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Removal of General Partners: A Method of Intrapartnership Dispute Resolution for Limited Partnerships

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NOTE

Removal of General Partners: A Method of Intrapartnership Dispute Resolution for Limited Partnerships

I. INTRODUCTION

A. *Purpose*

The term "limited partnership" denotes a business organization in which the liability of at least one partner, the "limited partner," for the debts and obligations of the partnership is limited to his contribution[1] to the partnership, whereas the other members of the partnership, the "general partners," may incur unlimited personal liability.[2] The limited partnership[3] is currently used primar-

1. Section 101 of the REVISED UNIFORM LIMITED PARTNERSHIP ACT defines contribution as "any casb, property, services rendered, or a promissory note or other binding obligation to contribute cash or property or to perform services, wbich a partner contributes to a limited partnership in his capacity as a partner." REVISED UNIFORM LIMITED PARTNERSHIP ACT § 101 (1976) (act superceded in 1985 by the 1985 ULPA) [hereinafter RULPA].

2. *See* Lewis, *The Uniform Limited Partnership Act*, 65 U. PA. L. REV. 715, 716 (1917).

ily as a public or private investment vehicle in oil and gas, mining, and real estate ventures.[4] Limited partnerships recently have become more popular, primarily because they receive advantageous tax treatment[5] and provide investors with the shelter of limited liability.[6]

Although many scholars have commented on the tax considerations associated with limited partnerships,[7] commentators virtually have ignored the issue of intrapartnership dispute resolution.[8] This Note sets forth and analyzes the issues surrounding the removal of general partners from the limited partnership as a method of resolving intrapartnership disputes.[9] Part II discusses the partnership agreement, its functions and contents, and highlights removal provisions that may prevent many potential partnership disputes. Part II also considers the applicable uniform legislation and the various rules promulgated by state securities

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3. A limited partnership formed in compliance with statutory requirements has one or more general partners and one or more limited partners. UNIFORM LIMITED PARTNERSHIP ACT § 1 (1916) (act superceded in 1976 by RULPA) [hereinafter ULPA]; RULPA § 101(7)(1976); UNIFORM LIMITED PARTNERSHIP ACT § 101(7)(1985) [hereinafter 1985 ULPA].

4. *See* J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP § 26, at 150 (1968) [hereinafter CRANE & BROMBERG]; Buxbaum, *Understanding California's New Limited Partnership Act*, 4 CAL. LAW. 1, 13-15 (May 1984); Note, *Partnerships: The Uniform Limited Partnership Act or the Partnership Agreement—Which Controls?*, 32 OKLA. L. REV. 681 (1979).

Investments in public and private limited partnerships exceeded $17 billion in 1984, including $10.4 billion in real estate ventures and $3.1 billion in oil and gas ventures. *News Report*, J. ACCT., April 1985, 31, 31-4. Robert A. Stranger & Co., a leading investment research firm that released this data, additionally determined that private transactions constitute fifty-three percent of the total partnership market. *Id.* Furthermore, income-oriented limited partnerships account for fifty-three percent of annual fund raising. *Id.*

5. For information regarding the prevalence of the limited partnership as a vehicle to gain favorable tax treatment, see *The Report of the Committee on Ways and Means, Tax Shelters: Use of Limited Partnerships*, reprinted in PRACTICING LAW INSTITUTE, *Limited Partnerships: Investment Vehicles in Transition* 367 (1975).

6. Limited investor liability is protected by uniform legislation. *See* ULPA § 1 and official comment; RULPA § 303; 1985 ULPA § 303. For further information detailing the advantages of selecting a limited partnership rather than a sole proprietorship, general partnership, or corporation as the preferred form of business organization, see generally Coleman & Weatherbie, *Special Problems in Limited Partnership Planning*, 30 SW. L.J. 887 (1976).

7. *See, e.g.*, Haims & Strock, *Federal Income Tax Classification of Limited Partnerships Formed Under the Revised Uniform Limited Partnership Act*, 9 ST. MARY'S L.J. 489 (1978); Weidner, *The Existence of State and Tax Partnerships: A Primer*, 11 FLA. ST. U.L. REV. 1 (1983).

8. *See* Roulac, *Resolution of Limited Partnership Disputes: Practical and Procedural Problems*, 10 REAL PROP. PROBATE AND TR. J. 276 (1975).

9. Professor Stephen Roulac's pre-RULPA article examined the difficulties inherent in resolving partnership disputes. This Note examines the use of removal provisions in the partnership agreement to resolve intrapartnership disputes.

administrators. Part III addresses the collateral effects of removing a general partner, including federal income tax consequences, exposure of the limited partners to general liability, and the post-removal status of the partnership's contracts with third parties. Part IV outlines and examines the substitution of a new general partner to the partnership and the potential legal claims the former general partner may have against the partnership. Part V suggests specific legislation that would provide limited partners with an effective means, through a statutory grant of power to remove a general partner, of supervising their investments. Finally, Part VI concludes that legislators should grant limited partners a statutory right to remove a general partner as a means of protecting their investment and as a method of resolving intrapartnership disputes.

B. Historical Background

At common law limited partnerships were nonexistent because individuals who shared in the profits of a noncorporate enterprise also were required to share unconditionally in the losses.[10] In 1822 the New York legislature adopted the first statute in the United States recognizing the limited partnership.[11] Designed to employ and utilize dormant capital and stimulate investment activity, the New York act restricted the limited partners' liability for partnership debts to the amount of their contributions to the partnership.[12] By the early 1900s every state had adopted legislation recognizing and governing limited partnerships.[13] Despite the enactment of these statutes, the judiciary perpetuated the common law's hostility toward limited liability. Generally, courts viewed limited partners as general partners and the grant of immunity from personal liability was contingent on full and exact compliance with the statutory requirements. Furthermore, courts strictly construed these statutory requirements.[14] Courts imposed general lia-

10. Comment, *Limited Partner Control and Liability Under the Revised Uniform Limited Partnership Act*, 32 Sw. L. J. 1301, 1301 (1979); *see* CRANE & BROMBERG, *supra* note 4, § 26(a), at 144; Basye, *A Survey of the Limited Partnership Form of Business Organization*, 42 OR. L. REV. 35, 36 (1962).

11. Act of April 17, 1822, ch. 244, 1822 N.Y. Laws, 259.

12. *See* ULPA § 1, official comment. The Act was modeled after the *Societe en Commendite* of the French Commercial Code. *See* Lewis, *supra* note 2, at 716.

13. *See* ULPA § 1, official comment. The majority of these statutes incorporated the language of the New York statute with few material alterations. *Id.*

14. CRANE & BROMBERG, *supra* note 4, § 26(a), at 144. Even an inconsequential deviation from statutory requirements often resulted in the imposition of personal liability on limited partners. *See, e.g.*, Andrews v. Schott, 10 Pa. 47 (1848) (using word "company" in

bility regardless of the good faith of the limited partners and without requiring deception of the partnership's creditors.[15] Gradually, the limited partnership became known as a liability trap for the unwary investor rather than as a practical noncorporate form of business organization.[16] Consequently, remedial legislation was necessary to alleviate the threat of unlimited personal liability for limited partners due to trivial infractions of the applicable statutes.[17]

The National Conference of Commissioners on Uniform State Laws drafted the Uniform Limited Partnership Act (ULPA) to discourage strict judicial interpretations of the early limited partnership statutes.[18] The ULPA expressly abrogated the general rule that statutes in derogation of the common law must be strictly construed.[19] The drafters sought to encourage the use of limited partnerships as an alternative to the corporate form of doing business;[20] thus, the ULPA eliminated the imposition of unlimited per-

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the limited partnership's name and absence of original cash contribution converted the limited partner into a general partner); *cf.* Rathke v. Griffith, 36 Wash. 2d 394, 218 P.2d 757 (1950) (denying limited partner was personally liable despite status as director because he never functioned as such); *see also* ULPA § 1, official comment; Comment, *supra* note 10, at 1302.

15. Basye, *supra* note 10, at 37.

16. *See id.*; Lewis, *supra* note 2, at 720-21.

17. Drafters of the ULPA noted that strict judicial interpretations of the early limited partnership statutes prevented any practical use of the statutory provisions. *See* Lewis, *supra* note 2, at 720-21.

18. *See* Henningsen v. Barnard, 117 Cal. App. 2d 352, 359, 255 P.2d 837, 841 (1953); Rathke v. Griffith, 36 Wash. 2d 394, 218 P.2d 757 (1950); Comment, *supra* note 10, at 1302. The ULPA was not intended to codify existing laws regulating limited partnerships; instead, the act was remedial in nature. Basye, *supra* note 10, at 37. Professor Lewis, one of the ULPA's drafters, commented that:

> The Conference on Uniform State Laws in preparing a limited partnership act had a larger problem to face than merely to choose the best among the conflicting provisions of existing state statutes. No existing limited partnership act, and no combination of the provisions of existing acts would make a satisfactory uniform statute. Existing acts [were] in more than one respect fundamentally defective.

Lewis, *supra* note 2, at 718. Professor Lewis further noted that the Conference desired:

> to present to the legislatures of the several states an act, under which a person willing to invest his money in a business for a share in the profits, may become a limited partner with the same sense of security from any possibility of unlimited liability as the subscribers to the shares of a corporation.

Id. at 720.

19. ULPA § 28(1) states that "the rule that statutes in derogation of the common law are to be strictly construed shall have no application to this act." *See* Stowe v. Merrilees, 6 Cal. App. 2d 217, 44 P.2d 368 (1935) (holding that the ULPA is remedial in nature and must be construed to effectuate this purpose and to protect the public).

20. The Commissioners intended to make available an attractive business organization; therefore, the Commissioners premised the ULPA on two fundamental principles:

sonal liability on limited partners due to minor deviations from the statutory provisions.[21] Indeed, the ULPA requires only substantial good faith compliance with its provisions to prevent a technical defect in the formation of the partnership from giving rise to general liability.[22]

The ULPA[23] defines a limited partnership as "a partnership

> First: No public policy requires a person who contributes to the capital of a business, acquires an interest in the profits, and some degree of control over the business, to become bound for obligations of the business, provided creditors have no reason to believe at the times their credits were extended that such person was so bound. Second: That persons in business should be able, while remaining themselves liable without limit for the obligations contracted in its conduct, to associate with themselves others who contribute to the capital and acquire rights of ownership, provided that such contributors do not compete with creditors for the assets of the partnership.

ULPA § 1, official comment. Although both the corporate and limited partnership forms of business organization offer limited investor liability, the limited partnership offers "a degree of flexibility in defining the relations among the partners that is not available in the corporate form." Commissioners' Prefatory Note to the RULPA. The consensual relationship among the parties forces the general partners to seek the limited partners' approval for certain decisions, whereas corporate management would not be so compelled. *Id.* Additionally, the Internal Revenue Code does not treat the limited partnership, unlike the corporation, as a separate legal entity for federal income tax purposes. I.R.C. § 701-702 (1982). *See generally* Bromberg, *Preface to Limited Partnership: Model Agreement and Certificate*, 26 S. TEX. L. J. 15, 16 & n.2 (1985).

21. *See* Plasteel Prods. Corp. v. Helman, 271 F.2d 354, 356 (1st Cir. 1959) (holding that the limited partners did not incur personal liability despite control over selection of partnership's general sales manager); Basye, *supra* note 10, at 38.

22. ULPA § 2(2). Section 2(2) ensures that limited partners are not exposed to unlimited liability due to a technical defect in the partnership's formation when they have substantially complied with the statutory requirements of section 2(1). *See, e.g.*, Franklin v. Rigg, 143 Ga. App. 60, 237 S.E.2d 526 (1977); Tiburon Nat'l Bank v. Wagner, 265 Cal. App. 2d 868, 875, 71 Cal. Rptr. 832, 837 (1968). *But see* Inland Real Estate Corp. v. Christoph, 107 Ill. App. 3d 183, 437 N.E.2d 658 (1981); Frigidaire Sales Corp. v. Union Properties, Inc., 88 Wash. 2d 400, 562 P.2d 244 (1976) (holding that limited partnerships are statutory creatures and parties creating limited partnerships must follow statutory requirements). Failure to comply with the ULPA's set requirements for establishing a limited partnership precludes such formation, renders the organization a general partnership, and results in the imposition of unlimited personal liability on limited partners. Peerless Mills, Inc. v. Amer. Tel. & Tel. Co., 527 F.2d 445 (2d Cir. 1975); Dwinell's Central Neon v. Cosmopolitan Chinook Hotel, 21 Wash. App. 929, 587 P.2d 191 (1978).

23. Twenty-four states, the District of Columbia and the Virgin Islands have adopted the ULPA subject to local modifications. ALASKA STAT. § 32.10.010-.290 (1962); D.C. CODE ANN. § 41-20 to 229 (1981); FLA. STAT. ANN. § 620.01-.32 (West 1977); GA. CODE ANN. § 14-9-1 to 91 (1982); HAWAII REV. STAT. § 425-21 to 52 (1976); ILL. ANN. STAT. ch. 106 ½, § 44 - 73 (Smith - Hurd 1959); IND. CODE § 23-4-2 to 2-30 (1971); KY. REV. STAT. § 362.410 - .700 (1970); ME. REV. STAT. ANN. tit. 31 § 151 - 181 (1964); MISS. CODE ANN. § 79-13-1 to 57 (1972); MO. ANN. STAT. § 359.010 - .290 (Vernon); NEV. REV. STAT. § 88.010 - .310 (1973); N.H. REV. STAT. ANN. § 305:1 - :30 (1966); N.M. STAT. ANN. § 54-2-1 to 30 (1978); N.Y. PARTNERSHIP LAW § 90 - 120 (McKinney 1948); N.C. GEN. STAT. § 59-1 - 30 (1973); PA. CONS. STAT. ANN. tit. 59 § 501 - 545 (1970); S.D. COMP. LAWS ANN. § 48-6-1 to 64 (1967); TENN. CODE ANN. § 61-2-101 to 130 (1953); TEX. CIV. STAT. ANN. art. 6132a (Vernon 1970); UTAH CODE ANN.

formed by two or more persons . . . having as members one or more general partners."[24] General partners manage the limited partnership and may incur unlimited personal liability for the partnership's debts.[25] Limited partners do not incur personal liability beyond the amount of their partnership contributions,[26] but they are prohibited from taking an active role in the management of the partnership. Limited partners who take part "in the control of the business"[27] are subject to unlimited personal liability and, therefore, essentially are considered to be general partners. The statutory disjunction between limited liability and managerial control originates from the same policy conflict that provoked courts to strictly construe the pre-ULPA statutes.[28] This conflict arose between the policy protecting the reliance interest of third parties[29] and the policy supporting the limited liability of investors.[30] The ULPA drafters reconciled the two interests by requiring the limited partnership to include a general partner to accept unlimited personal liability for partnership obligations and to control the limited partners' investments.[31] This resolution assured creditors that at least one member of the partnership would remain fully

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§ 48-2-1 to 27 (1953); VT. STAT. ANN. tit. 11 §§ 1391-1419 (1984); V.I. CODE ANN. tit. 26, §§ 201-228 (1970); VA. CODE §§ 50-44 to 73 (1950).

24. ULPA § 1.

25. ULPA § 9. Section 9 states in pertinent part: "[a] general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners . . . ." *See* Atlanta Warehouses, Inc. v. Housing Authority, 143 Ga. App. 588, 239 S.E.2d 387 (1977) (holding general partners bound by condemnation judgement against partnership); Wait v. Salestrom, 206 Neb. 578, 294 N.W. 2d 338 (1980) (holding that modification of partnership agreement requires unanimous consent of partners to be binding on general partner).

26. Delaney v. Fidelity Lease Ltd., 517 S.W. 2d 420 (Tex. Ct. App. 1974), *aff'd in part, rev'd in part*, 526 S.W. 2d 543 (1975); *see* UPLA § 1 (declaring that limited partners are not bound by partnership obligations).

27. ULPA § 7. Determining what constitutes controlling the business "stands as the single most difficult problem in drafting limited partnership agreements." Coleman & Weatherbie, *supra* note 6, at 897. Many commentators have addressed the drafting problems caused by limited partners actively participating in the management of the partnership and thereby forfeiting their limited personal liability status. *See generally* Basile, *Limited Liability for Limited Partners: An Argument for the Abolition of the Control Rule*, 38 VAND. L. REV. 1199 (1985) (proposing abolition of the "control" rule).

28. *See* Coleman & Weatherbie, *supra* note 6, at 897; Comment, *supra* note 10, at 1303.

29. Third parties who rely on representations by the limited partners that they will be responsible for the repayment of loans or the performance of contracts should be protected from later assertions by these limited partners that they are not personally liable for the partnership debts.

30. *See supra* note 29; ULPA § 1, official comment.

31. *See supra* note 29.

liable for its debts, yet enabled limited partners to limit their personal liability to the amount of their contribution. This compromise also created a form of limited partnership palatable to the courts. The ULPA drafters, however, neglected a third policy consideration: the limited partners' supervisory powers over their own investments.[32]

The drafters of the Revised Uniform Limited Partnership Act (RULPA) attempted to strike a balance between these three competing policies of creditor protection, limited investor liability, and investor supervision.[33] The National Conference of Commissioners on Uniform State Laws promulgated the RULPA to clarify the ambiguities and fill the interstices of the ULPA.[34] For example, the

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32. *See* Coleman & Weatherbie, *supra* note 6, at 897-98. The authors note that in the years subsequent to the drafting of the ULPA, the issue of investor supervision received greater consideration due to the stock market crash of 1929 and enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934. *Id.*

33. Unlike the ULPA, the RULPA expressly sets forth the allowable degree of flexibility to be afforded drafters of partnership agreements. *See infra* notes 51-53 and accompanying text. The RULPA allows drafters to include expanded supervisory measures for limited partners while incorporating the creditor protection policy of the ULPA.

