribute to the partnership. The ultimate effect of such contribution obligations may make each partner jointly and severally liable for all partnership obligations – even those incurred while the partnership is a limited liability partnership. Although the final sentence of subsection (c) negates such provisions existing before a statement of qualification is filed, it will have no effect on any amendments to the partnership agreement after the statement is filed.

The connection between partner status and personal liability for partnership obligations is severed only with respect to obligations incurred while the partnership is a limited liability partnership. Partnership obligations incurred before a partnership becomes a limited liability partnership or incurred after limited liability partnership status is revoked or canceled are treated as obligations of an ordinary partnership. See Sections 1001 (filing), 1003 (revocation), and 1006 (cancellation). Obligations incurred by a partnership during the period when its statement of qualification is administratively revoked will be considered as incurred by a limited liability partnership provided the partnership's status as such is reinstated within two years under Section 1003(e). See Section 1003(f).

When an obligation is incurred is determined by other law. See Section 104(a). Under that law, and for the limited purpose of determining when partnership contract obligations are incurred, the reasonable expectations of creditors and the partners are paramount. Therefore, partnership obligations under

or relating to a note, contract, or other agreement generally are incurred when the note, contract, or other agreement is made. Also, an amendment, modification, extension, or renewal of a note, contract, or other agreement should not affect or otherwise reset the time at which a partnership obligation under or relating to that note, contract, or other agreement is incurred, even as to a claim that relates to the subject matter of the amendment, modification, extension, or renewal. A note, contract, or other agreement may expressly modify these rules and fix the time a partnership obligation is incurred thereunder.

For the limited purpose of determining when partnership tort obligations are incurred, a distinction is intended between injury and the conduct causing that injury. The purpose of the distinction is to prevent unjust results. Partnership obligations under or relating to a tort generally are incurred when the tort conduct occurs rather than at the time of the actual injury or harm. This interpretation prevents a culpable partnership from engaging in wrongful conduct and then filing a statement of qualification to sever the vicarious responsibility of its partners for future injury or harm caused by conduct that occurred prior to the filing.

SECTION 307. ACTIONS BY AND AGAINST PARTNERSHIP AND PARTNERS.

(a) A partnership may sue and be sued in the name of the partnership.

(b) An action may be brought against the partnership and, to the extent not inconsistent with Section 306, any or all of the partners in the same action or in separate actions.

(c) A judgment against a partnership is not by itself a judgment against a partner. A judgment against a partnership may not be satisfied from a partner's assets unless there is also a judgment against the partner.

(d) A judgment creditor of a partner may not levy execution against the assets of the partner to satisfy a judgment based on a claim against the partnership unless the partner is personally liable for the claim under Section 306 and:

(1) a judgment based on the same claim has been obtained against the partnership and a writ of execution on the judgment has been returned unsatisfied in whole or in part;

(2) the partnership is a debtor in bankruptcy;

(3) the partner has agreed that the creditor need not exhaust partnership assets;

(4) a court grants permission to the judgment creditor to levy execution against the assets of a partner based on a finding that partnership assets subject to execution are clearly insufficient to satisfy the judgment, that exhaustion of partnership assets is excessively burdensome, or that the grant of permission is an appropriate exercise of the court's equitable powers; or

(5) liability is imposed on the partner by law or contract independent of the existence of the partnership.

(e) This section applies to any partnership liability or obligation resulting from a representation by a partner or purported partner under Section 308.

Comment

1. Section 307 is new. Subsection (a) provides that a partnership may sue and be sued in the partnership name. That entity approach is designed to simplify suits by and against a partnership.

At common law, a partnership, not being a legal entity, could not sue or be sued in the firm name. The UPA itself is silent on this point, so in the absence of another enabling statute, it is generally necessary to join all the partners in an action against the partnership.

Most States have statutes or rules authorizing partnerships to sue or be sued in the partnership name. Many of those statutes, however, are found in the state provisions dealing with civil procedure rather than in the partnership act.

2. Subsection (b) provides that suit generally may be brought against the partnership and any or all of the partners in the same action or in separate actions. It is intended to clarify that the partners need not be named in an action against the partnership. In particular, in an action against a partnership, it is not necessary to name a partner individually in addition to the partnership. This will simplify and reduce the cost of litigation, especially in cases of small claims where there are known to be significant partnership assets and thus no necessity to collect the judgment out of the partners' assets.

Where the partnership is a limited liability partnership, the limited liability partnership rules clarify that a partner not liable for the alleged partnership obligation may not be named in the action against the partnership unless the action also seeks to establish personal liability of the partner for the obligation. See subsections (b) and (d).

3. Subsection (c) provides that a judgment against the partnership is not, standing alone, a judgment against the partners, and it cannot be satisfied from a partner's personal assets unless there is a judgment against the partner. Thus, a partner must be individually named and served, either in the action against the partnership or in a later suit, before his personal assets may be subject to levy for a claim against the partnership.

RUPA leaves it to the law of judgments, as did the UPA, to determine the collateral effects to be accorded a prior judgment for or against the partnership in a subsequent action against a partner individually. See Section 60 of the Second Restatement of Judgments (1982) and the Comments thereto.

4. Subsection (d) requires partnership creditors to exhaust the partnership's assets before levying on a judgment debtor partner's individual property where the partner is personally liable for the partnership obligation under Section 306. That rule respects the concept of the partnership as an entity and makes partners more in the nature of guarantors than principal debtors on every partnership debt. It is already the law in some States.

As a general rule, a final judgment against a partner cannot be enforced by a creditor against the partner's separate assets unless a writ of execution against the partnership has been returned unsatisfied. Under subsection (d), however, a creditor may proceed directly against the partner's assets if (i) the partnership is a debtor in bankruptcy (see Section 101(2)); (ii) the partner has consented; or (iii) the liability is imposed on the partner independently of the partnership. For example, a judgment creditor may proceed directly against the assets of a partner who is liable independently as the primary tortfeasor, but must exhaust the partnership's assets

before proceeding against the separate assets of the other partners who are liable only as partners.

There is also a judicial override provision in subsection (d)(4). A court may authorize execution against the partner's assets on the grounds that (i) the partnership's assets are clearly insufficient; (ii) exhaustion of the partnership's assets would be excessively burdensome; or (iii) it is otherwise equitable to do so. For example, if the partners who are parties to the action have assets located in the forum State, but the partnership does not, a court might find that exhaustion of the partnership's assets would be excessively burdensome.

5. Although subsection (d) is silent with respect to pre-judgment remedies, the law of pre-judgment remedies already adequately embodies the principle that partnership assets should be exhausted before partners' assets are attached or garnished. Attachment, for example, typically requires a showing that the partnership's assets are being secreted or fraudulently transferred or are otherwise inadequate to satisfy the plaintiff's claim. A showing of some exigent circumstance may also be required to satisfy due process. *See Connecticut v. Doehr*, 501 U.S. 1, 16 (1991).

6. Subsection (e) clarifies that actions against the partnership under Section 308, involving representations by partners or purported partners, are subject to Section 307.

SECTION 308. LIABILITY OF PURPORTED PARTNER.

(a) If a person, by words or conduct, purports to be a partner, or consents to being represented by another as a partner, in a partnership or with one or more persons not partners, the purported partner is liable to a person to whom the representation is made, if that person, relying on the representation, enters into a transaction with the actual or purported partnership. If the representation, either by the purported partner or by a person with the purported partner's consent, is made in a public manner, the purported partner is liable to a person who relies upon the purported partnership even if the purported partner is not aware of being held out as

a partner to the claimant. If partnership liability results, the purported partner is liable with respect to that liability as if the purported partner were a partner. If no partnership liability results, the purported partner is liable with respect to that liability jointly and severally with any other person consenting to the representation.

(b) If a person is thus represented to be a partner in an existing partnership, or with one or more persons not partners, the purported partner is an agent of persons consenting to the representation to bind them to the same extent and in the same manner as if the purported partner were a partner, with respect to persons who enter into transactions in reliance upon the representation. If all of the partners of the existing partnership consent to the representation, a partnership act or obligation results. If fewer than all of the partners of the existing partnership consent to the representation, the person acting and the partners consenting to the representation are jointly and severally liable.

(c) A person is not liable as a partner merely because the person is named by another in a statement of partnership authority.

(d) A person does not continue to be liable as a partner merely because of a failure to file a statement of dissociation or to amend a statement of partnership authority to indicate the partner's dissociation from the partnership.

(e) Except as otherwise provided in subsections (a) and (b), persons who are not partners as to each other are not liable as partners to other persons.

Comment

Section 308 continues the basic principles of partnership by estoppel from UPA Section 16, now more accurately entitled "Liability of Purported Partner."

Subsection (a) continues the distinction between representations made to specific persons and those made in a public manner. It is the exclusive basis for imposing liability as a partner on persons who are not partners in fact. As under the UPA, there is no duty of denial, and thus a person held out by another as a partner is not liable unless he actually consents to the representation. See the Official Comment to UPA Section 16. Also see Section 308(c) (no duty to file statement of denial) and Section 308(d) (no duty to file statement of dissociation or to amend statement of partnership authority).

Subsection (b) emphasizes that the persons being protected by Section 308 are those who enter into transactions in reliance upon a representation. If all of the partners of an existing partnership consent to the representation, a partnership obligation results. Apart from Section 308, the firm may be bound in other situations under general principles of apparent authority or ratification.

If a partnership liability results under Section 308, the creditor must exhaust the partnership's assets before seeking to satisfy the claim from the partners. See Section 307.

Subsections (c) and (d) are new and deal with potential negative inferences to be drawn from a failure to correct inaccurate or outdated filed statements. Subsection (c) makes clear that an otherwise innocent person is not liable as a partner for failing to deny his partnership status as asserted by a third person in a statement of partnership authority. Under subsection (d), a partner's liability as a partner does not continue after dissociation solely because of a failure to file a statement of dissociation.

Subsection (e) is derived from UPA Section 7(1). It means that only those persons who are partners as among themselves are liable as partners to third parties for the obligations of the partnership, except for liabilities incurred by purported partners under Section 308(a) and (b).

[ARTICLE] 4

RELATIONS OF PARTNERS TO EACH OTHER AND TO PARTNERSHIP

SECTION 401. PARTNER'S RIGHTS AND DUTIES.

(a) Each partner is deemed to have an account that is:

(1) credited with an amount equal to the money plus the value of any other property, net of the amount of any liabilities, the partner contributes to the partnership and the partner's share of the partnership profits; and

(2) charged with an amount equal to the money plus the value of any other property, net of the amount of any liabilities, distributed by the partnership to the partner and the partner's share of the partnership losses.

(b) Each partner is entitled to an equal share of the partnership profits and is chargeable with a share of the partnership losses in proportion to the partner's share of the profits.

(c) A partnership shall reimburse a partner for payments made and indemnify a partner for liabilities incurred by the partner in the ordinary course of the business of the partnership or for the preservation of its business or property.

(d) A partnership shall reimburse a partner for an advance to the partnership beyond the amount of capital the partner agreed to contribute.

(e) A payment or advance made by a partner which gives rise to a partnership obligation under subsection (c) or (d) constitutes a loan to the partnership which accrues interest from the date of the payment or advance.

(f) Each partner has equal rights in the management and conduct of the partnership business.

(g) A partner may use or possess partnership property only on behalf of the partnership.

(h) A partner is not entitled to remuneration for services performed for the partnership, except for reasonable compensation for services rendered in winding up the business of the partnership.

(i) A person may become a partner only with the consent of all of the partners.

(j) A difference arising as to a matter in the ordinary course of business of a partnership may be decided by a majority of the partners. An act outside the ordinary course of business of a partnership and an amendment to the partnership agreement may be undertaken only with the consent of all of the partners.

(k) This section does not affect the obligations of a partnership to other persons under Section 301.

Comment

1. Section 401 is drawn substantially from UPA Section 18. It establishes many of the default rules that govern the relations among partners. All of these rules are, however, subject to contrary agreement of the partners as provided in Section 103.

2. Subsection (a) provides that each partner is deemed to have an account that is credited with the partner's contributions and share of the partnership profits and charged with distributions to the partner and the partner's share of partnership losses. In the absence of another system of partnership accounts, these rules establish a rudimentary system of accounts for the partnership. The rules regarding the settlement of the partners' accounts upon the dissolution and winding up of the partnership business are found in Section 807.

3. Subsection (b) establishes the default rules for the sharing of partnership profits and losses. The UPA Section 18(a) rules that profits are shared equally and that losses, whether capital or operating, are shared in proportion to each partner's share of the profits are continued. Thus, under the default rule, partners share profits per capita and not in proportion to capital contribution as do corporate shareholders or partners in limited partnerships. Compare RULPA Section 504. With respect to losses, the qualifying phrase, "whether capital or operating," has been deleted as inconsistent with contemporary partnership accounting practice and terminology; no substantive change is intended.

If partners agree to share profits other than equally, losses will be shared similarly to profits, absent agreement to do otherwise. That rule, carried over from the UPA, is predicated on the assumption that partners would likely agree to share losses on the same basis as profits, but may fail to say so. Of course, by agreement, they may share losses on a different basis from profits.

The default rules apply, as does UPA Section 18(a), where one or more of the partners contribute no capital, although there is case law to the contrary. *See, e.g., Kovacik v. Reed*, 49 Cal. 2d 166, 315 P.2d 314 (1957); *Becker v. Killarney*, 177 Ill. App. 3d 793, 523 N.E.2d 467 (1988). It may seem unfair that the contributor of services, who contributes little or no capital, should be obligated to contribute toward the capital loss of the large contributor who contributed no services. In entering a partnership with such a capital structure, the partners should foresee that application of the default rule may bring about unusual results and take advantage of their power to vary by agreement the allocation of capital losses.

Subsection (b) provides that each partner "is chargeable" with a share of the losses, rather than the UPA formulation that each partner shall "contribute" to losses. Losses are charged to each partner's account as provided in subsection (a)(2). It is intended to make clear that a partner is not obligated to contribute to partnership losses before his withdrawal or the liquidation of the partnership, unless the partners agree otherwise. In effect, unless related to an obligation for which the partner is not personally liable under Section 306(c), a partner's negative account represents a debt to the partnership unless the partners agree to the contrary. Similarly, each partner's share of the profits is credited to his account under

subsection (a)(1). Absent an agreement to the contrary, however, a partner does not have a right to receive a current distribution of the profits credited to his account, the interim distribution of profits being a matter arising in the ordinary course of business to be decided by majority vote of the partners.

However, where a liability to contribute at dissolution and winding up relates to a partnership obligation governed by the limited liability rule of Section 306(c), a partner is not obligated to contribute additional assets even at dissolution and winding up. See Section 807(b). In such a case, although a partner is not personally liable for the partnership obligation, that partner's interest in the partnership remains at risk. See also Comment to Section 401(c) relating to indemnification.

In the case of an operating limited liability partnership, the Section 306 liability shield may be partially eroded where the limited liability partnership incurs both shielded and unshielded liabilities. Where the limited liability partnership uses its assets to pay shielded liabilities before paying unshielded liabilities, each partner's obligation to contribute to the limited liability partnership for that partner's share of the unpaid and unshielded obligations at dissolution and winding up remains intact. The same issue is less likely to occur in the context of the termination of a limited liability partnership since a partner's contribution obligation is based only on that partner's share of unshielded obligations and the partnership will ordinarily use the contributed assets to pay unshielded claims first as they were the basis of the contribution obligations. See Comments to Section 807(b).

4. Subsection (c) is derived from UPA Section 18(b) and provides that the partnership shall reimburse partners for payments made and indemnify them for liabilities incurred in the ordinary course of the partnership's business or for the preservation of its business or property. Reimbursement and indemnification is an obligation of the partnership. Indemnification may create a loss toward which the partners must contribute. Although the right to indemnification is usually enforced in the settlement of accounts among partners upon dissolution and winding up of the partnership business, the right accrues when the liability is incurred and thus may be enforced during the term of the partnership in an appropriate case. *See* Section 405 and Comment. A partner's right to indemnification under this Act is not affected by the partnership becoming a limited liability partnership. Accordingly, partners continue to share partnership losses to the extent of partnership assets.

5. Subsection (d) is based on UPA Section 18(c). It makes explicit that the partnership must reimburse a partner for an advance of funds beyond the amount of the partner's agreed capital contribution, thereby treating the advance as a loan.

6. Subsection (e), which is also drawn from UPA Section 18(c), characterizes the partnership's obligation under subsection (c) or (d) as a loan to the partnership which accrues interest from the date of the payment or advance. See Section 104(b) (default rate of interest).

7. Under subsection (f), each partner has equal rights in the management and conduct of the business. It is based on UPA Section 18(e), which has been interpreted broadly to mean that, absent contrary agreement, each partner has a continuing right to participate in the management of the partnership and to be informed about the partnership business, even if his assent to partnership business decisions is not required. There are special rules regarding the partner vote necessary to approve a partnership becoming (or canceling its status as) a limited liability partnership. See Section 1001(b).

8. Subsection (g) provides that partners may use or possess partnership property only for partnership purposes. That is the edited remains of UPA Section 25(2)(a), which deals in detail with the incidents of tenancy in partnership. That tenancy is abolished as a consequence of the entity theory of partnerships. *See* Section 501 and Comments.

9. Subsection (h) continues the UPA Section 18(f) rule that a partner is not entitled to remuneration for services performed, except in winding up the partnership. Subsection (h) deletes the UPA reference to a "surviving" partner. That means any partner winding up the business is entitled to compensation, not just a surviving partner winding up after the death of another partner. The exception is not intended to apply in the hypothetical winding up that takes place if there is a buyout under Article 7.

10. Subsection (i) continues the substance of UPA Section 18(g) that no person can become a partner without the consent of all the partners.

11. Subsection (j) continues with one important clarification the UPA Section 18(h) scheme of allocating management authority among the partners. In the absence of an agreement to the contrary, matters arising in the ordinary course of the business may be decided by a majority of the partners. Amendments to the partnership agreement and matters outside the ordinary course of the partnership business require unanimous consent of the partners. Although the text of the UPA is silent regarding extraordinary matters, courts have generally required the consent of all partners for those matters. *See, e.g.*, *Paciaroni v. Crane*, 408 A.2d 946 (Del. Ch. 1989); *Thomas v. Marvin E. Jewell & Co.*, 232 Neb. 261, 440 N.W.2d 437 (1989); *Duell v. Hancock*, 83 A.D.2d 762, 443 N.Y.S.2d 490 (1981).

It is not intended that subsection (j) embrace a claim for an objection to a partnership decision that is not discovered until after the fact. There is no cause of action based on that after-the-fact second-guessing.

12. Subsection (k) is new and was added to make it clear that Section 301 governs partners' agency power to bind the partnership to third persons, while Section 401 governs partners' rights among themselves.

SECTION 402. DISTRIBUTIONS IN KIND. A partner has no right to receive, and may not be required to accept, a distribution in kind.

Comment

Section 402 provides that a partner has no right to demand and receive a distribution in kind and may not be required to take a distribution in kind. That continues the "in kind" rule of UPA Section 38(l). The new language is suggested by RULPA Section 605.

This section is complemented by Section 807(a) which provides that, in winding up the partnership business on dissolution, any surplus after the payment of partnership obligations must be applied to pay in cash the net amount distributable to each partner.

SECTION 403. PARTNER'S RIGHTS AND DUTIES WITH RESPECT TO INFORMATION.

(a) A partnership shall keep its books and records, if any, at its chief executive office.

(b) A partnership shall provide partners and their agents and attorneys access to its books and records. It shall provide former partners and their agents and attorneys access to books and records pertaining to the period during which they were partners. The right of access provides the opportunity to inspect and copy books and records during ordinary business hours. A partnership may impose

a reasonable charge, covering the costs of labor and material, for copies of documents furnished.

(c) Each partner and the partnership shall furnish to a partner, and to the legal representative of a deceased partner or partner under legal disability:

(1) without demand, any information concerning the partnership's business and affairs reasonably required for the proper exercise of the partner's rights and duties under the partnership agreement or this [Act]; and

(2) on demand, any other information concerning the partnership's business and affairs, except to the extent the demand or the information demanded is unreasonable or otherwise improper under the circumstances.

Comment

1. Subsection (a) provides that the partnership's books and records, if any, shall be kept at its chief executive office. It continues the UPA Section 19 rule, modified to include partnership records other than its "books," i.e., financial records. The concept of "chief executive office" comes from UCC Section 9-103(3)(d). See the Comment to Section 106.

Since general partnerships are often informal or even inadvertent, no books and records are enumerated as mandatory, such as that found in RULPA Section 105. Any requirement in UPA Section 19 that the partnership keep books is oblique at best, since it states merely where the books shall be kept, not that they shall be kept. Under RUPA, there is no liability to either partners or third parties for the failure to keep partnership books. A partner who undertakes to keep books, however, must do so accurately and adequately.

In general, a partnership should, at a minimum,, keep those books and records necessary to enable the partners to determine their share of the profits and losses, as well as their rights on withdrawal. An action for an accounting provides an adequate remedy in the event adequate records are not kept. The partnership must also maintain any books and records required by state or federal taxing or other governmental authorities.

2. Under subsection (b), partners are entitled to access to the partnership books and records. Former partners are expressly given a similar right, although limited to the books and records pertaining to the period during which they were partners. The line between partners and former partners is not a bright one for this purpose, however, and should be drawn in light of the legitimate interests of a dissociated partner in the partnership. For example, a withdrawing partner's liability is ongoing for pre-withdrawal liabilities and will normally be extended to new liabilities for at least 90 days. It is intended that a former partner be accorded access to partnership books and records as reasonably necessary to protect that partner's legitimate interests during the period his rights and liabilities are being wound down.

The right of access is limited to ordinary business hours, and the right to inspect and copy by agent or attorney is made explicit. The partnership may impose a reasonable charge for furnishing copies of documents. *Accord*, RULPA § 105(b).

A partner's right to inspect and copy the partnership's books and records is not conditioned on the partner's purpose or motive. Compare RMBCA Section 16.02(c)(l) (shareholder must have proper purpose to inspect certain corporate records). A partner's unlimited personal liability justifies an unqualified right of access to the partnership books and records. An abuse of the right to inspect and copy might constitute a violation of the obligation of good faith and fair dealing for which the other partners would have a remedy. See Sections 404(d) and 405.

Under Section 103(b)(2), a partner's right of access to partnership books and records may not be unreasonably restricted by the partnership agreement. Thus, to preserve a partner's core information rights despite unequal bargaining power, an agreement limiting a partner's right to inspect and copy partnership books and records is subject to judicial review. Nevertheless, reasonable restrictions on access to partnership books and records by agreement are authorized. For example, a provision in a partnership agreement denying partners access to the compensation of other partners should be upheld, absent any abuse such as fraud or duress.

3. Subsection (c) is a significant revision of UPA Section 20 and provides a more comprehensive, although not exclusive, statement of partners' rights and duties with respect to partnership information other than books and records. Both the partnership and the other partners are obligated to furnish partnership information.

Paragraph (1) is new and imposes an affirmative disclosure obligation on the partnership and partners. There is no express UPA provision imposing an affirmative obligation to disclose any information other than the partnership books. Under some circumstances, however, an affirmative disclosure duty has been inferred from other sections of the Act, as well as from the common law, such as the

fiduciary duty of good faith. Under UPA Section 18(e), for example, all partners enjoy an equal right in the management and conduct of the partnership business, absent contrary agreement. That right has been construed to require that every partner be provided with ongoing information concerning the partnership business. See Comment 7 to Section 401. Paragraph (1) provides expressly that partners must be furnished, without demand, partnership information reasonably needed for them to exercise their rights and duties as partners. In addition, a disclosure duty may, under some circumstances, also spring from the Section 404(d) obligation of good faith and fair dealing. See Comment 4 to Section 404.

Paragraph (2) continues the UPA rule that partners are entitled, on demand, to any other information concerning the partnership's business and affairs. The demand may be refused if either the demand or the information demanded is unreasonable or otherwise improper. That qualification is new to the statutory formulation. The burden is on the partnership or partner from whom the information is requested to show that the demand is unreasonable or improper. The UPA admonition that the information furnished be "true and full" has been deleted as unnecessary, and no substantive change is intended.

The Section 403(c) information rights can be waived or varied by agreement of the partners, since there is no Section 103(b) limitation on the variation of those rights as there is with respect to the Section 403(b) access rights to books and records. *See* Section 103(b)(2).

SECTION 404. GENERAL STANDARDS OF PARTNER'S CONDUCT.

