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I. Introduction

One of the important features of the limited partnership[1] that makes investment in this form of business organization attractive is the general immunity afforded to limited partners from liability for the obligations of the partnership.[2] This immunity, however, can be forfeited. Under both the Uniform Limited Partnership Act (ULPA) and the Revised Uniform Limited Partnership Act (RULPA),[3] a limited partner becomes liable for the obligations of

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1. A limited partnership is a partnership having as members one or more general partners and one or more limited partners. Unif. Limited Partnership Act § 1 (1916) (act superseded 1976), 6 U.L.A. 562 (1969) [hereinafter cited as ULPA]; Revised Unif. Limited Partnership Act § 101(7) (1976), 6 U.L.A. 217 (West Supp. 1985) [hereinafter cited as RULPA].

2. *See* ULPA § 1, 6 U.L.A. 562 (1969); RULPA § 303(a), 6 U.L.A. 245-46 (West Supp. 1985). By contrast, the general partners of a limited partnership are liable for the obligations of the partnership. ULPA § 9(1), 6 U.L.A. 586 (1969); RULPA § 403(b), 6 U.L.A. 254 (West Supp. 1985).

In addition to offering the allure of limited liability, a limited partnership can be an attractive investment vehicle because the drafter "of a limited partnership agreement has 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, 6 U.L.A. 200 (West Supp. 1985). Moreover, unlike corporations, limited partnerships are not subject to federal income tax. The partners are liable for federal income tax "only in their separate or individual capacities." I.R.C. § 701 (1982).

3. The ULPA was approved by the National Conference of Commissioners on Uniform State Laws (the Commissioners) in 1916. In 1976 the Commissioners approved the RULPA with the intention of modernizing the ULPA. *See* Commissioners' Prefatory Note, 6 U.L.A. 200 (West Supp. 1985). As of January 1, 1985, 27 states, the District of Columbia, Guam, and the Virgin Islands had adopted and not repealed the ULPA, and 22 states had adopted

the partnership if, in addition to the exercise of the rights and powers of a limited partner, the limited partner "takes part in the control of the business."[4]

Not surprisingly, when sophisticated investors are offered limited partnership interests,[5] these investors often request provisions in the certificate of limited partnership or the partnership agreement[6] providing that the general partners may commit the partnership to certain types of transactions only with the consent of the holders of some specified percentage of the limited partnership interests[7] or that the limited partners be given some voice in the

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the RULPA. Louisiana is the only state that has not adopted either the ULPA or the RULPA.

4. ULPA § 7, 6 U.L.A. 582 (1969); RULPA § 303(a), 6 U.L.A. 245-46 (West Supp. 1985). In addition, a limited partner may become liable to creditors of the partnership under certain circumstances if the limited partner's name appears in the partnership name, ULPA § 5(2), 6 U.L.A. 580 (1969); RULPA § 303(d), 6 U.L.A. 246 (West Supp. 1985), or if the limited partner executes a certificate of limited partnership that contains a false statement, ULPA § 6, 6 U.L.A. 581 (1969); RULPA § 207(1), 6 U.L.A. 241 (West Supp. 1985). The issues raised by the rules imposing liability on a limited partner in these cases are beyond the scope of this Article.

In August 1985 the Commissioners approved certain amendments to the RULPA, including amendments to § 303. *See infra* notes 69-73 and accompanying text. Throughout this Article, "section 303" and "former section 303" mean § 303 of the RULPA as approved by the Commissioners in 1976, and "new section 303" means § 303 of the 1985 amendments. Under new § 303(a), a limited partner becomes liable for the obligations of the partnership if the limited partner "participates in the control of the business." *See infra* note 71 and accompanying text.

5. A partnership interest is a partner's share of the profits and losses of a limited partnership and the right to receive distributions of partnership assets. RULPA § 101(10), 6 U.L.A. 217 (West Supp. 1985). In this Article, all references to "investors" in limited partnerships mean purchasers of limited partnership interests rather than persons who make loans to limited partnerships.