34. Commissioners' Prefatory Note to the RULPA (superceding the ULPA). Since its approval by the National Conference of Commissioners on Uniform State Laws in 1976, twenty-eight states have adopted the RULPA subject to local modifications. ALA. CODE §§ 10-9A-1 to 203 (1975); ARIZ. REV. STAT. ANN. §§ 29-301 to 366 (1976); ARK. STAT. ANN. §§ 65-501 to 566 (1980); CAL. CORP. CODE §§ 15511-15623 (West 1977); COLO. REV. STAT. §§ 7-62-101 to 1201 (1973); CONN. GEN. STAT. ANN. §§ 34-9 to 380 (West 1969); DEL. CODE ANN. tit. 6, §§ 17-101 to 1107 (1974); IDAHO CODE §§ 53-201 to 267 (1947); IOWA CODE ANN. §§ 545.101-.1106 (West 1946); KAN. STAT. ANN. §§ 56-1a01-1a607 (1976); MD. CORPS. & ASS'NS CODE ANN. §§ 10-101 to 1104 (1975); MASS. GEN. LAWS ANN. ch. 109, §§ 1 - 62 (West 1975); MICH. COMP. LAWS ANN. §§ 449.1101 - 2108 (West 1976); MINN. STAT. ANN. §§ 322A.01-.87 (West 1966); MO. ANN. STAT. §§ 359.011-.691 (Vernon Supp. 1986); MONT. CODE ANN. §§ 35-12-501 to 1404 (1970); NEB. REV. STAT. §§ 67-233 to 297 (1976); N.J. STAT. ANN. §§ 42:2A-1 to 72 (West 1940); N.D. CENT. CODE §§ 45-1.01-01 to 62 (Supp. 1985); OHIO REV. CODE ANN. §§ 1782.01-.62 (1985); OKLA. STAT. ANN. tit. 54, §§ 301-364 (West 1969); 1985 OR. LAWS Ch. 677; R.I. GEN. LAWS §§ 7-13-1 to 65 (1985); S.C. CODE ANN. §§ 33-42-10 to 2020 (Supp. 1985); WASH. REV. CODE ANN. §§ 25.10.010 - .690 (1969); W. VA. CODE §§ 47-9-1 to 63 (1976); WIS. STAT. ANN. §§ 179.01 - .94 (West 1974); WYO. STAT. §§ 17-14-201 to 1104 (1977). In most states adopting the RULPA, the provisions of the ULPA continue to have some applicability. Editorial Note to the RULPA. Many commentators view the RULPA as a progressive and thoughtful improvement over the ULPA. *See generally* Aslanides, Cardinaldi, Haynsworth, Lane & Niesar, *Limited Partnerships—What's Next and What's Left?*, 34 BUS. LAW. 257 (1978); Shapiro, *The Need for Limited Partnership Reform: A Revised Uniform Act*, 37 MD. L. REV. 544 (1978); Comment, *Investor Protection and the Revised Uniform Limited Partnership Act*, 56 WASH. L. REV. 99 (1980). *But see* Hecker, *The Revised Uniform Limited Partnership Act: Provisions Affecting the Relationship of the Firm and Its Members to Third Parties*, 27 U. KAN. L. REV. 1 (1978); Kessler, *The New Uniform Limited Partnership Act: A Critique*, 48 FORDHAM L. REV. 159 (1979). Note, however, that the National Commissioners on Uniform State Laws approved the 1985 ULPA that supercedes the RULPA.

RULPA maintains the dichotomy between limited liability and partnership management instituted by the ULPA,[35] yet establishes specific activities, including the removal of general partners, in which limited partners may engage without risking the imposition of unlimited personal liability.[36] The RULPA furthers the policy of investor supervision by expressly authorizing limited partner derivative suits, a provision absent in the ULPA.[37] This procedural device, analogous to the shareholder derivative suit in the corporate context,[38] enables limited partners to protect their investments from the mismanagement, negligence, or ultra vires acts of general partners.[39] The RULPA also creates a statute of limitations on the limited partnership's right to recover all or part of a contribution already returned to a limited partner, whether the recovery is to satisfy creditors or otherwise.[40]

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35. *See supra* notes 29-31 and accompanying text.

36. RULPA § 303; *see infra* notes 230-31 and accompanying text. *See generally* Burr, *The Potential Liability of Limited Partners as General Partners*, 67 MASS. L. REV. 22 (1982).

37. "[T]he virtually complete control given to general partners by the [ULPA] together with the evolution of limited partnerships from small personalized concerns to large, impersonal enterprises, has created a situation rife with opportunities for self-dealing and other misconduct by general partners." Hecker, *Limited Partners' Derivative Suits Under the Revised Uniform Limited Partnership Act*, 33 VAND. L. REV. 343, 346 (1980). The RULPA attempted to remedy this situation by providing that

> [a] limited partner may bring an action in the right of a limited partnership to recover a judgement in its favor if general partners with authority to do so have refused to bring the action or if an effort to cause those general partners to bring the action is not likely to succeed.

RULPA § 1001. Contrastingly, the ULPA did not specifically grant limited partners the right to bring derivative suits. Nevertheless, some courts have recognized a limited partner's standing to sue on behalf of the limited partnership when the general partners are unable to or wrongfully refuse to do so. *See, e.g.*, Strain v. Seven Hills Assocs., 75 A.D.2d 360, 429 N.Y.S.2d 424 (1980) (interpreting Ohio law granting limited partners the right to sue derivatively). *But see* Millard v. Newmark & Co., 24 A.D. 2d 333, 266 N.Y.S. 2d 254 (1966) (reading UPLA § 26 as an absolute prohibition against limited partner derivative suits).

38. *See* Hecker, *supra* note 37, at 344-45.

39. The court in Partnership Equities, Inc. v. Marten, 15 Mass. App. Ct. 42, 443 N.E. 2d 134 (1982), held that derivative suits serve as appropriate remedies for general partners' mismanagement, negligence, diversion of assets, ultra vires acts, or failure to perform certain elements of the limited partnership agreement.

40. RULPA § 608. The drafters modeled section 608 after section 17 of the ULPA but added the statute of limitations. RULPA § 608, official comment. *Compare* RULPA § 608 (containing statute of limitations) *with* ULPA § 17 (omitting statute of limitations).

II. Legal Background

A. *The Partnership Agreement*

The partnership agreement is a contractual document that sets forth the rights, responsibilities, and obligations of the partners, both general and limited.[41] The ULPA does not refer to the partnership agreement; consequently, limited partners must incorporate vital information, such as the character and location of the business and the share of profits each member will receive, in the certificate of limited partnership.[42] The RULPA, however, recognizes the partnership agreement and its function as the basic agreement among the partners "as to the affairs of a limited partnership and the conduct of its business."[43]

1. Functions of the Partnership Agreement

To avoid unlimited personal liability for the limited partners, the partnership must comply with all applicable statutory requirements, including the filing of a certificate of limited partnership.[44] The certificate and the partnership agreement constitute two separate documents[45] and, unlike the certificate, the partnership agree-

41. *See* Freshman, Principles of Real Estate Syndication 239 (1973) *cited in* Roulac, *supra* note 8, at 279.

42. ULPA § 2(1). The ULPA drafters stated that all important matters affecting limited partners should be set forth in the certificate of partnership. For a discussion of the certificate of limited partnership, see *infra* footnotes 44-47 and accompanying text.

43. ULPA § 101(9); 1985 RULPA § 101(9). Modern practice dictates comprehensive partnership agreements, only part of which needs to be included in the certificate of limited partnership. RULPA § 101, official comment. *See generally* Peel, *Definition of a Partnership*, 1979 Wis. L. Rev. 989 (discussing tax elements of limited partnership agreements that need not be included in the certificate of limited partnership).

44. *See* Allen v. Amber Manor Apartments Partnership, 95 Ill. App. 3d 541, 420 N.E. 2d 440 (1981); Note, *supra* note 4, at 682. The ULPA recognizes the formation of a limited partnership if the parties substantially and in good faith comply with the statutory requirements, including filing the certificate with the specified contents for local record. ULPA § 2(2). Courts have held that a failure to record the certificate precludes limited partners from claiming limited liability when dealing with third parties who have no notice of their limited partner status. *See* Grenada Bank v. Willey, 705 F.2d 176 (6th Cir.) (following Tennessee law), *cert. denied*, 464 U.S. 849 (1983); Ruth v. Crane, 392 F. Supp. 724 (E.D. Pa. 1975) (holding that upon failure to record a proper certificate, limited partners will be treated as general partners with respect to third parties and creditors under Pennsylvania law); *cf.* Mursor Builders, Inc. v. Crown Mountain Apartment Assocs., 467 F. Supp. 1316 (D.V.I. 1978) (stating that the only practical effect of recording the certificate is to shield the limited partners from personal liability for partnership debts). The doctrine of substantial compliance is carried over to the RULPA in section 201(b) (note that ULPA § 2(2)'s good faith requirement is absent in the RULPA).

45. Kratovil & Werner, *Fixing Up the Old Jalopy—the Modern Limited Partnership Under the ULPA*, 50 St. John's L. Rev. 51 (1975); Note, *supra* note 4, at 682. The partner-

ment does not have a filing requirement. The certificate of limited partnership outlines the purposes of the organization, the issues concerning capital contribution, and the procedures to be followed for the addition and withdrawal of partners.[46] The certificate may be drafted to describe completely the basic information regarding partnership formation, thus making a separate partnership agreement superfluous. Common practice, however, dictates that the certificate include only the minimum statutory requirements and that the parties draft a separate partnership agreement.[47] Therefore, the partnership agreement contains the details of the partners' rights, responsibilities, and obligations; confidential agreements among partners; and private business practices of the partnership.[48] The agreement also shields this information from public exposure, a feature not afforded the information and arrangements set forth in the certificate of limited partnership.

2. Dispute Resolution Provisions

Organizing ventures as limited partnerships is beneficial because they provide flexibility in structuring the rights and duties of the parties within the partnership agreement.[49] In addition to the provisions required by law,[50] the agreement can include other provisions reflecting concerns of the participants.[51] Ideally, limited partners should have a substantial role in drafting the partnership

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ship agreement defines the relationships of the parties involved, whereas the certificate notifies third parties who deal with the partnership of the organization's essential features. Note, *supra* note 4, at 682 n.7; *see, e.g.*, Holvey v. Stewart, 265 Or. 242, 509 P.2d 17 (1973) (certificate notifies third parties of limited partners' limited liability); Davis v. Davis, 247 Or. 352, 429 P.2d 808 (1967) (certificate did not embody business arrangement between members).

46. RULPA § 101, official comment.

47. *See* Note, *supra* note 4, at 682.

48. *See* Waters v. Harris, 17 N.Y.S. 370 (1892) (holding that the partnership agreement determines the relationship among the parties and that related settlements must conform with the agreement); RULPA § 101, official comment; Note, *supra* note 4, at 682.

49. CRANE & BROMBERG, *supra* note 4, at 4; Roulac, *supra* note 8, at 278. The fiduciary obligation of the general partner to the limited partners prohibits him from acting in conflict with the interests of the limited partners. Roulac, *supra* note 8, at 287-91. Freedom of contract gives the parties extensive flexibility in allocating their mutual rights and responsibilities, and uniform legislation protects them from entering into an unenforceable agreement. *See generally* Schwartz, *Freedom of Contract Among the Owners of a Partnership or Limited Partnership*, 36 MERCER L. REV. 701 (1985) (examining the regulation of limited partnerships' internal affairs by uniform legislation).

50. *See* ULPA § 2(1); RULPA § 201(a); 1985 ULPA § 201(a). *See generally* MOSBERG, REAL ESTATE SYNDICATION OFFERINGS LAW AND PRACTICE 73 (1974), *cited in* Roulac, *supra* note 8, at 279.

51. Roulac, *supra* note 8, at 279.

agreement.[52] In the overwhelming majority of partnerships, however, limited partners have no effective voice in drafting the agreement.[53] Thus, the limited partners are left with little power to supervise their investment. Today, common practice dictates that the promoter of the venture, generally a corporation, assume the role of general partner.[54] To promote greater investor supervision, the general and limited[55] partners should capitalize on the flexibility of

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52. The role of the limited partner, however, is analogous to that of a corporate shareholder hecause hoth seek to protect and maximize their investment, yet seldom does either possess the economic or managerial power to influence the agreements governing their relationship with their respective investment entities. *But see* Abrams, *Imposing Liability for "Control" Under Section 7 of the Uniform Limited Partnership Act*, 28 CASE W. RES. L. REV. 785, 822-23 (1978). For an example of a fully negotiated limited partnership agreement, see *Limited Partnership: Model Agreement and Certificate*, 26 S. TEX. L. J. 25 (1985) (drafted by the Partnership Law Committee; Corporation Banking and Business Law Section; State Bar of Texas) [hereinafter *Model Agreement*].

53. Roulac, *supra* note 8, at 280. In part, this lack of an effective voice stems from the limited partners' lack of representation when the general partner's attorney drafts the original partnership agreement. Limited partnership interests are often sold on a "take it or leave it" basis, leaving the limited partners little bargaining power to demand revisions of the agreement.

54. Because the general partner is subject to the risk of unlimited liability, individuals are often deterred from assuming this role. To shield individuals from general liability, several methods of organizing the partnership have emerged:

> (1) an established corporation engaged in regular business operations enters a limited partnership as the general partner; (2) promoters of a venture . . . desiring to retain control while shielding themselves from unlimited liability, cast the venture in the form of a limited partnership; they organize a corporation, in which tbey bold all or most of the shares, to serve as general partner and bring in outside investors as limited partners; . . . and (3) persons wbo want to set up an enterprise as a limited partnership and hecome limited partners for most or some of their investment organize a corporation in which they become principal shareholders, directors, and officers, to act as the limited partnership's sole general partner, thus shielding tbemselves from liability while retaining effective control of the enterprise.

O'Neal, *Comments on Recent Developments in Limited Partnership Law*, 1978 WASH. U.L.Q. 669, 683.

55. There is no limitation on tbe number of limited partners. *See* Roulac, *supra* note 8, at 280 n. 52 (noting that recent offerings have involved 500-1000 investors). The drafters of early partnership agreements probably did not contemplate that a corporation could serve as a general partner. Instead, they viewed limited partnerships as small business enterprises involving close contact between investors and managers. O'Neal, *supra* note 54, at 683. The drafters assumed that at least one individual participant would be subject to unlimited liability. *Id.*; CRANE & BROMBERG, *supra* note 4, at 146 ("the limited partnership was conceived to accommodate only a few limited partners"). Today, partnerships generally are no longer small and consensual. Basye, *supra* note 10 at 36; Hrusoff & Cazares, *Formation of the Public Limited Partnership*, 22 HASTINGS L.J. 87 (1977); Comment, *supra* note 34, at 102. The primary concern of limited partners, protecting and monitoring their investments, has overridden the importance of friendly relations between participants. Note, *Procedures and Remedies in Limited Partners' Suits For Breach of the General Partner's Fiduciary Duty*, 90 HARV. L. REV. 763, 779 (1977). Amicable relations and continuity of interest between the general and limited partners were once both the elements and result of a suc-

the partnership agreement and include nonjudicial methods of resolving potential intrapartnership disputes in the agreement. Nonjudicial methods of resolving these disputes avoid the high costs of litigation and protect partnership assets.[56]

Several mechanisms exist for resolving disputes in a limited partnership.[57] First, the parties may include an arbitration provision in the partnership agreement.[58] The drafter of an arbitration clause should exercise caution in establishing the method of choosing an arbitrator.[59] Limited partners should not permit the general partner to have complete discretion in naming an arbitrator; rather, the limited partners should insist on a voice in the decision of who will act as arbitrator. Furthermore, arbitration agreements may be subject to state statutory control; these state requirements must be met for the provision to be legally enforceable.[60] Second, independent legal representation of the limited partners' interests may be employed as an appropriate dispute resolution mechanism.[61] In fact, limited partners should retain legal counsel, or in-

cessful partnership since the general partners' compensation depended on that success rather than on a salary or fees. UNIF. PARTNERSHIP ACT § 18(f) [hereinafter UPA]. Today, general partners benefit from higher fees at the expense of the limited partners' return on their investment. Comment, *supra* note 35, at 103 n. 16.

56. The parties can avoid intrapartnership disputes by successfully negotiating and including specific dispute resolution provisions in tbe agreement. In essence, clearly drafted dispute resolution provisions enable the parties to assess immediately their position and provide the parties with an alternative to litigation.

57. Buy-out arrangements, including specific provisions for fundings, may be incorporated into the agreement as a dispute resolution procedure. *See* Coleman & Weatherbie, *supra* note 6, at 909; Massman, *Buy-Sell Arrangements*, in CORPORATION, BANKING AND BUSINESS LAW SECTION, STATE BAR OF TEXAS, TEXAS PARTNERSHIP LAW at E1 (1976). The parties can establish a "conflict insurance fund" which would cover the cost of legal representation and an independent economic analysis in the event of a dispute. Roulac, *supra* note 8, at 308.

58. Pacific Inv. Co. v. Townsend, 58 Cal. App. 3d 1, 129 Cal. Rptr. 489 (1976) (discussing arbitration clauses in limited partnerships); *see* Coleman & Weatberbie, *supra* note 6, at 909; Roulac, *supra* note 8, at 306.

59. *See supra* note 58. The arbitrator should possess a tborougb knowledge of limited partnerships and the particular industry in wbich the partnership operates.

60. *See, e.g.*, Texas General Arbitration Act, TEX. REV. CIV. STAT. ANN. arts. 224-249 (Vernon 1973). Tbe Texas General Arbitration Act sets fortb strict requirements for a valid and enforceable arbitration clause, namely that:

> [a] written agreement concluded upon the advice of counsel to both parties as evidenced by counsels' signatures thereto to submit any existing controversy to arbitration or a provision in a written contract concluded upon the advice of counsel to both parties as evidenced by counsels' signatures thereto to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Id. at 224.