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

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

(1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of

the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity;

(2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and

(3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

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

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

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

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

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

Comment

1. Section 404 is new. The title, "General Standards of Partner's Conduct," is drawn from RMBCA Section 8.30. Section 404 is both comprehensive and exclusive. In that regard, it is structurally different from the UPA which touches only sparingly on a partner's duty of loyalty and leaves any further development of the fiduciary duties of partners to the common law of agency. Compare UPA Sections 4(3) and 21.

Section 404 begins by stating that the **only** fiduciary duties a partner owes to the partnership and the other partners are the duties of loyalty and care set forth in subsections (b) and (c) of the Act. Those duties may not be waived or eliminated in the partnership agreement, but the agreement may identify activities and determine standards for measuring performance of the duties, if not manifestly unreasonable. *See* Sections 103(b)(3)-(5).

Section 404 continues the term "fiduciary" from UPA Section 21, which is entitled "Partner Accountable as a Fiduciary." Arguably, the term "fiduciary" is inappropriate when used to describe the duties of a partner because a partner may legitimately pursue self-interest (see Section 404(e)) and not solely the interest of the partnership and the other partners, as must a true trustee. Nevertheless, partners have long been characterized as fiduciaries. *See, e.g., Meinhard v. Salmon*, 249 N.Y. 458, 463, 164 N.E. 545, 546 (1928) (Cardozo, J.). Indeed, the law of partnership reflects the broader law of principal and agent, under which every agent is a fiduciary. *See* Restatement (Second) of Agency § 13 (1957).

2. Section 404(b) provides three specific rules that comprise a partner's duty of loyalty. Those rules are exclusive and encompass the entire duty of loyalty.

Subsection (b)(l) is based on UPA Section 21(1) and continues the rule that partnership property usurped by a partner, including the misappropriation of a partnership opportunity, is held in trust for the partnership. The express reference to the appropriation of a partnership opportunity is new, but merely codifies case law on the point. *See, e.g., Meinhard v. Salmon, supra*; *Fouchek v. Janicek*, 190 Ore. 251, 225 P.2d 783 (1950). Under a constructive trust theory, the partnership can recover any money or property in the partner's hands that can be traced to the partnership. *See, e.g., Yoder v. Hooper*, 695 P.2d 1182 (Colo. App. 1984), *aff'd*, 737 P.2d 852 (Colo. 1987); *Fortugno v. Hudson Manure Co.*, 51 N.J. Super. 482,

7-108

144 A.2d 207 (1958); *Harestad v. Weitzel*, 242 Or. 199, 536 P.2d 522 (1975). As a result, the partnership's claim is greater than that of an ordinary creditor. See Official Comment to UPA Section 21.

UPA Section 21(1) imposes the duty on partners to account for profits and benefits in all transactions connected with "the formation, conduct, or liquidation of the partnership." Reference to the "formation" of the partnership has been eliminated by RUPA because of concern that the duty of loyalty could be inappropriately extended to the pre-formation period when the parties are really negotiating at arm's length. *Compare Herring v. Offutt*, 295 A.2d 876 (Ct. App. Md. 1972), *with Phoenix Mutual Life Ins. Co. v. Shady Grove Plaza Limited Partnership*, 734 F. Supp. 1181 (D. Md. 1990), *aff'd*, 937 F.2d 603 (4th Cir. 1991). Once a partnership is agreed to, each partner becomes a fiduciary in the "conduct" of the business. Pre-formation negotiations are, of course, subject to the general contract obligation to deal honestly and without fraud.

Upon a partner's dissociation, Section 603(b)(3) limits the application of the duty to account for personal profits to those derived from matters arising or events occurring before the dissociation, unless the partner participates in winding up the partnership's business. Thus, after withdrawal, a partner is free to appropriate to his own benefit any new business opportunity thereafter coming to his attention, even if the partnership continues.

Subsection (b)(2) provides that a partner must refrain from dealing with the partnership as or on behalf of a party having an interest adverse to the partnership. This rule is derived from Sections 389 and 391 of the Restatement (Second) of Agency. Comment c to Section 389 explains that the rule is not based upon the harm caused to the principal, but upon avoiding a conflict of opposing interests in the mind of an agent whose duty is to act for the benefit of his principal.

Upon a partner's dissociation, Section 603(b)(3) limits the application of the duty to refrain from representing interests adverse to the partnership to the same extent as the duty to account. Thus, after withdrawal, a partner may deal with the partnership as an adversary with respect to new matters or events.

Section 404(b)(3) provides that a partner must refrain from competing with the partnership in the conduct of its business. This rule is derived from Section 393 of the Restatement (Second) of Agency and is an application of the general duty of an agent to act solely on his principal's behalf.

The duty not to compete applies only to the "conduct" of the partnership business; it does not extend to winding up the business, as do the other loyalty rules. Thus, a partner is free to compete immediately upon an event of dissolution under

Section 801, unless the partnership agreement otherwise provides. A partner who dissociates without a winding up of the business resulting is also free to compete, because Section 603(b)(2) provides that the duty not to compete terminates upon dissociation. A dissociated partner is not, however, free to use confidential partnership information after dissociation. *See* Restatement (Second) of Agency § 393 cmt. e (1957). Trade secret law also may apply. See the Uniform Trade Secrets Act.

Under Section 103(b)(3), the partnership agreement may not "eliminate" the duty of loyalty. Section 103(b)(3)(i) expressly empowers the partners, however, to identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable. As under UPA Section 21, the other partners may also consent to a specific act or transaction that otherwise violates one of the rules. For the consent to be effective under Section 103(b)(3)(ii), there must be full disclosure of all material facts regarding the act or transaction and the partner's conflict of interest. See Comment 5 to Section 103.

3. Subsection (c) is new and establishes the duty of care that partners owe to the partnership and to the other partners. There is no statutory duty of care under the UPA, although a common law duty of care is recognized by some courts. *See, e.g., Rosenthal v. Rosenthal*, 543 A.2d 348, 352 (Me. 1988) (duty of care limited to acting in a manner that does not constitute gross negligence or willful misconduct).

The standard of care imposed by RUPA is that of gross negligence, which is the standard generally recognized by the courts. *See, e.g., Rosenthal v. Rosenthal, supra*. Section 103(b)(4) provides that the duty of care may not be eliminated entirely by agreement, but the standard may be reasonably reduced. See Comment 6 to Section 103.

4. Subsection (d) is also new. It provides that partners have an obligation of good faith and fair dealing in the discharge of all their duties, including those arising under the Act, such as their fiduciary duties of loyalty and care, and those arising under the partnership agreement. The exercise of any rights by a partner is also subject to the obligation of good faith and fair dealing. The obligation runs to the partnership and to the other partners in all matters related to the conduct and winding up of the partnership business.

The obligation of good faith and fair dealing is a contract concept, imposed on the partners because of the consensual nature of a partnership. See Restatement (Second) of Contracts § 205 (1981). It is not characterized, in RUPA, as a fiduciary duty arising out of the partners' special relationship. Nor is it a separate and

independent obligation. It is an ancillary obligation that applies whenever a partner discharges a duty or exercises a right under the partnership agreement or the Act.

The meaning of "good faith and fair dealing" is not firmly fixed under present law. "Good faith" clearly suggests a subjective element, while "fair dealing" implies an objective component. It was decided to leave the terms undefined in the Act and allow the courts to develop their meaning based on the experience of real cases. Some commentators, moreover, believe that good faith is more properly understood by what it excludes than by what it includes. See Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 Va. L. Rev. 195, 262 (1968):

> Good faith, as judges generally use the term in matters contractual, is best understood as an "excluder" – a phrase with no general meaning or meanings of its own. Instead, it functions to rule out many different forms of bad faith. It is hard to get this point across to persons used to thinking that every word must have one or more general meanings of its own – must be either univocal or ambiguous.

The UCC definition of "good faith" is honesty in fact and, in the case of a merchant, the observance of reasonable commercial standards of fair dealing in the trade. *See* UCC §§ 1-201(19), 2-103(b). Those definitions were rejected as too narrow or not applicable.

In some situations the obligation of good faith includes a disclosure component. Depending on the circumstances, a partner may have an affirmative disclosure obligation that supplements the Section 403 duty to render information.

Under Section 103(b)(5), the obligation of good faith and fair dealing may not be eliminated by agreement, but the partners by agreement may determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable. See Comment 7 to Section 103.

5. Subsection (e) is new and deals expressly with a very basic issue on which the UPA is silent. A partner as such is not a trustee and is not held to the same standards as a trustee. Subsection (e) makes clear that a partner's conduct is not deemed to be improper merely because it serves the partner's own individual interest.

That admonition has particular application to the duty of loyalty and the obligation of good faith and fair dealing. It underscores the partner's rights as an owner and principal in the enterprise, which must always be balanced against his duties and obligations as an agent and fiduciary. For example, a partner who, with

consent, owns a shopping center may, under subsection (e), legitimately vote against a proposal by the partnership to open a competing shopping center.

6. Subsection (f) authorizes partners to lend money to and transact other business with the partnership and, in so doing, to enjoy the same rights and obligations as a nonpartner. That language is drawn from RULPA Section 107. The rights and obligations of a partner doing business with the partnership as an outsider are expressly made subject to the usual laws governing those transactions. They include, for example, rules limiting or qualifying the rights and remedies of inside creditors, such as fraudulent transfer law, equitable subordination, and the law of avoidable preferences, as well as general debtor-creditor law. The reference to "other applicable law" makes clear that subsection (f) is not intended to displace those laws, and thus they are preserved under Section 104(a).

It is unclear under the UPA whether a partner may, for the partner's own account, purchase the assets of the partnership at a foreclosure sale or upon the liquidation of the partnership. Those purchases are clearly within subsection (f)'s broad approval. It is also clear under that subsection that a partner may purchase partnership assets at a foreclosure sale, whether the partner is the mortgagee or the mortgagee is an unrelated third party. Similarly, a partner may purchase partnership property at a tax sale. The obligation of good faith requires disclosure of the partner's interest in the transaction, however.

7. Subsection (g) provides that the prescribed standards of conduct apply equally to a person engaged in winding up the partnership business as the personal or legal representative of the last surviving partner, as if the person were a partner. This is derived from UPA Section 21(2), but now embraces the duty of care and the obligation of good faith and fair dealing, as well as the duty of loyalty.

SECTION 405. ACTIONS BY PARTNERSHIP AND PARTNERS.

(a) A partnership may maintain an action against a partner for a breach of the partnership agreement, or for the violation of a duty to the partnership, causing harm to the partnership.

(b) A partner may maintain an action against the partnership or another partner for legal or equitable relief, with or without an accounting as to partnership business, to:

(1) enforce the partner's rights under the partnership agreement;

(2) enforce the partner's rights under this [Act], including:

(i) the partner's rights under Sections 401, 403, or 404;

(ii) the partner's right on dissociation to have the partner's interest in the partnership purchased pursuant to Section 701 or enforce any other right under [Article] 6 or 7; or

(iii) the partner's right to compel a dissolution and winding up of the partnership business under Section 801 or enforce any other right under [Article] 8; or

(3) enforce the rights and otherwise protect the interests of the partner, including rights and interests arising independently of the partnership relationship.

(c) The accrual of, and any time limitation on, a right of action for a remedy under this section is governed by other law. A right to an accounting upon a dissolution and winding up does not revive a claim barred by law.

Comment

1. Section 405(a) is new and reflects the entity theory of partnership. It provides that the partnership itself may maintain an action against a partner for any breach of the partnership agreement or for the violation of any duty owed to the partnership, such as a breach of fiduciary duty.

2. Section 405(b) is the successor to UPA Section 22, but with significant changes. At common law, an accounting was generally not available before dissolution. That was modified by UPA Section 22 which specifies certain circumstances in which an accounting action is available without requiring a partner to dissolve the partnership. Section 405(b) goes far beyond the UPA rule. It provides that, during the term of the partnership, partners may maintain a variety of legal or equitable actions, including an action for an accounting, as well as a final

action for an accounting upon dissolution and winding up. It reflects a new policy choice that partners should have access to the courts during the term of the partnership to resolve claims against the partnership and the other partners, leaving broad judicial discretion to fashion appropriate remedies.

Under RUPA, an accounting is not a prerequisite to the availability of the other remedies a partner may have against the partnership or the other partners. That change reflects the increased willingness courts have shown to grant relief without the requirement of an accounting, in derogation of the so-called "exclusivity rule." *See, e.g., Farney v. Hauser*, 109 Kan. 75, 79, 198 Pac. 178, 180 (1921) ("[For] all practical purposes a partnership may be considered as a business entity"); *Auld v. Estridge*, 86 Misc. 2d 895, 901, 382 N.Y.S.2d 897, 901 (1976) ("No purpose of justice is served by delaying the resolution here on empty procedural grounds").

Under subsection (b), a partner may bring a direct suit against the partnership or another partner for almost any cause of action arising out of the conduct of the partnership business. That eliminates the present procedural barriers to suits between partners filed independently of an accounting action. In addition to a formal account, the court may grant any other appropriate legal or equitable remedy. Since general partners are not passive investors like limited partners, RUPA does not authorize derivative actions, as does RULPA Section 1001.

Subsection (b)(3) makes it clear that a partner may recover against the partnership and the other partners for personal injuries or damage to the property of the partner caused by another partner. *See, e.g., Duffy v. Piazza Construction Co.*, 815 P.2d 267 (Wash. App. 1991); *Smith v. Hensley*, 354 S.W.2d 744 (Ky. App.). One partner's negligence is not imputed to bar another partner's action. *See, e.g., Reeves v. Harmon*, 475 P.2d 400 (Okla. 1970); *Eagle Star Ins. Co. v. Bean*, 134 F.2d 755 (9th Cir. 1943) (fire insurance company not subrogated to claim against partners who negligently caused fire that damaged partnership property).

3. Generally, partners may limit or contract away their Section 405 remedies. They may not, however, eliminate entirely the remedies for breach of those duties that are mandatory under Section 103(b). See Comment 1 to Section 103.

4. Section 405(c) replaces UPA Section 43 and provides that other (i.e., non-partnership) law governs the accrual of a cause of action for which subsection (b) provides a remedy. The statute of limitations on such claims is also governed by other law, and claims barred by a statute of limitations are not revived by reason of the partner's right to an accounting upon dissolution, as they were under the UPA. The effect of those rules is to compel partners to litigate their claims during the life

of the partnership or risk losing them. Because an accounting is an equitable proceeding, it may also be barred by laches where there is an undue delay in bringing the action. Under general law, the limitations periods may be tolled by a partner's fraud.

5. UPA Section 39 grants ancillary remedies to a person who rescinds his participation in a partnership because it was fraudulently induced, including the right to a lien on surplus partnership property for the amount of that person's interest in the partnership. RUPA has no counterpart provision to UPA Section 39, and leaves it to the general law of rescission to determine the rights of a person fraudulently induced to invest in a partnership. See Section 104(a).

SECTION 406. CONTINUATION OF PARTNERSHIP BEYOND DEFINITE TERM OR PARTICULAR UNDERTAKING.

(a) If a partnership for a definite term or particular undertaking is continued, without an express agreement, after the expiration of the term or completion of the undertaking, the rights and duties of the partners remain the same as they were at the expiration or completion, so far as is consistent with a partnership at will.

(b) If the partners, or those of them who habitually acted in the business during the term or undertaking, continue the business without any settlement or liquidation of the partnership, they are presumed to have agreed that the partnership will continue.

Comment

Section 406 continues UPA Section 23, with no substantive change. Subsection (a) provides that, if a term partnership is continued without an express agreement beyond the expiration of its term or the completion of the undertaking, the partners' rights and duties remain the same as they were, so far as is consistent with a partnership at will.

Subsection (b) provides that if the partnership is continued by the partners without any settlement or liquidation of the business, it is presumed that the partners have agreed not to wind up the business. The presumption is rebuttable. If the partnership is continued under this subsection, there is no dissolution under Section 801(2)(iii). As a partnership at will, however, the partnership may be dissolved under Section 801(1) at any time.

[ARTICLE] 5

TRANSFEREES AND CREDITORS OF PARTNER

SECTION 501. PARTNER NOT CO-OWNER OF PARTNERSHIP PROPERTY. A partner is not a co-owner of partnership property and has no interest in partnership property which can be transferred, either voluntarily or involuntarily.

Comment

Section 501 provides that a partner is not a co-owner of partnership property and has no interest in partnership property that can be transferred, either voluntarily or involuntarily. Thus, the section abolishes the UPA Section 25(1) concept of tenants in partnership and reflects the adoption of the entity theory. Partnership property is owned by the entity and not by the individual partners. See also Section 203, which provides that property transferred to or otherwise acquired by the partnership is property of the partnership and not of the partners individually.

RUPA also deletes the references in UPA Sections 24 and 25 to a partner's "right in specific partnership property," although those rights are largely defined away by the detailed rules of UPA Section 25 itself. Thus, it is clear that a partner who misappropriates partnership property is guilty of embezzlement the same as a shareholder who misappropriates corporate property.

Adoption of the entity theory also has the effect of protecting partnership property from execution or other process by a partner's personal creditors. That continues the result under UPA Section 25(2)(c). Those creditors may seek a charging order under Section 504 to reach the partner's transferable interest in the partnership.

RUPA does not interfere with a partner's exemption claim in nonpartnership property. As under the UPA, disputes over whether specific property belongs to the partner or to the firm will likely arise in the context of an exemption claim by a partner.

A partner's spouse, heirs, or next of kin are not entitled to allowances or other rights in partnership property. That continues the result under UPA Section 25(2)(e).

SECTION 502. PARTNER'S TRANSFERABLE INTEREST IN PARTNERSHIP.

SECTION 502. PARTNER'S TRANSFERABLE INTEREST IN PARTNERSHIP. The only transferable interest of a partner in the partnership is the partner's share of the profits and losses of the partnership and the partner's right to receive distributions. The interest is personal property.

Comment

Section 502 continues the UPA Section 26 concept that a partner's only transferable interest in the partnership is the partner's share of profits and losses and right to receive distributions, that is, the partner's financial rights. The term "distribution" is defined in Section 101(3). Compare RULPA Section 101(10) ("partnership interest").

The partner's transferable interest is deemed to be personal property, regardless of the nature of the underlying partnership assets.

Under Section 503(b)(3), a transferee of a partner's transferable interest has standing to seek judicial dissolution of the partnership business.

A partner has other interests in the partnership that may not be transferred, such as the right to participate in the management of the business. Those rights are included in the broader concept of a "partner's interest in the partnership." *See* Section 101(7).

SECTION 503. TRANSFER OF PARTNER'S TRANSFERABLE INTEREST.

(a) A transfer, in whole or in part, of a partner's transferable interest in the partnership:

(1) is permissible;

(2) does not by itself cause the partner's dissociation or a dissolution and winding up of the partnership business; and

(3) does not, as against the other partners or the partnership, entitle the transferee, during the continuance of the partnership, to participate in the management or conduct of the partnership business, to require access to information concerning partnership transactions, or to inspect or copy the partnership books or records.

(b) A transferee of a partner's transferable interest in the partnership has a right:

(1) to receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled;

(2) to receive upon the dissolution and winding up of the partnership business, in accordance with the transfer, the net amount otherwise distributable to the transferor; and

(3) to seek under Section 801(6) a judicial determination that it is equitable to wind up the partnership business.

(c) In a dissolution and winding up, a transferee is entitled to an account of partnership transactions only from the date of the latest account agreed to by all of the partners.

(d) Upon transfer, the transferor retains the rights and duties of a partner other than the interest in distributions transferred.

(e) A partnership need not give effect to a transferee's rights under this section until it has notice of the transfer.

(f) A transfer of a partner's transferable interest in the partnership in violation of a restriction on transfer contained in the partnership agreement is ineffective as to a person having notice of the restriction at the time of transfer.

Comment

1. Section 503 is derived from UPA Section 27. Subsection (a)(1) states explicitly that a partner has the right to transfer his transferable interest in the partnership. The term "transfer" is used throughout RUPA in lieu of the term "assignment." See Section 101(10).

Subsection (a)(2) continues the UPA Section 27(1) rule that an assignment of a partner's interest in the partnership does not of itself cause a winding up of the partnership business. Under Section 601(4)(ii), however, a partner who has transferred substantially all of his partnership interest may be expelled by the other partners.

Subsection (a)(3), which is also derived from UPA Section 27(l), provides that a transferee is not, as against the other partners, entitled (i) to participate in the management or conduct of the partnership business; (ii) to inspect the partnership books or records; or (iii) to require any information concerning or an account of partnership transactions.

2. The rights of a transferee are set forth in subsection (b). Under subsection (b)(1), which is derived from UPA Section 27(l), a transferee is entitled to receive, in accordance with the terms of the assignment, any distributions to which the transferor would otherwise have been entitled under the partnership agreement before dissolution. After dissolution, the transferee is also entitled to receive, under subsection (b)(2), the net amount that would otherwise have been distributed to the transferor upon the winding up of the business.

Subsection (b)(3) confers standing on a transferee to seek a judicial dissolution and winding up of the partnership business as provided in Section 801(6), thus continuing the rule of UPA Section 32(2).

Section 504(b) accords the rights of a transferee to the purchaser at a sale foreclosing a charging order. The same rule should apply to creditors or other

purchasers who acquire partnership interests by pursuing UCC remedies or statutory liens under federal or state law.

3. Subsection (c) is based on UPA Section 27(2). It grants to transferees the right to an account of partnership transactions, limited to the period since the date of the last account agreed to by all of the partners.

4. Subsection (d) is new. It makes clear that unless otherwise agreed the partner whose interest is transferred retains all of the rights and duties of a partner, other than the right to receive distributions. That means the transferor is entitled to participate in the management of the partnership and remains personally liable for all partnership obligations, unless and until he withdraws as a partner, is expelled under Section 601(4)(ii), or is otherwise dissociated under Section 601.

A divorced spouse of a partner who is awarded rights in the partner's partnership interest as part of a property settlement is entitled only to the rights of a transferee. The spouse may instead be granted a money judgment in the amount of the property award, enforceable by a charging order in the same manner as any other money judgment against a partner. In neither case, however, would the spouse become a partner by virtue of the property settlement or succeed to any of the partner's management rights. *See, e.g., Warren v. Warren*, 12 Ark. App. 260, 675 S.W.2d 371 (1984).

5. Subsection (e) is new and provides that the partnership has no duty to give effect to the transferee's rights until the partnership receives notice of the transfer. This is consistent with UCC Section 9-318(3), which provides that an "account debtor" is authorized to pay the assignor until the account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee. It further provides that the assignee, on request, must furnish reasonable proof of the assignment.

6. Subsection (f) is new and provides that a transfer of a partner's transferable interest in the partnership in violation of a restriction on transfer contained in a partnership agreement is ineffective as to a person with timely notice of the restriction. Under Section 103(a), the partners may agree among themselves to restrict the right to transfer their partnership interests. Subsection (f) makes explicit that a transfer in violation of such a restriction is ineffective as to a transferee with notice of the restriction. See Section 102(b) for the meaning of "notice." RUPA leaves to general law and the UCC the issue of whether a transfer in violation of a valid restriction is effective as to a transferee without notice of the restriction.

Whether a particular restriction will be enforceable, however, must be considered in light of other law. *See* 11 U.S.C. § 541(c)(1) (property owned by bankrupt passes to trustee regardless of restrictions on transfer); UCC § 9-318(4) (agreement between account debtor and assignor prohibiting creation of security interest in a general intangible or requiring account debtor's consent is ineffective); *Battista v. Carlo*, 57 Misc. 2d 495, 293 N.Y.S.2d 227 (1968) (restriction on transfer of partnership interest subject to rules against unreasonable restraints on alienation of property) (dictum); *Tupper v. Kroc*, 88 Nev. 146, 494 P.2d 1275 (1972) (partnership interest subject to charging order even if partnership agreement prohibits assignments). *Cf. Tu-Vu Drive-In Corp. v. Ashkins*, 61 Cal. 2d 283, 38 Cal. Rptr. 348, 391 P.2d 828 (1964) (restraints on transfer of corporate stock must be reasonable). Even if a restriction on the transfer of a partner's transferable interest in a partnership were held to be unenforceable, the transfer might be grounds for expelling the partner-transferor from the partnership under Section 601(5)(ii).

7. Other rules that apply in the case of transfers include Section 601(4)(ii) (expulsion of partner who transfers substantially all of partnership interest); Section 601(6) (dissociation of partner who makes an assignment for benefit of creditors); and Section 801(6) (transferee has standing to seek judicial winding up).

SECTION 504. PARTNER'S TRANSFERABLE INTEREST SUBJECT TO CHARGING ORDER.