6. A certificate of limited partnership is a document containing certain information prescribed by statute, the filing of which in a designated public office is required for the formation of a limited partnership. *See* ULPA § 2, 6 U.L.A. 568 (1969); RULPA § 201, 6 U.L.A. 230 (West Supp. 1985). A partnership agreement is an agreement of the partners concerning the affairs of the partnership and the conduct of its business. *See* RULPA § 101(9), 6 U.L.A. 217 (West Supp. 1985). Although a certificate of limited partnership is technically a partnership agreement, most limited partnerships have a separate partnership agreement that contains terms not required to be set forth in the certificate. Although provisions limiting a general partner's management authority could be included in either the certificate of limited partnership or in a separate partnership agreement, this Article generally treats these provisions as being set forth in the partnership agreement.

7. Indeed, the securities laws of a number of states require that the partnership agreements of certain types of limited partnerships contain these provisions before state residents may be invited to invest in the limited partnerships. *See, e.g.*, CAL. ADMIN. CODE tit. 10, R. 260.140.116.2, 1 BLUE SKY L. REP. (CCH) ¶ 11,999 (Apr. 1984); MICHIGAN CORPORATION AND SECURITIES BUREAU, STATEMENT OF POLICY REGARDING LIMITED AND CERTAIN QUALIFIED OFFERINGS OF REAL ESTATE PARTNERSHIPS/PROGRAMS, pt. VII, para. B, 1A BLUE SKY L. REP. (CCH) ¶ 32,569 (Feb. 1985); MO. ADMIN. CODE § 30-52.180, 2 BLUE SKY L. REP. (CCH)

selection of the partnership's managers. Although these requests are understandable, an obvious tension arises between the limited partners' desire to exercise control over important decisions affecting the partnership and the threat of personal liability for taking part, or participating, in the control of the business of the partnership. One of the most vexing problems facing lawyers who represent sophisticated limited partnership investors is advising these investors how much decision-making power they can obtain through negotiation with the general partners without losing immunity from liability for the obligations of the partnership.

There has been no dearth of insightful commentary pointing out the uncertainty inherent in the control rule. Most of this commentary has attempted to suggest the appropriate judicial standards for deciding whether the particular conduct of a limited partner in relation to the partnership business should subject the limited partner to personal liability for the obligations of the partnership.[8] Few commentators, however, have had the temerity even to suggest that the control rule be abolished[9] and that limited partners have no personal liability for the obligations of the partnership regardless of the degree to which the limited partners participate in the control of the partnership business.

This Article presses that argument. Part II examines the origins and present status of the control rule. This examination exposes the uncertain boundaries of a limited partner's potential liability under the rule and the resulting difficulty of advising potential investors in limited partnerships. Part III criticizes the control rule on the grounds that it complicates a potential investor's calculation of the risk of investing in a limited partnership,

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¶ 35,468 (Apr. 1985); NEB. ADMIN. R. 64, pt. VII(b), 2 BLUE SKY L. REP. (CCH) ¶ 37,411 (May, 1980); TEX. ADMIN. CODE tit. 7, § 117.7, 3 BLUE SKY L. REP. (CCH) ¶ 55,607 (July 1985); WASH. ADMIN. CODE R. 460-32A-150, 3 BLUE SKY L. REP. (CCH) ¶ 61,673 (Apr. 1983). *See generally* Augustine, Fass, Lester & Robinson, *The Liability of Limited Partners Having Certain Statutory Voting Rights Affecting the Basic Structure of the Partnership*, 31 BUS. LAW. 2087 (1976) (examining when a voting rights provision subjects a limited partner to personal liability for "taking part in the control of the partnership business"); Comment, *Partnership: Can Rights Required To Be Given Limited Partners Under New Tax Shelter Investment Regulations Be Reconciled with Section 7 of the Uniform Limited Partnership Act?*, 26 OKLA. L. REV. 289 (1973) (discussing what legal and practical effects the requirement of certain control rights will have on a limited partner's liability for the obligations of a partnership).

8. *See, e.g.*, Abrams, *Imposing Liability for "Control" Under Section 7 of the Uniform Limited Partnership Act*, 28 CASE W. RES. L. REV. 785 (1978); Feld, *The "Control" Test for Limited Partnerships*, 82 HARV. L. REV. 1471 (1969); Feldman, *The Limited Partner's Participation in the Control of the Partnership Business*, 50 CONN. B.J. 168 (1976).