61. Coleman & Weatherbie, *supra* note 6, at 909; Roulac, *supra* note 8, at 308.

duce the general partners to do so for them, not only during the initial drafting of the partnership agreement, but also during any subsequent intrapartnership disputes.[62] Third, removal of the general partner is an important nonjudicial method for resolving intrapartnership disputes. Because neither the ULPA, the RULPA, nor the 1985 ULPA provides a statutory right of removal,[63] the limited partners must negotiate the inclusion of this provision and its specific contents.

3. Contents of Removal Provisions

Under a theory of partnership democracy, the partnership would grant the limited partners a right to approve, by majority vote, specific actions taken by the general partners.[64] Partnership voting rights promote the investment protection policy underlying limited partnership and securities statutes because the limited partners can oversee their investment more effectively.[65] The partnership agreement may grant the limited partners voting rights concerning the removal or election of general partners, sale of all or substantially all of the partnership's assets, termination of the partnership, or extraordinary managerial issues such as changing the purpose of the business or incurring excessive debt.[66] Of all these voting rights, the right to remove general partners provides the limited partners with the most direct method of influencing partnership management and protecting their investments.[67] If the

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62. Ideally the limited and general partners should engage separate counsel. However, the general partners' counsel usually drafts the partnership agreement and also serves as the limited partnership's counsel. Roulac, *supra* note 8, at 308. This situation requires a clarification as to whom the attorney actually represents. *Id.*

63. *See infra* note 107 and accompanying text.

64. Coleman & Weatherbie, *supra* note 6, at 906. The RULPA sanctions the grant of voting rights to limited partners by expressly providing that "the partnership agreement may grant to all or a specified group of the limited partners the right to vote (on a per capita or other basis) upon any matter." RULPA § 302. The limited partners, however, cannot exercise rights beyond those enumerated in § 303(b) without risking unlimited personal liability because the official comment to § 302 expressly states that its protection is "[s]uhject to Section 303."

65. *See supra* notes 32, 37-40 and accompanying text.

66. Coleman & Weatherbie, *supra* note 6, at 906. The RULPA enumerates the specific voting rights that the partnership agreement may grant limited partners. RULPA § 303(b)(5); 1985 ULPA § 303(B)(6).

67. Augustine, Fass, Lester & Robinson, *The Liability of Limited Partners Having Statutory Voting Rights Affecting the Basic Structure of the Partnership*, 31 Bus. Law 2087, 2101 (1976) [hereinafter Augustine]. Note, however, that removal provisions may influence strongly the course of the partnership's business and, therefore, may cause the imposition of unlimited personal liability for the limited partners under the ULPA. *Id.*; *see infra*

parties intend to include a removal provision in the limited partnership agreement, the mechanics of the removal process should be particularized and codified. Specific issues, including the percentage of limited partners needed to call a partnership meeting and the notification requirements, must be addressed. The partnership agreement also must specify the percentage of limited partners' votes required to effect removal, quorum requirements, availability of proxies, and method of valuation of the removed general partner's interest.

(a) The Partnership Meeting

Removal provisions should specifically permit limited partners constituting a predetermined partnership interest percentage, such as ten or twenty percent, to call a partnership meeting.[68] Alternatively, limited partners satisfying a requisite percentage could be given the right to compel the general partner to convene a partnership meeting.[69]

The form and manner of notification to the partners of any partnership meeting should be stipulated in the removal provision. The provision should require the general partner to furnish the limited partners with records disclosing the names of all parties holding outstanding limited partnership interests.[70] Furthermore, the removal provision should require that the notice outline the proposal and include the material facts and allegations necessitating the general partner's removal. Additionally, the removal provision should provide an adequate amount of time prior to the meeting during which the general partner can prepare a rebuttal to the allegations set forth in the notice.[71]

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notes 222-24 and accompanying text. In contrast, the RULPA prevents the imposition of liability and provides a "safe harbor" for limited partners exercising specific voting rights. RULPA § 303(b)(5); *see infra* notes 230-31 and accompanying text.

68. The limited partners' right to call a partnership meeting also could be based on their contribution of a minimum dollar amount to the total capital investment. Coleman & Weatherbie, *supra* note 6, at 907.

69. Of course, this particular procedure might be ineffective if the general partner refuses to call the meeting. Therefore, the removal provision should authorize the limited partners to call the meeting. Otherwise, the limited partners might have to petition the courts in an equitable action to call for a vote.

70. *See* Coleman & Weatherbie, *supra* note 6, at 907.

71. *Id.* If the provision requires "cause" for removal, the general partner should receive adequate notice of the charges and an opportunity to present his rebuttal at the partnership meeting.

(b) Voting Requirements for Removal

In addition to establishing provisions controlling the partnership meeting, the partnership agreement also should specify the voting requirements for removing a general partner. Ordinarily, the partnership agreement grants a right of removal to limited partners whose aggregate interests exceed a given percentage, such as fifty percent, of the outstanding limited partnership interests.[72] This percentage, however, is subject to negotiation. Therefore, the general partner may seek to include a supermajority voting requirement in the agreement.[73] The agreement also could distribute the voting power based on the dollar amount invested by limited partners or on a per capita basis.[74]

The partnership agreement should state whether a general partner can be removed "without cause."[75] When the removal provision requires a showing of "good cause"[76] prior to removal the limited partners are forced to tolerate the general partner, purchase the general partner's interest, or litigate the existence of "good cause."[77] Granting limited partners the right to remove a general partner "without cause" allows them to avoid this costly dilemma.[78] The formation of limited partnerships with numerous

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72. *Id.*

73. Harkleroad, Limited Partnership Practice: Rights, Duties and Liabilities of Partners 98 (October 27, 1983) (presented to the Second Annual Corporate and Banking Law Institute at Sea Island, Georgia). A supermajority voting provision requires that a percentage greater than 50%, such as 80%, of the limited partners' interest be voted in favor of the general partners' removal.

74. Coleman & Weatherbie, *supra* note 6, at 907. Thus, the voting power of the limited partners could be distributed according to the percentage of limited partnership interests owned, the dollar value of those interests, or equally among the limited partners.

75. Commentators have noted that although the removal of a general partner "without cause" appears harsh, limited partners do not need to exercise that power if the general partner is managing the partnership profitably. *See Model Agreement, supra* note 52, at 58 & n.48; Note, *Partnership: Can Rights Required to be Given Limited Partners Under the New Tax Shelter Investment Regulations be Reconciled with Section 7 of the Uniform Limited Partnership Act?*, 26 OKLA. L. REV. 289, 295 (1973).

76. A provision specifying removal of the general partner only for "cause" should specify events triggering the provision. Mismanagement, negligence, diversion of partnership assets, action without or beyond authority, or failure to perform certain elements of the partnership agreement are examples of possible triggering events.

77. *See Model Agreement, supra* note 52, at 58 & n. 48.

78. General partners can negate the harsh effects of "without cause" removal provisions by negotiating for a supermajority voting requirement to effectuate removal. *See Model Agreement, supra* note 52, at 58 & n. 48. The drafters of the *Model Agreement* suggest a requisite vote of seventy-five percent of the limited partners' interest to remove a general partner "without cause". The higher percentage usually will minimize arbitrary removal of the general partner. *Id.*

limited partners may compel drafters of removal provisions to include provisions for proxy voting,[79] provisions that are subject to the proxy rules of state and federal securities laws.[80] Proxy voting, however, may permit outsiders or the limited partners to attempt a takeover of the general partner's interest.[81] A takeover bid may result in the limited partners' loss of limited liability and application of the complex federal securities laws.[82] Although the general principles regulating takeover bids in the corporate securities area may apply, no rules specifically regulate proxy battles or takeover attempts in the limited partnership area.[83] To avoid potential problems, drafters should design carefully the proxy voting provisions to curtail the use of proxies.

(c) Other Considerations

General partners can restrict any removal power given to limited partners by negotiating for time restrictions on the removal. For example, the removal provision could grant the general partner an initial grace period, possibly two or more years, during which the limited partners could not remove the general partner.[84] Alter-

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79. Alternatively, the removal provision could provide for ballot voting. In lieu of notifying the limited partners of an impending partnership meeting, the general or limited partner discloses the facts and allegations to the limited partners by mail and provides the recipients with a ballot. The ballot is then returned by the voters, indicating either opposition or approval of the proposed removal. *See* Lesesne v. Mast Property Management, Inc., 251 Ga. 550, 307 S.E.2d 661 (1983).

80. *See* Securities and Exchange Act, § 14(a), 15 U.S.C. § 78n(a) (1982); CAL. CORP. CODE § 15637(i) (West Supp. 1986)

81. Roulac, *supra* note 8, at 304. Professor Roulac notes that although the "takeover" of the general partner's interest is rarely attempted, the possibility increases when the general partner's interest is primarily "a participation in ongoing income." *Id.* For an example of a takeover by a limited partner, see Weil v. Diversified Properties, 319 F. Supp. 778 (D.D.C. 1970) (illustrating situation in which the limited partners instituted takeover during partnership financial crisis).

82. *See generally* Roulac, *supra* note 8, at 303-04; 15 U.S.C. § 78m(d)(1), § 78n(d)(1),(5)-(7); Loss, *The SEC Proxy Rules and State Law*, 73 HARV. L. REV. 1249 (1960); Bromberg, *Tender Offers: Safeguards and Restraints—An Interest Analysis*, 21 CASE W. RES. L. REV. 613 (1970).

83. Professor Roulac suggests that proxy rules are playing an increasingly important role in the limited partnership context:

> [p]roxy requirements and even guidelines governing tender offers are not alien to the limited partnership context. . . .The mechanics for conducting a takeover bid in the corporate securities area are complex and subject to very specific regulation. Although the same general principles would seem to apply to the partnership area as well, there are no specific guidelines to suggest how such a contest might he handled in the partnership context.

Roulac, *supra* note 8, at 303.

84. Harkleroad, *supra* note 73, at 98. A specified grace period gives the general partner

natively, the general partner could demand that the removal provision require notification of the reasons for removal and a time period to correct any deficiencies or problems.[85] Because the partnership agreement is contractual in nature, inclusion of these provisions is subject to negotiation.

A removal provision also should include terms, triggered by a vote to remove the general partner, specifying the effective date of removal; rights of limited partners to elect a successor general partner;[86] and continuing rights, interests, and liabilities of the removed general partner. Depending on the terms of the removal provision, the removed general partner may be expelled from the partnership, demoted to a passive managerial role, or converted into a special limited partner. Although no statutory provision explicitly grants limited partners the right to expel a general partner, section 38(1) of the UPA implicitly authorizes "expulsion of a partner, bonafide under the partnership agreement."[87] Therefore, drafters should provide contractually for the expulsion of a general partner. It must be noted, however, that expulsion of the sole general partner may cause dissolution of the limited partnership.[88] Alternatively, the removal provision may terminate the agency status of the general partner, divest him of all managerial authority, and permit the limited partners to appoint a partnership "manager" to assume the general partner's managerial responsibilities.[89] Al-

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an opportunity to confront and solve problems that arise in the initial phase of any business organization. By providing a limited grace period, general partners are assured of their tenure as managers and, thus, can make business decisions in the formative period of the limited partnership without seeking the continued approval of the limited partners. *Cf.* Abrams, *supra* note 52, at 823 (arguing that removal provisions give limited partners a weapon that forces the general partner to conduct the partnership's affairs merely to maintain the limited partners' approval).

85. Harkleroad, *supra* note 73, at 98. "Cure provisions", however, benefit general partners only when the partnership agreement requires "cause" for removal.

86. *See infra* notes 246-55 and accompanying text.

87. UPA § 38(1); *Model Agreement, supra* note 52, at 58 & n.47. The ULPA and the revised acts expressly state that the UPA governs in situations not specifically provided for in the uniform limited partnership statutes. ULPA § 29; RULPA § 1105; 1985 RULPA § 1106.

88. *See infra* notes 124-26 and accompanying text.

89. The "manager" would assume contractually the administrative and business function of the removed general partner. *Model Agreement, supra* note 52, at 58 & n.47. The general partner would remain personally liable for partnership debts. In Weil v. Diversified Properties, 319 F. Supp. 778 (D.D.C. 1970), the limited partners managed the business through a manager and the general partner renounced his salary and duties as manager of the partnership's properties. The court, however, did not address directly the issue of replacing the general partner with a non-partner manager. Instead, the court focused on whether the actions of the limited partners violated the "control" limitation of ULPA § 7.

though this procedure avoids technical dissolution and reconstitution requirements,[90] there are several potential problems. First, finding a capable and experienced "manager" willing to risk the assumption of partnership liabilities may prove difficult.[91] Second, the manager would need cooperation from the removed general partner during the transition period. Realistically, however, the limited partners and manager should not expect an overwhelming amount of help from the general partner they recently stripped of managerial power.[92] Finally, in most situations it is unlikely that the removed general partner will be willing to maintain the position of general partner, risking unlimited liability, without managerial control of the partnership.

The removal provision also may convert the removed general partner's interest into a limited partner interest. This permits the removed general partner to retain at least part of his original partnership interest.[93] As a "special limited partner," the removed general partner has limited liability status; the partnership agreement, however, may not grant him rights identical to those of ordinary limited partners.[94] If the removal provision establishes the "special limited partner" alternative, either a substantial part of the general partner's interest must be forfeited contractually or the remaining limited partners' interests will be diluted considerably.[95] The removal provision also should condition conversion of the general partner's interest upon removal "without cause" because readmitting a general partner removed for "cause" merely perpetuates an unsatisfactory arrangement.[96]

The removal provision should stipulate an amount, or formula for determining an amount, constituting payment to the expelled

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The court held that the limited partners' actions were required to prevent the business from financial failure and, thus, declined to impose general liability. *Id.* at 782.

90. The ULPA and the RULPA require the presence of a general partner with unlimited liability for the protection of creditors. ULPA § 1; RULPA § 403(b); 1985 ULPA § 403(b).

91. *Model Agreement, supra* note 52, at 58 & n.47. In addition, the newly-appointed manager may find it difficult to convince creditors that he possesses the legal authority to manage the partnership. *Id.*

92. *Id.*

93. *Id.*

94. Section 302 of the RULPA states that "the partnership agreement may grant to all or *a specified group of the limited partners the right to vote . . . upon any matter.*" RULPA § 302 (emphasis added); 1985 ULPA § 302. Thus, to prevent the removed general partner from retaliating against the new general partner, the partnership agreement may not grant special limited partners certain powers, such as the removal of general partners.

95. *Model Agreement, supra* note 52, at 58 & n.47.

96. Furthermore, equity does not compel the readmission of the general partner. *Id.*

general partner for his partnership interest. The UPA, the ULPA, and the RULPA do not state explicitly what a general partner should receive upon expulsion. The UPA,[97] however, provides that an expelled partner who is discharged from all partnership liabilities shall receive, in cash, "only the net amount due him from the partnership".[98] Similarly, UPA sections 38(2)(b)[99] and 38(2)(c)(II)[100] refer to "the value of [the parties'] interest" upon dissolution. The UPA, therefore, affords the expelled partner the right to receive fair value payment for his partnership interest absent an express contractual provision.[101] The removal provision should provide a basis for determining fair value,[102] such as the book value of the partner's share, a pro rata share of partnership earnings, or a pro rata share of the appraised value of the partnership's net assets.[103] Drafters of removal provisions may want to provide different valuation methods, dependent upon whether the general partner was removed with or without "cause."[104] If the removed general partner contributed services, the removal provision also should provide a method for evaluating those services, regardless of whether the general partner is expelled or merely exchanging his interest.[105]

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97. UPA § 38(1).

98. *Id.*

99. UPA § 38(2)(b).

100. UPA § 38(2)(c)(II).

101. If, however, the general partner damaged the partnership, the general partner's payment may be offset by the amount of damages. *See* UPA § 38(2)(c)(II); *Model Agreement*, *supra* note 52, at 58 & n.49.

102. These terms, subject to general contractual rules, could be invalidated if they resemble penalty clauses. *Model Agreement*, *supra* note 52, at 58 & n.49. Additionally, the removal provision should establish either a fixed or floating rate of interest to be paid on the removed general partner's partnership interest.

103. Practitioners are cautioned that an appraisal method may be deemed an arbitration agreement subject to regulation by state arbitration statutes. *Model Agreement*, *supra* note 52, at 58 & n.49; *see supra* notes 58-60 and accompanying text. Furthermore, drafters may have difficulty specifying the various elements to be considered and weigbed in appraising the partnership interest.

104. *See Model Agreement*, *supra* note 52, at 58.

105. *See* Coleman & Weatherbie, *supra* note 6, at 914; Roulac, *supra* note 8, at 295-96. Exchanging the removed general partner's interest for a limited partnership interest becomes more complicated, if not impossible, when services constitute the general partner's contribution because § 4 of tbe ULPA states that "the contributions of a limited partner may be cash or other property, *but not services*" (emphasis added). RULPA § 501, however, expands § 4 of the ULPA and explicitly permits limited partners to make contributions of services. RULPA § 501, official comment.

B. Uniform Legislation

Although freedom of contract theories provide the limited and general partners with great flexibililty in drafting a partnership agreement, conflicts may arise between the business relationship established by the agreement and the relationship permissible under uniform legislation.[106] To avoid future litigation, drafters must ensure not only that the agreement reflects the desires of the parties, but also that it conforms to the applicable statutory provisions. The ULPA, the RULPA, and the 1985 ULPA all fail to provide limited partners with an explicit right of removal. At first glance, this omission raises questions concerning the enforceability of a removal provision included in the partnership agreement.[107] The right of removal, however, is both consistent with the policies underlying the uniform statutes[108] and implicit in specific statutory provisions.

1. The Uniform Limited Partnership Act

Although the ULPA does not expressly grant limited partners the right to remove general partners,[109] some courts have recognized that the partnership agreement may provide for the involuntary dismissal of a general partner.[110] Similarly, in construing UPA section 30, courts have declared that they will not frustrate the intention of the parties by imposing a good faith requirement on the right of dismissal. This relieves the limited partners of the burden of establishing good faith.[111] These courts, however, have strictly scrutinized the limited partners' compliance with any con-

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106. *See generally* Note, *supra* note 4, at 682-91.