(a) On application by a judgment creditor of a partner or of a partner's transferee, a court having jurisdiction may charge the transferable interest of the judgment debtor to satisfy the judgment. The court may appoint a receiver of the share of the distributions due or to become due to the judgment debtor in respect of the partnership and make all other orders, directions, accounts, and inquiries the judgment debtor might have made or which the circumstances of the case may require.

(b) A charging order constitutes a lien on the judgment debtor's transferable interest in the partnership. The court may order a foreclosure of the

interest subject to the charging order at any time. The purchaser at the foreclosure sale has the rights of a transferee.

(c) At any time before foreclosure, an interest charged may be redeemed:

(1) by the judgment debtor;

(2) with property other than partnership property, by one or more of the other partners; or

(3) with partnership property, by one or more of the other partners with the consent of all of the partners whose interests are not so charged.

(d) This [Act] does not deprive a partner of a right under exemption laws with respect to the partner's interest in the partnership.

(e) This section provides the exclusive remedy by which a judgment creditor of a partner or partner's transferee may satisfy a judgment out of the judgment debtor's transferable interest in the partnership.

Comment

1. Section 504 continues the UPA Section 28 charging order as the proper remedy by which a judgment creditor of a partner may reach the debtor's transferable interest in a partnership to satisfy the judgment. Subsection (a) makes the charging order available to the judgment creditor of a transferee of a partnership interest. Under Section 503(b), the transferable interest of a partner or transferee is limited to the partner's right to receive distributions from the partnership and to seek judicial liquidation of the partnership. The court may appoint a receiver of the debtor's share of the distributions due or to become due and make all other orders that may be required.

2. Subsection (b) is new and codifies the case law under the UPA holding that a charging order constitutes a lien on the debtor's transferable interest. The lien may be foreclosed by the court at any time, and the purchaser at the foreclosure sale has the Section 503(b) rights of a transferee. For a general discussion of the charging order remedy, see *I Alan R. Bromberg & Larry E. Ribstein, Partnership* (1988), at 3:69.

3. Subsection (c) continues the UPA Section 28(2) right of the debtor or other partners to redeem the partnership interest before the foreclosure sale. Redemption by the partnership (i.e., with partnership property) requires the consent of all the remaining partners. Neither the UPA nor RUPA provide a statutory procedural framework for the redemption.

4. Subsection (d) provides that nothing in RUPA deprives a partner of his rights under the State's exemption laws. That is essentially the same as UPA Section 28(3).

5. Subsection (e) provides that the charging order is the judgment creditor's exclusive remedy. Although the UPA nowhere states that a charging order is the exclusive process for a partner's individual judgment creditor, the courts have generally so interpreted it. *See, e.g., Matter of Pischke*, 11 B.R. 913 (E.D. Va. 1981); *Baum v. Baum*, 51 Cal. 2d 610, 335 P.2d 481 (1959); *Atlantic Mobile Homes, Inc. v. LeFever*, 481 So. 2d 1002 (Fla. App. 1986).

Notwithstanding subsection (e), there may be an exception for the enforcement of family support orders. Some States have unique statutory procedures for the enforcement of support orders. In Florida, for example, a court may issue an "income deduction order" requiring any person or entity providing "income" to the obligor of a support order to remit to the obligee or a depository, as directed by the court, a specified portion of the income. Fla. Stat. § 61.1301 (1993). "Income" is broadly defined to include any form of payment to the obligor, including wages, salary, compensation as an independent contractor, dividends, interest, or other payment, regardless of source. Fla. Stat. § 61.046(4) (1993). That definition includes distributions payable to an obligor partner. A charging order under RUPA would still be necessary to reach the obligor's entire partnership interest, however.

[ARTICLE] 6

PARTNER'S DISSOCIATION

SECTION 601. EVENTS CAUSING PARTNER'S DISSOCIATION. A partner is dissociated from a partnership upon the occurrence of any of the following events:

(1) the partnership's having notice of the partner's express will to withdraw as a partner or on a later date specified by the partner;

(2) an event agreed to in the partnership agreement as causing the partner's dissociation;

(3) the partner's expulsion pursuant to the partnership agreement;

(4) the partner's expulsion by the unanimous vote of the other partners if:

(i) it is unlawful to carry on the partnership business with that partner;

(ii) there has been a transfer of all or substantially all of that partner's transferable interest in the partnership, other than a transfer for security purposes, or a court order charging the partner's interest, which has not been foreclosed;

(iii) within 90 days after the partnership notifies a corporate partner that it will be expelled because it has filed a certificate of dissolution or the equivalent, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its incorporation, there is no revocation of the certificate of dissolution or no reinstatement of its charter or its right to conduct business; or

(iv) a partnership that is a partner has been dissolved and its business is being wound up;

(5) on application by the partnership or another partner, the partner's expulsion by judicial determination because:

(i) the partner engaged in wrongful conduct that adversely and materially affected the partnership business;

(ii) the partner willfully or persistently committed a material breach of the partnership agreement or of a duty owed to the partnership or the other partners under Section 404; or

(iii) the partner engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with the partner;

(6) the partner's:

(i) becoming a debtor in bankruptcy;

(ii) executing an assignment for the benefit of creditors;

(iii) seeking, consenting to, or acquiescing in the appointment of a trustee, receiver, or liquidator of that partner or of all or substantially all of that partner's property; or

(iv) failing, within 90 days after the appointment, to have vacated or stayed the appointment of a trustee, receiver, or liquidator of the partner or of all or substantially all of the partner's property obtained without the partner's consent or

acquiescence, or failing within 90 days after the expiration of a stay to have the appointment vacated;

(7) in the case of a partner who is an individual:

(i) the partner's death;

(ii) the appointment of a guardian or general conservator for the partner; or

(iii) a judicial determination that the partner has otherwise become incapable of performing the partner's duties under the partnership agreement;

(8) in the case of a partner that is a trust or is acting as a partner by virtue of being a trustee of a trust, distribution of the trust's entire transferable interest in the partnership, but not merely by reason of the substitution of a successor trustee;

(9) in the case of a partner that is an estate or is acting as a partner by virtue of being a personal representative of an estate, distribution of the estate's entire transferable interest in the partnership, but not merely by reason of the substitution of a successor personal representative; or

(10) termination of a partner who is not an individual, partnership, corporation, trust, or estate.

Comment

1. RUPA dramatically changes the law governing partnership breakups and dissolution. An entirely new concept, "dissociation," is used in lieu of the UPA term "dissolution" to denote the change in the relationship caused by a partner's ceasing to be associated in the carrying on of the business. "Dissolution" is retained but with a different meaning. See Section 802. The entity theory of partnership provides a conceptual basis for continuing the firm itself despite a partner's withdrawal from the firm.

Under RUPA, unlike the UPA, the dissociation of a partner does not necessarily cause a dissolution and winding up of the business of the partnership. Section 801 identifies the situations in which the dissociation of a partner causes a winding up of the business. Section 701 provides that in all other situations there is a buyout of the partner's interest in the partnership, rather than a windup of the partnership business. In those other situations, the partnership entity continues, unaffected by the partner's dissociation.

A dissociated partner remains a partner for some purposes and still has some residual rights, duties, powers, and liabilities. Although Section 601 determines when a partner is dissociated from the partnership, the consequences of the partner's dissociation do not all occur at the same time. Thus, it is more useful to think of a dissociated partner as a partner for some purposes, but as a former partner for others. For example, see Section 403(b) (former partner's access to partnership books and records). The consequences of a partner's dissociation depend on whether the partnership continues or is wound up, as provided in Articles 6, 7, and 8.

Section 601 enumerates all of the events that cause a partner's dissociation. Section 601 is similar in approach to RULPA Section 402, which lists the events resulting in a general partner's withdrawal from a limited partnership.

2. Section 601(1) provides that a partner is dissociated when the partnership has notice of the partner's express will to withdraw as a partner, unless a later date is specified by the partner. If a future date is specified by the partner, other partners may dissociate before that date; specifying a future date does not bind the others to remain as partners until that date. See also Section 801(2)(i).

Section 602(a) provides that a partner has the power to withdraw at any time. The power to withdraw is immutable under Section 103(b)(6), with the exception that the partners may agree the notice must be in writing. This continues the present rule that a partner has the power to withdraw at will, even if not the right. See UPA Section 31(2). Since no writing is required to create a partner relationship, it was felt unnecessarily formalistic, and a trap for the unwary, to require a writing to end one. If a written notification is given, Section 102(d) clarifies when it is deemed received.

RUPA continues the UPA "express will" concept, thus preserving existing case law. Section 601(1) clarifies existing law by providing that the partnership must have notice of the partner's expression of will before the dissociation is effective. See Section 102(b) for the meaning of "notice."

3. Section 601(2) provides expressly that a partner is dissociated upon an event agreed to in the partnership agreement as causing dissociation. There is no such provision in the UPA, but that result has been assumed.

4. Section 601(3) provides that a partner may be expelled by the other partners pursuant to a power of expulsion contained in the partnership agreement. That continues the basic rule of UPA Section 31(1)(d). The expulsion can be with or without cause. As under existing law, the obligation of good faith under Section 404(d) does not require prior notice, specification of cause, or an opportunity to be heard. *See Holman v. Coie*, 11 Wash. App. 195, 522 P.2d 515, *cert. denied*, 420 U.S. 984 (1974).

5. Section 601(4) empowers the partners, by unanimous vote, to expel a partner for specified causes, even if not authorized in the partnership agreement. This changes the UPA Section 31(1)(d) rule that authorizes expulsion only if provided in the partnership agreement. A partner may be expelled from a term partnership, as well as from a partnership at will. Under Section 103(a), the partnership agreement may change or abolish the partners' power of expulsion.

Subsection (4)(i) is derived from UPA Section 31(3). A partner may be expelled if it is unlawful to carry on the business with that partner. Section 801(4), on the other hand, provides that the partnership itself is dissolved and must be wound up if substantially all of the business is unlawful.

Subsection (4)(ii) provides that a partner may be expelled for transferring substantially all of his transferable interest in the partnership, other than as security for a loan. (He may, however, be expelled upon foreclosure.) This rule is derived from UPA Section 31(1)(c). To avoid the presence of an unwelcome transferee, the remaining partners may dissolve the partnership under Section 801(2)(ii), after first expelling the transferor partner. A transfer of a partner's entire interest may, in some circumstances, evidence the transferor's intention to withdraw under Section 601(1).

Subsection (4)(iii) provides for the expulsion of a corporate partner if it has filed a certificate of dissolution, its charter has been revoked, or its right to conduct business has been suspended, unless cured within 90 days after notice. This provision is derived from RULPA Section 402(9). The cure proviso is important because charter revocation is very common in some States and partner status should not end merely because of a technical noncompliance with corporate law that can easily be cured. Withdrawal of a voluntarily filed notice of dissolution constitutes a cure.

Subsection (4)(iv) is the partnership analogue of paragraph (iii) and is suggested by RULPA Section 402(8). It provides that a partnership that is a partner may be expelled if it has been dissolved and its business is being wound up. It is intended that the right of expulsion not be triggered solely by the dissolution event, but only upon commencement of the liquidation process.

6. Section 601(5) empowers a court to expel a partner if it determines that the partner has engaged in specified misconduct. The enumerated grounds for judicial expulsion are based on the UPA Section 32(1) grounds for judicial dissolution. The application for expulsion may be brought by the partnership or any partner. The phrase "judicial determination" is intended to include an arbitration award, as well as any final court order or decree.

Subsection (5)(i) provides for the partner's expulsion if the court finds that the partner has engaged in wrongful conduct that adversely and materially affected the partnership business. That language is derived from UPA Section 32(1)(c).

Subsection (5)(ii) provides for expulsion if the court determines that the partner willfully or persistently committed a material breach of the partnership agreement or of a duty owed to the partnership or to the other partners under Section 404. That would include a partner's breach of fiduciary duty. Paragraph (ii), together with paragraph (iii), carry forward the substance of UPA Section 32(1)(d).

Subsection (5)(iii) provides for judicial expulsion of a partner who engaged in conduct relating to the partnership business that makes it not reasonably practicable to carry on the business in partnership with that partner. Expulsion for such misconduct makes the partner's dissociation wrongful under Section 602(a)(ii) and may also support a judicial decree of dissolution under Section 801(5)(ii).

7. Section 601(6) provides that a partner is dissociated upon becoming a debtor in bankruptcy or upon taking or suffering other action evidencing the partner's insolvency or lack of financial responsibility.

Subsection (6)(i) is derived from UPA Section 31(5), which provides for dissolution upon a partner's bankruptcy. *Accord* RULPA § 402(4)(ii). There is some doubt as to whether UPA Section 31(1) is limited to so-called "straight bankruptcy" under Chapter 7 or includes other bankruptcy relief, such as Chapter 11. Under RUPA Section 101(2), however, "debtor in bankruptcy" includes a person who files a voluntary petition, or against whom relief is ordered in an involuntary case, under any chapter of the Bankruptcy Code.

Initially, upon the filing of the bankruptcy petition, the debtor partner's transferable interest in the partnership will pass to the bankruptcy trustee as property of the estate under Section 541(a)(1) of the Bankruptcy Code, notwithstanding any restrictions on transfer provided in the partnership agreement. In most Chapter 7 cases, that will result in the eventual buyout of the partner's interest.

The application of various provisions of the federal Bankruptcy Code to Section 601(6)(i) is unclear. In particular, there is uncertainty as to the validity of UPA Section 31(5), and thus its RUPA counterpart, under Sections 365(e) and 541(c)(1) of the Bankruptcy Code. Those sections generally invalidate so-called *ipso facto* laws that cause a termination or modification of the debtor's contract or property rights because of the bankruptcy filing. As a consequence, RUPA Section 601(6)(i), which provides for a partner's dissociation by operation of law upon becoming a debtor in bankruptcy, may be invalid under the Supremacy Clause. *See, e.g.*, *In the Matter of Phillips*, 966 F.2d 926 (5th Cir. 1992); *In re Cardinal Industries, Inc.*, 105 B.R. 385 (Bankr. S.D. Ohio 1989), 116 B.R. 964 (Bankr. S.D. Ohio 1990); *In re Corky Foods Corp.*, 85 B.R. 903 (Bankr. S.D. Fla. 1988). *But see*, *In re Catron*, 158 B.R. 629 (E.D. Va. 1993) (partnership agreement could not be assumed by debtor under Bankruptcy Code § 365(c)(1) because other partners excused by UPA from accepting performance by or rendering performance to party other than debtor and buyout option not invalid *ipso facto* clause under Code § 365 (e)), *aff'd per curiam*, 25 F.3d 1038 (4th Cir. 1994). RUPA reflects the policy choice, as a matter of state partnership law, that a partner be dissociated upon becoming a debtor in bankruptcy.

Subsection (6)(ii) is new and provides for dissociation upon a general assignment for the benefit of a partner's creditors. The UPA says nothing about an assignment for the benefit of creditors or the appointment of a trustee, receiver, or liquidator. Subsection (6)(iii) and (iv) cover the latter and are based substantially on RULPA Section 402(4) and (5).

8. UPA Section 31(4) provides for the dissolution of a partnership upon the death of any partner, although by agreement the remaining partners may continue the partnership business. RUPA Section 601(7)(i), on the other hand, provides for dissociation upon the death of a partner who is an individual, rather than dissolution of the partnership. That changes existing law, except in those States previously adopting a similar non-uniform provision, such as California, Georgia, and Texas. Normally, under RUPA, the deceased partner's transferable interest in the partnership will pass to his estate and be bought out under Article 7.

Section 601(7)(ii) replaces UPA Section 32(1)(a) and provides for dissociation upon the appointment of a guardian or general conservator for partner

who is an individual. The appointment itself operates as the event of dissociation, and no further order of the court is necessary.

Section 601(7)(iii) is based on UPA Section 32(1)(b) and provides for dissociation upon a judicial determination that an individual partner has in any other way become incapable of performing his duties under the partnership agreement. The intent is to include physical incapacity.

9. Section 601(8) is new and provides for the dissociation of a partner that is a trust, or is acting as a partner by virtue of being a trustee of a trust, upon the distribution by the trust of its entire transferable interest in the partnership, but not merely upon the substitution of a successor trustee. The provision is inspired by RULPA Section 402(7).

10. Section 601(9) is new and provides for the dissociation of a partner that is an estate, or is acting as a partner by virtue of being a personal representative of an estate, upon the distribution of the estate's entire transferable interest in the partnership, but not merely the substitution of a successor personal representative. It is based on RULPA Section 402(10). Under Section 601(7), a partner is dissociated upon death, however, and the estate normally becomes a transferee, not a partner.

11. Section 601(10) is new and provides that a partner that is not an individual, partnership, corporation, trust, or estate is dissociated upon its termination. It is the comparable "death" analogue for other types of entity partners, such as a limited liability company.

SECTION 602. PARTNER'S POWER TO DISSOCIATE; WRONGFUL DISSOCIATION.

(a) A partner has the power to dissociate at any time, rightfully or wrongfully, by express will pursuant to Section 601(1).

(b) A partner's dissociation is wrongful only if:

(1) it is in breach of an express provision of the partnership agreement; or

(2) in the case of a partnership for a definite term or particular undertaking, before the expiration of the term or the completion of the undertaking:

(i) the partner withdraws by express will, unless the withdrawal follows within 90 days after another partner's dissociation by death or otherwise under Section 601(6) through (10) or wrongful dissociation under this subsection;

(ii) the partner is expelled by judicial determination under Section 601(5);

(iii) the partner is dissociated by becoming a debtor in bankruptcy; or

(iv) in the case of a partner who is not an individual, trust other than a business trust, or estate, the partner is expelled or otherwise dissociated because it willfully dissolved or terminated.

(c) A partner who wrongfully dissociates is liable to the partnership and to the other partners for damages caused by the dissociation. The liability is in addition to any other obligation of the partner to the partnership or to the other partners.

Comment

1. Subsection (a) states explicitly what is implicit in UPA Section 31(2) and RUPA Section 601(1) – that a partner has the power to dissociate at any time by expressing a will to withdraw, even in contravention of the partnership agreement. The phrase "rightfully or wrongfully" reflects the distinction between a partner's **power** to withdraw in contravention of the partnership agreement and a partner's **right** to do so. In this context, although a partner can not be enjoined from exercising the power to dissociate, the dissociation may be wrongful under subsection (b).

2. Subsection (b) provides that a partner's dissociation is wrongful only if it results from one of the enumerated events. The significance of a wrongful dissociation is that it may give rise to damages under subsection (c) and, if it results

in the dissolution of the partnership, the wrongfully dissociating partner is not entitled to participate in winding up the business under Section 804.

Under subsection (b), a partner's dissociation is wrongful if (1) it breaches an express provision of the partnership agreement or (2), in a term partnership, before the expiration of the term or the completion of the undertaking (i) the partner voluntarily withdraws by express will, except a withdrawal following **another** partner's wrongful dissociation or dissociation by death or otherwise under Section 601(6) through (10); (ii) the partner is expelled for misconduct under Section 601(5); (iii) the partner becomes a debtor in bankruptcy (see Section 101(2)); or (iv) a partner that is an entity (other than a trust or estate) is expelled or otherwise dissociated because its dissolution or termination was willful. Since subsection (b) is merely a default rule, the partnership agreement may eliminate or expand the dissociations that are wrongful or modify the effects of wrongful dissociation.

The exception in subsection (b)(2)(i) is intended to protect a partner's reactive withdrawal from a term partnership after the premature departure of another partner, such as the partnership's rainmaker or main supplier of capital, under the same circumstances that may result in the dissolution of the partnership under Section 801(2)(i). Under that section, a term partnership is dissolved 90 days after the bankruptcy, incapacity, death (or similar dissociation of a partner that is an entity), or wrongful dissociation of any partner, unless a majority in interest (see Comment 5(i) to Section 801 for a discussion of the term "majority in interest") of the remaining partners agree to continue the partnership. Under Section 602(b)(2)(i), a partner's exercise of the right of withdrawal by express will under those circumstances is rendered "rightful," even if the partnership is continued by others, and does not expose the withdrawing partner to damages for wrongful dissociation under Section 602(c).

A partner wishing to withdraw prematurely from a term partnership for any other reason, such as another partner's misconduct, can avoid being treated as a wrongfully dissociating partner by applying to a court under Section 601(5)(iii) to have the offending partner expelled. Then, the partnership could be dissolved under Section 801(2)(i) or the remaining partners could, by unanimous vote, dissolve the partnership under Section 801(2)(ii).

3. Subsection (c) provides that a wrongfully dissociating partner is liable to the partnership and to the other partners for any damages caused by the wrongful nature of the dissociation. That liability is in addition to any other obligation of the partner to the partnership or to the other partners. For example, the partner would be liable for any damage caused by breach of the partnership agreement or other misconduct. The partnership might also incur substantial expenses resulting from a partner's premature withdrawal from a term partnership, such as replacing the

partner's expertise or obtaining new financing. The wrongfully dissociating partner would be liable to the partnership for those and all other expenses and damages that are causally related to the wrongful dissociation.

Section 701(c) provides that any damages for wrongful dissociation may be offset against the amount of the buyout price due to the partner under Section 701(a), and Section 701(h) provides that a partner who wrongfully dissociates from a term partnership is not entitled to payment of the buyout price until the term expires.

Under UPA Section 38(2)(c)(II), in addition to an offset for damages, the goodwill value of the partnership is excluded in determining the value of a wrongfully dissociating partner's partnership interest. Under RUPA, however, unless the partnership's goodwill is damaged by the wrongful dissociation, the value of the wrongfully dissociating partner's interest will include any goodwill value of the partnership. If the firm's goodwill is damaged, the amount of the damages suffered by the partnership and the remaining partners will be offset against the buyout price. See Section 701 and Comments.

SECTION 603. EFFECT OF PARTNER'S DISSOCIATION.

(a) If a partner's dissociation results in a dissolution and winding up of the partnership business, [Article] 8 applies; otherwise, [Article] 7 applies.

(b) Upon a partner's dissociation:

(1) the partner's right to participate in the management and conduct of the partnership business terminates, except as otherwise provided in Section 803;

(2) the partner's duty of loyalty under Section 404(b)(3) terminates; and

(3) the partner's duty of loyalty under Section 404(b)(1) and (2) and duty of care under Section 404(c) continue only with regard to matters arising and events occurring before the partner's dissociation, unless the partner participates in winding up the partnership's business pursuant to Section 803.

Comment

1. Section 603(a) is a "switching" provision. It provides that, after a partner's dissociation, the partner's interest in the partnership must be purchased pursuant to the buyout rules in Article 7 **unless** there is a dissolution and winding up of the partnership business under Article 8. Thus, a partner's dissociation will always result in either a buyout of the dissociated partner's interest or a dissolution and winding up of the business.

By contrast, under the UPA, every partner dissociation results in the dissolution of the partnership, most of which trigger a right to have the business wound up unless the partnership agreement provides otherwise. *See* UPA § 38. The only exception in which the remaining partners have a statutory right to continue the business is when a partner wrongfully dissolves the partnership in breach of the partnership agreement. *See* UPA § 38(2)(b).

2. Section 603(b) is new and deals with some of the internal effects of a partner's dissociation. Subsection (b)(1) makes it clear that one of the consequences of a partner's dissociation is the immediate loss of the right to participate in the management of the business, unless it results in a dissolution and winding up of the business. In that case, Section 804(a) provides that all of the partners who have not wrongfully dissociated may participate in winding up the business.

Subsection (b)(2) and (3) clarify a partner's fiduciary duties upon dissociation. No change from current law is intended. With respect to the duty of loyalty, the Section 404(b)(3) duty not to compete terminates upon dissociation, and the dissociated partner is free immediately to engage in a competitive business, without any further consent. With respect to the partner's remaining loyalty duties under Section 404(b) and duty of care under Section 404(c), a withdrawing partner has a continuing duty after dissociation, but it is limited to matters that arose or events that occurred before the partner dissociated. For example, a partner who leaves a brokerage firm may immediately compete with the firm for new clients, but must exercise care in completing on-going client transactions and must account to the firm for any fees received from the old clients on account of those transactions. As the last clause makes clear, there is no contraction of a dissociated partner's duties under subsection (b)(3) if the partner thereafter participates in the dissolution and winding up the partnership's business.

[ARTICLE] 7

PARTNER'S DISSOCIATION WHEN BUSINESS NOT WOUND UP

SECTION 701. PURCHASE OF DISSOCIATED PARTNER'S INTEREST.

(a) If a partner is dissociated from a partnership without resulting in a dissolution and winding up of the partnership business under Section 801, the partnership shall cause the dissociated partner's interest in the partnership to be purchased for a buyout price determined pursuant to subsection (b).