107. *See generally* Wertheimer, *Substantive Law and Special Problems of General and Limited Partnerships* in RESOURCE MATERIALS—PARTNERSHIPS: UPA, ULPA, SECURITIES, TAXATION, AND BANKRUPTCY 104-05 (5th ed. 1984). The author conclusively states that a provision not addressed in the ULPA "is enforceable and governs the relations of the partners." *Id.*

108. *See supra* notes 28-34 and accompanying text.

109. However, unless otherwise provided in the partnership agreement, the UPA expressly commands that a general partnership dissolve upon expulsion of a partner. UPA § 31(1)(d).

110. *See* Betz v. Chena Hot Springs Group, 657 P.2d 831 (Alaska 1982); *see also* Gelder Medical Group v. Webber, 41 N.Y.2d 680, 363 N.E.2d 573, 394 N.Y.S.2d 867 (1977) (involving a general partnership).

111. *See, e.g.*, Gelder Medical Group v. Webber, 41 N.Y.2d 680, 294 N.Y.S.2d 867 (1977) (holding tbat partners do not have to prove that they acted in good faith even if bad faith would nullify the right to expel a general partner). For the vote to be nullified, the expelled general partner must allege and prove bad faith in the formation of the original partnership agreement.

ditions and procedures prescribed in the partnership agreement's dismissal provision.[112]

The ULPA's drafters intended for limited partners to maintain supervisory control over their limited partnership interest.[113] The official comment to section 1 of the ULPA provides that "[n]o public policy requires a person who contributes to the capital of a business, acquires an interest in the profits, and *some degree of control over the conduct of the business*, to become bound for the obligations of the business."[114] Because their partnership investments are managed by a general partner, limited partners obviously are interested in and affected by the identity of the general partner.[115] Limited partners originally consented to the identity of the general partner by merely investing in the limited partnership.[116] The limited partners' concerns regarding clandestine changes in management have been alleviated by section 9(1) of the ULPA, which prohibits the admission of a person as general partner without the consent of all the limited partners.[117] This unanimous voting requirement reflects the ULPA drafters' intention to give the limited partners an effective control mechanism over changes in the general partner's identity subsequent to formation of the limited partnership.[118] This policy of granting the limited partners greater control over the direction of the partnership extends to the limited partners' removal rights because removal also serves as a device to ensure that the limited partners have an effec-

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112. *See* Millett v. Slocum, 4 A.D.2d 528, 167 N.Y.S.2d 136 (1957), *aff'd*, 5 N.Y.2d 734, 152 N.E.2d 672, 177 N.Y.S.2d 716 (1958).

113. Augustine, *supra* note 67, at 2101.

added).

115. The limited partners' concern over the security of their investment is analogous to a creditor's concern over the selection of parties to whom credit will be extended. *See* Note, *supra* note 75, at 295.

116. *Id.*

117. ULPA § 9(1) provides:

> A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to . . . (e) [a]dmit a person as a general partner, (f) [a]dmit a person as a limited partner, unless the right to do so is given in the certificate, (g) [c]ontinue the business with partnership property on the death, retirement or insanity of a general partner, unless the right to do so is given in the certificate.

See also ULPA §§ 20, 24.

118. The drafters designed the UPLA to promote capital investments by granting investors limited liability and permitting investors sufficient control to protect their investments. Analyzing managerial performance and correcting discovered deficiencies is the "quintessence of protecting one's investment." Note, *supra* note 75, at 295.

tive voice in determining the identity of the general partner.

Section 10 of the ULPA[119] grants other rights to limited partners that are comparable to their general partner removal powers. Section 10 recognizes a limited partner's right of access to partnership information.[120] Courts have indicated that in extraordinary situations limited partners may respond to the information they acquire by taking actions necessary to protect their investments without incurring general liability.[121] Therefore, the power to remove a general partner complements the limited partners' information rights.[122] Furthermore, a contrary conclusion exposing limited partners to unlimited liability would deny investors the means to protect and secure their investment short of dissolving the partnership.[123] Additionally, the limited partners' right to seek dissolution and liquidation is analogous to their right to remove a sole general partner[124] because, similar to a situation in which the partnership agreement fails to provide for a substitute general partner,[125] the limited partnership dissolves if none of its members accept general liability.[126]

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119. ULPA § 10(1) provides:

A limited partner shall have the same rights as a general partner to (a) [h]ave the partnership books kept at the principal place of business of the partnership, and at all times to inspect and copy any of them, (b) [h]ave on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable, and (c) [h]ave dissolution and winding up by decree of court.

120. *Id.*

121. *See* Weil v. Diversified Properties, 319 F. Supp. 778 (D.D.C. 1970) (allowing a limited partner to hire and confer with business managers when the general partner renounces his salary and managerial responsibilities).

122. *See* Note, *supra* note 75, at 296. Removal rights complement other rights inherent in limited partner status without violating the "control" prohibition of ULPA § 7.

123. ULPA § 10(1)(c) grants limited partners the right to seek judicial dissolution of the partnership. *See infra* note 124 and accompanying text. Dissolution by court decree is not exclusive. Therefore, the partnership agreement may grant limited partners the right to dissolve the partnership. *See* Roulac, *supra* note 8, at 294.

124. Augustine, *supra* note 67, at 2102. Even after a particular limited partnership is dissolved, the participants still may reconstitute with a new general partner.

125. ULPA § 20 states that "[t]he retirement, death, or insanity of a general partner dissolves the partnership, unless the business is continued by the remaining general partners (a) [u]nder a right to do so stated in the certificate, or (b) [w]ith the consent of all members." Logically, if the partnership agreement provides for a successor general partner upon removal of the original general partner, dissolution of the partnership due to removal of the sole general partner can be avoided. *See infra* notes 246-48 and accompanying text; *see also* Betz v. Chena Hot Springs Group, 657 P.2d 831 (Alaska 1982) (finding that amendment to partnership agreement providing for continuance vote illustrated parties' intent to continue partnership upon involuntary retirement of general partner).

126. *See* In re Harms, 10 Bankr. 817 (D. Colo. 1981) (dissolving limited partnership without a general partner).

While dissolution provided an adequate remedy prior to passage of uniform legislation,[127] the size and structure of modern limited partnerships often render dissolution an inappropriate remedy.[128] Limited partners who seek judicial dissolution and liquidation of the partnership may produce a more harmful result than a general partner guilty of fraud or mismanagement. Because of the time constraints and decreased bargaining power inherent in forced sales, limited partners may realize a less favorable return on their investment.[129] Furthermore, dissolution may result in substantial tax liabilities for the limited partnership, including the realization of gain on outstanding nonrecourse loans and cash received.[130] Upon dissolution, limited partners receive a proportionate share of the partnership's outstanding nonrecourse debts and cash; therefore, the limited partners may be taxed on gains yielded if they previously took large depreciation deductions to reduce their bases.[131] Thus, limited partners should seek judicial dissolution only when the harm resulting from the general partner's misconduct substantially outweighs the deprivation of either a greater return on their investment or income tax benefits.

Removal of a general partner is far less disruptive to a limited partnership's business than judicial dissolution.[132] Removal alleviates the unreasonable requirement of forcing limited partners to terminate their investments to protect against a general partner's fraud or mismanagement. If limited partners possess a right of removal and if the partnership agreement provides for a successor general partner and continuation of the partnership, then the limited partners may retain their investments in addition to receiving protection from mismanagement. By exercising their power to remove a general partner, limited partners can avoid a reduction in the return on their partnership interest and the attendant loss of

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127. When partnerships were primarily small organizations with personal relationships among the members, courts were reluctant to interfere in the essentially private relationships and preferred terminating the common association. *See* Note, *supra* note 55, at 779.

128. Modern limited partnerships often involve hundreds of limited partners who require protection from the general partners' mismanagement. *See* Hecker, *supra* note 37, at 344; Note, *supra* note 55, 779. Dissolving a large limited partnership would be costly to the business and to the limited partners.

129. *See* Note, *supra* note 55, at 779.

130. Crane v. Comm'r, 331 U.S. 1 (1947) (holding that taxpayer realized gain on sale of property subject to non-recourse mortgage).

131. *See generally* Note, *supra* note 55, at 780-83.

132. With judicial dissolution, the partnership may continue to exist only until winding up its existing business. *See* CRANE & BROMBERG, *supra* note 4, § 90B, at 518-519 and n.22.

tax benefits.

Section 9(1)(g) of the ULPA[133] allows the limited partnership to continue transacting business with a remaining general partner following the death, retirement, or insanity of another general partner if the partnership agreement so provides or if the limited partners unanimously agree to a continuation.[134] Section 9(1)(g) acknowledges the importance of the limited partners' approval concerning continuation of the business when the identities of the general partners have changed. Granting limited partners the right to remove a general partner and to continue the business with another existing general partner produces the same circumstantial result as section 9(1)(g). Furthermore, permitting the business to continue with a substitute general partner enables the limited partners to protect their investments without resorting to dissolution.[135]

2. The Revised Uniform Limited Partnership Act

Similar to the ULPA, the RULPA does not explicitly grant limited partners the right to remove general partners. The RULPA, however, grants limited partners specific rights that are analagous to the right of removal. For example, section 401[136] of

133. For the actual language of ULPA § 9(1)(g), see *supra* note 117.

134. A provision in the partnership agreement allowing a simple majority of the limited partners to elect a general partner and continue the business should not be objectionable because the limited partners agreed to the provision upon entering the agreement. Augustine, *supra* note 67, at 2102; *see infra* notes 253-54 and accompanying text. At least one court, however, has held that a condition agreed to in advance does not necessarily constitute the "written consent . . . of tbe specific act" required by ULPA § 9(1). Newburger, Loeb & Co. v. Gross, 365 F. Supp. 1369 (S.D.N.Y. 1973) (bolding the language of section 9(1)(b) to be absolute and not subject to variation by the partnership agreement and, therefore, requiring a unanimous vote of the partners prior to the transfer of partnership assets to a successor corporation).

135. The limited partners' right to remove a general partner and to continue the business with a substitute general partner affects the partnership in the same way as tbe limited partners' exercise of their 9(1)(g) rights because both permit the partnership business to be continued by the remaining general partners upon tbe death, retirement, or insanity of a general partner with the limited partners unanimous consent. *See supra* note 125 and accompanying text; *infra* notes 246-48 and accompanying text.

136. RULPA § 401 provides that "[a]fter the filing of a limited partnership's original certificate of limited partnership, additional general partners may be admitted only with the specific written consent of each partner." *But see* Basile, *Admission of Additional and Substitute General Partners to a Limited Partnership: A Proposal for Freedom of Contract*, 1984 ARIZ. ST. L.J. 235 (arguing tbat the contemporaneous consent rule for the admission of additional and substitute general partners should be repealed); 1985 ULPA § 401 (permitting partnership certificate to provide for admission of general partners upon less than unanimous vote of limited partners).

the RULPA, like section 9(1)(e)[137] of the ULPA, requires the limited partners' unanimous approval as a condition precedent to the admission of a new general partner. The RULPA's drafters intended to provide limited partners with a method for controlling changes in the partnership's management.[138] The power to remove a general partner furthers this intent by providing limited partners with a related mechanism for instituting managerial change and protecting their investment.

In several areas, however, the RULPA considerably expands the removal power implicit in the ULPA. For instance, RULPA section 303(b) permits the partnership agreement to grant, and limited partners to exercise, specific voting rights.[139] Enumerated statutory voting rights include the limited partners' right to remove a general partner.[140] Additionally, section 402 provides for cessation of the general partner's agency status if he is removed in accordance with the partnership agreement.[141] Although the RULPA does not explicitly grant limited partners the right to remove a general partner, its provisions establish that the "general partner's agency relationship is terminable at will".[142]

Unlike the ULPA, the RULPA enables the limited partners to remove a sole general partner without causing dissolution of the limited partnership.[143] Under the ULPA, if the removed general partner is also the sole general partner, then dissolution will occur automatically. If, however, the removed general partner is not the sole general partner and the partnership agreement specifically authorizes continuation under direction of the remaining general partners, then the limited partnership is sustained.[144] To avoid dissolution, the RULPA permits the limited partners to remove the sole general partner, continue the business, and appoint one or

137. ULPA § 9(1)(e) states that general partners have no authority to "[a]dmit a person as a general partner" without the unanimous consent of the limited partners.

138. *See supra* note 118 and accompanying text.

139. Note that the 1985 ULPA expands the voting rights of § 303(b) significantly. *See* 1985 ULPA § 303(h)(6).

140. RULPA § 303(b)(5)(v); 1985 ULPA § 303(b)(6)(v).

141. *See also* 1985 ULPA § 402(3). RULPA § 402(3) provides that a person ceases to be a general partner in a limited partnership if "the general partner is removed as a general partner in accordance with the partnership agreement."

142. RULPA § 402, official comment. The RULPA's drafters further noted that removal of the general partner might "result in a breach of the partnership agreement giving rise to an action for damages."

143. RULPA § 801(3); 1985 ULPA § 801(4); *see infra* note 147.

144. ULPA § 20; *see supra* notes 124-26 and accompanying text.

more additional general partners.[145] RULPA section 801(3)[146] gives the limited partners a ninety day grace period during which to unanimously agree, in writing, to continue the business and to appoint one or more substitute general partners.[147] The section 801(3) grace period, coupled with the inclusion of removal voting rights in section 303(b) and the explicit recognition in section 402 that the general partner's agency relationship terminates at will, affirms the limited partners' right to remove general partners under the RULPA.

C. *State Securities Regulations*

By definition, limited partnerships are securities because the limited partners cannot participate in management of the partnership's business.[148] Thus, limited partners are considered quasi-stockholders.[149] Section 18 of the Securities Act of 1933 specifically preserves the states' right to regulate the offering, sale, and distribution of securities.[150] Similar to the federal securities laws, state blue-sky laws[151] require disclosure and dissemination of informa-

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145. RULPA § 801(3); 1985 ULPA § 801(4); *see* Basile, *supra* note 136, at 244.

146. Section 801(3) provides for dissolution of the limited partnership upon:

> withdrawal of a general partner unless at the time there is at least one other general partner and the certificate of limited partnership permits the business of the limited partnership to be carried on by the remaining general partner and that partner does so, hut the limited partnership is not dissolved and is not required to be wound up by reason of any event of withdrawal if, within 90 days after withdrawal, all partners agree in writing to continue the business of the limited partnership and to the appointment of one or more additional general partners if necessary or desired . . . .

See also 1895 ULPA § 801(4). Removal of a general partner constitutes an "event of withdrawal." RULPA §§ 101(3), 402(3); 1985 ULPA §§ 101(3), 402(3).

147. *But see* Lovell v. Hallelujah, Inc., 451 So. 2d 116 (La. Ct. App. 1984) (construing Louisiana partnership law). In *Lovell* the court rejected the provisions of RULPA § 801(3) because it "would require a limbo period at least until an additional general partner is appointed, where the firm would either be without management or the limited partners would be held liable as general partners." *Id.* at 121. Instead, the court held that "the departure of all general partners results in dissolution." *Id.; see* Comment, *An Examination of Louisiana Limited Partnership—The Partnership In Commendam*, 55 TUL. L. REV. 515, 540 (1981).

148. *See, e.g.*, Hirsch v. duPont, 396 F. Supp. 1214, 1227-28 (S.D.N.Y. 1975), *aff'd* 553 F.2d 750 (2d Cir. 1977) (holding that because limited partners must, by statute, rely solely on tbe efforts of others for tbeir profit, their limited partnership interest is a security); Stowell v. Ted S. Finkel Invs. Servs., Inc. [1981-82 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,321 (S.D. Fla. 1980) (holding that the right to replace a general partner does not affect the securities status of a limited partnership interest).

149. Boyle & Sommer, *Securities Law Aspects of Partnerships* in RESOURCE MATERIALS—PARTNERSHIPS: UPA, ULPA, SECURITIES, TAXATION, AND BANKRUPTCY 456-57 (5th ed. 1984).

150. Securities Act of 1933, § 18, 15 U.S.C. § 77r (1982).

151. Kansas enacted the first state securities law in 1911 to protect investors from

tion concerning securities through a registration process.[152] In 1956 the National Conference of Commissioners on Uniform State Laws promulgated the Uniform Securities Act. More than thirty states have subsequently adopted specific provisions of this Act.[153] In addition, state regulating agencies formed the North American Securities Administrators Association "to coordinate state securities laws and to adopt joint policies and guidelines in connection with securities offerings."[154] Finally, the Midwest Securities Commissioners Association, also composed of state securities regulators, releases policy statements and guidelines that member states may choose to adopt.[155] Promoters who register offerings in the form of a limited partnership with the Securities and Exchange Commission and state securities administrators must comply with guidelines and regulations adopted by the various states.[156]

The number of large, public limited partnerships has increased dramatically in recent years, in part due to the various tax shelter benefits inuring to investors.[157] This rapid expansion, coupled with reports of general partners' mismanagement and self-dealing,[158] prompted some states' securities administrators to promulgate rules, guidelines, and regulations to eliminate problems presented by public limited partnerships.[159] These state securities

"speculative schemes which have no more basis than so many feet of 'blue sky'." Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917). Hence, state securities statutes are labeled "blue sky laws."

152. *See Limited Partnerships—Recent Developments: Securities, Tax, and Substantive Partnership Law Issues*, 39 BUS. LAW. 677, 687 (1984) [hereinafter *Recent Developments*]. Exemptions from state and federal registration requirements are available. *See generally id.* at 689-92.

153. *See* D. RATNER, SECURITIES REGULATION IN A NUTSHELL § 44, at 302-03 (2d ed. 1982).

154. *Recent Developments, supra* note 152, at 687. The North American Securities Administrators Association is hereinafter referred to as the NASAA.