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

(c) Damages for wrongful dissociation under Section 602(b), and all other amounts owing, whether or not presently due, from the dissociated partner to the partnership, must be offset against the buyout price. Interest must be paid from the date the amount owed becomes due to the date of payment.

(d) A partnership shall indemnify a dissociated partner whose interest is being purchased against all partnership liabilities, whether incurred before or after the dissociation, except liabilities incurred by an act of the dissociated partner under Section 702.

(e) If no agreement for the purchase of a dissociated partner's interest is reached within 120 days after a written demand for payment, the partnership shall pay, or cause to be paid, in cash to the dissociated partner the amount the partnership estimates to be the buyout price and accrued interest, reduced by any offsets and accrued interest under subsection (c).

(f) If a deferred payment is authorized under subsection (h), the partnership may tender a written offer to pay the amount it estimates to be the buyout price and accrued interest, reduced by any offsets under subsection (c), stating the time of payment, the amount and type of security for payment, and the other terms and conditions of the obligation.

(g) The payment or tender required by subsection (e) or (f) must be accompanied by the following:

(1) a statement of partnership assets and liabilities as of the date of dissociation;

(2) the latest available partnership balance sheet and income statement, if any;

(3) an explanation of how the estimated amount of the payment was calculated; and

(4) written notice that the payment is in full satisfaction of the obligation to purchase unless, within 120 days after the written notice, the dissociated partner commences an action to determine the buyout price, any offsets under subsection (c), or other terms of the obligation to purchase.

(h) A partner who wrongfully dissociates before the expiration of a definite term or the completion of a particular undertaking is not entitled to payment of any portion of the buyout price until the expiration of the term or completion of the undertaking, unless the partner establishes to the satisfaction of the court that earlier payment will not cause undue hardship to the business of the partnership. A deferred payment must be adequately secured and bear interest.

(i) A dissociated partner may maintain an action against the partnership, pursuant to Section 405(b)(2)(ii), to determine the buyout price of that partner's interest, any offsets under subsection (c), or other terms of the obligation to purchase. The action must be commenced within 120 days after the partnership has tendered payment or an offer to pay or within one year after written demand for payment if no payment or offer to pay is tendered. The court shall determine the buyout price of the dissociated partner's interest, any offset due under subsection (c), and accrued interest, and enter judgment for any additional payment or refund. If deferred payment is authorized under subsection (h), the court shall also determine the security for payment and other terms of the obligation to purchase. The court may assess reasonable attorney's fees and the fees and expenses of appraisers or other experts for a party to the action, in amounts the court finds

equitable, against a party that the court finds acted arbitrarily, vexatiously, or not in good faith. The finding may be based on the partnership's failure to tender payment or an offer to pay or to comply with subsection (g).

Comment

1. Article 7 is new and provides for the buyout of a dissociated partner's interest in the partnership when the partner's dissociation does not result in a dissolution and winding up of its business under Article 8. *See* Section 603(a). If there is no dissolution, the remaining partners have a right to continue the business and the dissociated partner has a right to be paid the value of his partnership interest. These rights can, of course, be varied in the partnership agreement. *See* Section 103. A dissociated partner has a continuing relationship with the partnership and third parties as provided in Sections 603(b), 702, and 703. See also Section 403(b) (former partner's access to partnership books and records).

2. Subsection (a) provides that, if a partner's dissociation does not result in a windup of the business, the partnership shall cause the interest of the dissociating partner to be purchased for a buyout price determined pursuant to subsection (b). The buyout is mandatory. The "cause to be purchased" language is intended to accommodate a purchase by the partnership, one or more of the remaining partners, or a third party.

For federal income tax purposes, a payment to a partner for his interest can be characterized either as a purchase of the partner's interest or as a liquidating distribution. The two have different tax consequences. RUPA permits either option by providing that the payment may come from either the partnership, some or all of the continuing partners, or a third party purchaser.

3. Subsection (b) provides how the "buyout price" is to be determined. The terms "fair market value" or "fair value" were not used because they are often considered terms of art having a special meaning depending on the context, such as in tax or corporate law. "Buyout price" is a new term. It is intended that the term be developed as an independent concept appropriate to the partnership buyout situation, while drawing on valuation principles developed elsewhere.

Under subsection (b), the buyout price is the amount that would have been distributable to the dissociating partner under Section 807(b) if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of liquidation value or going concern value without the departing partner. Liquidation value is not intended to mean distress sale value. Under general principles of valuation, the hypothetical selling price in either case should be the price that a

willing and informed buyer would pay a willing and informed seller, with neither being under any compulsion to deal. The notion of a minority discount in determining the buyout price is negated by valuing the business as a going concern. Other discounts, such as for a lack of marketability or the loss of a key partner, may be appropriate, however.

Since the buyout price is based on the value of the business at the time of dissociation, the partnership must pay interest on the amount due from the date of dissociation until payment to compensate the dissociating partner for the use of his interest in the firm. Section 104(b) provides that interest shall be at the legal rate unless otherwise provided in the partnership agreement. The UPA Section 42 option of electing a share of the profits in lieu of interest has been eliminated.

UPA Section 38(2)(c)(II) provides that the good will of the business not be considered in valuing a wrongfully dissociating partner's interest. The forfeiture of good will rule is implicitly rejected by RUPA. See Section 602(c) and Comment 3.

The Section 701 rules are merely default rules. The partners may, in the partnership agreement, fix the method or formula for determining the buyout price and all of the other terms and conditions of the buyout right. Indeed, the very right to a buyout itself may be modified, although a provision providing for a complete forfeiture would probably not be enforceable. *See* Section 104(a).

4. Subsection (c) provides that the partnership may offset against the buyout price all amounts owing by the dissociated partner to the partnership, whether or not presently due, including any damages for wrongful dissociation under Section 602(c). This has the effect of accelerating payment of amounts not yet due from the departing partner to the partnership, including a long-term loan by the partnership to the dissociated partner. Where appropriate, the amounts not yet due should be discounted to present value. A dissociating partner, on the other hand, is not entitled to an add-on for amounts owing to him by the partnership. Thus, a departing partner who has made a long-term loan to the partnership must wait for repayment, unless the terms of the loan agreement provide for acceleration upon dissociation.

It is not intended that the partnership's right of setoff be construed to limit the amount of the damages for the partner's wrongful dissociation and any other amounts owing to the partnership to the value of the dissociated partner's interest. Those amounts may result in a net sum due to the partnership from the dissociated partner.

5. Subsection (d) follows the UPA Section 38 rule and provides that the partnership must indemnify a dissociated partner against all partnership liabilities,

whether incurred before or after the dissociation, except those incurred by the dissociated partner under Section 702.

6. Subsection (e) provides that, if no agreement for the purchase of the dissociated partner's interest is reached within 120 days after the dissociated partner's written demand for payment, the partnership must pay, or cause to be paid, in cash the amount it estimates to be the buyout price, adjusted for any offsets allowed and accrued interest. Thus, the dissociating partner will receive in cash within 120 days of dissociation the undisputed minimum value of the partner's partnership interest. If the dissociated partner claims that the buyout price should be higher, suit may thereafter be brought as provided in subsection (i) to have the amount of the buyout price determined by the court. This is similar to the procedure for determining the value of dissenting shareholders' shares under RMBCA Sections 13.20-13.28.

The "cause to be paid" language of subsection (a) is repeated here to permit either the partnership, one or more of the continuing partners, or a third-party purchaser to tender payment of the estimated amount due.

7. Subsection (f) provides that, when deferred payment is authorized in the case of a wrongfully dissociating partner, a written offer stating the amount the partnership estimates to be the purchase price should be tendered within the 120-day period, even though actual payment of the amount may be deferred, possibly for many years. See Comment 8. The dissociated partner is entitled to know at the time of dissociation what amount the remaining partners think is due, including the estimated amount of any damages allegedly caused by the partner's wrongful dissociation that may be offset against the buyout price.

8. Subsection (g) provides that the payment of the estimated price (or tender of a written offer under subsection (f)) by the partnership must be accompanied by (1) a statement of the partnership's assets and liabilities as of the date of the partner's dissociation; (2) the latest available balance sheet and income statement, if the partnership maintains such financial statements; (3) an explanation of how the estimated amount of the payment was calculated; and (4) a written notice that the payment will be in full satisfaction of the partnership's buyout obligation unless the dissociated partner commences an action to determine the price within 120 days of the notice. Subsection (g) is based in part on the dissenters' rights provisions of RMBCA Section 13.25(b).

Those disclosures should serve to identify and narrow substantially the items of dispute between the dissociated partner and the partnership over the valuation of the partnership interest. They will also serve to pin down the parties as to their claims of partnership assets and values and as to the existence and amount

of all known liabilities. See Comment 4. Lastly, it will force the remaining partners to consider thoughtfully the difficult and important questions as to the appropriate method of valuation under the circumstances, and in particular, whether they should use going concern or liquidation value. Simply getting that information on the record in a timely fashion should increase the likelihood of a negotiated resolution of the parties' differences during the 120-day period within which the dissociated partner must bring suit.

9. Subsection (h) replaces UPA Section 38(2)(c) and provides a somewhat different rule for payment to a partner whose dissociation before the expiration of a definite term or the completion of a particular undertaking is wrongful under Section 602(b). Under subsection (h), a wrongfully dissociating partner is not entitled to receive any portion of the buyout price before the expiration of the term or completion of the undertaking, unless the dissociated partner establishes to the satisfaction of the court that earlier payment will not cause undue hardship to the business of the partnership. In all other cases, there must be an immediate payment in cash.

10. Subsection (i) provides that a dissociated partner may maintain an action against the partnership to determine the buyout price, any offsets, or other terms of the purchase obligation. The action must be commenced within 120 days after the partnership tenders payment of the amount it estimates to be due or, if deferred payment is authorized, its written offer. This provision creates a 120-day "cooling off" period. It also allows the parties an opportunity to negotiate their differences after disclosure by the partnership of its financial statements and other required information.

If the partnership fails to tender payment of the estimated amount due (or a written offer, if deferred payment is authorized), the dissociated partner has one year after written demand for payment in which to commence suit.

If the parties fail to reach agreement, the court must determine the buyout price of the partner's interest, any offsets, including damages for wrongful dissociation, and the amount of interest accrued. If payment to a wrongfully dissociated partner is deferred, the court may also require security for payment and determine the other terms of the obligation.

Under subsection (i), attorney's fees and other costs may be assessed against any party found to have acted arbitrarily, vexatiously, or not in good faith in connection with the valuation dispute, including the partnership's failure to tender payment of the estimated price or to make the required disclosures. This provision is based in part on RMBCA Section 13.31(b).

SECTION 702. DISSOCIATED PARTNER'S POWER TO BIND AND LIABILITY TO PARTNERSHIP.

(a) For two years after a partner dissociates without resulting in a dissolution and winding up of the partnership business, the partnership, including a surviving partnership under [Article] 9, is bound by an act of the dissociated partner which would have bound the partnership under Section 301 before dissociation only if at the time of entering into the transaction the other party:

(1) reasonably believed that the dissociated partner was then a partner;

(2) did not have notice of the partner's dissociation; and

(3) is not deemed to have had knowledge under Section 303(e) or notice under Section 704(c).

(b) A dissociated partner is liable to the partnership for any damage caused to the partnership arising from an obligation incurred by the dissociated partner after dissociation for which the partnership is liable under subsection (a).

Comment

1. Section 702 deals with a dissociated partner's lingering apparent authority to bind the partnership in ordinary course partnership transactions and the partner's liability to the partnership for any loss caused thereby. It also applies to partners who withdraw incident to a merger under Article 9. *See* Section 906(e).

A dissociated partner has no **actual** authority to act for the partnership. *See* Section 603(b)(1). Nevertheless, in order to protect innocent third parties, Section 702(a) provides that the partnership remains bound, for two years after a partner's dissociation, by that partner's acts that would, before his dissociation, have bound the partnership under Section 301 if, and only if, the other party to the transaction reasonably believed that he was still a partner, did not have notice of the partner's dissociation, and is not deemed to have had knowledge of the dissociation under Section 303(e) or notice thereof under Section 704(c).

Under Section 301, every partner has **apparent** authority to bind the partnership by any act for carrying on the partnership business in the ordinary course, unless the other party knows that the partner has no actual authority to act for the partnership or has received a notification of the partner's lack of authority. Section 702(a) continues that general rule for two years after a partner's dissociation, subject to three modifications.

After a partner's dissociation, the general rule is modified, first, by requiring the other party to show reasonable reliance on the partner's status as a partner. Section 301 has no explicit reliance requirement, although the partnership is bound only if the partner purports to act on its behalf. Thus, the other party will normally be aware of the partnership and presumably the partner's status as such.

The second modification is that, under Section 702(a), the partnership is not bound if the third party has **notice** of the partner's dissociation, while under the general rule of Section 301 the partnership is bound unless the third party **knows** of the partner's lack of authority. Under Section 102(b), a person has "notice" of a fact if he knows or has reason to know it exists from all the facts that are known to him or he has received a notification of it. Thus, the partnership may protect itself by sending a notification of the dissociation to a third party, and a third party may, in any event, have a duty to inquire further based on what is known. That provides the partnership with greater protection from the unauthorized acts of a dissociated partner than from those of partners generally.

The third modification of the general apparent authority rule under Section 702(a) involves the effect of a statement of dissociation. Section 704(c) provides that, for the purposes of Sections 702(a)(3) and 703(b)(3), third parties are deemed to have notice of a partner's dissociation 90 days after the filing of a statement of dissociation. Thus, the filing of a statement operates as constructive notice of the dissociated partner's lack of authority after 90 days, conclusively terminating the dissociated partner's Section 702 apparent authority.

With respect to a dissociated partner's authority to transfer partnership real property, Section 303(e) provides that third parties are deemed to have knowledge of a limitation on a partner's authority to transfer real property held in the partnership name upon the proper recording of a statement containing such a limitation. Section 704(b) provides that a statement of dissociation operates as a limitation on the dissociated partner's authority for the purposes of Section 303(e). Thus, a properly recorded statement of dissociation operates as constructive knowledge of a dissociated partner's lack of authority to transfer real property held in the partnership name, effective immediately upon recording.

Under RUPA, therefore, a partnership should notify all known creditors of a partner's dissociation and may, by filing a statement of dissociation, conclusively limit to 90 days a dissociated partner's lingering agency power. Moreover, under Section 703(b), a dissociated partner's lingering liability for post-dissociation partnership liabilities may be limited to 90 days by filing a statement of dissociation. These incentives should encourage both partnerships and dissociating partners to file statements routinely. Those transacting substantial business with partnerships can protect themselves from the risk of dealing with dissociated partners, or relying on their credit, by checking the partnership records at least every 90 days.

2. Section 702(b) is a corollary to subsection (a) and provides that a dissociated partner is liable to the partnership for any loss resulting from an obligation improperly incurred by the partner under subsection (a). In effect, the dissociated partner must indemnify the partnership for any loss, meaning a loss net of any gain from the transaction. The dissociated partner is also personally liable to the third party for the unauthorized obligation.

SECTION 703. DISSOCIATED PARTNER'S LIABILITY TO OTHER PERSONS.

(a) A partner's dissociation does not of itself discharge the partner's liability for a partnership obligation incurred before dissociation. A dissociated partner is not liable for a partnership obligation incurred after dissociation, except as otherwise provided in subsection (b).

(b) A partner who dissociates without resulting in a dissolution and winding up of the partnership business is liable as a partner to the other party in a transaction entered into by the partnership, or a surviving partnership under [Article] 9, within two years after the partner's dissociation, only if the partner is liable for the obligation under Section 306 and at the time of entering into the transaction the other party:

(1) reasonably believed that the dissociated partner was then a partner;

(2) did not have notice of the partner's dissociation; and

(3) is not deemed to have had knowledge under Section 303(e) or notice under Section 704(c).

(c) By agreement with the partnership creditor and the partners continuing the business, a dissociated partner may be released from liability for a partnership obligation.

(d) A dissociated partner is released from liability for a partnership obligation if a partnership creditor, with notice of the partner's dissociation but without the partner's consent, agrees to a material alteration in the nature or time of payment of a partnership obligation.

Comment

Section 703(a) is based on UPA Section 36(1) and continues the basic rule that the departure of a partner does not of itself discharge the partner's liability to third parties for any partnership obligation incurred before dissociation. The word "obligation" is used instead of "liability" and is intended to include broadly both tort and contract liability incurred before dissociation. The second sentence states affirmatively that a dissociating partner is not liable for any partnership obligation incurred after dissociation except as expressly provided in subsection (b).

Section 703(b) is new and deals with the problem of protecting third parties who extend credit to the partnership after a partner's dissociation, believing that he is still a partner. It provides that the dissociated partner remains liable as a partner for transactions entered into by the partnership within two years after departure, if the other party does not have notice of the partner's dissociation and reasonably believes when entering the transaction that the dissociated partner is still a partner. The dissociated partner is not personally liable, however, if the other party is deemed to know of the dissociation under Section 303(e) or to have notice thereof under Section 704(c). Also, a dissociated partner is not personally liable for limited liability partnership obligations for which the partner is not personally liable under Section 306.

Section 703(b) operates similarly to Section 702(a) in that it requires reliance on the departed partner's continued partnership status, as well as lack of

notice. Under Section 704(c), a statement of dissociation operates conclusively as constructive notice 90 days after filing for the purposes of Section 703(b)(3) and, under Section 704(b), as constructive knowledge when recorded for the purposes of Section 303(d) and (e).

Section 703(c) continues the rule of UPA Section 36(2) that a departing partner can bargain for a contractual release from personal liability for a partnership obligation, but it requires the consent of both the creditor and the remaining partners.

Section 703(d) continues the rule of UPA Section 36(3) that a dissociated partner is released from liability for a partnership obligation if the creditor, with notice of the partner's departure, agrees to a material alteration in the nature or time of payment, without that partner's consent. This rule covers all partner dissociations and is not limited, as is the UPA rule, to situations in which a third party "agrees to assume the existing obligations of a dissolved partnership."

In general under RUPA, as a result of the adoption of the entity theory, relationships between a partnership and its creditors are not affected by the dissociation of a partner or by the addition of a new partner, unless otherwise agreed. Therefore, there is no need under RUPA, as there is under the UPA, for an elaborate provision deeming the new partnership to assume the liabilities of the old partnership. See UPA Section 41.

The "dual priority" rule in UPA Section 36(4) is eliminated to reflect the abolition of the "jingle rule," providing that separate debts have first claim on separate property, in order to conform to the Bankruptcy Code. See Comment 2 to Section 807. A deceased partner's estate, and thus all of his individual property, remains liable for partnership obligations incurred while he was a partner, however.

SECTION 704. STATEMENT OF DISSOCIATION.

(a) A dissociated partner or the partnership may file a statement of dissociation stating the name of the partnership and that the partner is dissociated from the partnership.

(b) A statement of dissociation is a limitation on the authority of a dissociated partner for the purposes of Section 303(d) and (e).

(c) For the purposes of Sections 702(a)(3) and 703(b)(3), a person not a partner is deemed to have notice of the dissociation 90 days after the statement of dissociation is filed.

Comment

Section 704 is new and provides for a statement of dissociation and its effects. Subsection (a) authorizes either a dissociated partner or the partnership to file a statement of dissociation. Like other RUPA filings, the statement of dissociation is voluntary. Both the partnership and the departing partner have an incentive to file, however, and it is anticipated that those filings will become routine upon a partner's dissociation. The execution, filing, and recording of the statement is governed by Section 105.

Filing or recording a statement of dissociation has threefold significance:

(1) It is a statement of limitation on the dissociated partner's authority to the extent provided in Section 303(d) and (e). Under Section 303(d), a filed or recorded limitation on the authority of a partner destroys the conclusive effect of a prior grant of authority to the extent it contradicts the prior grant. Under Section 303(e), nonpartners are conclusively bound by a limitation on the authority of a partner to transfer real property held in the partnership name, if the statement is properly recorded in the real property records.

(2) Ninety days after the statement is filed, nonpartners are deemed to have notice of the dissociation and thus conclusively bound for purposes of cutting off the partner's apparent authority under Sections 301 and 702(a)(3).

(3) Ninety days after the statement is filed, third parties are conclusively bound for purposes of cutting off the dissociated partner's continuing liability under Section 703(b)(3) for transactions entered into by the partnership after dissociation.

SECTION 705. CONTINUED USE OF PARTNERSHIP NAME.

Continued use of a partnership name, or a dissociated partner's name as part thereof, by partners continuing the business does not of itself make the dissociated partner liable for an obligation of the partners or the partnership continuing the business.

Comment

Section 705 is an edited version of UPA Section 41(10) and provides that a dissociated partner is not liable for the debts of the continuing business simply because of continued use of the partnership name or the dissociated partner's name as a part thereof. That prevents forcing the business to forego the good will associated with its name.

[ARTICLE] 8

WINDING UP PARTNERSHIP BUSINESS

SECTION 801. EVENTS CAUSING DISSOLUTION AND WINDING UP OF PARTNERSHIP BUSINESS. A partnership is dissolved, and its business must be wound up, only upon the occurrence of any of the following events:

(1) in a partnership at will, the partnership's having notice from a partner, other than a partner who is dissociated under Section 601(2) through (10), of that partner's express will to withdraw as a partner, or on a later date specified by the partner;

(2) in a partnership for a definite term or particular undertaking:

(i) the expiration of 90 days after a partner's dissociation by death or otherwise under Section 601(6) through (10) or wrongful dissociation under Section 602(b), unless before that time a majority in interest of the remaining partners, including partners who have rightfully dissociated pursuant to Section 602(b)(2)(i), agree to continue the partnership;

(ii) the express will of all of the partners to wind up the partnership business; or

(iii) the expiration of the term or the completion of the undertaking;

(3) an event agreed to in the partnership agreement resulting in the winding up of the partnership business;

(4) an event that makes it unlawful for all or substantially all of the business of the partnership to be continued, but a cure of illegality within 90 days after notice to the partnership of the event is effective retroactively to the date of the event for purposes of this section;

(5) on application by a partner, a judicial determination that:

(i) the economic purpose of the partnership is likely to be unreasonably frustrated;

(ii) another partner has engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with that partner; or

(iii) it is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement; or

(6) on application by a transferee of a partner's transferable interest, a judicial determination that it is equitable to wind up the partnership business:

(i) after the expiration of the term or completion of the undertaking, if the partnership was for a definite term or particular undertaking at the time of the transfer or entry of the charging order that gave rise to the transfer; or

(ii) at any time, if the partnership was a partnership at will at the time of the transfer or entry of the charging order that gave rise to the transfer.

Comment

1. Under UPA Section 29, a partnership is dissolved every time a partner leaves. That reflects the aggregate nature of the partnership under the UPA. Even if the business of the partnership is continued by some of the partners, it is

technically a new partnership. The dissolution of the old partnership and creation of a new partnership causes many unnecessary problems.

Under RULPA, limited partnerships dissolve far less readily than do general partnerships under the UPA. A limited partnership does not dissolve on the withdrawal of a limited partner, nor does it necessarily dissolve on the withdrawal of a general partner. *See* RULPA § 801(4).

RUPA's move to the entity theory is driven in part by the need to prevent a technical dissolution or its consequences. Under RUPA, not every partner dissociation causes a dissolution of the partnership. Only certain departures trigger a dissolution. The basic rule is that a partnership is dissolved, and its business must be wound up, only upon the occurrence of one of the events listed in Section 801. All other dissociations result in a buyout of the partner's interest under Article 7 and a continuation of the partnership entity and business by the remaining partners. *See* Section 603(a).

With only three exceptions, the provisions of Section 801 are merely default rules and may by agreement be varied or eliminated as grounds for dissolution. The first exception is dissolution under Section 801(4) resulting from carrying on an illegal business. The other two exceptions cover the power of a court to dissolve a partnership under Section 801(5) on application of a partner and under Section 801(6) on application of a transferee. See Comments 6-8 for further explanation of these provisions.

2. Under RUPA, "dissolution" is merely the commencement of the winding up process. The partnership continues for the limited purpose of winding up the business. In effect, that means the scope of the partnership business contracts to completing work in process and taking such other actions as may be necessary to wind up the business. Winding up the partnership business entails selling its assets, paying its debts, and distributing the net balance, if any, to the partners in cash according to their interests. The partnership entity continues, and the partners are associated in the winding up of the business until winding up is completed. When the winding up is completed, the partnership entity terminates.

3. Section 801 continues two basic rules from the UPA. First, it continues the rule that any member of an **at-will** partnership has the right to force a liquidation. Second, by negative implication, it continues the rule that the partners who wish to continue the business of a **term** partnership can not be forced to liquidate the business by a partner who withdraws prematurely in violation of the partnership agreement.

Those rules are gleaned from the separate UPA provisions governing dissolution and its consequences. Under UPA Section 31(1)(b), dissolution is caused by the express will of any partner when no definite term or particular undertaking is specified. UPA Section 38(1) provides that upon dissolution any partner has the right to have the business wound up. That is a default rule and applies only in the absence of an agreement affording the other partners a right to continue the business.

UPA Section 31(2) provides that a term partnership may be dissolved at any time, in contravention of the partnership agreement, by the express will of any partner. In that case, however, UPA Section 38(2)(b) provides that the nonbreaching partners may by unanimous consent continue the business. If the business is continued, they must buy out the breaching partner.

4. Section 801(1) provides that a partnership at will is dissolved and its business must be wound up upon the partnership's having notice of a partner's express will to withdraw as a partner, unless a later effective date is specified by the partner. A partner at will who has already been dissociated in some other manner, such as a partner who has been expelled, does not thereafter have a right to cause the partnership to be dissolved and its business wound up.

If, after dissolution, none of the partners wants the partnership wound up, Section 802(b) provides that, with the consent of all the partners, including the withdrawing partner, the remaining partners may continue the business. In that event, although there is a technical dissolution of the partnership and, at least in theory, a temporary contraction of the scope of the business, the partnership entity continues and the scope of its business is restored. See Section 802(b) and Comment 2.

5. Section 801(2) provides three ways in which a term partnership may be dissolved before the expiration of the term:

(i) Subsection (2)(i) provides for dissolution upon the expiration of 90 days after any partner's dissociation by death or otherwise under Section 601(6) to (10) or wrongful dissociation under Section 602(b), unless within that 90-day period a majority in interest of the remaining partners agree to continue the partnership. This reactive dissolution of a term partnership protects the remaining partners where the dissociating partner is crucial to the successful continuation of the business. The corresponding UPA Section 38(2)(b) rule requires unanimous consent of the remaining partners to continue the business, thus giving each partner an absolute right to a reactive liquidation. Under RUPA, if the partnership is continued by the majority, any dissenting partner who wants to withdraw may do so rightfully under the exception to Section 602(b)(2)(i), in which case his interest in the partnership

will be bought out under Article 7. By itself, however, a partner's vote not to continue the business is not necessarily an expression of the partner's will to withdraw, and a dissenting partner may still elect to remain a partner and continue in the business.

The Section 601 dissociations giving rise to a reactive dissolution are: (6) a partner's bankruptcy or similar financial impairment; (7) a partner's death or incapacity; (8) the distribution by a trust-partner of its entire partnership interest; (9) the distribution by an estate-partner of its entire partnership interest; and (10) the termination of an entity-partner. Any dissociation during the term of the partnership that is wrongful under Section 602(b), including a partner's voluntary withdrawal, expulsion or bankruptcy, also gives rise to a reactive dissolution. Those statutory grounds may be varied by agreement or the reactive dissolution may be abolished entirely.

Under subsection (2)(i), a term partnership is dissolved 90 days after the first partner's dissociation unless within that time a majority in interest of the remaining partners have agreed to continue the partnership. Continuation under subsection (2)(i) requires the agreement of at least a majority in interest of the remaining partners. The interest and vote of a partner who dissociates rightfully under Section 602(b)(2)(i) is counted in determining whether a majority in interest agrees to continue.

Decision-making by a majority in interest is not the normal RUPA default rule. Section 401(j) requires a majority in number, rather than a majority in interest, for ordinary business decisions and unanimity for extraordinary matters and amendments to the partnership agreement. Requiring only majority approval to continue the partnership, rather than unanimity, in effect treats the decision as an ordinary business matter, thereby enhancing firm stability. At the same time, requiring a majority in interest, rather than a majority in number, satisfies Internal Revenue Service concerns regarding a partnership's continuity of life. *See* Treas. Reg. § 301.7701-2(b)(1).

"Majority in interest" is not defined in the Act, but is intended to satisfy Internal Revenue Service regulations regarding continuity of life. Under Rev. Proc. 94-46 (June 29, 1994), the "in-interest" concept refers to the partners' economic interests in both the profits and capital of the partnership.

Under Section 601(6)(i), a partner is dissociated upon becoming a debtor in bankruptcy. The bankruptcy of a partner or of the partnership is not, however, an event of dissolution under Section 801. That is a change from UPA Section 31(5). A partner's bankruptcy does, however, cause dissolution of a term partnership under Section 801(2)(i), unless a majority in interest of the remaining partners thereafter

agree to continue the partnership. Affording the other partners the option of buying out the bankrupt partner's interest avoids the necessity of winding up a term partnership every time a partner becomes a debtor in bankruptcy.

Similarly, under Section 801(2)(i), the death of any partner will result in the dissolution of a term partnership, unless a majority in interest of the remaining partners agree to continue the business. In that case, the deceased partner's transferable interest in the partnership passes to his estate and must be bought out under Article 7. See Comment 8 to Section 601.

(ii) Section 801(2)(ii) provides that a term partnership may be dissolved and wound up at any time by the express will of all the partners. That is merely an expression of the general rule that the partnership agreement may override the statutory default rules and that the partnership agreement, like any contract, can be amended at any time by unanimous consent.

UPA Section 31(1)(c) provides that a term partnership may be wound up by the express will of all the partners whose transferable interests have not been assigned or charged for a partner's separate debts. That rule reflects the belief that the remaining partners may find transferees very intrusive. This provision has been deleted, however, because the liquidation is easily accomplished under Section 801(2)(ii) by first expelling the transferor partner under Section 601(4)(ii).

(iii) Section 801(2)(iii) is based on UPA Section 31(1)(a) and provides for winding up a term partnership upon the expiration of the term or the completion of the undertaking.

Subsection (2)(iii) must be read in conjunction with Section 406. Under Section 406(a), if the partners continue the business after the expiration of the term or the completion of the undertaking, the partnership will be treated as a partnership at will. Moreover, if the partners continue the business without any settlement or liquidation of the partnership, under Section 406(b) they are presumed to have agreed that the partnership will continue, despite the lack of a formal agreement. The partners may also agree to ratify all acts taken since the end of the partnership's term.

6. Section 801(3) provides for dissolution upon the occurrence of an event specified in the partnership agreement as resulting in the winding up of the partnership business. The partners may, however, agree to continue the business and to ratify all acts taken since dissolution.

7. Section 801(4) continues the basic rule in UPA Section 31(3) and provides for dissolution if it is unlawful to continue the business of the partnership,

unless cured. The "all or substantially all" proviso is intended to avoid dissolution for insubstantial or innocent regulatory violations. If the illegality is cured within 90 days after notice to the partnership, it is effective retroactively for purposes of this section. The requirement that an uncured illegal business be wound up cannot be varied in the partnership agreement. *See* Section 103(b)(8).

8. Section 801(5) provides for judicial dissolution on application by a partner. It is based in part on UPA Section 32(1), and the language comes in part from RULPA Section 802. A court may order a partnership dissolved upon a judicial determination that: (i) the economic purpose of the partnership is likely to be unreasonably frustrated; (ii) another partner has engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with that partner; or (iii) it is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement. The court's power to wind up the partnership under Section 801(5) cannot be varied in the partnership agreement. *See* Section 103(b)(8).

RUPA deletes UPA Section 32(1)(e) which provides for dissolution when the business can only be carried on at a loss. That provision might result in a dissolution contrary to the partners' expectations in a start-up or tax shelter situation, in which case "book" or "tax" losses do not signify business failure. Truly poor financial performance may justify dissolution under subsection (5)(i) as a frustration of the partnership's economic purpose.

RUPA also deletes UPA Section 32(1)(f) which authorizes a court to order dissolution of a partnership when "other circumstances render a dissolution equitable." That provision was regarded as too open-ended and, given RUPA's expanded remedies for partners, unnecessary. No significant change in result is intended, however, since the interpretation of UPA Section 32(1)(f) is comparable to the specific grounds expressed in subsection (5). *See, e.g., Karber v. Karber*, 145 Ariz. 293, 701 P.2d 1 (Ct. App. 1985) (partnership dissolved on basis of suspicion and ill will, citing UPA §§ 32(1)(d) and (f)); *Fuller v. Brough*, 159 Colo. 147, 411 P.2d 18 (1966) (not equitable to dissolve partnership for trifling causes or temporary grievances that do not render it impracticable to carry on partnership business); *Lau v. Wong*, 1 Haw. App. 217, 616 P.2d 1031 (1980) (partnership dissolved where business operated solely for benefit of managing partner).

9. Section 801(6) provides for judicial dissolution on application by a transferee of a partner's transferable interest in the partnership, including the purchaser of a partner's interest upon foreclosure of a charging order. It is based on UPA Section 32(2) and authorizes dissolution upon a judicial determination that it is equitable to wind up the partnership business (i) after the expiration of the partnership term or completion of the undertaking or (ii) at any time, if the

partnership were a partnership at will at the time of the transfer or when the charging order was issued. The requirement that the court determine that it is equitable to wind up the business is new. The rights of a transferee under this section cannot be varied in the partnership agreement. *See* Section 103(b)(8).

SECTION 802. PARTNERSHIP CONTINUES AFTER DISSOLUTION.

(a) Subject to subsection (b), a partnership continues after dissolution only for the purpose of winding up its business. The partnership is terminated when the winding up of its business is completed.

(b) At any time after the dissolution of a partnership and before the winding up of its business is completed, all of the partners, including any dissociating partner other than a wrongfully dissociating partner, may waive the right to have the partnership's business wound up and the partnership terminated. In that event:

(1) the partnership resumes carrying on its business as if dissolution had never occurred, and any liability incurred by the partnership or a partner after the dissolution and before the waiver is determined as if dissolution had never occurred; and

(2) the rights of a third party accruing under Section 804(1) or arising out of conduct in reliance on the dissolution before the third party knew or received a notification of the waiver may not be adversely affected.

Comment

1. Section 802(a) is derived from UPA Section 30 and provides that a partnership continues after dissolution only for the purpose of winding up its business, after which it is terminated. RUPA continues the concept of "termination" to mark the completion of the winding up process. Since no filing or other formality

is required, the date will often be determined only by hindsight. No legal rights turn on the partnership's termination or the date thereof. Even after termination, if a previously unknown liability is asserted, all of the partners are still liable.

2. Section 802(b) makes explicit the right of the remaining partners to continue the business after an event of dissolution if all of the partners, including the dissociating partner or partners, waive the right to have the business wound up and the partnership terminated. Only those "dissociating" partners whose dissociation was the immediate cause of the dissolution must waive the right to have the business wound up. The consent of wrongfully dissociating partners is not required.

3. Upon waiver of the right to have the business wound up, Paragraph (1) of the subsection provides that the partnership entity may resume carrying on its business as if dissolution had never occurred, thereby restoring the scope of its business to normal. "Resumes" is intended to mean that acts appropriate to winding up, authorized when taken, are in effect ratified, and the partnership remains liable for those acts, as provided explicitly in paragraph (2).

If the business is continued following a waiver of the right to dissolution, any liability incurred by the partnership or a partner after the dissolution and before the waiver is to be determined as if dissolution had never occurred. That has the effect of validating transactions entered into after dissolution that might not have been appropriate for winding up the business, because, upon waiver, any liability incurred by either the partnership or a partner in those transactions will be determined under Sections 702 and 703, rather than Sections 804 and 806.

As to the liability for those transactions among the partners themselves, the partners by agreement may provide otherwise. Thus, a partner who, after dissolution, incurred an obligation appropriate for winding up, but **not** appropriate for continuing the business, may protect himself by conditioning his consent to the continuation of the business on the ratification of the transaction by the continuing partners.

Paragraph (2) of the subsection provides that the rights of third parties accruing under Section 804(1) before they knew (or were notified) of the waiver may not be adversely affected by the waiver. That is intended to mean the partnership is bound, notwithstanding a subsequent waiver of dissolution and resumption of its business, by a transaction entered into after dissolution that was appropriate for winding up the partnership business, even if **not** appropriate for continuing the business. Similarly, any rights of a third party arising out of conduct in reliance on the dissolution are protected, absent knowledge (or notification) of the waiver. Thus, for example, a partnership loan, callable upon dissolution, that has been called is not reinstated by a subsequent waiver. If the loan has not been

called before the lender learns (or is notified) of the waiver, however, it may not thereafter be called because of the dissolution. On the other hand, a waiver does not reinstate a lease that is terminated by the dissolution itself.

SECTION 803. RIGHT TO WIND UP PARTNERSHIP BUSINESS.

(a) After dissolution, a partner who has not wrongfully dissociated may participate in winding up the partnership's business, but on application of any partner, partner's legal representative, or transferee, the [designate the appropriate court], for good cause shown, may order judicial supervision of the winding up.

(b) The legal representative of the last surviving partner may wind up a partnership's business.

(c) A person winding up a partnership's business may preserve the partnership business or property as a going concern for a reasonable time, prosecute and defend actions and proceedings, whether civil, criminal, or administrative, settle and close the partnership's business, dispose of and transfer the partnership's property, discharge the partnership's liabilities, distribute the assets of the partnership pursuant to Section 807, settle disputes by mediation or arbitration, and perform other necessary acts.

Comment

Section 803(a) is drawn from UPA Section 37. It provides that the partners who have not wrongfully dissociated may participate in winding up the partnership business. Wrongful dissociation is defined in Section 602. On application of any partner, a court may for good cause judicially supervise the winding up.

Section 803(b) continues the rule of UPA Section 25(2)(d) that the legal representative of the last surviving partner may wind up the business. It makes clear that the representative of the last surviving partner will not be forced to go to court

for authority to wind up the business. On the other hand, the legal representative of a deceased partner, other than the last surviving partner, has only the rights of a transferee of the deceased partner's transferable interest. See Comment 8 to Section 601.

Section 803(c) is new and provides further guidance on the powers of a person who is winding up the business. It is based on Delaware Laws, Title 6, Section 17-803. The powers enumerated are not intended to be exclusive.

Subsection (c) expressly authorizes the preservation of the partnership's business or property as a going concern for a reasonable time. Some courts have reached that result without benefit of statutory authority. *See, e.g., Paciaroni v. Crane*, 408 A.2d 946 (Del. Ch. 1979). An agreement to continue the partnership business in order to preserve its going-concern value until sale is not a waiver of a partner's right to have the business liquidated.

The authorization of mediation and arbitration implements Conference policy to encourage alternative dispute resolution.

A partner's fiduciary duties of care and loyalty under Section 404 extend to winding up the business, except as modified by Section 603(b).

SECTION 804. PARTNER'S POWER TO BIND PARTNERSHIP AFTER DISSOLUTION. Subject to Section 805, a partnership is bound by a partner's act after dissolution that:

(1) is appropriate for winding up the partnership business; or

(2) would have bound the partnership under Section 301 before dissolution, if the other party to the transaction did not have notice of the dissolution.

Comment

Section 804 is the successor to UPA Sections 33(2) and 35, which wind down the authority of partners to bind the partnership to third persons.

Section 804(1) provides that partners have the authority to bind the partnership after dissolution in transactions that are appropriate for winding-up the

partnership business. Section 804(2) provides that partners also have the power after dissolution to bind the partnership in transactions that are inconsistent with winding up. The partnership is bound in a transaction not appropriate for winding up, however, only if the partner's act would have bound the partnership under Section 301 before dissolution and the other party to the transaction did not have notice of the dissolution. *See* Section 102(b) (notice). Compare Section 301(1) (partner has apparent authority unless other party knows or has received a notification of lack of authority).

Section 804(2) attempts to balance the interests of the partners to terminate their mutual agency authority against the interests of outside creditors who have no notice of the partnership's dissolution. Even if the partnership is not bound under Section 804, the faithless partner who purports to act for the partnership after dissolution may be liable individually to an innocent third party under the law of agency. See Section 330 of the Restatement (Second) of Agency (agent liable for misrepresentation of authority), applicable under RUPA as provided in Section 104(a).

RUPA eliminates the special and confusing UPA rules limiting the authority of partners after dissolution. The special protection afforded by UPA Section 35(1)(b)(I) to former creditors and the lesser special protection afforded by UPA Section 35(1)(b)(II) to other parties who knew of the partnership before dissolution are both abolished. RUPA eschews these cumbersome notice provisions in favor of the general apparent authority rules of Section 301, subject to the effect of a filed or recorded statement of dissolution under Section 805. This enhances the protection of innocent third parties and imposes liability on the partnership and the partners who choose their fellow partner-agents and are in the best position to protect others by providing notice of the dissolution.

Also deleted are the special rules for unknown partners in UPA Section 35(2) and for certain causes of dissolution in UPA Section 35(3). Those, too, are inconsistent with RUPA's policy of adhering more closely to the general agency rules of Section 301.

Section 804 should be contrasted with Section 702, which winds down the power of a partner being bought out. The power of a dissociating partner is limited to transactions entered into within two years after the partner's dissociation. Section 804 has no time limitation. However, the apparent authority of partners in both situations is now subject to the filing of a statement of dissociation or dissolution, as the case may be, which operates to cut off such authority after 90 days.

SECTION 805. STATEMENT OF DISSOLUTION.

(a) After dissolution, a partner who has not wrongfully dissociated may file a statement of dissolution stating the name of the partnership and that the partnership has dissolved and is winding up its business.

(b) A statement of dissolution cancels a filed statement of partnership authority for the purposes of Section 303(d) and is a limitation on authority for the purposes of Section 303(e).

(c) For the purposes of Sections 301 and 804, a person not a partner is deemed to have notice of the dissolution and the limitation on the partners' authority as a result of the statement of dissolution 90 days after it is filed.

(d) After filing and, if appropriate, recording a statement of dissolution, a dissolved partnership may file and, if appropriate, record a statement of partnership authority which will operate with respect to a person not a partner as provided in Section 303(d) and (e) in any transaction, whether or not the transaction is appropriate for winding up the partnership business.

Comment

1. Section 805 is new. Subsection (a) provides that, after an event of dissolution, any partner who has not wrongfully dissociated may file a statement of dissolution on behalf of the partnership. The filing and recording of a statement of dissolution is optional. The execution, filing, and recording of the statement is governed by Section 105. The legal consequences of filing a statement of dissolution are similar to those of a statement of dissociation under Section 704.

2. Subsection (b) provides that a statement of dissolution cancels a filed statement of partnership authority for the purposes of Section 303(d), thereby terminating any extraordinary grant of authority contained in that statement.

A statement of dissolution also operates as a limitation on authority for the purposes of Section 303(e). That section provides that third parties are deemed to know of a limitation on the authority of a partner to transfer real property held in the name of the partnership if a certified copy of the statement containing the limitation is recorded with the real estate records. In effect, a properly recorded statement of dissolution restricts the authority of all partners to real property transfers that are appropriate for winding up the business. Thus, third parties must inquire of the partnership whether a contemplated real property transfer is appropriate for winding up. After dissolution, the partnership may, however, file and record a new statement of authority that will bind the partnership under Section 303(d).

3. Subsection (c) operates in conjunction with Sections 301 and 804 to wind down partners' apparent authority after dissolution. It provides that, for purposes of those sections, 90 days after the filing of a statement of dissolution nonpartners are deemed to have notice of the dissolution and the corresponding limitation on the authority of all partners. Sections 301 and 804 provide that a partner's lack of authority is binding on persons with notice thereof. Thus, after 90 days the statement of dissolution operates as constructive notice conclusively limiting the apparent authority of partners to transactions that are appropriate for winding up the business.

4. Subsection (d) provides that, after filing and, if appropriate, recording a statement of dissolution, the partnership may file and record a new statement of partnership authority that will operate as provided in Section 303(d). A grant of authority contained in that statement is conclusive and may be relied upon by a person who gives value without knowledge to the contrary, whether or not the transaction is appropriate for winding up the partnership business. That makes the partners' record authority conclusive after dissolution, and precludes going behind the record to inquire into whether or not the transaction was appropriate for winding up.

SECTION 806. PARTNER'S LIABILITY TO OTHER PARTNERS AFTER DISSOLUTION.

(a) Except as otherwise provided in subsection (b) and Section 306, after dissolution a partner is liable to the other partners for the partner's share of any partnership liability incurred under Section 804.

(b) A partner who, with knowledge of the dissolution, incurs a partnership liability under Section 804(2) by an act that is not appropriate for winding up the partnership business is liable to the partnership for any damage caused to the partnership arising from the liability.

Comment

Section 806 is the successor to UPA Sections 33(1) and 34, which govern the rights of partners among themselves with respect to post-dissolution liability.

Subsection (a) provides that, except as provided in Section 306(a) and subsection (b), after dissolution each partner is liable to the other partners by way of contribution for his share of any partnership liability incurred under Section 804. That includes not only obligations that are appropriate for winding up the business, but also obligations that are inappropriate if within the partner's apparent authority. Consistent with other provisions of this Act, Section 806(a) makes clear that a partner does not have a contribution obligation with regard to limited liability partnership obligations for which the partner is not liable under Section 306. See Comments to Section 401(b).

Subsection (a) draws no distinction as to the cause of dissolution. Thus, as among the partners, their liability is treated alike in all events of dissolution. That is a change from UPA Section 33(l).

Subsection (b) creates an exception to the general rule in subsection (a). It provides that a partner, who with knowledge of the winding up nevertheless incurs a liability binding on the partnership by an act that is inappropriate for winding up the business, is liable to the partnership for any loss caused thereby.

Section 806 is merely a default rule and may be varied in the partnership agreement. *See* Section 103(a).

SECTION 807. SETTLEMENT OF ACCOUNTS AND CONTRIBUTIONS AMONG PARTNERS.

(a) In winding up a partnership's business, the assets of the partnership, including the contributions of the partners required by this section, must be applied

to discharge its obligations to creditors, including, to the extent permitted by law, partners who are creditors. Any surplus must be applied to pay in cash the net amount distributable to partners in accordance with their right to distributions under subsection (b).

(b) Each partner is entitled to a settlement of all partnership accounts upon winding up the partnership business. In settling accounts among the partners, profits and losses that result from the liquidation of the partnership assets must be credited and charged to the partners' accounts. The partnership shall make a distribution to a partner in an amount equal to any excess of the credits over the charges in the partner's account. A partner shall contribute to the partnership an amount equal to any excess of the charges over the credits in the partner's account but excluding from the calculation charges attributable to an obligation for which the partner is not personally liable under Section 306.

(c) If a partner fails to contribute the full amount required under subsection (b), all of the other partners shall contribute, in the proportions in which those partners share partnership losses, the additional amount necessary to satisfy the partnership obligations for which they are personally liable under Section 306. A partner or partner's legal representative may recover from the other partners any contributions the partner makes to the extent the amount contributed exceeds that partner's share of the partnership obligations for which the partner is personally liable under Section 306.

(d) After the settlement of accounts, each partner shall contribute, in the proportion in which the partner shares partnership losses, the amount necessary to satisfy partnership obligations that were not known at the time of the settlement and for which the partner is personally liable under Section 306.

(e) The estate of a deceased partner is liable for the partner's obligation to contribute to the partnership.

(f) An assignee for the benefit of creditors of a partnership or a partner, or a person appointed by a court to represent creditors of a partnership or a partner, may enforce a partner's obligation to contribute to the partnership.

Comment

1. Section 807 provides the default rules for the settlement of accounts and contributions among the partners in winding up the business. It is derived in part from UPA Sections 38(1) and 40.

2. Subsection (a) continues the rule in UPA Section 38(l) that, in winding up the business, the partnership assets must first be applied to discharge partnership liabilities to creditors. For this purpose, any required contribution by the partners is treated as an asset of the partnership. After the payment of all partnership liabilities, any surplus must be applied to pay in cash the net amount due the partners under subsection (b) by way of a liquidating distribution.

RUPA continues the "in-cash" rule of UPA Section 38(1) and is consistent with Section 402, which provides that a partner has no right to receive, and may not be required to accept, a distribution in kind, unless otherwise agreed. The in-cash rule avoids the valuation problems that afflict unwanted in-kind distributions.

The partnership must apply its assets to discharge the obligations of partners who are creditors on a parity with other creditors. See Section 404(f) and Comment 6. In effect, that abolishes the priority rules in UPA Section 40(b) and (c) which subordinate the payment of inside debt to outside debt. Both RULPA and the RMBCA do likewise. *See* RULPA § 804; RMBCA §§ 6.40(f), 14.05(a). Ultimately, however, a partner whose "debt" has been repaid by the partnership is personally liable, as a partner, for any outside debt remaining unsatisfied, unlike a limited partner or corporate shareholder. Accordingly, the obligation to contribute

sufficient funds to satisfy the claims of outside creditors may result in the equitable subordination of inside debt when partnership assets are insufficient to satisfy all obligations to non-partners.