155. Note, *supra* note 55, at 780 n.86. Twenty-four states comprise the Midwest Securities Commissioners' Association [hereinafter MSCA]. Roulac, *supra* note 8, at 279 n.45.

156. *See, e.g.*, CAL. ADMIN. CODE tit. 10, R.260.140.116.2, 1 BLUE SKY L. REP. (CCH) ¶ 11,999 (Oct. 1985); MO. ADMIN. CODE § 30-152.180, 2 BLUE SKY L. REP. (CCH) ¶ 35,468 (June 1986); TEX. ADMIN. CODE tit 7 § 117.7, 3 BLUE SKY L. REP. (CCH) ¶ 55,607 (June 1986). These statutes require partnership agreements to provide for the removal of general partners, election of new general partners, and fair methods of valuation and payment for the removed general partner's share.

157. Hecker, *supra* note 34, at 58. Investment in publicly registered limited partnerships exceeded $8.2 billion in 1984. *News Report, supra* note 4, at 31.

158. *See e.g.*, Executive Hotel Assocs. v. Elm Hotel Corp., 41 Misc. 2d 354, 245 N.Y.S.2d 929 (N.Y. Civ. Ct.), *aff'd mem.*, 43 Misc. 2d 153, 250 N.Y.S.2d 351 (N.Y. App. Term 1964); Hecker, *supra* note 34, at 58-59.

159. *See e.g.*, *MSCA Statement of Policy Regarding Real Estate Programs* (adopted

administrators sought to provide limited partners with a measure of control over the management of the limited partnership, thereby enabling them to protect their investments from general partners' abusive actions.[160] To achieve this objective, some state regulations require that the partnership agreement grant a majority of the outstanding limited partnership interests specific rights, including the right to amend the partnership agreement, dissolve the partnership, remove a general partner, and elect a substitute general partner.[161] These requirements potentially conflict with the ULPA's provision that limited partners cannot participate in the partnership's management without incurring unlimited personal liability.[162] Thus, compliance with state securities guidelines could jeopardize the limited partners' status as limited partners and expose them to general liability.

In accord with the guidelines promulgated by their state securities administrators, several states have amended their partnership statutes so that the possession or exercise of specified voting rights will not constitute managerial control of the partnership.[163] Potential problems still exist, however, because many states have failed to amend their partnership statutes, thus raising choice of law problems.[164] The RULPA drafters attempted to alleviate this

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on Feb. 28, 1973; amended on Feb. 26, 1974 and July 22, 1975; adopted by the NASAA on April 15, 1980), *reprinted in* [1980 Transfer Binder] 1 BLUE SKY L. REP. (CCH) ¶ 4821; *NASAA Guidelines for the Registration of Oil and Gas Programs* (adopted Sept. 22, 1976; amended Oct. 12, 1977 and Oct. 31, 1979), *reprinted in* [1980 Transfer Binder] 1 BLUE SKY L. REP. (CCH) ¶ 4582.

160. *See* Hecker, *supra* note 34, at 59; Note, *supra* note 75, at 290.

161. *See supra* note 159.

162. *See* ULPA § 7. *See generally* Note, *supra* note 75, at 290-96.

163. *See, e.g.*, CAL. CORP. CODE § 15507 (1977 & West Supp. 1986); *see also* Hecker, *supra* note 34, at 59.

164. If a limited partnership "organized in a state authorizing such voting rights had contacts in a state not having such statutory authority and suit was brought in the latter jurisdiction, the possibility always existed that the forum state's choice of law rules would dictate application of its own version of [ULPA] section 7." Hecker, *supra* note 34, at 59. *See generally* Augustine, *supra* note 67, at 2089-99 (discussing choice of law problem). Furthermore, some states' blue sky laws include an introductory phase that raises conflict of law questions. For example, the Florida regulation, which mandates limited partner voting rights in real estate limited partnerships, provides in pertinent part: *"[t]o the extent that the law of the state in question is not inconsistent*, the limited partnership agreement must provide that a majority of the then outstanding limited partnership interests may, without the necessity of concurrence by the general partner(s), vote to . . . (3) remove the general partner(s) [and] elect a new general sponsor . . . ." FLA ADMIN. CODE ch. 3E-100, R. 3E-700.06(2)(b)(3), 1 BLUE SKY L. REP. (CCH) ¶ 17,476 (1983) (emphasis added). Commentators have noted that this rule may require giving limited partners these powers even if the formation state's law prohibits the grant and even though the exercise of these powers could result in the loss of limited liability. Coleman & Weatherbie, *supra* note 6, at 898 & n.87. A

quandry by specifically authorizing voting rights for limited partners and by providing that possession and exercise of these rights will not amount to control over partnership management.[165] RULPA section 303(b) not only solves the conflict between state securities regulations and partnership laws, but also recognizes the right of limited partners to control fundamental changes in the structure of the limited partnership. This right to control structural changes in the partnership differs greatly from daily participation in partnership business.[166] Blue sky regulations that require the partnership agreement to provide for a general partner's removal and for appointment of a successor general partner by a majority vote by the limited partners effectuate the investor supervision policy underlying the RULPA.[167]

III. Collateral Effects of Removal

Whether the removal provision is mandated by state blue sky laws or is included in the partnership agreement as a result of the parties' negotiations, exercise of the removal provision produces a myriad of changes in the legal and financial relationship among the parties and in the basic structure of the partnership itself. For example, questions arise concerning whether the removal of a general partner forces the parties to recognize gain or loss as a result of the conversion of partnership interests and whether removal alters the tax classification of the limited partnership. Removal of a general partner also may expose the limited partners to unlimited personal liability or jeopardize outstanding partnership contracts with third parties. Practitioners should consider these and other collateral effects of removal when drafting a partnership agreement and when advising clients about limited partnerships.

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similar California statute regulating oil and gas limited partnerships clarifies the applicability of the rule mandating limited partner voting rights by providing, "[t]o the extent the law of the state of organization is not inconsistent." *Id.* R. 260.140.128.2, 1 Blue Sky L. Rep. (CCH) ¶ 12,052 (1984).

165. RULPA § 303, official comment; *see also* 1985 ULPA § 303.

166. *See In re* Overthrust Mineral Corp., [1982-1984 Decisions Transfer Binder] Blue Sky L. Rep. (CCH) ¶ 71,849, at 70,094-95 (Wyo. Sec. of State, No. 5-394, July 25, 1983) (reconciling RULPA § 303(b)(5) with the NASAA's requirement that the partnership agreement include removal provisions); Hecker, *supra* note 34, at 59.

167. *See supra* notes 30-33 and accompanying text.

A. Tax Implications of Removal

Limited partnerships have experienced tremendous growth as investment vehicles primarily because of the tax advantages associated with the pass-through concept.[168] The pass-through concept requires individual partners to recognize the limited partnership's profits or losses on their personal tax returns.[169] Under the pass-through concept, limited partners can "shelter" their own income by deducting, on their personal tax returns, their proportionate share of partnership losses up to the amount of their adjusted basis.[170] A limited partner's adjusted basis consists of his capital contribution and his proportionate share of partnership liabilities.[171] If the partnership agreement's removal provision converts the removed general partner's partnership interest into a limited partnership interest, then questions arise over whether the conversion is a taxable event. Additionally, the right to remove a general partner may affect the tax status of the organization as a limited partnership.

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168. 3 A. WILLIS, J. PENNELL & P. POSTLEWAITE, PARTNERSHIP TAXATION B-1 (3d ed. 1981). Note, however, the Tax Reform Act of 1986 limits the deduction of losses and credits from income generated by passive activities that include "trade or business activities in which the taxpayer (or spouse) does not materially participate (i.e., is not involved on a regular, continuous, and substantial basis)." H.R. Rep. No. 841, 99th Cong., 2d Sess., The Tax Reform Act of 1986: Conference Committee Report, at II-137 (P-H 1986). Passive income can be offset only by losses generated by passive activities. *Id.* Similarly, taxes payable on passive income can be reduced only by tax credits from passive activities. *Id.* Thus, because limited partners are "precluded from materially participating in the partnership's activities, losses and credits attributable to the limited partnership's activities are generally treated as from passive activities." *Id.* at II-145. Under the passive loss rule, however, suspended deductions with respect to any activities of the limited partnership are allowed on the taxpayer's disposition of his entire interest in the limited partnership because "it becomes possible at that time to measure the taxpayer's actual gain or loss from the activity." *Id.*

169. *See generally* Note, *Income Tax Treatment of Shifts in Partnership Profit and Loss Interests*, 1984 DUKE L.J. 805 (discussing the "flip-flop" method of structuring partnerships to enable partners to allocate profits and losses for a predetermined period of time).

170. I.R.C. § 704(d) (1982). Section 704(d) further provides that "[a]ny excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership." *But see supra* note 168 (regarding passive loss rule contained in the Tax Reform Act of 1986).

171. *See* I.R.C. §§ 722, 752. A limited partner also may increase his basis by the amount of his proportionate share in the partnership's nonrecourse loans. *Id.* § 752(c); Treas. Reg. § 1.752-1(e) (1956).

1. Tax Consequences of Converting a General Partnership Interest

In Revenue Ruling 84-52[172] the Internal Revenue Service considered the tax consequences of converting a general partnership interest into a limited partnership interest.[173] Section 741 of the Internal Revenue Code provides that realization of gain or loss must be recognized upon the sale or exchange of a partnership interest.[174] Likewise, section 1001 of the Code requires that the entire amount of a gain or loss realized from the sale or other disposition of property be recognized, unless another Code section under subtitle A provides for nonrecognition.[175] Code section 721, however, provides that no gain or loss is recognized by a partnership or its partners when property is contributed to the partnership in exchange for an interest therein.[176] In Revenue Ruling 84-52 the Service determined that, pursuant to section 721, no gain or loss would be recognized under sections 741 or 1001 as a result of the conversion of a general partnership interest into a limited partnership interest in the same partnership.[177] Even though the conversion constitutes an "exchange," if the partners each retain their respective percentage interest in partnership profits, losses, and capital, then they will not recognize gain or loss under Section 721.[178] If, however, a partner's share of the liabilities decreases, the decrease will be treated as a distribution of cash by the partnership and will result in a decrease of the partner's basis.[179] In addition, the Service held that the conversion is not considered a "sale or exchange" under section 708's termination provision.[180] Thus,

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172. Rev. Rul. 84-52, 1984-1 C.B. 157.

173. A general partnership, consisting of four general partners with equal interests in the partnership, proposed to amend the partnership agreement to convert the general partnership into a limited partnership under the ULPA. Each partner's total percentage interest in the partnership's profits, losses, and capital remained the same upon conversion, hut two of the four partners assumed limited partner status. The partnership's business continued after the conversion. *Id.*

174. I.R.C. § 741 (1982); *see also id.*

175. I.R.C. § 1001 (1982); *see also* Rev. Rul. 84-52, 1984-1 C.B. 157.

176. I.R.C. § 721 (1982); *see also* Rev. Rul. 84-52, 1984-1 C.B. 157.

177. Rev. Rul. 84-52, 1984-1 C.B. 157. Although the ruling deals with a limited partnership formed under the ULPA, at least one commentator has noted that "the ruling's underlying rationale that a partnership conversion constitutes a tax-free sale or exchange of a partnership interest should apply equally to partnerships formed under the [RULPA]." Banoff, *In New Revenue Ruling 84-52, the IRS Uses an "Exchange" Approach to Conversions,* 61 J. TAX'N 98, 99 (1984).

178. Rev. Rul. 84-52, 1984-1 C.B. 157 I.R.B. 16, 16-17.

179. *Id.* at 158; *see also* I.R.C. § 752(b) (1982).

180. Rev. Rul. 84-52, 1984-1 C.B. 158. In Revenue Ruling 84-52 the partnership was

the removed general partner who converts his general partnership interest into a limited partnership interest does not recognize gain or loss.

2. Effects of Removal on the Taxation Status of the Limited Partnership

Generally, the tax consequences of a limited partnership are similar to those of a general partnership; the partners recognize their proportionate share of certain income[181] and deductions to the extent of their basis.[182] A limited partnership qualifies for partnership tax status if it lacks a predominance of corporate characteristics.[183] These corporate characteristics include continuity of life,[184] centralization of management,[185] limited liability,[186] and free transferability of interests.[187] If these characteristics predominate, the limited partnership will be characterized as an "association,"[188] subject to taxation as a corporation.

(a) Continuity of Life

Lack of continuity of life is a favorable factor in allowing limited partnerships to avoid corporate taxation. Under the current tax regulations, a limited partnership lacks continuity of life if the general partner's retirement, death, or insanity causes dissolution of the partnership "unless the remaining general partners agree to continue the partnership or unless all remaining members agree to continue the partnership."[189] Limited partnerships also lack continuity of life if the partnership agreement provides that the lim-

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not terminated for tax purposes under § 708 because the business was to continue after the conversion. Also, a transaction governed by § 721 is not treated as a sale or exchange for purposes of section 708. Banoff, *supra* note 177, at 99.

181. I.R.C. § 702(a) (1982).

182. *Id.* § 752; Treas. Reg. § 1.752-1(e) (1986). *But see supra* note 168 (regarding passive loss rule contained in the Tax Reform Act of 1986).

183. Treas. Reg. § 301.7701-2 (1986).

184. *Id.* § 301.7701-2(b); *see infra* notes 189-96 and accompanying text.

185. *Id.* § 301.7701-2(c); *see infra* notes 197-207 and accompanying text.

186. *Id.* § 301.7701-2(d); *see infra* notes 208-11 and accompanying text.

187. *Id.* § 301.7701-2(e),-3(b)(2); *see infra* notes 212-13 and accompanying text.

188. An "association" is defined as "an organization whose characteristics require it to be classified for purposes of taxation as a corporation rather than as another type of organization such as a partnership or a trust." Treas. Reg. § 301.7701-2(a)(1).

189. *Id.* § 301.7701-2(b)(1); *see* Glensder Textile Co. v. Comm'r, 46 B.T.A. 176 (1942). Treas. Reg. § 301.7701-2(b)(3) states that a limited partnership "subject to a statute corresponding to tbe Uniform Limited Partnership Act" lacks continuity of life. Treas. Reg. § 301.7701-2(a)(5) extends this conclusion to the RULPA.

ited partnership can be terminated at will by any member.[190]

The policy of investor supervision underlying state partnership law clashed with the prohibition against continuity of life[191] in 1973 when California amended its version of the ULPA. The California amendment provided for advance consent to the continuation of the partnership upon certain events and granted limited partners specific voting rights, including the removal and election of general partners by majority vote.[192] The Internal Revenue Service, in 1973, determined that partnerships formed under the California ULPA did not lack continuity of life because the majoritarian provisions permitted advance consent to the partnership's continuation and because the partnership could not be terminated at will by a general partner.[193] The California ULPA was subsequently amended to conform with section 20 of the ULPA.[194] In Revenue Ruling 84-80,[195] however, the Service conceded that limited partnerships that are organized under versions of the RULPA permitting partnership agreements to contain both majoritarian general partner removal and election provisions and an advance consent to the admission of additional or substitute general partners provision lack the corporate characteristic of continuity of life.[196]

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190. If the partnership agreement provides that the partnership "is to continue for a stated period or until the completion of a stated transaction," the partnership has continuity of life because no member has the power to dissolve the limited partnership in contravention of the agreement. Treas. Reg. § 301.7701-2(b)(3).

191. *See* Buxbaum, *supra* note 4, at 14.

192. CAL. CORP. CODE § 15520(a), (b) (West 1955). Under the ULPA, the partnership dissolves upon the retirement, death, or insanity of a general partner unless the business is continued by the remaining general partners in accordance with the partnership certificate or with the consent of all partners. ULPA § 20. The California ULPA allowed limited partnerships to be continued "by the remaining general partners and/or the general partner or partners elected in place thereof, provided the right is spelled out in the certificate." CAL. CORP. CODE § 15520(a) (West 1955). Furthermore, voting rights granted by the California ULPA enabled the limited partners to elect a new general partner and perpetuate the limited partnership. *See id.* § 15520(b); Roulac, *supra* note 8, at 284.

193. The Internal Revenue Service [hereinafter IRS] issued a "private" release that provided technical advice on the formation of limited partnerships under the California ULPA. Roulac, *supra* note 8, at 285.

194. The California ULPA was amended on Oct. 5, 1973 to conform to ULPA § 20. *See* CAL. CORP. CODE § 15520.5 (West Supp. 1976). Subsequently, the IRS issued a revenue ruling which noted that the amendment to the California ULPA corrected the continuity of life problem. Rev. Rul. 74-320, 1974-2 C.B. 404.

195. Rev. Rul. 84-80, 1984-1 C.B. 275.

196. *See* CAL. CORP. CODE § 15632, 15636, 15641 (West Supp. 1986); DEL. CODE ANN. tit. 6, § 17-401 (Supp. 1984). Partnerships formed under the RULPA do not have continuity of life due to the provisions of section 801. *See* RULPA § 801(3); *see generally* Basile, *supra* note 136, at 237-55.

(b) Centralization of Management

Another criteria used in determining the tax treatment of limited partnerships is whether the organization has centralized management. Centralized management is defined as "a concentration of continuing exclusive authority to make independent business decisions on behalf of the organization [without] ratification by members of such organization."[197] At first glance, limited partnerships appear to fit this definition because general partners exercise their authority on behalf of the limited partners.[198] General partners, however, also act for their own benefit and not exclusively as representatives of the limited partners.[199] Therefore, centralization of management does not seem to exist. The treasury regulations recognize that limited partnerships subject to the uniform statutes generally do not have centralized management;[200] if, however, limited partners own all or substantially all of the partnership interests, then centralized management exists.[201] Thus, if the general partners lack substantial interests, they are assumed to be managers for the limited partners and the limited partnership possesses centralized management.[202]

Granting limited partners the right to remove a general partner affects the presence or absence of centralized management.[203] Treasury Department regulations provide that if the limited partners have the power to remove a general partner, then the determination of whether a limited partnership has centralized management will turn on the attendant circumstances.[204] The regulations, however, note that "a substantially restricted right of the limited partners to remove the general partner" would not cause the existence of centralized management.[205] According to the regulations, the limited partners' right to remove a general partner because of

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197. Treas. Reg. § 301.7701-2(c)(3).