RUPA in effect abolishes the "dual priority" or "jingle" rule of UPA Section 40(h) and (i). Those sections gave partnership creditors priority as to partnership property and separate creditors priority as to separate property. The jingle rule has already been preempted by the Bankruptcy Code, at least as to Chapter 7 partnership liquidation proceedings. Under Section 723(c) of the Bankruptcy Code, and under RUPA, partnership creditors share pro rata with the partners' individual creditors in the assets of the partners' estates.

3. Subsection (b) provides that each partner is entitled to a settlement of all partnership accounts upon winding up. It also establishes the default rules for closing out the partners' accounts. First, the profits and losses resulting from the liquidation of the partnership assets must be credited or charged to the partners' accounts, according to their respective shares of profits and losses. Then, the partnership must make a final liquidating distribution to those partners with a positive account balance. That distribution should be in the amount of the excess of credits over the charges in the account. Any partner with a negative account balance must contribute to the partnership an amount equal to the excess of charges over the credits in the account provided the excess relates to an obligation for which the partner is personally liable under Section 306. The partners may, however, agree that a negative account does not reflect a debt to the partnership and need not be repaid in settling the partners' accounts.

Section 807(b) makes clear that a partner's contribution obligation to a partnership in dissolution only considers the partner's share of obligations for which the partner was personally liable under Section 306 ("unshielded obligations"). See Comments to Section 401(b) (partner contribution obligation to an operating partnership). Properly determined under this Section, the total required partner contributions will be sufficient to satisfy the partnership's total unshielded obligations. In special circumstances where a partnership has both shielded and unshielded obligations and the partner required contributions are used to first pay shielded partnership obligations, the partners may be required to make further contributions to satisfy the partnership unpaid unshielded obligations. The proper resolution of this matter is left to debtor-creditor law as well as the law governing the fiduciary obligations of the partners. See Section 104(a).

RUPA eliminates the distinction in UPA Section 40(b) between the liability owing to a partner in respect of capital and the liability owing in respect of profits. Section 807(b) speaks simply of the right of a partner to a liquidating distribution. That implements the logic of RUPA Sections 401(a) and 502 under which

contributions to capital and shares in profits and losses combine to determine the right to distributions. The partners may, however, agree to share "operating" losses differently from "capital" losses, thereby continuing the UPA distinction.

4. Subsection (c) continues the UPA Section 40(d) rule that solvent partners share proportionately in the shortfall caused by insolvent partners who fail to contribute their proportionate share. The partnership may enforce a partner's obligation to contribute. *See* Section 405(a). A partner is entitled to recover from the other partners any contributions in excess of that partner's share of the partnership's liabilities. *See* Section 405(b)(iii).

5. Subsection (d) provides that, after settling the partners' accounts, each partner must contribute, in the proportion in which he shares losses, the amount necessary to satisfy partnership obligations that were not known at the time of the settlement. That continues the basic rule of UPA Section 40(d) and underscores that the obligation to contribute exists independently of the partnership's books of account. It specifically covers the situation of a partnership liability that was unknown when the partnership books were closed.

6. Under subsection (e), the estate of a deceased partner is liable for the partner's obligation to contribute to partnership losses. That continues the rule of UPA Section 40(g).

7. Subsection (f) provides that an assignee for the benefit of creditors of the partnership or of a partner (or other court appointed creditor representative) may enforce any partner's obligation to contribute to the partnership. That continues the rules of UPA Sections 36(4) and 40(e).

[ARTICLE] 9

CONVERSIONS AND MERGERS

SECTION 901. DEFINITIONS. In this [article]:

(1) "General partner" means a partner in a partnership and a general partner in a limited partnership.

(2) "Limited partner" means a limited partner in a limited partnership.

(3) "Limited partnership" means a limited partnership created under the [State Limited Partnership Act], predecessor law, or comparable law of another jurisdiction.

(4) "Partner" includes both a general partner and a limited partner.

Comment

1. Article 9 is new. The UPA is silent with respect to the conversion or merger of partnerships, and thus it is necessary under the UPA to structure those types of transactions as asset transfers. RUPA provides specific statutory authority for conversions and mergers. It provides for continuation of the partnership entity, thereby simplifying those transactions and adding certainty to the legal consequences.

A number of States currently authorize the merger of limited partnerships, and some authorize them to merge with other business entities such as corporations and limited liability companies. A few States currently authorize the merger of a general and a limited partnership or the conversion of a general to a limited partnership.

2. As Section 908 makes clear, the requirements of Article 9 are not mandatory, and a partnership may convert or merge in any other manner provided by law. Article 9 is merely a "safe harbor." If the requirements of the article are followed, the conversion or merger is legally valid. Since most States have no other established procedure for the conversion or merger of partnerships, it is likely that the Article 9 procedures will be used in virtually all cases.

3. Article 9 does not restrict the provisions authorizing conversions and mergers to domestic partnerships. Since no filing is required for the creation of a partnership under RUPA, it is often unclear where a partnership is domiciled. Moreover, a partnership doing business in the State satisfies the definition of a partnership created under this Act since it is an association of two or more co-owners carrying on a business for profit. Even a partnership clearly domiciled in another State could easily amend its partnership agreement to provide that its internal affairs are to be governed by the laws of a jurisdiction that has enacted Article 9 of RUPA. No harm is likely to result from extending to foreign partnerships the right to convert or merge under local law.

4. Because Article 9 deals with the conversion and merger of both general and limited partnerships, Section 901 sets forth four definitions distinguishing between the two types of partnerships solely for the purposes of Article 9. "Partner" includes both general and limited partners, and "general partner" includes general partners in both general and limited partnerships.

SECTION 902. CONVERSION OF PARTNERSHIP TO LIMITED PARTNERSHIP.

(a) A partnership may be converted to a limited partnership pursuant to this section.

(b) The terms and conditions of a conversion of a partnership to a limited partnership must be approved by all of the partners or by a number or percentage specified for conversion in the partnership agreement.

(c) After the conversion is approved by the partners, the partnership shall file a certificate of limited partnership in the jurisdiction in which the limited partnership is to be formed. The certificate must include:

(1) a statement that the partnership was converted to a limited partnership from a partnership;

(2) its former name; and

(3) a statement of the number of votes cast by the partners for and against the conversion and, if the vote is less than unanimous, the number or percentage required to approve the conversion under the partnership agreement.

(d) The conversion takes effect when the certificate of limited partnership is filed or at any later date specified in the certificate.

(e) A general partner who becomes a limited partner as a result of the conversion remains liable as a general partner for an obligation incurred by the partnership before the conversion takes effect. If the other party to a transaction with the limited partnership reasonably believes when entering the transaction that the limited partner is a general partner, the limited partner is liable for an obligation incurred by the limited partnership within 90 days after the conversion takes effect. The limited partner's liability for all other obligations of the limited partnership incurred after the conversion takes effect is that of a limited partner as provided in the [State Limited Partnership Act].

Comment

Section 902(a) authorizes the conversion of a "partnership" to a "limited partnership." Section 202(b) limits the usual RUPA definition of "partnership" to general partnerships. That definition is applicable to Article 9. If a limited partnership is contemplated, Article 9 uses the term "limited partnership." See Section 901(3).

Subsection (b) provides that the terms and conditions of the conversion must be approved by all the partners, unless the partnership agreement specifies otherwise for a conversion.

Subsection (c) provides that, after approval, the partnership must file a certificate of limited partnership which includes the requisite information concerning the conversion.

Subsection (d) provides that the conversion takes effect when the certificate is filed, unless a later effective date is specified.

Subsection (e) establishes the partners' liabilities following a conversion. A partner who becomes a limited partner as a result of the conversion remains fully liable as a general partner for any obligation arising before the effective date of the conversion, both to third parties and to other partners for contribution. Third parties who transact business with the converted partnership unaware of a partner's new status as a limited partner are protected for 90 days after the conversion. Since RULPA Section 201(a)(3) requires the certificate of limited partnership to name all of the general partners, and under RUPA Section 902(c) the certificate must also include a statement of the conversion, parties transacting business with the converted partnership can protect themselves by checking the record of the State where the limited partnership is formed (the State where the conversion takes place). A former general partner who becomes a limited partner as a result of the conversion can avoid the lingering 90-day exposure to liability as a general partner by notifying those transacting business with the partnership of his limited partner status.

Although Section 902 does not expressly provide that a partner's withdrawal upon a term partnership's conversion to a limited partnership is rightful, it was assumed that the unanimity requirement for the approval of a conversion would afford a withdrawing partner adequate opportunity to protect his interest as a condition of approval. This question is left to the partnership agreement if it provides for conversion without the approval of all the partners.

SECTION 903. CONVERSION OF LIMITED PARTNERSHIP TO PARTNERSHIP.

(a) A limited partnership may be converted to a partnership pursuant to this section.

(b) Notwithstanding a provision to the contrary in a limited partnership agreement, the terms and conditions of a conversion of a limited partnership to a partnership must be approved by all of the partners.

(c) After the conversion is approved by the partners, the limited partnership shall cancel its certificate of limited partnership.

(d) The conversion takes effect when the certificate of limited partnership is canceled.

(e) A limited partner who becomes a general partner as a result of the conversion remains liable only as a limited partner for an obligation incurred by the limited partnership before the conversion takes effect. Except as otherwise provided in Section 306, the partner is liable as a general partner for an obligation of the partnership incurred after the conversion takes effect.

Comment

Section 903(a) authorizes the conversion of a limited partnership to a general partnership.

Subsection (b) provides that the conversion must be approved by all of the partners, even if the partnership agreement provides to the contrary. That includes all of the general and limited partners. *See* Section 901(4). The purpose of the unanimity requirement is to protect a limited partner from exposure to personal liability as a general partner without clear and knowing consent at the time of conversion. Despite a general voting provision to the contrary in the partnership agreement, conversion to a general partnership may never have been contemplated by the limited partner when the partnership investment was made.

Subsection (c) provides that, after approval of the conversion, the converted partnership must cancel its certificate of limited partnership. *See* RULPA § 203.

Subsection (d) provides that the conversion takes effect when the certificate of limited partnership is canceled.

Subsection (e) provides that a limited partner who becomes a general partner is liable as a general partner for all partnership obligations for which a general partner would otherwise be personally liable for if incurred after the effective date of the conversion, but still has only limited liability for obligations incurred before the conversion.

SECTION 904. EFFECT OF CONVERSION; ENTITY UNCHANGED.

(a) A partnership or limited partnership that has been converted pursuant to this [article] is for all purposes the same entity that existed before the conversion.

(b) When a conversion takes effect:

(1) all property owned by the converting partnership or limited partnership remains vested in the converted entity;

(2) all obligations of the converting partnership or limited partnership continue as obligations of the converted entity; and

(3) an action or proceeding pending against the converting partnership or limited partnership may be continued as if the conversion had not occurred.

Comment

Section 904 sets forth the effect of a conversion on the partnership. Subsection (a) provides that the converted partnership is for all purposes the same entity as before the conversion.

Subsection (b) provides that upon conversion: (1) all partnership property remains vested in the converted entity; (2) all obligations remain the obligations of the converted entity; and (3) all pending legal actions may be continued as if the conversion had not occurred. The term "entity" as used in Article 9 refers to either or both general and limited partnerships as the context requires.

Under subsection (b)(1), title to partnership property remains vested in the converted partnership. As a matter of general property law, title remains vested without further act or deed and without reversion or impairment.

SECTION 905. MERGER OF PARTNERSHIPS.

(a) Pursuant to a plan of merger approved as provided in subsection (c), a partnership may be merged with one or more partnerships or limited partnerships.

(b) The plan of merger must set forth:

(1) the name of each partnership or limited partnership that is a party to the merger;

(2) the name of the surviving entity into which the other partnerships or limited partnerships will merge;

(3) whether the surviving entity is a partnership or a limited partnership and the status of each partner;

(4) the terms and conditions of the merger;

(5) the manner and basis of converting the interests of each party to the merger into interests or obligations of the surviving entity, or into money or other property in whole or part; and

(6) the street address of the surviving entity's chief executive office.

(c) The plan of merger must be approved:

(1) in the case of a partnership that is a party to the merger, by all of the partners, or a number or percentage specified for merger in the partnership agreement; and

(2) in the case of a limited partnership that is a party to the merger, by the vote required for approval of a merger by the law of the State or foreign jurisdiction in which the limited partnership is organized and, in the absence of such a specifically applicable law, by all of the partners, notwithstanding a provision to the contrary in the partnership agreement.

(d) After a plan of merger is approved and before the merger takes effect, the plan may be amended or abandoned as provided in the plan.

(e) The merger takes effect on the later of:

(1) the approval of the plan of merger by all parties to the merger, as provided in subsection (c);

(2) the filing of all documents required by law to be filed as a condition to the effectiveness of the merger; or

(3) any effective date specified in the plan of merger.

Comment

Section 905 provides a "safe harbor" for the merger of a general partnership and one or more general or limited partnerships. The surviving entity may be either a general or a limited partnership.

The plan of merger must set forth the information required by subsection (b), including the status of each partner and the manner and basis of converting the interests of each party to the merger into interests or obligations of the surviving entity.

Subsection (c) provides that the plan of merger must be approved: (1) by all the partners of each general partnership that is a party to the merger, unless its partnership agreement specifically provides otherwise for mergers; and (2) by all the partners, including both general and limited partners, of each limited partnership that is a party to the merger, notwithstanding a contrary provision in its partnership agreement, unless specifically authorized by the law of the jurisdiction in which that limited partnership is organized. Like Section 902(b), the purpose of the unanimity requirement is to protect limited partners from exposure to liability as general partners without their clear and knowing consent.

Subsection (d) provides that the plan of merger may be amended or abandoned at any time before the merger takes effect, if the plan so provides.

Subsection (e) provides that the merger takes effect on the later of: (1) approval by all parties to the merger; (2) filing of all required documents; or (3) the effective date specified in the plan. The surviving entity must file all notices and documents relating to the merger required by other applicable statutes governing the

entities that are parties to the merger, such as articles of merger or a certificate of limited partnership. It may also amend or cancel a statement of partnership authority previously filed by any party to the merger.

SECTION 906. EFFECT OF MERGER.

(a) When a merger takes effect:

(1) the separate existence of every partnership or limited partnership that is a party to the merger, other than the surviving entity, ceases;

(2) all property owned by each of the merged partnerships or limited partnerships vests in the surviving entity;

(3) all obligations of every partnership or limited partnership that is a party to the merger become the obligations of the surviving entity; and

(4) an action or proceeding pending against a partnership or limited partnership that is a party to the merger may be continued as if the merger had not occurred, or the surviving entity may be substituted as a party to the action or proceeding.

(b) The [Secretary of State] of this State is the agent for service of process in an action or proceeding against a surviving foreign partnership or limited partnership to enforce an obligation of a domestic partnership or limited partnership that is a party to a merger. The surviving entity shall promptly notify the [Secretary of State] of the mailing address of its chief executive office and of any change of address. Upon receipt of process, the [Secretary of State] shall mail a copy of the process to the surviving foreign partnership or limited partnership.

(c) A partner of the surviving partnership or limited partnership is liable for:

(1) all obligations of a party to the merger for which the partner was personally liable before the merger;

(2) all other obligations of the surviving entity incurred before the merger by a party to the merger, but those obligations may be satisfied only out of property of the entity; and

(3) except as otherwise provided in Section 306, all obligations of the surviving entity incurred after the merger takes effect, but those obligations may be satisfied only out of property of the entity if the partner is a limited partner.

(d) If the obligations incurred before the merger by a party to the merger are not satisfied out of the property of the surviving partnership or limited partnership, the general partners of that party immediately before the effective date of the merger shall contribute the amount necessary to satisfy that party's obligations to the surviving entity, in the manner provided in Section 807 or in the [Limited Partnership Act] of the jurisdiction in which the party was formed, as the case may be, as if the merged party were dissolved.

(e) A partner of a party to a merger who does not become a partner of the surviving partnership or limited partnership is dissociated from the entity, of which that partner was a partner, as of the date the merger takes effect. The surviving entity shall cause the partner's interest in the entity to be purchased under Section 701 or another statute specifically applicable to that partner's interest with respect

to a merger. The surviving entity is bound under Section 702 by an act of a general partner dissociated under this subsection, and the partner is liable under Section 703 for transactions entered into by the surviving entity after the merger takes effect.

Comment

Section 906 states the effect of a merger on the partnerships that are parties to the merger and on the individual partners.

Subsection (a) provides that when the merger takes effect: (1) the separate existence of every partnership that is a party to the merger (other than the surviving entity) ceases; (2) all property owned by the parties to the merger vests in the surviving entity; (3) all obligations of every party to the merger become the obligations of the surviving entity; and (4) all legal actions pending against a party to the merger may be continued as if the merger had not occurred or the surviving entity may be substituted as a party. Title to partnership property vests in the surviving entity without further act or deed and without reversion or impairment.

Subsection (b) makes the Secretary of State the agent for service of process in any action against the surviving entity, if it is a foreign entity, to enforce an obligation of a domestic partnership that is a party to the merger. The purpose of this rule is to make it more convenient for local creditors to sue a foreign surviving entity when the credit was extended to a domestic partnership that has disappeared as a result of the merger.

Subsection (c) provides that a general partner of the surviving entity is liable for (1) all obligations for which the partner was personally liable before the merger; (2) all other obligations of the surviving entity incurred before the merger by a party to the merger, which obligations may be satisfied only out of the surviving entity's partnership property; and (3) all obligations incurred by the surviving entity after the merger, limited to the surviving entity's property in the case of limited partners and also limited to obligations of the partnership for which the partner was personally liable under Section 306.

This scheme of liability is similar to that of an incoming partner under Section 306(b). Only the surviving partnership itself is liable for all obligations, including obligations incurred by every constituent party before the merger. A general partner of the surviving entity is personally liable for obligations of the surviving entity incurred before the merger by the partnership of which he was a partner and those incurred by the surviving entity after the merger. Thus, a general partner of the surviving entity is liable only to the extent of his partnership interest

for obligations incurred before the merger by a constituent party of which he was not a general partner.

Subsection (d) requires general partners to contribute the amount necessary to satisfy all obligations for which they were personally liable before the merger, if such obligations are not satisfied out of the partnership property of the surviving entity, in the same manner as provided in Section 807 or the limited partnership act of the applicable jurisdiction, as if the merged party were then dissolved. *See* RULPA §§ 502, 608.

Subsection (e) provides for the dissociation of a partner of a party to the merger who does not become a partner in the surviving entity. The surviving entity must buy out that partner's interest in the partnership under Section 701 or other specifically applicable statute. If the state limited partnership act has a dissenter's rights provision providing a different method of determining the amount due a dissociating limited partner, it would apply, rather than Section 701, since the two statutes should be read *in pari materia*.

Although subsection (e) does not expressly provide that a partner's withdrawal upon the merger of a term partnership is rightful, it was assumed that the unanimity requirement for the approval of a merger would afford a withdrawing partner adequate opportunity to protect his interest as a condition of approval. This question is left to the partnership agreement if it provides for merger without the approval of all the partners.

Under subsection (e), a dissociating general partner's lingering agency power is wound down, pursuant to Section 702, the same as in any other dissociation. Moreover, a dissociating general partner may be liable, under Section 703, for obligations incurred by the surviving entity for up to two years after the merger. A dissociating general partner can, however, limit to 90 days his exposure to liability by filing a statement of dissociation under Section 704.

SECTION 907. STATEMENT OF MERGER.

(a) After a merger, the surviving partnership or limited partnership may file a statement that one or more partnerships or limited partnerships have merged into the surviving entity.

(b) A statement of merger must contain:

(1) the name of each partnership or limited partnership that is a party to the merger;

(2) the name of the surviving entity into which the other partnerships or limited partnership were merged;

(3) the street address of the surviving entity's chief executive office and of an office in this State, if any; and

(4) whether the surviving entity is a partnership or a limited partnership.

(c) Except as otherwise provided in subsection (d), for the purposes of Section 302, property of the surviving partnership or limited partnership which before the merger was held in the name of another party to the merger is property held in the name of the surviving entity upon filing a statement of merger.

(d) For the purposes of Section 302, real property of the surviving partnership or limited partnership which before the merger was held in the name of another party to the merger is property held in the name of the surviving entity upon recording a certified copy of the statement of merger in the office for recording transfers of that real property.

(e) A filed and, if appropriate, recorded statement of merger, executed and declared to be accurate pursuant to Section 105(c), stating the name of a partnership or limited partnership that is a party to the merger in whose name property was held before the merger and the name of the surviving entity, but not containing all of the other information required by subsection (b), operates with respect to the

partnerships or limited partnerships named to the extent provided in subsections (c) and (d).

Comment

Section 907(a) provides that the surviving entity may file a statement of merger. The execution, filing, and recording of the statement are governed by Section 105.

Subsection (b) requires the statement to contain the name of each party to the merger, the name and address of the surviving entity, and whether it is a general or limited partnership.

Subsection (c) provides that, for the purpose of the Section 302 rules regarding the transfer of partnership property, all personal and intangible property which before the merger was held in the name of a party to the merger becomes, upon the filing of the statement of merger with the Secretary of State, property held in the name of the surviving entity.

Subsection (d) provides a similar rule for real property, except that real property does not become property held in the name of the surviving entity until a certified copy of the statement of merger is recorded in the office for recording transfers of that real property under local law.

Subsection (e) is a savings provision in the event a statement of merger fails to contain all of the information required by subsection (b). The statement will have the operative effect provided in subsections (c) and (d) if it is executed and declared to be accurate pursuant to Section 105(e) and correctly states the name of the party to the merger in whose name the property was held before the merger, so that it would be found by someone searching the record. Compare Section 303(c) (statement of partnership authority).

SECTION 908. NONEXCLUSIVE. This [article] is not exclusive. Partnerships or limited partnerships may be converted or merged in any other manner provided by law.

Comment

Section 908 provides that Article 9 is not exclusive. It is merely a "safe harbor." Partnerships may be converted or merged in any other manner provided by

statute or common law. Existing statutes in a few States already authorize the conversion or merger of general partnerships and limited partnerships. See Comment 1 to Section 901. Those procedures may be followed in lieu of Article 9.

[ARTICLE] 10

LIMITED LIABILITY PARTNERSHIP

SECTION 1001. STATEMENT OF QUALIFICATION.

(a) A partnership may become a limited liability partnership pursuant to this section.

(b) The terms and conditions on which a partnership becomes a limited liability partnership must be approved by the vote necessary to amend the partnership agreement except, in the case of a partnership agreement that expressly considers obligations to contribute to the partnership, the vote necessary to amend those provisions.

(c) After the approval required by subsection (b), a partnership may become a limited liability partnership by filing a statement of qualification. The statement must contain:

(1) the name of the partnership;

(2) the street address of the partnership's chief executive office and, if different, the street address of an office in this State, if any;

(3) if the partnership does not have an office in this State, the name and street address of the partnership's agent for service of process;

(4) a statement that the partnership elects to be a limited liability partnership; and

(5) a deferred effective date, if any.

(d) The agent of a limited liability partnership for service of process must be an individual who is a resident of this State or other person authorized to do business in this State.

(e) The status of a partnership as a limited liability partnership is effective on the later of the filing of the statement or a date specified in the statement. The status remains effective, regardless of changes in the partnership, until it is canceled pursuant to Section 105(d) or revoked pursuant to Section 1003.

(f) The status of a partnership as a limited liability partnership and the liability of its partners is not affected by errors or later changes in the information required to be contained in the statement of qualification under subsection (c).

(g) The filing of a statement of qualification establishes that a partnership has satisfied all conditions precedent to the qualification of the partnership as a limited liability partnership.

(h) An amendment or cancellation of a statement of qualification is effective when it is filed or on a deferred effective date specified in the amendment or cancellation.

Comment

Any partnership may become a limited liability partnership by filing a statement of qualification. See Comments to Sections 101(6) and 202(b) regarding a limited partnership filing a statement of qualification to become a limited liability limited partnership. Section 1001 sets forth the required contents of a statement of qualification. The section also sets forth requirements for the approval of a statement of qualification, establishes the effective date of the filing (and any amendments) which remains effective until canceled or revoked, and provides that the liability of the partners of a limited liability partnership is not affected by errors or later changes in the statement information.