198. *See* Haims & Strock, *supra* note 7, at 499.

199. *Id.* The authors note that the agency relationsbip between limited and general partners, incorporated in the ULPA and RULPA, prevents the recognition of centralized management. *See* ULPA § 9; RULPA § 403.

200. Treas. Reg. § 301.7701-2(c)(4).

201. *Id. See* Willis, *Optional Adjustments to Basis of Partnership Properties under Section 743(b) and 734(b)* in RESOURCE MATERIALS—PARTNERSHIPS: UPA, ULPA, SECURITIES, TAXATION, AND BANKRUPTCY 184 (1st ed. 1978) (stating that the IRS' rule-of-thumb is an 80-20 percent substantiality test); Larson v. Comm'r, 66 T.C. 159 (1976).

202. *See* Haims & Strock, *supra* note 7, at 499-500.

203. *See* T.D. 7889, 48 Fed. Reg. 18,805 (1983) (codified at 26 C.F.R. 301.7702 (1986)).

204. Treas. Reg. § 301.7701-2(c)(4).

205. *Id.*

gross negligence, self-dealing, or embezzlement constitutes a "substantially restricted right."[206] This limitation on the limited partners' right of removal illustrates the belief that an unrestricted right to remove general partners would indicate that the general partner is merely managing the limited partnership on behalf of the limited partners and not for his own benefit.[207] Consequently, the partnership would possess centralized management.[208]

(c) Limited Liability

A partnership will have limited liability if no member of the limited partnership is personally liable for the present and potential debts of the partnership.[209] Ordinarily, the general partners possess the requisite unlimited personal liability.[210] The treasury regulations, however, state that unlimited personal liability does not exist if the general partners have no substantial assets outside the partnership *and* if they are merely "strawmen" acting as the limited partners' agents.[211] Additionally, unlimited personal liability is presumed absent if the partnership agreement provides that the general partner maintains no personal liability to creditors for partnership debts.[212] Thus, removal provisions that demote a removed general partner to passive limited partner status should not grant the removed general partner protection against personal liability. Otherwise, the limited partnership may possess the corporate characteristic of limited liability and risk the loss of its limited partnership tax status.

(d) Free Transferability of Interests

A limited partnership possesses the corporate characteristic of free transferability of interests if each of its members, or those owning all or substantially all of the partnership interests, "have the power, without the consent of other members, to substitute for themselves in the same organization a person who is not a member

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206. *Id.*

207. T.D. 7889, 48 Fed. Reg. 18,804 (1983) (codified at 26 C.F.R. 301.7702 (1986)). However, an unrestricted right of removal arguably indicates the absence of centralized management. *See* Haims & Strock, *supra* note 7, at 504.

208. Treas. Reg. § 301.7701-2(d)(1); *see* Comment, *supra* note 34, at 124.

209. Treas. Reg. § 301.7701-2(d).

210. *Id.* § 301.7701-2(d)(2). Unlimited personal liability exists if the general partners are not mere "dummies" acting as agents for the limited partners, even if the general partners lack substantial assets.

211. *Id.* This provision concerns debts for which no other general partner is liable.

212. *Id.* § 301.7701-2(e)(1).

of the organization."[213] However, the characteristic of free transferability is absent if the partnership agreement authorizes partners to assign only their right to share in the profits without the other partners' consent, but not to assign their right to participate in the organization's management.[214] A removal provision, therefore, can provide for the substitution of a new general partner upon removal without risking corporate taxation of the organization.

B. Exposure of Limited Partners to General Liability

Under certain circumstances, removal of a general partner could alter the status of the limited partners and expose them to unlimited personal liability. The ULPA and the RULPA both restrict the limited partners' participation in the management of the partnership.[215] The limited partners' removal of a general partner could modify the partnership's structure and, therefore, could violate the uniform statutes' ambiguous restrictions on limited partners' actions.

1. Limited Partner Control and Liability Under the ULPA

When limited partners invest in a limited partnership, they expect their financial exposure to be limited to their capital contribution. Under section 7 of the ULPA, however, limited liability status depends on whether the limited partner refrains from "tak[ing] part in the control of the business."[216] The ULPA, however, fails to define this phrase.[217] The judiciary, therefore, has been forced to define and interpret "control". The courts have employed primarily two tests to determine "control": the "power test" and the "reliance" test.[218] The "power" test focuses on the organic structure of the limited partnership. If the partnership agreement empowers limited partners to initiate and decide business matters without the general partner's interference, the limited partners' authority may constitute control and may result in the loss of limited liability.[219] However, the mere potential for control

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213. *See* Haims & Strock, *supra* note 7, at 501.

214. *See generally supra* notes 197-207 and accompanying text.

215. ULPA § 7; RULPA § 303; *see also* 1985 ULPA § 303.

216. The official comments to ULPA § 7 fail to define "control." *See* Coleman & Weatherbie, *supra* note 6, at 897.

217. *See* Coleman & Weatherbie, *supra* note 6, at 899; Roulac, *supra* note 8, at 283-85.

218. *See* CRANE & BROMBERG, *supra* note 4, § 26, at 147; Coleman & Weatherbie, *supra* note 6, at 899.

219. *See* Brodsky, *Corporate and Securities Litigation—Shelter Litigation: Partici-*

may be insufficient to force unlimited liability on the limited partners. Rather, limited partners may have to exercise *actual* control to violate section 7.[220] The "reliance" test focuses on whether the limited partners' actions would cause creditors to reasonably rely upon the apparent general liability of the limited partners.[221] In determining whether to impose unlimited personal liability on the limited partners, courts should balance the limited partners' right to supervise their investment against the creditor's right to assurance of repayment.

The ULPA drafters required a general partner's existence to resolve the policy conflict between the reliance interest of third party creditors and the limited partners' interest in limited personal liability. When limited partners decide to remove a general partner, the ULPA's policy equilibrium is disturbed and the "control" problem rears its ugly head. Limited partners' removal rights, however, do not violate the control test because section 7's prohibition against limited partners' participation "in the control of the business" contemplates operational actions in the partnership's daily business, not the ability to influence structural changes.[222] Furthermore, the courts have permitted extensive limited partner participation in the partnership's day-to-day activities. For example, in *Plasteel Products Corp. v. Helman*[223] the court elected not to impose general liability on the limited partners, even though they selected a sales manager to assist the general partner in controlling the finances of the business. Similarly, in *Weil v. Diversified Properties*[224] the limited partners consulted with the partnership's business manager about the operation of the business and, yet, the court still held that these actions did not constitute participation in control of the partnership.

Similarly, the limited partners' right of removal satisfies the "reliance" test. First, if the general partner manages the partner-

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pating in the Control of the Partnership, 176 N.Y.L.J. 1 (1976), *cited in* Coleman & Weatherbie, *supra* note 6, at 899 n.91. No court has ever held that mere possession of power to control violates section 7.

220. *See* Note, *supra* note 75, at 293. Logically, limited partners should be liable if they hold themselves out to creditors as generally liable.

221. *See supra* notes 30-31 and accompanying text.

222. This proposition is supported by § 7's prohibition against limited partners controlling the *business* of the partnership, rather than forbidding control over the partnership's *structure*. *See* Augustine, *supra* note 67, at 2101.

223. 271 F.2d 354 (1st Cir. 1959).

224. 319 F. Supp. 778 (D.D.C. 1970). The court's holding addressed the issue of whether the general partners could have the courts declare the limited partners generally liable under section 7.

ship profitably, the limited partners have no cause to remove him. If, however, the general partner proves inadequate, either financially or managerially, creditors and limited partners share a mutual economic concern that may be alleviated by removing the general partner.[225] The partnership's creditors would have an increased fear of uncertainty of repayment only if the limited partners remove the general partner and replace him with a "strawman" lacking substantial assets. The case law, however, indicates that general liability will be imposed on limited partners when their actions induce creditors to rely on their personal assets and promises to repay.[226] In *J. C. Wattenbargar & Sons v. Sanders*[227] the limited partner personally guaranteed a loan to the limited partnership. The court denied summary judgment against the defendant limited partner, emphasizing that the question of whether the limited partner induced the creditor's reliance is a fact question to be determined in light of the surrounding circumstances.[228] No cases directly address the relationship between removal rights and their possible interference with creditor protection. If, however, the removal provision provides for substitution of new management with substantially the same personal assets and business experience as the removed general partner, then removal would not threaten creditors. Thus, courts would have no reason, at least under section 7's "reliance" test, to impose unlimited personal liability on the limited partners.

2. Limited Partner Control and Liability Under the RULPA

The RULPA's drafters attempted to clarify the inherent ambiguities of the ULPA's section 7 limitation on limited partners' participation in the partnership business.[229] The RULPA supplies an additional "safe harbor" that allows limited partners to participate in certain activities without risking unlimited personal liability.[230]

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225. *See* Note, *supra* note 75, at 294-95.

226. *See generally* Coleman & Weatherbie, *supra* note 6, at 900 (discussing treatment of third party reliance issues). The purpose of the ULPA is not to assist creditors nor to induce creditors to extend credit under the mistaken belief that the limited partner is a general partner and personally liable for repayment of partnership debts. Vulcan Furniture Mfg. Corp. v. Vaughn, 168 So. 2d 760 (Fla. Dist. Ct. App. 1964); *accord* Hoefer v. Hall, 75 N.M. 751, 411 P.2d 230 (1966) (holding that a limited partnership effectively limits the liability of its limited partners to third parties to a fixed amount).

227. 191 Cal. App. 2d 857, 13 Cal. Rptr. 92 (1961).

228. *Id.* at 864-65, 13 Cal. Rptr. at 95-96.

229. RULPA § 303, official comment.

230. RULPA § 303(b).

Section 303(b)(5)(v) provides that limited partners may vote to remove a general partner without assuming general liability. Thus, this provision implicitly recognizes that removal of a general partner is not equivalent to "taking control of the business."[231]

The RULPA establishes a new standard permitting limited partners greater participation in the partnership's business: "if the limited partner's participation in the control of the business is not substantially the same as the exercise of the powers of a general partner, he is liable only to persons who transact business with the limited partnership with actual knowledge of his participation in control."[232] Under the "substantially the same" test, limited partners risk unlimited personal liability only if they exercise authority similar to that granted a general partner. Thus, the RULPA balances the competing policies of limited liability and investment supervision desired by limited partners against the protection needs of creditors.

Although the RULPA protects the limited partners' right to remove a general partner, limited partners still may risk incurring general liability if they assume the authority and power of the general partner upon his removal.[233] If the limited partners assume the authority and power of the removed general partner prior to the selection of a new business manager, courts may determine that the limited partners' participation in the business is substantially the same as the general partner's. Thus, removal provision

231. Section 303(b)(5) lists specific issues on which limited partners may vote without risking unlimited liability. This list includes the limited partners' vote to remove a general partner. In addition, the issues listed in § 303(b)(5) all relate to structural changes in the partnership, such as the sale of all or substantially all of the partnership's assets and the incurrence of a debt outside the usual course of business. Section 303(a), however, forbids participation by the limited partners in the control of the business. Furthermore, § 303(a) forbids limited partners from exercising powers that are "substantially the same" as those of the general partners (i.e. managerial powers). Thus, in reading § 303 as a whole, the limited partners' removal of a general partner does not constitute business participation, but rather merely generates a structural alteration.

232. RULPA § 303(a). The first sentence in RULPA § 303(a) incorporates the "control" test of ULPA § 7 to ensure that the case law under the ULPA remains applicable to the extent not expressly changed by the RULPA. RULPA § 303, official comment.

233. *See* RULPA § 303(c). Section 303(c) states that the limited partners' exercise of any powers outside those listed in § 303(b) constitutes participation in the partnership's business. For example, if the partnership agreement authorizes limited partners to strip the general partner of his managerial powers and appoint a business manager, the courts may determine that this exercise of authority is substantially the same as the authority granted to a general partner. However, the limited partners in Plasteel Products Corp. v. Helman, 271 F.2d 354 (1st Cir. 1959), selected a business manager to assist in controlling the financial dealings of the limited partnership and the court did not impose general liability on the limited partners.

drafters should insure that no lag time exists between removal of the outgoing general partner and installation of a new general partner because limited partners may lose their limited liability if forced to assume the responsibilities of the removed general partner.

3. Limited Partner Control and Liability Under the 1985 ULPA

Section 303(a) of the RULPA was amended in August 1985 by the National Conference of Commissioners on Uniform State Laws to rephrase the "control" rule, eliminate the "substantially the same" test, and revise the standard of liability for limited partners.[234] The first sentence of 1985 ULPA section 303(a) places liability for partnership obligations on limited partners who "participat[e] in the control of the business,"[235] as opposed to "tak[e] part in the control of the business" under the RULPA.[236] Additionally, the second sentence of section 303(a) restricts the liability of limited partners who participate in the control of the partnership business to "persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner."[237] Thus, the "substantially the same" standard for liability was abandoned by section 303(a) of the 1985 ULPA and the new "reasonable reliance" test determines limited partners' liability to third parties.[238]

The Commissioners additionally amended section 303(b) to expand the list of "safe harbor" activities in which limited partners may participate without violating the control rule.[239] Pursuant to

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234. 1985 ULPA § 303(a). Although the Commissioner's comments to the new § 303 were not yet available in puhlished form at the time of this writing, at least one commentator has asserted that the Commissioners intended the adoption of the new § 303 to relax the control rule. *See* Basile, *supra* note 27, at 1214.

235. The first sentence of § 303(a) of the 1985 ULPA states: "[e]xcept as provided in subsection (d), a limited partner is not liable for the obligations of a limited partnership unless he [or she] is also a general partner or, in addition to the exercise of his [or her] rights and powers as a limited partner, he [or she] *participates in the control of the business.*" (emphasis added).

236. Despite the change in § 303(a)'s language, the Commissioners likely did not intend a substantive change in the control rule. *See* Basile, *supra* note 27, at 1214 & n.71 (asserting that the Commissioners changed the language in § 303(a) to "participate" merely to achieve parallelism with the language of § 303(b)).

237. 1985 ULPA § 303(a).

238. *See* Basile, *supra* note 27, at 1214-15. The limited partnership statutes of both California and Delaware employ a "reasonable reliance" test to determine if third parties may bring suit against limited partners for participating in the control of the business. CAL. CORP. CODE § 15632(a) (West Supp. 1986); DEL. CODE ANN. tit 6, § 17-303(a) (Supp. 1984).

239. Section 303(b) provides:

section 303(b)(6), limited partners may, by voting or otherwise, remove a general partner without fear of "participating in the control of the business" and, thus, possibly incurring unlimited personal liability.[240] Whereas the original language of the RULPA granted limited partners the right *to vote* on the removal of a general partner, the 1985 ULPA permits the limited partners *to propose, approve, or disapprove* the removal of a general partner, *by voting or otherwise*; clarifies the scope of the limited partners' removal right; and protects them from sacrificing limited liability upon the exercise of their right to remove a general partner.[241]

C. *Effects of Removal on Limited Partnership Contracts*

In their analysis of a limited partnership, creditors and lenders look to the assets of the general partners because the general partners are personally liable for all partnership debts. Creditors usually will not object if the limited partners remove an ineffective or unsatisfactory general partner because removal should enhance the partnership's ability to satisfy its debts. Lenders, however, often insert acceleration clauses,[242] which are triggered by the removal of

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A limited partner does not participate in the control of the business within the meaning of subsection (a) solely by doing one or more of the following: (1) being a contractor for or an agent or employee of the limited partnership or of a general partner or being an officer, director, or shareholder of a general partner that is a corporation; (2) consulting with and advising a general partner with respect to the business of the limited partnership; (3) acting as surety for the limited partnership or guaranteeing or assuming one or more specific obligations of the limited partnership; (4) taking any action required or permitted by law to bring or pursue a derivative action in the right of the limited partnership; (5) requesting or attending a meeting of partners; (6) proposing, approving, or disapproving, by voting or otherwise, one or more of the following matters: (i) the dissolution and winding up of the limited partnership; (ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership; (iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business; (iv) a change in the nature of the business; (v) the admission or removal of a general partner; (vi) the admission or removal of a limited partner; (vii) a transaction involving an actual or potential conflict of interest between a general partner and the limited partnership or the limited partners; (viii) an amendment to the partnership agreement or certificate of limited partnership; or (ix) matters related to the business of the limited partnership not otherwise enumerated in this subsection, which the partnership agreement states in writing may be subject to the approval or disapproval of limited partners; (7) winding up the limited partnership pursuant to Section 803; or (8) exercising any right or power permitted to limited partners under this [Act] and not specifically enumerated in this subsection.

1985 ULPA § 303(b).

240. 1985 ULPA § 303(b)(6)(v).

241. *Compare* RULPA § 303(b)(5)(v) *with* 1985 ULPA § 303(b)(6)(v).

242. An acceleration clause is "[a] provision or clause in a mortgage, note, bond, deed of trust, or other credit agreement, which allows a lender the opportunity to call monies due

a general partner or by the lender's "insecurity", in partnership loan agreements. Therefore, a limited partnership's loans may be accelerated either automatically upon removal of the general partner or at the discretion of the lender if he deems himself to be insecure following the removal. Thus, the limited partners' removal powers present a double-edged sword. The threat of the partnership's loans being accelerated realistically may preclude the limited partners from removing a general partner despite his mismanagement or fraudulent conduct.