Subsection (b) provides that the terms and conditions on which a partnership becomes a limited liability partnership must be generally be approved by the vote necessary to amend the partnership agreement. This means that the act of becoming a limited liability partnership is equivalent to an amendment of the partnership agreement. Where the partnership agreement is silent as to how it may be amended, the subsection (b) vote requires the approval of every partner. Since the limited liability partnership rules are not intended to increase the vote necessary to amend the partnership agreement, where the partnership agreement specifically sets forth an amendment process, that process may be used. Where a partnership agreement sets forth several amendment procedures depending upon the nature of the amendment, the required vote will be that necessary to amend the contribution obligations of the partners. The specific "contribution" vote is preferred because the filing of the statement directly affects partner contribution obligations. Therefore, the language "considers contribution" should be broadly interpreted to include any amendment vote that indirectly affects any partner's contribution obligation such as a partner's obligation to "indemnify" other partners.

The unanimous vote default rule reflects the significance of a partnership becoming a limited liability partnership. In general, upon such a filing each partner is released from the personal contribution obligation imposed under this Act in exchange for relinquishing the right to enforce the contribution obligations of other partners under this Act. See Comments to Sections 306(c) and 401(b). The wisdom of this bargain will depend on many factors including the relative risks of the partners' duties and the assets of the partnership.

Subsection (c) sets forth the information required in a statement of qualification. The must include the name of the partnership which must comply with Section 1002 to identify the partnership as a limited liability partnership. The statement must also include the address of the partnership's chief executive office and, if different, the street address of any other office in this State. A statement must include the name and street address of an agent for service of process only if it does not have any office in this State.

As with other statements, a statement of qualification must be filed in the office of the Secretary of State. See Sections 101(13) and 105(a). Accordingly, a statement of qualification is executed, filed, and otherwise regarded as a statement under this Act. For example, a copy of a filed statement must be sent to every nonfiling partner unless otherwise provided in the partnership agreement. See Sections 105(e) and 103(b)(1). A statement of qualification must be executed by at least two partners under penalties of perjury that the contents of the statement are accurate. See Section 105(c). A person who files the statement must promptly send a copy of the statement to every nonfiling partner but failure to send the copy does not limit the effectiveness of the filed statement to a nonpartner. Section 105(e).

The filing must be accompanied by the fee required by the Secretary of State. Section 105(f).

Subsection (d) makes clear that once a statement is filed and effective, the status of the partnership as a limited liability partnership remains effective until the partnership status is either canceled or revoked "regardless of changes in the partnership." Accordingly, a partnership that dissolves but whose business is continued under a business continuation agreement retains its status as a limited liability partnership without the need to refile a new statement. Also, limited liability partnership status remains even though a partnership may be dissolved, wound up, and terminated. Even after the termination of the partnership, the former partners of a terminated partnership would not be personally liable for partnership obligations incurred while the partnership was a limited liability partnership.

Subsection (d) also makes clear that limited liability partnership status remains effective until actual cancellation under Section 1003 or revocation under Section 105(d). Ordinarily the terms and conditions of becoming a limited liability partnership must be approved by the vote necessary to amend the partnership agreement. See Sections 1001(b), 306(c), and 401(j). Since the statement of cancellation may be filed by a person authorized to file the original statement of qualification, the same vote necessary to approve the filing of the statement of qualification must be obtained to file the statement of cancellation. See Section 105(d).

Subsection (f) provides that once a statement of qualification is executed and filed under subsection (c) and Section 105, the partnership assumes the status of a limited liability partnership. This status is intended to be conclusive with regard to third parties dealing with the partnership. It is not intended to affect the rights of partners. For example, a properly executed and filed statement of qualification conclusively establishes the limited liability shield described in Section 306(c). If the partners executing and filing the statement exceed their authority, the internal abuse of authority has no effect on the liability shield with regard to third parties. Partners may challenge the abuse of authority for purposes of establishing the liability of the culpable partners but may not effect the liability shield as to third parties. Likewise, third parties may not challenge the existence of the liability shield because the decision to file the statement lacked the proper vote. As a result, the filing of the statement creates the liability shield even when the required subsection (b) vote is not obtained.

SECTION 1002. NAME. The name of a limited liability partnership must end with "Registered Limited Liability Partnership", "Limited Liability Partnership", "R.L.L.P.", "L.L.P.", "RLLP," or "LLP".

Comment

The name provisions are intended to alert persons dealing with a limited liability partnership of the presence of the liability shield. Because many jurisdictions have adopted the naming concept of a "registered" limited liability partnership, this aspect has been retained. These name requirements also distinguish limited partnerships and general partnerships that become limited liability partnerships because the new name must be at the end of and in addition to the general or limited partnership's regular name. See Comments to Section 101(6). Since the name identification rules of this section do not alter the regular name of the partnership, they do not disturb historic notions of apparent authority of partners in both general and limited partnerships.

SECTION 1003. ANNUAL REPORT.

(a) A limited liability partnership, and a foreign limited liability partnership authorized to transact business in this State, shall file an annual report in the office of the [Secretary of State] which contains:

(1) the name of the limited liability partnership and the State or other jurisdiction under whose laws the foreign limited liability partnership is formed;

(2) the street address of the partnership's chief executive office and, if different, the street address of an office of the partnership in this State, if any; and

(3) if the partnership does not have an office in this State, the name and street address of the partnership's current agent for service of process.

(b) An annual report must be filed between [January 1 and April 1] of each year following the calendar year in which a partnership files a statement of

qualification or a foreign partnership becomes authorized to transact business in this State.

(c) The [Secretary of State] may revoke the statement of qualification of a partnership that fails to file an annual report when due or pay the required filing fee. To do so, the [Secretary of State] shall provide the partnership at least 60 days' written notice of intent to revoke the statement. The notice must be mailed to the partnership at its chief executive office set forth in the last filed statement of qualification or annual report. The notice must specify the annual report that has not been filed, the fee that has not been paid, and the effective date of the revocation. The revocation is not effective if the annual report is filed and the fee is paid before the effective date of the revocation.

(d) A revocation under subsection (c) only affects a partnership's status as a limited liability partnership and is not an event of dissolution of the partnership.

(e) A partnership whose statement of qualification has been revoked may apply to the [Secretary of State] for reinstatement within two years after the effective date of the revocation. The application must state:

(1) the name of the partnership and the effective date of the revocation; and

(2) that the ground for revocation either did not exist or has been corrected.

(f) A reinstatement under subsection (e) relates back to and takes effect as of the effective date of the revocation, and the partnership's status as a limited liability partnership continues as if the revocation had never occurred.

Comment

Section 1003 sets forth the requirements of an annual report that must be filed by all limited liability partnerships and any foreign limited liability partnership authorized to transact business in this State. See Sections 101(5)(definition of a limited liability partnership) and 101(4)(definition of a foreign limited liability partnership). The failure of a limited liability partnership to file an annual report is a basis for the Secretary of State to administratively revoke its statement of qualification. See Section 1003(c). A foreign limited liability partnership that fails to file an annual report may not maintain an action or proceeding in this State. See Section 1103(a).

Subsection (a) generally requires that an annual report contain the same information required in a statement of qualification. Compare Sections 1001(a) and 1003(a). The differences are that the annual report requires disclosure of the State of formation of a foreign limited liability partnership but deletes the delayed effective date and limited liability partnership election statement provisions of a statement of qualification. As such, the annual report serves to update the information required in a statement of qualification. Under subsection (b), the annual report must be filed between January 1 and April 1 of each calendar year following the year in which a statement of qualification was filed or a foreign limited liability partnership becomes authorized to transact business. This timing requirement means that a limited liability partnership must make an annual filing and may not prefile multiple annual reports in a single year.

Subsection (c) sets forth the procedure for the Secretary of State to administratively revoke a partnership's statement of qualification for the failure to file an annual report when due or pay the required filing fee. The Secretary of State must provide a partnership at least 60 days' written notice of the intent to revoke the statement. The notice must be mailed to the partnership at the address of its chief executive office set forth in the last filed statement or annual report and must state the grounds for revocation as well as the effective date of revocation. The revocation is not effective if the stated problem is cured before the stated effective date.

Under subsection (d), a revocation only terminates the partnership's status as a limited liability partnership but is not an event of dissolution of the partnership itself. Where revocation occurs, a partnership may apply for reinstatement under

subsection (e) within two years after the effective date of the revocation. The application must state that the grounds for revocation either did not exist or have been corrected. The Secretary of State may grant the application on the basis of the statements alone or require proof of correction. Under subsection (f), when the application is granted, the reinstatement relates back to and takes effect as of the effective date of the revocation. The relation back doctrine prevents gaps in a reinstated partnership's liability shield. See Comments to Section 306(c).

[ARTICLE] 11

FOREIGN LIMITED LIABILITY PARTNERSHIP

SECTION 1101. LAW GOVERNING FOREIGN LIMITED LIABILITY PARTNERSHIP.

(a) The law under which a foreign limited liability partnership is formed governs relations among the partners and between the partners and the partnership and the liability of partners for obligations of the partnership.

(b) A foreign limited liability partnership may not be denied a statement of foreign qualification by reason of any difference between the law under which the partnership was formed and the law of this State.

(c) A statement of foreign qualification does not authorize a foreign limited liability partnership to engage in any business or exercise any power that a partnership may not engage in or exercise in this State as a limited liability partnership.

Comment

Section 1101 provides that the laws where a foreign limited liability partnership is formed rather than the laws of this State govern both the internal relations of the partnership and liability of its partners for the obligations of the partnership. See Section 101(4)(definition of a foreign limited liability partnership). Section 106(b) provides that the laws of this State govern the internal relations of a domestic limited liability and the liability of its partners for the obligations of the partnership. See Sections 101(5)(definition of a domestic limited liability partnership). A partnership may therefore chose the laws of a particular jurisdiction by filing a statement of qualification in that jurisdiction. But there are limitations on this choice.

Subsections (b) and (c) together make clear that although a foreign limited liability partnership may not be denied a statement of foreign qualification simply because of a difference between the laws of its foreign jurisdiction and the laws of this State, it may not engage in any business or exercise any power in this State that a domestic limited liability partnership may not engage in or exercise. Under subsection (c), a foreign limited liability partnership that engages in a business or exercises a power in this State that a domestic may not engage in or exercise, does so only as a ordinary partnership without the benefit of the limited liability partnership liability shield set forth in Section 306(c). In this sense, a foreign limited liability partnership is treated the same as a domestic limited liability partnership. Also, the Attorney General may maintain an action to restrain a foreign limited liability partnership from transacting an unauthorized business in this State. See Section 1105.

SECTION 1102. STATEMENT OF FOREIGN QUALIFICATION.

(a) Before transacting business in this State, a foreign limited liability partnership must file a statement of foreign qualification. The statement must contain:

(1) the name of the foreign limited liability partnership which satisfies the requirements of the State or other jurisdiction under whose law it is formed and ends with "Registered Limited Liability Partnership", "Limited Liability Partnership", "R.L.L.P.", "L.L.P.", "RLLP," or "LLP";

(2) the street address of the partnership's chief executive office and, if different, the street address of an office of the partnership in this State, if any;

(3) if there is no office of the partnership in this State, the name and street address of the partnership's agent for service of process; and

(4) a deferred effective date, if any.

(b) The agent of a foreign limited liability company for service of process must be an individual who is a resident of this State or other person authorized to do business in this State.

(c) The status of a partnership as a foreign limited liability partnership is effective on the later of the filing of the statement of foreign qualification or a date specified in the statement. The status remains effective, regardless of changes in the partnership, until it is canceled pursuant to Section 105(d) or revoked pursuant to Section 1003.

(d) An amendment or cancellation of a statement of foreign qualification is effective when it is filed or on a deferred effective date specified in the amendment or cancellation.

Comment

Section 1102 provides that a foreign limited liability partnership must file a statement of foreign qualification before transacting business in this State. The section also sets forth the information required in the statement. As with other statements, a statement of foreign qualification must be filed in the office of the Secretary of State. See Sections 101(13), 105(a), and 1001(c). Accordingly, a statement of foreign qualification is executed, filed, and otherwise regarded as a statement under this Act. See Section 101(13)(definition of a statement includes a statement of foreign qualification).

Subsection (a) generally requires the same information in a statement of foreign qualification as is required in a statement of qualification. Compare Section 1001(c). The statement of foreign qualification must include a name that complies with the requirements for domestic limited liability partnership under Section 1002 and must include the address of the partnership's chief executive office and, if different, the street address of any other office in this State. If a foreign limited liability partnership does not have any office in this State, the statement of foreign qualification must include the name and street address of an agent for service of process.

As with a statement of qualification, a statement of foreign qualification (and amendments) is effective when filed or at a later specified filing date. Compare Sections 1102(b) and (c) with Sections 1001(e) and (h). Likewise, a statement of foreign qualification remains effective until canceled by the partnership or revoked by the Secretary of State, regardless of changes in the partnership. See Sections 105(d) (statement cancellation) and Section 1003 (revocation for failure to file annual report or pay annual filing fee) and Compare Sections 1102(b) and 1001(e). Statement of qualification provisions regarding the relationship of the status of a foreign partnership relative to its initial filing of a statement are governed by foreign law and are therefore omitted from this section. See Sections 1001(f)(effect of errors and omissions) and (g)(filing establishes all conditions precedent to qualification).

SECTION 1103. EFFECT OF FAILURE TO QUALIFY.

(a) A foreign limited liability partnership transacting business in this State may not maintain an action or proceeding in this State unless it has in effect a statement of foreign qualification.

(b) The failure of a foreign limited liability partnership to have in effect a statement of foreign qualification does not impair the validity of a contract or act of the foreign limited liability partnership or preclude it from defending an action or proceeding in this State.

(c) A limitation on personal liability of a partner is not waived solely by transacting business in this State without a statement of foreign qualification.

(d) If a foreign limited liability partnership transacts business in this State without a statement of foreign qualification, the [Secretary of State] is its agent for service of process with respect to a right of action arising out of the transaction of business in this State.

Comment

Section 1103 makes clear that the only consequence of a failure to file a statement of foreign qualification is that the foreign limited liability partnership will not be able to maintain an action or proceeding in this State. The partnership's contracts remain valid, it may defend an action or proceeding, personal liability of the partners is not waived, and the Secretary of State is the agent for service of process with respect to claims arising out of transacting business in this State. Sections 1103(b)-(d). Once a statement of foreign qualification is filed, the Secretary of State may revoke the statement for failure to file an annual report but the partnership has the right to cure the failure for two years. See Section 1003(c) and (e). Since the failure to file a statement of foreign qualification has no impact on the liability shield of the partners, a revocation of a statement of foreign qualification also has no impact on the liability shield created under foreign laws. Compare Sections 1103(c) and 1003(f)(revocation of the statement of qualification of a domestic limited liability partnership removes partner liability shield unless filing problems cured within two years).

SECTION 1104. ACTIVITIES NOT CONSTITUTING TRANSACTING BUSINESS.

(a) Activities of a foreign limited liability partnership which do not constitute transacting business for the purpose of this [article] include:

(1) maintaining, defending, or settling an action or proceeding;

(2) holding meetings of its partners or carrying on any other activity concerning its internal affairs;

(3) maintaining bank accounts;

(4) maintaining offices or agencies for the transfer, exchange, and registration of the partnership's own securities or maintaining trustees or depositories with respect to those securities;

(5) selling through independent contractors;

(6) soliciting or obtaining orders, whether by mail or through employees or agents or otherwise, if the orders require acceptance outside this State before they become contracts;

(7) creating or acquiring indebtedness, with or without a mortgage, or other security interest in property;

(8) collecting debts or foreclosing mortgages or other security interests in property securing the debts, and holding, protecting, and maintaining property so acquired;

(9) conducting an isolated transaction that is completed within 30 days and is not one in the course of similar transactions; and

(10) transacting business in interstate commerce.

(b) For purposes of this [article], the ownership in this State of income-producing real property or tangible personal property, other than property excluded under subsection (a), constitutes transacting business in this State.

(c) This section does not apply in determining the contacts or activities that may subject a foreign limited liability partnership to service of process, taxation, or regulation under any other law of this State.

Comment

Because the Attorney General may restrain a foreign limited liability partnership from transacting an unauthorized business in this State and a foreign partnership may not maintain an action or proceeding in this State, the concept of "transacting business" in this State is important. To provide more certainty, subsection (a) sets forth ten separate categories of activities that do not constitute transacting business. Subsection (c) makes clear that the section only considers the definition of "transacting business" and as no impact on whether a foreign limited

liability partnership's activities in this State subject it to service of process, taxation, or regulation under any other law of this State.

SECTION 1105. ACTION BY [ATTORNEY GENERAL]. The [Attorney General] may maintain an action to restrain a foreign limited liability partnership from transacting business in this State in violation of this [article].

Comment

Section 1105 makes clear that the Attorney General may restrain a foreign limited liability from transacting an unauthorized business in this State. As a threshold matter, a foreign limited liability partnership must be "transacting business" in this State within the meaning of Section 1104. Secondly, the business transacted in this State must be that which could not be engaged in by a domestic limited liability partnership. See Section 1101(c). The fact that a foreign limited liability partnership has a statement of foreign qualification does not permit it to engage in any unauthorized business in this State or impair the power of the Attorney General to restrain the foreign partnership from engaging in the unauthorized business. See Section 1101(c).

[ARTICLE] 12

MISCELLANEOUS PROVISIONS

SECTION 1201. UNIFORMITY OF APPLICATION AND CONSTRUCTION. This [Act] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [Act] among States enacting it.

SECTION 1202. SHORT TITLE. This [Act] may be cited as the Uniform Partnership Act (1994).

SECTION 1203. SEVERABILITY CLAUSE. If any provision of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

SECTION 1204. EFFECTIVE DATE. This [Act] takes effect

. . . .

Comment

The effective date of the Act established by an adopting State has operative effects under Section 1006, which defers mandatory application of the Act to existing partnerships.

SECTION 1205. REPEALS. Effective January 1, 199___, the following acts and parts of acts are repealed: [the State Partnership Act as amended and in effect immediately before the effective date of this [Act]].

Comment

This section repeals the adopting State's present general partnership act. The effective date of the repealer should not be any earlier than the date selected by that State in Section 1206(b) for the application of the Act to all partnerships.

SECTION 1206. APPLICABILITY.

(a) Before January 1, 199___, this [Act] governs only a partnership formed:

(1) after the effective date of this [Act], except a partnership that is continuing the business of a dissolved partnership under [Section 41 of the superseded Uniform Partnership Act]; and

(2) before the effective date of this [Act], that elects, as provided by subsection (c), to be governed by this [Act].

(b) On and after January 1, 199___, this [Act] governs all partnerships.

(c) Before January 1, 199___, a partnership voluntarily may elect, in the manner provided in its partnership agreement or by law for amending the partnership agreement, to be governed by this [Act]. The provisions of this [Act] relating to the liability of the partnership's partners to third parties apply to limit those partners' liability to a third party who had done business with the partnership within one year before the partnership's election to be governed by this [Act] only if the third party

7-201

knows or has received a notification of the partnership's election to be governed by this [Act].

Comment

This section provides for a transition period in the applicability of the Act to existing partnerships, similar to that provided in the revised Texas partnership act. *See* Tex. Rev. Civ. Stat. Ann. art. 6132b-10.03 (Vernon Supp. 1994). Subsection (a) makes application of the Act mandatory for all partnerships formed after the effective date of the Act and permissive, by election, for existing partnerships. That affords existing partnerships and partners an opportunity to consider the changes effected by RUPA and to amend their partnership agreements, if appropriate.

Under subsection (b), application of the Act becomes mandatory for all partnerships, including existing partnerships that did not previously elect to be governed by it, upon a future date to be established by the adopting State. Texas, for example, deferred for five years mandatory compliance by existing partnerships.

Subsection (c) provides that an existing partnership may voluntarily elect to be governed by RUPA in the manner provided for amending its partnership agreement. Under UPA Section 18(h), that requires the consent of all the partners, unless otherwise agreed. Third parties doing business with the partnership must know or be notified of the election before RUPA's rules limiting a partner's liability become effective as to them. Those rules would include, for example, the provisions of Section 704 limiting the liability of a partner 90 days after the filing of a statement of dissociation. Without knowledge of the partnership's election, third parties would not be aware that they must check the record to ascertain the extent of a dissociated partner's personal liability.

SECTION 1207. SAVINGS CLAUSE. This [Act] does not affect an action or proceeding commenced or right accrued before this [Act] takes effect.

Comment

This section continues the prior law after the effective date of the Act with respect to a pending action or proceeding or a right accrued at the time of the effective date. Since courts generally apply the law that exists at the time an action is commenced, in many circumstances the new law of this Act would displace the old law, but for this section.

Almost all States have general savings statutes, usually as part of their statutory construction acts. These are often very broad. Compare Uniform Statute and Rule Construction Act § 16(a) (narrow savings clause). As RUPA is remedial, the more limited savings provisions in Section 1007 are more appropriate than the broad savings provisions of the usual general savings clause. *See generally*, Comment to Uniform Statute and Rule Construction Act § 16.

Pending "action" refers to a judicial proceeding, while "proceeding" is broader and includes administrative proceedings. Although it is not always clear whether a right has "accrued," the term generally means that a cause of action has matured and is ripe for legal redress. *See, e.g., Estate of Hoover v. Iowa Dept. of Social Services*, 299 Iowa 702, 251 N.W.2d 529 (1977); *Nielsen v. State of Wisconsin*, 258 Wis. 1110, 141 N.W.2d 194 (1966). An inchoate right is not enough, and thus, for example, there is no accrued right under a contract until it is breached.

[Sections 1208 through 1211 are necessary only for jurisdictions adopting Uniform Limited Liability Partnership Act Amendments after previously adopting Uniform Partnership Act (1994)]

SECTION 1208. EFFECTIVE DATE. These [Amendments] take effect

....

SECTION 1209. REPEALS. Effective January 1, 199__, the following acts and parts of acts are repealed: [the Limited Liability Partnership amendments to the State Partnership Act as amended and in effect immediately before the effective date of these [Amendments]].

SECTION 1210. APPLICABILITY.

(a) Before January 1, 199__, these [Amendments] govern only a limited liability partnership formed:

(1) on or after the effective date of these [Amendments], unless that partnership is continuing the business of a dissolved limited liability partnership; and

(2) before the effective date of these [Amendments], that elects, as provided by subsection (c), to be governed by these [Amendments].

(b) On and after January 1, 199__, these [Amendments] govern all partnerships.

(c) Before January 1, 199__, a partnership voluntarily may elect, in the manner provided in its partnership agreement or by law for amending the partnership agreement, to be governed by these [Amendments]. The provisions of these [Amendments] relating to the liability of the partnership's partners to third parties apply to limit those partners' liability to a third party who had done business with the partnership within one year before the partnership's election to be governed by these [Amendments], only if the third party knows or has received a notification of the partnership's election to be governed by these [Amendments].

(d) The existing provisions for execution and filing a statement of qualification of a limited liability partnership continue until either the limited liability partnership elects to have this [Act] apply or January 1, 199__.

SECTION 1211. SAVINGS CLAUSE. These [Amendments] do not affect an action or proceeding commenced or right accrued before these [Amendments] take effect.

KANSAS BAR ASSOCIATION

1200 SW Harrison St.
P.O. Box 1037
Topeka, Kansas 66601-1037
Telephone (785) 234-5696
FAX (785) 234-3813
Email: ksbar@ink.org

OFFICERS
John C. Tillotson, President
David J. Waxse, President-elect
Zackery E. Reynolds, Vice President
Kerry McQueen, Secretary-Treasurer
Dale L. Somers, Past President

BOARD OF GOVERNORS
Ernest C. Ballweg, District 1
Lynn R. Johnson, District 1
Hon. Steve Leben, District 1
Edward G. Collister, District 2
Michael P. Crow, District 2
Sara S. Beezley, District 3
Warren D. Andreas, District 4
Hon. Richard W. Holmes, District 5
Hon. Marla J. Luckert, District 5
Debra Egli James, District 6
Marilyn M. Harp, District 7
Bryce A. Abbott, District 7
Daniel J. Sevart, District 7
Hon. Patricia Macke Dick, District 8
David J. Rebein, District 9
Randall W. Weller, District 10
David W. Boal, District 11
Thomas A. Hamill, Assn. ABA Delegate
William B. Swearer, Assn. ABA Delegate
Hon. Christel E. Marquardt, KS ABA Delegate
Roger E. McClellan, YLS President
Hon. Larry McClain, KDJA Rep.

EXECUTIVE STAFF
Marcia Poell Holston, CAE, Executive Director
Karla Beam, Assistant Executive Director
Ginger Brinker, Administrative Director
Vicki Bigham, Communications Director
Ronald Smith, General Counsel
Art Thompson, Public Services Director

January 12, 1998

Hon. Timothy J. Carmody
Chair, House Judiciary Committee
115-S, Statehouse
Topeka, KS 66612

Dear Rep. Carmody,

On behalf of the Kansas Bar Association, we would like to request two new bill introductions.

Since one or both of the Uniform Laws Commission bills from last year, SB 8 and SB 9, are assigned to the House Judiciary Committee, we would ask that this committee introduce another such bill, the 1997 amendments to the Uniform Child Custody Jurisdiction and Enforcement Act (UCCJEA). The UCCJEA is a recent change from the Uniform Laws Commission to our current law, the Uniform Child Custody Jurisdiction Act. It is a large bill but I am advised by the ULC and KBA members who have read the bill that the changes are minor in substance and scope and speak to interstate enforcement of child support orders. It would repeal all of Chapter 38, article 13 of our code and replace it with the provisions in the UCCJEA. Jill Wolters has a copy of the act.

The second bill is new legislation to make cleanup amendments to the confidentiality statutes regarding mediation and mediators. These statutes are scattered throughout the code, but we've grouped them together in the attached document. When the state mediation statue was introduced by Rep. Chronister several years ago, we inadvertently left in many of the statutes the language allowing a court *on its own* to haul a mediator into court as a witness against one or both parties. This result was never intended by the original act. What was intended was that the *legislature* would control, through specific statutes, when a mediator could be compelled to disclose confidential information in another forum, such as a court. This would be done through specific statutes. This bill, while striking existing language, looks like it is making substantive change, but it is not. It is simply conforming the statutes to original intent, which was that statutes – not individual court whim – would control instances when testimony is required. When we have hearings on the bill, we'd be glad to speak further to these questions.

Thank you.

Best regards,

Ron Smith
General Counsel

cc: Jack Brand
Whitney Damron

enc/

House Judiciary
1-26-98
Attachment 8

KBA Proposal
Amending Mediation Statutes

KSA 75-4332. Memoranda of agreement; procedure in case of impasse; fact-finding board; hearing; costs; confidentiality.

(a) Public employers may include in memoranda of agreement concluded with recognized employee organizations a provision setting forth the procedures to be invoked in the event of disputes which reach an impasse in the course of meet and confer proceedings.

Such memorandum shall define conditions under which an impasse exists, and if the employer is bound by the budget law set forth in K.S.A.79-2925 et seq. and amendments thereto, the memorandum shall provide that an impasse is deemed to exist if the parties fail to achieve agreement at least 14 days prior to budget submission date.

(b) In the absence of such memorandum of procedures, or upon the failure of such procedures resulting in an impasse, either party may request the assistance of the public employee relations board, or the board may render such assistance on its own motion.

In either event, if the board determines an impasse exists in meet and confer proceedings between a public employer and a recognized employee organization, the board shall aid the parties in effecting a voluntary resolution of the dispute, and request the appointment of a mediator or mediators, representative of the public, from a list of qualified persons maintained by the secretary of human resources, and such appointment of a mediator or mediators shall be made forthwith by the secretary.

(c) All verbal or written information transmitted between any party to a dispute and a mediator conducting the proceeding, or the staff of an approved program under K.S.A.5-501 et seq. and amendments thereto shall be confidential communications. No admission, representation or statement made in the proceeding shall be admissible as evidence or subject to discovery. A mediator shall not be subject to process requiring the disclosure of any matter discussed during the proceedings unless all the parties consent to a waiver. Any party, including the neutral person or staff of an approved program conducting the proceeding, participating in the proceeding has a privilege in any action to refuse to disclose, and to prevent a witness from disclosing, any communication made in the course of the proceeding. The privilege may be claimed by the party or anyone the party authorizes to claim the privilege.

(d) The confidentiality and privilege requirements of this section shall not apply to:

(1) Information that is reasonably necessary to establish a defense for the mediator or staff of an approved program conducting the proceeding in the case of an action against the mediator or staff of an approved program that is filed by a party to the mediation;

(2) any information that the mediator is required to report under K.S.A.38-1522 and amendments thereto;

(3) any information that is reasonably necessary to stop the commission of an ongoing crime or fraud or to prevent the commission of a crime or fraud in the future for which there was an expressed intent to commit such crime or fraud; or

(4) any information that the mediator is required to report or communicate under the specific provisions of any statute~~ or in order to comply with orders of the court~~.

(e) If the impasse persists seven days after the mediators have been appointed, the board shall request the appointment of a fact-finding board of not more than three members, each representative of the public, from a list of qualified persons maintained by the secretary of human resources. The fact-finding board shall conduct a hearing, may administer oaths, and may request the board to issue subpoenas. It shall make written findings of facts and recommendations for resolution of the dispute and, not later than 21 days from the day of appointment, shall serve such findings on the public employer and the recognized employee organization. The board may make this report public seven days after it is submitted to the parties. If the dispute continues 14 days after the report is submitted to the parties, the report shall be made public.

(f) If the parties have not resolved the impasse by the end of a forty-day period, commencing with the appointment of the fact-finding board, or by a date not later than 14 days prior to the budget submission date, whichever date occurs first: (1) The representative of the public employer involved shall submit to the governing body of the public employer involved a copy of the findings of fact and recommendations of the fact-finding board, together with the representative's recommendations for settling the dispute; (2) the employee organization may submit to such governing body its recommendations for settling the dispute; (3) the governing body or a duly authorized committee thereof shall forthwith conduct a hearing at which the parties shall be required to explain their positions; and (4) thereafter, the governing body shall take such action as it deems to be in the public interest, including the interest of the public employees involved. The provisions of this subsection shall not be applicable to the state and its agencies and employees.

(g) The cost for the mediation and fact-finding services provided by the secretary of human resources upon request of the board shall be borne by the secretary of human resources. All other costs, including that of a neutral arbitrator, shall be borne equally by the parties to a dispute.

KSA 5-512. Confidentiality of proceedings.

(a) All verbal or written information transmitted between any party to a dispute and a neutral person conducting a proceeding under the dispute resolution act or the staff of an approved program shall be confidential communications. No admission, representation or statement made in the proceeding shall be admissible as evidence or subject to discovery. A neutral person conducting a proceeding under the dispute resolution act shall not be subject to process requiring the disclosure of any matter discussed during the proceedings unless all the parties consent to a waiver. Any party, including the neutral person conducting the proceeding, participating in the proceeding has a privilege in any action to refuse to disclose, and to prevent a witness from disclosing, any communication made in the course of the proceeding. The privilege may be claimed by the party or anyone the party authorized to claim the privilege.

(b) The confidentiality and privilege requirements of this section shall not apply to:

(1) Information that is reasonably necessary to establish a defense for the neutral person or staff of an approved program conducting the proceeding in the case of an action against the neutral person or staff of an approved program that is filed by a party to the proceeding;

(2) any information that the neutral person conducting the proceeding is required to report under K.S.A.38-1522, and amendments thereto;

(3) any information that is reasonably necessary to stop the commission of an ongoing crime or fraud or to prevent the commission of a crime or fraud in the future for which there was an expressed intent to commit such crime or fraud; or

(4) any information that the neutral person conducting the proceeding is required to report or communicate under the specific provisions of any statute ~~or in order to comply with orders of a court~~.

KSA 23-605. Confidentiality.

(a) A mediator appointed under K.S.A.23-602 and amendments thereto shall treat all verbal or written information transmitted between any party to a dispute and a mediator conducting the proceeding, or the staff of an approved program under K.S.A.5-501 et seq. and amendments thereto as confidential communications. No admission, representation or statement made in the proceeding shall be admissible as evidence or subject to discovery. A mediator shall not be subject to process requiring the disclosure of any matter discussed during the proceedings unless all the parties consent to a waiver. Any party, including the neutral person or staff of an approved program conducting the proceeding, participating in the proceeding has a privilege in any action to refuse to disclose, and to prevent a witness from disclosing, any communication made in the course of the proceeding. The privilege may be claimed by the party or anyone the party authorizes to claim the privilege. A neutral person conducting the proceeding shall not be subject to process requiring the disclosure of any matter discussed within the proceedings unless all parties consent to a waiver.

(b) The confidentiality and privilege requirements of this section shall not apply to:

(1) Information that is reasonably necessary to allow investigation of or action for ethical violations against the neutral person conducting the proceeding or for the defense of the neutral person or staff of an approved program conducting the proceeding in an action against the neutral person or staff of an approved program if the action is filed by a party to the proceeding;

(2) any information that the mediator is required to report under K.S.A.38-1522 and amendments thereto;

(3) any information that is reasonably necessary to stop the commission of an ongoing crime or fraud or to prevent the commission of a crime or fraud in the future for which there was an expressed intent to commit such crime or fraud;

(4) any information that the mediator is required to report or communicate under the specific provisions of any statute ~~or in order to comply with orders of the court~~; or

(5) a report to the court of threats of physical violence made by a party during the proceeding.

KSA 44-817. Mediators; appointment; functions; compensation; confidentiality.

(a) The secretary of human resources shall have power to appoint any competent, impartial, disinterested person to act as mediator in any labor dispute either upon the secretary's own initiative or upon the request of one of the parties to the dispute.

It shall be the function of such mediator to bring the parties together voluntarily under such favorable auspices as will tend to effectuate settlement of the dispute, but neither the mediator nor the secretary of human resources shall have any power of compulsion in mediation proceedings. The secretary of human resources shall provide necessary expenses for such mediators as may be appointed, under reasonable compensation not exceeding $50 per day for each such mediator, and prescribe reasonable rules of procedure for such mediators.

(b) All verbal or written information transmitted between any party to a dispute and a mediator conducting the proceeding, or the staff of an approved program under K.S.A.5-501 et seq. and amendments thereto shall be confidential communications. No admission, representation or statement made in the proceeding shall be admissible as evidence or subject to discovery. A mediator shall not be subject to process requiring the disclosure of any matter discussed during the proceedings unless all the parties consent to a waiver.

Any party, including the neutral person or staff of an approved program conducting the proceeding, participating in the proceeding has a privilege in any action to refuse to disclose, and to prevent a witness from disclosing, any communication made in the course of the proceeding. The privilege may be claimed by the party or anyone the party authorizes to claim the privilege.

(c) The confidentiality and privilege requirements of this section shall not apply to:

(1) Information that is reasonably necessary to establish a defense for the mediator or staff of an approved program conducting the proceeding in the case of an action against the mediator or staff of an approved program that is filed by a party to the mediation;

(2) any information that the mediator is required to report under K.S.A.38-1522 and amendments thereto;

(3) any information that is reasonably necessary to stop the commission of an ongoing crime or fraud or to prevent the commission of a crime or fraud in the future for which there was an expressed intent to commit such crime or fraud; or

(4) any information that the mediator is required to report or communicate under the specific provisions of any statute ~~or in order to comply with orders of the court~~.

KSA 60-452a. Dispute resolution; confidentiality.

(a) All verbal or written information transmitted between any party to a dispute and a neutral person conducting the proceeding, or the staff of an approved program under K.S.A.5-501 et seq. and amendments thereto shall be confidential communications. No admission, representation or statement made in the proceeding shall be admissible as evidence or subject to discovery. A neutral person shall not be subject to process requiring the disclosure of any matter discussed during the proceedings unless all the parties consent to a waiver. Any party, including the neutral person or staff of an approved program conducting the proceeding, participating in the proceeding has a privilege in any action to refuse to disclose, and to prevent a witness from disclosing, any communication made in the course of the proceeding. The privilege may be claimed by the party or anyone the party authorizes to claim the privilege.

(b) The confidentiality and privilege requirements of this section shall not apply to:

(1) Information that is reasonably necessary to establish a defense for the neutral person or staff of an approved program conducting the proceeding in the case of an action against the neutral person or staff of an approved program that is filed by a party to the mediation;

(2) any information that the neutral person is required to report under K.S.A.38-1522 and amendments thereto;

(3) any information that is reasonably necessary to stop the commission of an ongoing crime or fraud or to prevent the commission of a crime or fraud in the future for which there was an expressed intent to commit such crime or fraud; or

(4) any information that the neutral person is required to report or communicate under the specific provisions of any statute ~~or in order to comply with orders of the court~~.

KSA 72-5427. Mediation; request for appointment of fact-finding board; time limitations; memorandum describing issues and final position of parties; confidentiality.

(a) Upon finding that an impasse exists in professional negotiation or upon receipt of a joint notice of the existence of impasse filed by the parties under subsection (d) of K.S.A.72-5426 and amendments thereto, the secretary shall appoint a mediator to assist in resolving the impasse, from a list maintained by the secretary of qualified and impartial individuals who are representative of the public. To the extent practicable, the secretary shall utilize the services of the federal mediation and conciliation service for mediation under this section.

(b) The mediator shall meet with the parties or their representatives, or both, either jointly or separately, and shall take such other steps as appropriate in order to assist the parties to resolve the impasse and to proceed with professional negotiation.

(c) If either party determines, after the seven-day period immediately succeeding the appointment of the mediator, that mediation has failed to resolve the impasse, such party may within 10 days after the unsuccessful conclusion of mediation file a written request with the secretary to appoint a fact-finding board to assist in resolving the impasse and the secretary shall immediately notify the other party of the request. Within three days thereafter, each of the parties shall prepare and submit to the secretary a written memorandum containing a description of the issues upon which the impasse exists and shall include therein a specific description of the final position of the party on each issue.

(d) All verbal or written information transmitted between any party to a dispute and a mediator conducting the proceeding, or the staff of an approved program under K.S.A.5-501 et seq. and amendments thereto shall be confidential communications. No admission, representation or statement made in the proceeding shall be admissible as evidence or subject to discovery. A mediator shall not be subject to process requiring the disclosure of any matter discussed during the proceedings unless all the parties consent to a waiver. Any party, including the neutral person or staff of an approved program conducting the proceeding, participating in the proceeding has a privilege in any action to refuse to disclose, and to prevent a witness

from disclosing, any communication made in the course of the proceeding. The privilege may be claimed by the party or anyone the party authorizes to claim the privilege.

(e) The confidentiality and privilege requirements of this section shall not apply to:

(1) Information that is reasonably necessary to establish a defense for the mediator or staff of an approved program conducting the proceeding in the case of an action against the mediator or staff of an approved program that is filed by a party to the mediation;

(2) any information that the mediator is required to report under K.S.A.38-1522 and amendments thereto;

(3) any information that is reasonably necessary to stop the commission of an ongoing crime or fraud or to prevent the commission of a crime or fraud in the future for which there was an expressed intent to commit such crime or fraud; or

(4) any information that the mediator is required to report or communicate under the specific provisions of any statute ~~or in order to comply with orders of the court~~.

KSA 74-545. Farm assistance, counseling and training referral program; administration; personnel; eligible persons; included services and assistance; rural opportunity program; confidentiality of meetings and records; secretary authorized to negotiate contracts for services and receive grant moneys; notice of the FACTS program required; expiration date.

(a) The secretary of the state board of agriculture with the cooperation of the director of extension of Kansas state university shall coordinate a farm assistance, counseling and training referral program which shall include a rural opportunity program. The rural opportunity program will gather information and will inform rural communities, businesses, and potential entrepreneurs of available programs, resources, and strategies which they can use to develop themselves economically and create alternative or improved employment for farmers and rural residents. For the purposes of providing such assistance and program, the secretary shall utilize the services of the director and division of extension of Kansas state university, other state agencies, county extension personnel, municipal and community services organizations, private foundations, institutes, and personnel and private business and professional agencies or services available for such purpose. The secretary shall compile a directory of programs and services which may be utilized in providing the assistance contemplated by this act. Staff required by the secretary for the purposes of implementing this act shall be employed by the secretary with the approval of the director of extension and shall serve in the offices of the division of extension at Kansas state university. Personnel employed by the secretary for the purpose of implementing this act shall be employed as special project employees and shall be in the unclassified service under the Kansas civil service act. The personnel employed by the secretary for this purpose and county extension personnel shall be utilized in: (1) Receiving requests for assistance; (2) determining the eligibility of persons requesting assistance; and (3) determining if such assistance can best be provided by staff or by referral to an appropriate public or private agency or party for direct assistance. Personnel receiving requests for assistance will provide where possible such assistance or refer the person requesting such assistance to a public or private agency or, when appropriate, to a person qualified to provide such assistance in the home community or county of the person requesting such assistance.

(b) Persons requesting farm assistance, counseling and training referral services shall be eligible to receive assistance pursuant to this act if they: (1) Are primarily engaged in the business of farming, ranching, agribusiness or other agriculture-related activities; and (2) will be unable to continue in such business or activity or be seriously handicapped in such continued operation without the assistance provided pursuant to this act.

(c) The assistance to be made available to eligible persons requesting farm assistance, counseling and training referral services by staff, by contract or by referral to appropriate persons or agencies shall include farm management, legal assistance, legal advice and referrals, financial planning, employment services, business planning, voluntary mediation and personal and family support counseling. The secretary may provide legal assistance through a contract for legal services with any private or corporate law firm.

(d) Meetings in which mediation assistance is provided through the voluntary mediation service authorized under subsection (c) shall be closed and shall not be subject to the provisions of K.S.A.75-4317 to 75-4320, inclusive, and amendments thereto. The record of information relating to the finances of individual borrowers and creditors created, collected and maintained by the mediation service shall not constitute a public record and shall not be open for inspection under the open records act. Mediation sessions shall be confidential and the secretary shall ensure that all lenders and borrowers of agricultural loans receive adequate notification of the mediation service.

(e) All verbal or written information transmitted between any party to a dispute and a mediator conducting the proceeding, or the staff of an approved program under K.S.A.5-501 et seq. and amendments thereto shall be confidential communications. No admission, representation or statement made in the proceeding shall be admissible as evidence or subject to discovery. A mediator shall not be subject to process requiring the disclosure of any matter discussed during the proceedings unless all the parties consent to a waiver. Any party, including the neutral person or staff of an approved program conducting the proceeding, participating in the proceeding has a privilege in any

action to refuse to disclose, and to prevent a witness from disclosing, any communication made in the course of the proceeding. The privilege may be claimed by the party or anyone the party authorizes to claim the privilege.

(f) The confidentiality and privilege requirements of this section shall not apply to:

(1) Information that is reasonably necessary to establish a defense for the mediator or staff of an approved program conducting the proceeding in the case of an action against the mediator or staff of an approved program that is filed by a party to the mediation;

(2) any information that the mediator is required to report under K.S.A.38-1522 and amendments thereto;

(3) any information that is reasonably necessary to stop the commission of an ongoing crime or fraud or to prevent the commission of a crime or fraud in the future for which there was an expressed intent to commit such crime or fraud; or

(4) any information that the mediator is required to report or communicate under the specific provisions of any statute ~~or in order to comply with orders of the court~~.

(g) The secretary is hereby authorized to negotiate and enter into contracts for the performance of the powers, duties and functions of the program established under this section and under K.S.A.74-544 and amendments thereto. All such contracts shall be exempt from the competitive bid requirements of K.S.A.75-3739 and amendments thereto.

(h) The secretary is hereby authorized to receive grants, gifts or donations from the United States government, or its agencies, or any other source whatsoever for the purposes of the program established under this section and under K.S.A.74-544 and amendments thereto, and any moneys so received shall be deposited in the state treasury and credited to the FACTS gifts and contributions fund which is hereby created. All expenditures from such fund shall be made in accordance with appropriation acts upon warrants of the director of accounts and reports issued pursuant to vouchers approved by the secretary of the state board of agriculture or a person designated by the secretary.

(i) A creditor of a farm borrower, when notifying a farm borrower of intent to accelerate or call such note or, in the event none of the above notices has occurred, before filing suit to foreclose on a deed of trust or mortgage on agricultural land, shall notify the borrower of the availability of the mediation service as contracted by the secretary, and shall prominently include on or with the notice the address and telephone number of such mediation service unless the borrower and creditor have previously been involved with each other in mediation through such mediation service. A copy of the notice, including names, addresses and phone numbers of creditor and borrower, shall be sent to the mediation service at the same time it is mailed to the borrower, if the borrower consents thereto in writing.

(j) The provisions of this act shall expire on September 30, 1996.

KANSAS BOARD OF HEALING ARTS

BILL GRAVES
Governor

235 S. Topeka Blvd.
Topeka, KS 66603-3068
(785) 296-7413
FAX # (785) 296-0852
(785) 368-7102

MEMORANDUM

To: House Committee on Judiciary
From: Mark W. Stafford, General Counsel
Date: January 26, 1998
Re: House Bill No. 2126

On behalf of the Kansas State Board of Healing Arts, thank you for the opportunity to appear before you today and speak in support of House Bill No. 2126. This bill was requested by the Board to address concerns which arise when certain regulated professionals practice as limited liability companies (LLCs). The proposal would not change the substantive law regarding any profession, but would merely amend the procedure by which a professional would form a limited liability company. The procedure would parallel the procedure for forming a professional corporation.

The rule has long been established that certain professions may be practiced by licensed individuals only, and not by non-licensed legal entities. This common law rule was recently discussed in *Early Detection Center, Inc. v. Wilson*, 248 Kan. 869 (1991) and in *St. Francis Regional Med. Center, Inc. v. Weiss*, 254 Kan. 728 (1994). An exception to the rule was created by the Legislature to allow these professionals to form professional corporations (PAs). The professional corporation act, K.S.A. 17-2701, *et seq.*, provides that a PA generally may be formed or owned only by a person who is licensed to practice the profession for which the professional corporation is organized. This form of professional practice was important to professionals as a means of shielding personal assets from professional liability claims.

An LLC is a separate legal entity, and thus the common law prohibition of corporate professional practice would apply to an LLC unless otherwise provided by the LLC act. The LLC act was enacted in the 1990 legislative session. Originally, the law did not provide that an LLC could be formed to engage in a professional practice. The following year, subsection (q) of K.S.A. 17-7608 was added to the statutes, stating that an LLC may be organized to exercise the powers which may be exercised by a professional corporation. There was no intent to abrogate the corporate practice prohibition. However, there were no safeguards in place to insure that limited liability companies which were formed to practice a profession would only be formed by licensed professionals, as such is the case with professional corporations. The Board believes that only duly licensed professionals should practice certain professions, and that the public should be protected from non-licensed persons using a business structure to invade the practice of such professions. House Bill No. 2126 would

LAWRENCE T. BUENING, JR.
EXECUTIVE DIRECTOR

MEMBERS OF THE BOARD
JOHN P. GRAVINO, D.O., PRESIDENT
LAWRENCE
RONALD J. ZOELLER, D.C., VICE-PRESIDENT
TOPEKA

DONALD B. BLETZ, M.D., OVERLAND PARK
C. J. CONRADY, JR., ANTHONY
JAMES D. EDWARDS, D.C., EMPORIA
HOWARD D. ELLIS, M.D., LEAWOOD
ROBERT L. FRAYSER, D.O., HOISINGTON
JANA D. JONES, M.D., LANSING
LANCE MALMSTROM, D.C., TOPEKA

LAUREL H. RICKARD, MEDICINE LODGE
CHRISTOPHER P. RODGERS, M.D., HUTCHINSON
HAROLD J. SAUDER, D.P.M., INDEPENDENCE
EMILY TAYLOR, LAWRENCE
HAI K. TRUONG, D.O., WICHITA
ROGER D. WARREN, M.D., HANOVER

House Judiciary
1-26-98
Attachment 9

create those safeguards.

New Section 1 of the Bill re-authorizes LLCs to exercise powers available to PAs, just as the current law allows. However, the new language limits this authority to "qualified persons". The definition of a "qualified person" is drawn from the professional corporation act, K.S.A. 17-2707(d).

New Section 2 retains authority of licensing boards over licensed individuals who form LLCs. This language parallels K.S.A. 17-2716.

New Section 3 vests civil enforcement power in the appropriate licensing board, the attorney general and county or district attorney.

New Section 4 provides for updating documentation on LLCs previously organized by professionals. The grandfather date of July 1, 1997, appearing on page 2, line 26, should be amended to July 1, 1998.

Section 7 of the bill requires that the purpose of the LLC practicing a profession to identify the profession in the articles of organization.

Section 8 amends K.S.A. 17-7608 to require the same type of certification from the licensing agency as is required for PAs.

Section 9 of the bill amends the definition of "health care provider" in the health care provider insurance availability act, K.S.A. 40-3401, *et seq.* This amendment is not necessary because the language was previously added. The bill should be amended to delete section 9.

Once again, thank you for the opportunity to appear in support of House Bill 2126. I will be happy to respond to questions.