Limited partners can avoid this "catch 22" by providing for a substitute general partner in the partnership agreement[243] and by submitting the substitute's financial and managerial credentials for the lender's evaluation. If the limited partners select a substitute general partner contemporaneously with the exercise of their removal power and the lender approves the substitution, then the lender would have little cause for insecurity. Thus, limited partners could remove a general partner without jeopardizing the partnership's contracts with third parties.

IV. Post-Removal Actions of Parties

The limited partners may desire to admit a substitute general partner after removing a general partner.[244] In fact, the limited partners may be forced to make a substitution if they removed the sole general partner.[245] To accomplish this, the remaining general partners and the limited partners must comply with the applicable statutory voting requirements, requirements that may call for either a unanimous or majoritarian vote. The partners also should consider indemnification of the removed and substitute general partners and determine the removed general partner's compensation. Finally, an amendment outlining the partnership's structural changes must be drafted, signed, and filed with the appropriate

under the instrument." Black's Law Dictionary 12 (5th ed. 1979).

243. *See infra* notes 246-50 and accompanying text.

244. The admission of an additional general partner and the admission of a substitute general partner are two conceptually different events. A hypothetical will illustrate the distinction more accurately. Assume a limited partnership includes two general partners. If they desire three general partners, the admission of the third exemplifies the admission of an *additional* general partner. In the alternative, if one of the two original general partners is removed and the limited partners desire to replace the removed general partner, the addition of the second general partner illustrates the admission of a *substitute* general partner. *See* Basile, *supra* note 136, at 237.

245. Limited partnerships, by definition, must have at least one general partner. *See supra* note 24 and accompanying text.

state official in accordance with state statutory requirements.

Once the general partner is removed as a matter of law, he may decide to file suit against the limited partners for damages. The general partner may attempt to establish one or more causes of action. These actions might include tortious interference with a contractual relationship, tortious interference with a business relationship, and tortious interference with an employment relationship.

A. *Admission of Substitute General Partners*

1. Statutory Requirements for Admission

Neither the ULPA nor the RULPA specifically provides for the admission of a substitute general partner into a limited partnership. ULPA section 9(1)(e) explicitly provides for the admission of an additional general partner and implicitly permits the admission of a substitute general partner.[246] Following the removal of a general partner, the remaining general partners may desire or need to admit a substitute general partner.[247] Section 9(1) requires "the written consent or ratification of the specific act [substitution of a general partner] by all the limited partners."[248] Thus, unanimous consent of the limited partners is required to effectuate the substitution of a general partner.

Similarly, RULPA section 401 authorizes the admission of an additional or substitute general partner "only with the specific written consent of each partner."[249] Thus, the RULPA adopts the ULPA's requirement of limited partner unanimity. The RULPA, however, permits the admission of a substitute general partner following removal of the sole general partner to continue the partnership business,[250] whereas the ULPA requires dissolution.[251]

RULPA section 801(3) provides for the limited partnership's dissolution upon "an event of withdrawal of a general partner," unless the certificate permits the continuation of partnership busi-

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246. ULPA § 9(1)(e); *see* Basile, *supra* note 136, at 242.

247. Under the ULPA, the removal of a sole general partner results in dissolution. *See supra* notes 126-27 and accompanying text.

248. ULPA § 9(1).

249. RULPA § 401. *But see* 1985 ULPA § 401 (permitting partnership agreement to provide terms for admission).

250. The official comment explains that RULPA § 401 is derived from ULPA § 9(1)(e). *Id.*

251. ULPA § 20.

ness and the partnership includes a new general partner.[252] If the certificate does not authorize the remaining general partners to continue partnership business or if no remaining general partner exists after the "event of withdrawal" of a general partner, then, under section 801(3), the partners unanimously may agree, in writing and within ninety days, to continue business and to appoint one or more substitute general partners.[253] An "event of withdrawal" includes removal of a general partner.[254] Upon removal of a general partner, therefore, the remaining general partners and the limited partners may appoint a substitute general partner and continue the partnership business with or without the certificate's express authorization. Furthermore, pursuant to section 801(3), the limited partners may remove the sole general partner without dissolving the limited partnership if they admit a substitute general partner.

In August 1985, however, the Commissioners amended section 401 of the RULPA and permitted parties to provide in advance the terms for admission of additional or substitute general partners into the partnership.[255] In the absence of a contrary provision in the partnership agreement, section 401 mandates that the contemporaneous unanimous consent rule apply automatically.[256] Thus, the 1985 ULPA not only protects the parties' freedom of contract with respect to voting requirements and procedures for the admission or substitution of general partners, but also permits advance, rather than contemporaneous, consent to such an admission.[257] In essence, the 1985 ULPA aids limited partners who exercise their right to remove a general partner by enabling them to agree in advance to the admission or substitution of a general partner upon less than unanimous consent.

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252. RULPA § 801(3); *see* 1985 ULPA § 801(4).

253. Several state partnership acts provide for advance, rather than contemporaneous, consent to the admission of additional or substitute general partners. *See, e.g.*, CAL. CORP. CODE §§ 15632, 15636, 15641 (West Supp. 1986); DEL. CODE. ANN. tit. 6, § 17-401 (Supp. 1984). Additionally, the IRS recently concluded that partnerships formed under statutes tbat permit advance consent to the admission of additional or substitute general partners lack continuity of life. Therefore, these partnerships qualify for partnership taxation. *See* Rev. Rul. 84-80, 1984-1 C.B. 275.

254. RULPA § 801(3). For an analysis of § 801(3) and the "contemporaneous consent" rule, see generally Basile, *supra* note 136, at 242-55.

255. RULPA §§ 101(3), 402(3); 1985 ULPA §§ 101(3), 402(3).

256. *See* Basile, *supra* note 136, at 253-54 (containing proposed RULPA amendment to permit advance consent to admission or substitution of a general partner).

257. *See* Basile, *supra* note 136, at 253.

2. Indemnification and Compensation of the Parties

Following a general partner's removal, the limited partners and the remaining general partners must address the issue of indemnification of the removed and substituted general partners. Because the removed general partner remains personally liable for pre-removal transactions, he may seek indemnification for any subsequent claims.[258] Similarly, the new general partner assumes unlimited personal liability upon admission and, thus, will seek indemnification for claims arising from his predecessor's actions.[259] The partners may be forced to resolve this issue prior to the admission of the substituted general partner because the substitute partner probably will not be willing to assume general liability otherwise.

The partnership also must determine the removed general partner's compensation, absent an applicable provision in the partnership agreement. A value must be established for the removed general partner's interest and the partnership must decide whether to repay him in cash or with a promissory note.[260] A removed general partner generally prefers cash to a note because he no longer controls the partnership's management and cannot personally ensure repayment.[261]

3. Limited Partnership Certificate Amendments

Both removal of a general partner and admission of an additional or substitute general partner necessitate an amendment to the partnership certificate.[262] The certificate serves as notice to third parties of the partnership agreement's fundamental terms, particularly the extent of the limited partners' liability.[263] Failure to amend the certificate upon the removal and substitution of general partners could jeopardize the assets of the limited partnership and its members because third parties, reasonably relying on the unamended certificate, might enter into a contract with the re-

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258. *See* Coleman & Weatherbie, *supra* note 6, at 914.

259. *See id.*

260. *See* Roulac, *supra* note 8, at 296.

261. *See id.* Thus, if the limited partnership is experiencing negative cash flow, possibly caused by the removed general partner's mismanagement, the removed general partner may demand higher compensation if a note must be used in payment. Of course, this demand is subject to negotiation.

262. ULPA § 24(b),(d),(e); RULPA § 204(a),(b). The official comment to RULPA § 204 notes that the addition, substitution, or withdrawal of partners each constitutes an event that is central to the function of the certificate.

263. *See* Brown v. Panish, 99 Cal. App. 3d 429, 160 Cal. Rptr. 282 (1979).

moved general partner.[264] Additionally, if the removed general partner assumes "special limited partner" status and no amendment to the certificate is filed, third parties may rely on the original certificate and the "special limited partner" could incur unlimited personal liability.

ULPA section 25[265] sets forth procedural requirements for amending the limited partnership certificate. This provision requires that the amendment "be signed and sworn to by all members."[266] At first glance, this requirement provides general partners with a method to circumvent removal because they merely could refuse to sign the amendment.[267] State statutes, however, commonly provide statutory mechanisms to execute writings despite the refusal of a necessary party.[268] RULPA section 204 avoids this problem by requiring the signature of only one general partner.[269]

B. *Claims of the General Partner upon Removal*

As a matter of law, the limited partners may remove a general partner if they comply with the partnership agreement's removal provision. If the partnership agreement expressly empowers a specific percentage of interests in the limited partnership to remove a general partner, then removal becomes effective when the voting percentage is acquired.[270] No judicial intervention is needed to accomplish removal[271] if the parties unconditionally agree to the removal provision by signing the partnership agreement and any subsequent action by the courts is purely ministerial.[272]

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264. *See, e.g.*, Gilman Paint & Varnish Co. v. Legum, 197 Md. 665, 80 A.2d 906 (1951).

265. ULPA § 25.

266. *Id.* at § 25(1)(b).

267. *See* Consortium Management Co. v. Mutual Am. Corp., 246 Ga. 346, 271 S.E.2d 488 (1980).

268. *See id.*; GA. CODE ANN. § 14-9-26(c) (1982) (permitting petition of court to direct amendment).

269. RULPA § 204(a)(2); 1985 ULPA § 204(a)(2).

270. Consortium Management Co. v. Mutual Am. Corp., 246 Ga. 346, 271 S.E.2d 488 (1980). In *Consortium Management Co.*, the partnership agreement required a vote of seventy-five percent of the limited partnership interests to remove a general partner. The corporate holder of an eighty percent interest in the limited partnership notified all the other partners that it was exercising its right to remove the general partners and to substitute itself and an individual of its choosing as general partners. *Id.* at 346, 271 S.E.2d at 489.

271. *Id.* at 348, 271 S.E.2d at 490.

272. *Id.* In *Consortium Management Co.*, following removal, the remaining general partners refused to execute an amendment to tbe certificate of limited partnership to show the change in general partners. The new general partners brought an action to direct the court clerk to record the amendment. They also sought an injunction to compel the former general partners to relinquish the partnership's records and to prohibit them from interfer-

The general partner, once he is removed, is not entitled to reinstatement even if the legal efficacy of the vote is questioned.[273] The Georgia Supreme Court addressed this issue in *Lesesne v. Mast Property Management, Inc.*[274] In *Lesesne* a removed general partner challenged the validity of the limited partners' vote. The removed general partner alleged that the votes had been obtained by fraud and misrepresentation on the part of one of the limited partners.[275] The removed general partner sought to set aside the limited partners' removal vote and appointment of a substitute general partner.[276] The court analogized the factual situation to a wrongful employment termination case.[277] Consequently, the court held that the removed general partner had no right to reinstatement regardless of his fraud and misrepresentation claim.[278] Removal of a general partner cannot be enjoined if the removal provision of the partnership agreement is met; instead, a removed general partner must institute a claim at law for damages.[279]

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ing with business operations. *Id.* at 346-47, 271 S.E.2d at 489. Initially, it appeared that the general partners could prevent consummation of the transaction, initially agreed to in the partnership agreement, by refusing to sign the amendment substituting the new general partners. Furthermore, the new general partners could not secure service of process on a former general partner who resided outside the forum state. *Id.* The court determined that personal service on the former general partner was unnecessary. In addition, because the new general partners had a right to have the writing executed, the court ordered the clerk to record the amendment. *Id.* at 348, 271 S.E.2d at 490. The court noted that its function in the case was purely ministerial because removal became effective upon the limited partner's vote. *Id.*

273. *See* Lesesne v. Mast Property Management, Inc., 251 Ga. 550, 307 S.E.2d 661 (1983).

274. *Id.*

275. The removed general partner claimed that one of the limited partners made fraudulent statements in asserting that the limited partners were not receiving a return on their investment because of the removed general partner's mismanagement of partnership property. *Id.* at 551, 307 S.E.2d at 662.

276. *Id.* The limited partnership agreement provided that limited partners whose aggregate interest exceeded fifty percent could remove the general partners and select an experienced individual or corporation to become the substitute general partner and assume control of the limited partnership's business operations. *Id.* Pursuant to these provisions, the limited partners removed the general partner and appointed a substitute general partner.

277. *Id.* at 552, 307 S.E.2d at 663. *See* Georgia Power Co. v. Busbin, 242 Ga. 612, 250 S.E.2d 442 (1978), (denying that employment terminable at will creates a cause of action against the employer for wrongful termination, but stating that an action may be maintained against a third party for tortious interference with an employment contract), *rev'd on other grounds*, 249 Ga. 180, 289 S.E.2d 514 (1982).

278. *Lesesne*, 251 Ga. at 552, 307 S.E.2d at 663.

279. The court in *Lesesne* held that the removed general partner might have a claim for tortious interference with an employment relationship. *Id.*

1. Tortious Interference with a Contractual Relationship

Following removal, a removed general partner may bring an action for tortious interference with a contractual relationship against a limited partner, a remaining general partner, or a third party for procuring the removal maliciously and without just cause.[280] It is irrelevant that the contractual relationship could be terminated at the will of the parties.[281] A removed general partner can pursue successfully an action for intentional interference with a contractual relationship despite the fact that a limited partnership can be dissolved judicially or contractually at the will of either the general or limited partners.[282] A tort action for intentional interference with a contractual relationship arises when a person "intentionally and improperly interferes with the performance of a contract . . . between another and a third person by inducing or otherwise causing the third person not to perform the contract."[283] To prevail in an action for tortious interference with a contractual relationship, the removed general partner must prove: (1) that a valid contract existed; (2) that the third party possessed knowledge of the contract; (3) that the third party intended to procure its breach; (4) that there was no legal justification for the third party's interference; and (5) that damages resulted from the interference.[284]

The general partner first must prove that a valid, legally enforceable contract existed. The contractual relationship may derive from either the limited partnership agreement or a separate management contract between the removed general partner and the limited partnership. Courts disagree over whether the general partner can bring an action for intentional interference if the partnership agreement is the contract affected by the third parties' ac-

280. For purposes of this Note, tortious interference with a contractual relationship contemplates intentional rather than negligent interference.

281. RESTATEMENT (SECOND) OF TORTS § 766 comment g (1977) [hereinafter RESTATEMENT]; *see* Yaindl v. Ingersoll-Rand Co., 281 Pa. Super. 560, 574-75 & n.6, 422 A.2d 611, 618 & n.6 (1980); Todd v. Farm Bureau Mut. Ins. Co., 283 S.C. 155, 163-64, 321 S.E.2d 602, 607 (1984), *quashed in part*, 287 S.C. 190, 336 S.E.2d 472 (1985); *see also* Kelly v. St. Vincent Hosp., 102 N.M. 201, 207, 692 P.2d 1350, 1357 (Ct. App. 1984) (interfering with a contract terminable at will is analogous to interfering with a prospective contract).

282. *See* ULPA §§ 10, 20; UPA § 38(2).

283. RESTATEMENT, *supra* note 281, § 766; *see* Wilmington Trust Co. v. Clark, 289 Md. 313, 329-30, 424 A.2d 744, 754 (1981); Kelly v. St. Vincent Hosp., 102 N.M. 201, 207, 692 P.2d 1350, 1356 (Ct. App. 1984); Yaindl v. Ingersoll-Rand Co., 281 Pa. Super. 560, 573-74, 422 A.2d 611, 618 (1980).

284. *See* Todd v. Farm Bureau Mut. Ins. Co., 283 S.C. 155, 163, 321 S.E.2d 602, 607 (1984), *quashed in part*, 287 S.C. 190, 336 S.E.2d 472 (1985).

tions. Some courts maintain that an action for intentional interference with contractual relations "will not lie against one who is a party to the contract."[285] These courts assert that a suit for breach of contract is the appropriate cause of action when one party to an agreement alleges that the other party has interfered with his contractual rights.[286] Other courts, however, hold that parties to the contract may be held liable for intentional interference with the other party's contractual rights.[287] In these jurisdictions a cause of action may lie against the limited or remaining general partners based on the partnership agreement.

Second, the removed general partner must show that the interferor possessed actual knowledge of the contract at issue or knowledge of facts that would enable the third party to reasonably conclude that a contract existed.[288] Questions arise regarding what facts or circumstances would evidence an implied knowledge of the contract or notice of the contract's possible existence, thereby requiring the third party's inquiry.[289] The removed general partner, however, should have little difficulty proving actual knowledge by the limited and remaining general partners of the existence of the partnership agreement. Similarly, the limited and remaining general partners should have actual knowledge of a management contract between the removed general partner and the limited partnership.

Third, the removed general partner must prove that the other partners' or third party's actions were malicious and that their in-

285. *Id.* at 164, 321 S.E.2d at 607; *see* Cummings v. Walsh Constr. Co., 561 F. Supp. 872 (S.D. Ga. 1983); George A. Davis, Inc. v. Camp Trails Co., 447 F. Supp. 1304 (E.D. Pa. 1978); Wilmington Trust Co. v. Clark, 289 Md. 313, 424 A.2d 744 (1981); Wild v. Rarig, 302 Minn. 419, 234 N.W.2d 775 (1975), *cert. denied*, 424 U.S. 902 (1976); Houser v. City of Redmond, 91 Wash. 2d 36, 586 P.2d 482 (1978) (en banc); Board of Trustees v. Holso, 584 P.2d 1009 (Wyo. 1978).

286. *See e.g.*, Wilmington Trust Co. v. Clark, 289 Md. 313, 329-30, 424 A.2d 744, 755 (1981).

287. *See e.g.*, Murphy v. McIntyre, 69 N.C. App. 323, 328-29, 317 S.E.2d 397, 401 (1984); Smith v. Ford Motor Co., 289 N.C. 71, 221 S.E.2d 282 (1976).

288. Steinmetz & Assocs. v. Crow, 700 S.W.2d 276, 277-78 (Tex. Ct. App. 1985).

289. *See* 45 AM. JUR. 2D *Interference* § 11 (1969), which states in pertinent part: "it is not necessary to prove actual knowledge; it is enough to show that defendant had knowledge of facts which, if followed by reasonable inquiry, would have led to complete disclosure of the contractual relations and rights of the parties." Courts define knowledge as "a clear perception of fact, an awareness of truth." In order to imply knowledge of the contract with which the third party or partner interfered, a clear connection between known facts and facts discoverable upon reasonable inquiry must be established. Mere suspicion or conjecture does not constitute knowledge or a reasonable means of obtaining knowledge. Steinmetz & Assocs. v. Crow, 700 S.W.2d 276, 280 (Tex. Ct. App. 1985).

terference in fact caused a breach of the contractual relationship. In the legal sense, a malicious act includes any intentional act, in excess of legal authority, designed to injure a party to the contract or to gain an advantage at that party's expense.[290] Courts consider many factors in determining whether an act is improper, including the actor's conduct, his motive, the proximity of the actor's conduct to the interference, the interests of the parties, and the relationship of the parties.[291] Thus, courts focus primarily on the actor's improper motive and the means employed to effectuate that motive.[292] Furthermore, the removed general partner must prove that the other partners' or third party's actions induced or coerced the other contractual parties to abandon the contact.[293] In essence, the removed general partner must establish that the contractual relationship would have continued absent the other partners' or third party's interference.

Finally, some courts require that the removed general partner demonstrate that the other partners or third party possessed no legal right, privilege, or justification for the interference.[294] Indeed, the actor is exempt from liability, even though his conduct may be reprehensible, if he has a sufficient legal basis for inducing breach of the contractual relationship.[295] If the partnership agreement grants limited partners the right to remove a general partner without cause, and if the limited partners fully comply with the partnership agreement's removal provisions, then the limited partners' contractual rights constitute a defense against the removed general partner's action for tortious interference with a contractual relationship.

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290. *See* Murphy v. McIntyre, 69 N.C. App. 323, 328-29, 317 S.E.2d 397, 401 (1984).

291. Yaindl v. Ingersoll-Rand Co., 281 Pa. Super. 560, 574, 422 A.2d 611, 618 (1980); RESTATEMENT, *supra* note 281, § 767.

292. In *Kelly v. St. Vincent Hospital* the court determined that tortious interference with contractual relations can be accomplished by either the "improper motive solely to harm the plaintiff, or by improper means." 102 N.M. 201, 207, 692 P.2d 1350, 1356 (Ct. App. 1984). The court held that a legitimate business purpose for an action dispelled any improper motive and, in addition, defined improper means as "actions which are innately wrongful or predatory in character." *Id.* at 207, 692 P.2d at 1356-57.

293. *See* Todd v. Farm Bureau Mut. Ins. Co., 283 S.C. 155, 164, 321 S.E.2d 602, 608 (Ct. App. 1984), *quashed in part*, 287 S.C. 190, 336 S.E.2d 472 (1985).

294. *See, e.g.*, Murphy v. McIntyre, 69 N.C. App. 323, 329, 317 S.E.2d 397, 401 (1984).

295. *See* Childress v. Abeles, 240 N.C. 667, 675, 84 S.E.2d 176, 182 (1954); Bruton v. Smith, 225 N.C. 584, 586, 36 S.E.2d 9, 10 (1945) (stating that a "malicious motive makes a bad act worse, but it cannot make that wrong which, in its own essence, is lawful").

2. Tortious Interference with a Business Relationship

The removed general partner may file suit against the limited partners, the remaining general partners, or against third parties for tortious interference with a business relationship if the removed partner cannot establish a cause of action for contractual interference because an express management contract does not exist or because a jurisdictional law precludes him from basing a tort action on the partnership agreement.[296] To establish a cause of action for tortious interference with a business relationship, the removed general partner must prove the existence of such a relationship[297] and the interfering party's knowledge of that relationship.[298] Additionally, he must demonstrate the interferor's intent to injure the relationship[299] and that the interference resulted in damage.[300]

The threshold requirement for maintaining a claim of tortious interference with a business relationship is the establishment of the existence of a business relationship. To determine whether a business relationship exists, courts will make an ad hoc analysis of the parties' actions. Some courts, however, have concluded that the exchange of memoranda and correspondence between the parties and the inspection of goods to be bought or sold are actions sufficient to form a business relationship.[301] Once the injured party has established the existence of a business relationship, he also must prove that the interferor possessed the requisite knowledge of this relationship. The surrounding facts and circumstances may imply knowledge.[302] Furthermore, the complaining party need not estab-

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296. *See supra* notes 285-88 and accompanying text.

297. *See* Miller Chem. Co. v. Tams, 211 Neb. 837, 841, 320 N.W.2d 759, 762 (1982); Torbett v. Wheeling Dollar Sav. & Trust Co., 314 S.E.2d 166, 173 (W. Va. 1983); Topline Equip., Inc. v. Stan Witty Land, Inc., 639 P.2d 825, 829 (Wash. Ct. App. 1982).

298. *See* Miller Chem. Co. v. Tams, 211 Neb. 837, 841, 320 N.W.2d 759, 762 (1982); Topline Equip., Inc. v. Stan Witty Land, Inc., 639 P.2d 825, 829 (Wash. Ct. App. 1982).

299. *See* Miller Chem. Co. v. Tams, 211 Neb. 837, 841, 320 N.W.2d 759, 762 (1982); Classic Instruments, Inc. v. VDO-Argo Instruments, Inc., 73 Or. App. 732, 751, 700 P.2d 677, 693 (1985); Torbett v. Wheeling Dollar Sav. & Trust Co., 314 S.E.2d 166, 173 (W. Va. 1983); Topline Equip., Inc. v. Stan Witty Land, Inc., 639 P.2d 825, 829 (Wash. Ct. App. 1982).

300. *See* Taylor v. Sugar Hollow Park, Inc., 1 Conn. App. 38, 39, 467 A.2d 935, 936 (1983); Miller Chem. Co. v. Tams, 211 Neb. 837, 841, 320 N.W.2d 759, 762 (1982); Classic Instruments, Inc. v. VDO-Argo Instruments, Inc., 73 Or. App. 732, 751, 700 P.2d 677, 693 (1985); Torbett v. Wheeling Dollar Sav. & Trust Co., 314 S.E.2d 166, 173 (W. Va. 1983); Topline Equip., Inc. v. Stan Witty Land, Inc., 639 P.2d 825, 829 (Wash. Ct. App. 1982).

301. *See, e.g.*, Topline Equip., Inc. v. Stan Witty Land, Inc., 639 P.2d 825, 829-30 (Wash. Ct. App. 1982) (finding that memoranda, inspection of the goods for sale, and advertisement of the goods established a business relationship).

302. *See id.* at 830.

lish that the interferor understood "the legal significance of such facts."[303]

The removed general partner also must prove that the interferor intended to disrupt the business relationship and that this disruption injured the relationship and the removed partner. In *Topline Equipment, Inc. v. Stan Witty Land, Inc.*[304] Topline Equipment interfered with an existing business relationship between the plaintiff, Stan Witty Land, and a third party, Northwest Auction of Portland.[305] Stan Witty Land and Northwest Auction entered into a memorandum agreement to auction off logging equipment. This equipment included several pieces covered by contracts between Topline Equipment and Stan Witty Land.[306] Topline Equipment notified the plaintiff that it would stop the auction unless Stan Witty Land repaid certain debts that were secured by the equipment as well as other unsecured debts.[307] The court held that Topline Equipment's actions constituted intentional interference with the business relationship between Northwest Auction and the plaintiff even though Topline Equipment alleged that it retracted its demands prior to the plaintiff's cancellation of its auction contract and the resulting loss of profits.[308] Analogizing from *Topline Equipment*, a removed general partner must prove that the interferor wrongfully intended to induce his removal and that he sustained damages as a result.[309]

If the removed general partner establishes a prima facie case, the interferor may assert an affirmative defense of legal justification or privilege.[310] Interference with a business relationship is justified as a matter of law "only when the interferor engages in the exercise of an absolute right, equal or superior to the right which is invaded."[311] Thus, if the partnership agreement grants an unquali-

303. *See id.*

304. 639 P.2d 825 (Wash. Ct. App. 1982).

305. *Id.* at 830.

306. *Id.* at 828.

307. *Id.*

308. *Id.* at 830.

309. A general partner could suffer monetary loss from the forfeiture, sale, or conversion of his partnership interest.

310. *See* Topline Equipment, Inc. v. Stan Witty Land, Inc., 639 P.2d at 830 (holding that the existence of a secured debt does not provide a creditor with an absolute right to interfere with a contractual relationship); Torbett v. Wheeling Dollar Sav. & Trust Co., 314 S.E.2d 166, 173 (W. Va. 1983). *Contra* Bahleda v. Hankison Corp., 228 Pa. Super. 153, 156, 323 A.2d 121, 122-23 (1974) (holding that the lack of a privilege to interfere must be pled and proved as an element of the tort).

311. Topline Equip., Inc. v. Stan Witty Land, Inc., 639 P.2d 825, 830 (Wash. Ct. App.

fied right of removal, the limited partners may argue that their interference with the removed general partner's business relationship was privileged.

3. Tortious Interference with an Employment Relationship

The removed general partner may have an additional claim against the limited partners, the remaining general partners, or against third parties for tortious interference with an employment relationship. If an employment contract is terminable at the will of the parties, then it does not give rise to a cause of action for wrongful termination against the limited partnership or its members.[312] However, some courts have held that a removed general partner still may bring an action against the limited partners or third parties for tortious interference with an employment relationship.[313] A removed general partner need not establish even the existence of an express employment contract.[314]

The general partner must prove that the limited partners or third party maliciously interfered with his employment[315] and caused his subsequent removal.[316] Conduct will be deemed "malicious" if the interferor intended, without justifiable cause, to interfere with the general partner's rights.[317] Thus, if the limited partner or third party induces the general partner's removal through fraud or misrepresentation, the removed general partner may have a claim for tortious interference with an employment relationship.[318]

1982).

312. *See* Lesesne v. Mast Property Management, Inc., 251 Ga. 550, 552, 307 S.E.2d 661, 663 (1983).

313. *Id.* In *Lesesne* the court analogized the removal of a general partner to the wrongful termination of an employee and determined that the removed general partner could not bring an action against a limited partner for wrongful termination. Instead, the court stated that an action for tortious interference with the employment relationship stood as the appropriate remedy.

314. *Id.*

315. *See* Architectural Mfg. Co. v. Airotec, Inc., 119 Ga. App. 245, 250, 166 S.E.2d 744, 747 (1969).

316. *See* Nager v. Lad'n Dad Slacks, 148 Ga. App. 401, 403-04, 251 S.E.2d 330, 333 (1978) (requiring employee to establish damages from the interferor's actions).

317. *See* Architectural Mfg. Co. v. Airotec, Inc., 119 Ga. App. 245, 250, 166 S.E.2d 744, 747 (1969).

318. *See* Lesesne v. Mast Property Management, Inc., 251 Ga. 550, 307 S.E.2d 661 (1983).

V. A Proposal for Legislation

Modern limited partnerships are often extensive organizations consisting of hundreds of members that conduct business on an interstate or national level.[319] Today's limited partners purchase limited partnership interests primarily as investments;[320] therefore, they require the means to supervise effectively the partnership's management because management's decisions will affect materially the value of the limited partners' investments.[321] Considering the changes in the modern limited partnership's structure, its use as an investment vehicle,[322] and the policies underlying the uniform limited partnership laws,[323] limited partners should be granted the statutory right to remove a general partner to insure that they can supervise adequately their investments.

The Commissioners should amend the 1985 ULPA to include a removal right for limited partners as a method of resolving intrapartnership disputes without necessitating dissolution. In essence, the 1985 ULPA encourages limited partners to seek judicial resolution of intrapartnership problems, yet judicial remedies are often wholly inadequate in the modern limited partnership context.[324] The 1985 ULPA should be modified to include a right of removal that would give limited partners an effective mechanism for resolving intrapartnership disputes concerning the management of their investments. Furthermore, limited partnership agreements often include poorly drafted removal provisions. As a result, litigation and judicial intervention usually are required to resolve subsequent disputes. To eliminate this problem, the statutory amendment should provide adequate guidelines for drafting removal provisions. These guidelines should set forth procedures for removal and specific limitations on the limited partners' exercise of these rights. Additionally, the amendment should protect the parties' freedom to contract; therefore, the limited partners' removal right should be subject to certain modifications by the partnership agreement.

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319. *See generally Publicly Traded Limited Partnerships: An Emerging Financial Alternative to the Public Corporation*, 39 Bus. Law. 709 (1984).

320. *See* Basile, *supra* note 27, at 1218; Lipman, *Real Estate Syndicators Dream Up Exotic Deals to Win Back Investors*, Wall St. J., Jan. 25, 1985, at 23, col. 4.

321. *See supra* notes 52-55 and accompanying text.

322. *See supra* notes 4-6 and accompanying text.

323. *See supra* notes 30-33 and accompanying text.

324. *See supra* notes 127-32 and accompanying text; *see generally* Comment, *supra* note 34, at 123-28.

To achieve these objectives, the Commissioners should adopt a statute similar to the following:

The limited partnership agreement must provide that at least a majority of the limited partners, without the necessity for concurrence by the general partner(s), may remove the general partner(s) and must further provide:
(1) that limited partners whose aggregate percentage of interests equal or exceed twenty percent may notify the general partner(s) that they wish to propose the removal of the general partner(s) and the general partner(s) must notify all limited partners of the proposal by either
(a) mailing, within thirty days, a notice describing the proposal and containing a ballot to be returned within ten days indicating the limited partner's approval of or opposition to said proposal; or
(b) notifying the limited partners of the proposal within ten days and calling, within thirty days, a partnership meeting at which time the limited partners will vote on said proposal;
(2) a detailed provision for the purchase of the removed general partner's interest, excluding any interest he may have as a limited partner, and including within the provision
(a) a fair valuation method of the general partner's interest; and
(b) a fair method of payment that protects the liquidity and solvency of the partnership.

This proposed statutory provision promotes freedom of contract by allowing the contracting parties to negotiate the requisite voting percentage required to effect removal.[325] If the parties determine that a supermajority vote, rather than a simple majority vote, is appropriate, they can incorporate such a provision in their partnership agreement. Additionally, the proposed provision does not specify the basis for a removal vote. Thus, parties may choose to base the vote on an aggregate percentage of partnership interests, on the dollar amount invested by limited partners, or on a per capita basis.[326] Similarly, the proposed provision is silent regarding the limited partners' right to remove a general partner with or without "cause," thereby alleviating the problem of defining "cause". Likewise, it allows the parties to negotiate this term in light of their decision to require a majority or supermajority vote and the inherent nature of their partnership business.[327] However, to qualify for limited partnership taxation status, the parties must "substantially restrict", as specified in the applicable treasury regulations, the limited partners' removal power.[328]

To protect the efficacy of the limited partners' removal right, section 1 of the proposed provision sets forth the basic procedural

325. *See supra* notes 72-73 and accompanying text.
326. *See supra* notes 72-74 and accompanying text.
327. *See supra* notes 75-78 and accompanying text.
328. *See supra* notes 203-07 and accompanying text.

requirements for notification and voting.[329] Drafters often insert removal provisions in partnership agreements without specifying adequate procedures to effect removal. Without clear notification and voting procedures, the validity of a vote to remove a general partner might he subsequently challenged in court.[330] Thus, an absence of procedural requirements could thwart the effectiveness of removal as a nonjudicial dispute resolution method. Furthermore, sections 1(a) and (b) of the proposed provision grant general partners a reasonable period of time to notify the limited partners of an upcoming removal vote and to prepare a rebuttal to any allegations set forth in the notice.[331]

Section 2(a) of the proposed provision requires an express valuation method for assessing the value of the general partner's interest and section 2(b) mandates a fair method of payment. The provision, however, does not stipulate a specific basis for determining fair value. Instead, the parties may negotiate the valuation method vis-a-vis the nature of the partnership business. The partners could employ several different methods of valuation, including arbitration, computation of net partnership earnings, or appraisal of the partnership's net assets.[332] Furthermore, the parties can structure the general partner's payment to prevent unduly hampering the limited partnership's cash fiow.[333]

The proposed removal provision grants limited partners the most direct method of influencing partnership management and protecting their investment. Additionally, the provision insures that general partners will receive fair treatment upon removal regarding their partnership interest. Furthermore, if the general partner wishes to contribute significant amounts of capital to the limited partnership, he may protect his contribution by investing as a limited partner and, thus, exercise any voting rights granted to limited partners by the partnership agreement.[334] The proposed provision balances the competing interests of all parties involved.

VI. Conclusion

Limited partners clearly need a statutory right of removal as a method of resolving intrapartnership disputes. The RULPA's

329. *See supra* notes 68-71 and accompanying text.
330. *See supra* notes 274-79 and accompanying text.
331. *See supra* note 71 and accompanying text.
332. *See supra* notes 98-105 and accompanying text.
333. *See supra* notes 275-80 and accompanying text.
334. *See* Note, *supra* note 75, at 295 & n.33; ULPA § 13.

drafters intended to expand limited partners' supervisory powers over their own investments. However, the absence of bargaining power on the part of limited partners during the negotiation of partnership agreements renders the drafters' efforts moot. Limited partners have no effective mechanism for instituting managerial change and protecting their investment. A statutory right to remove general partners would enable limited partners to assess the quality of managerial performance and to respond accordingly to reports of a general partner's gross negligence, self-dealing, mismanagement, or fraud. Absent an explicit right of removal, limited partners must tolerate the general partner's mismanagement, sell their partnership interest, or dissolve the partnership. These alternatives, in essence, deny limited partners the right to investment protection rather than promote investor supervision as the RULPA's drafters intended. Thus, given the proliferation of limited partnerships formed as investment vehicles and the opportunities for potential abuse by general partners, legislators cannot continue to ignore the limited partners' need for a statutory right of removal to protect their investments.

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