9. *But see infra* note 115 and accompanying text.

compromises the negotiating position of limited partners relative to general partners, and is not supported by any valid policy that could not be accommodated by other existing legal principles. Finally, part IV argues that the control rule should be abolished in favor of a rule that generally would free limited partners from personal liability for the obligations of the partnership. Part IV also suggests specific legislation that would effect this change.

II. Origins and Present Status of the Control Rule

A. *The Early Limited Partnership Acts*

The first limited partnership act in the United States was adopted by New York in 1822 and was copied largely from the then-extant French statute.[10] Within the following sixty years, all the states adopted limited partnership acts[11] based generally upon the New York model.[12]

Most of the early limited partnership acts provided that a limited partner could neither "transact any business on account of the partnership, nor be employed for that purpose as agent, attorney, or otherwise."[13] If a limited partner acted contrary to these prohibitions, the limited partner was deemed a general partner.[14] Thus, under the early acts, the test of a limited partner's personal liability for the obligations of the partnership was whether the limited partner "interfered" with the general partner's management of the partnership business. The drafters of these statutes, however, made no attempt to define the type of conduct that would constitute "interference" by a limited partner. When partnership creditors claimed that limited partners had "interfered" in violation of the acts, the courts were required to decide each case on its own facts.

Although the results of the early cases were mixed, generally, the greater the quantum of the limited partner's participation in the business of the partnership, the greater the likelihood that the limited partner would be held liable for the obligations of the partnership. For example, limited partners were held *not* to be liable

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10. C. Bates, The Law of Limited Partnership 20 (1886).

11. *Id.* at 21.

12. ULPA § 1, Official Comment, 6 U.L.A. 563 (1969).

13. C. Bates, *supra* note 10, at 129.

14. *Id.* Some early limited partnership statutes provided that a limited partner would be "deemed and treated as a general partner" if the limited partner personally made "any contract respecting the concerns of the partnership with any person except the general partners." *Id.* at 131.

for the obligations of partnerships when: title to real estate was taken in the name of two general partners and a limited partner, but the evidence did not show that the limited partner participated in the conveyance or knew that he was named as a grantee in the deed;[15] a limited partner conducted the sale of partnership assets after dissolution;[16] a limited partner agreed to the proposed terms of the partnership's dissolution;[17] a limited partner purchased goods from and sold goods to the partnership and performed an occasional errand for the partnership;[18] a limited partner on one occasion "consulted with one of the general partners" and telegraphed persons who requested information about the partnership to the effect that the firm was "all right";[19] a limited partner guaranteed certain obligations of the partnership;[20] a limited partner sold goods to the partnership;[21] a limited partner brought an action for partnership dissolution and was appointed receiver;[22] and a limited partner, following the illness of the general partner, looked over the business, examined the books of the partnership, and stated that he expected to close out the business to pay off the creditors.[23] On the other hand, limited partners *were* held liable for the obligations of partnerships when: the partnership agreement provided that the partnership was to employ a son of the limited partner as a bookkeeper and that the general partner could sign no notes, checks, or contracts on behalf of the partnership without the bookkeeper's approval;[24] the general partners transferred all the partnership assets to a limited partner and the limited partner thereafter carried on the business in his own name;[25] a limited partner was a party to a contract transferring all the assets of an insolvent partnership to a creditor and made a contract with the creditor regarding disposal of the assets and pay-

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15. Madison County Bank v. Gould, 5 Hill 309, 315 (N.Y. Sup. Ct. 1843).

16. Lawson v. Wilmer, 3 Phila. 122, 15 Leg. Int. 133, 133 (Phila. Common Pl. 1858); Outcalt & Co. v. Burnet & Brother, 1 Handy 404, 405 (Ohio 1855).

17. Lachaise v. Marks, 4 E.D. Smith 610, 619 (N.Y. Common Pl. 1855).

18. McKnight v. Ratcliff, 44 Pa. 156, 162-63 (1863).

19. Ulman & Co. v. Briggs, Payne & Co., 32 La. Ann. 655, 662 (1880).

20. R. W. Rayne & Co. v. Terrell, 33 La. Ann. 812, 814 (1881).

21. Hanover Nat'l Bank v. Sirrett, 15 Abb. N. Cas. 334, 336 (N.Y. Sup. Ct. 1883).

22. Continental Nat'l Bank v. Strauss, 137 N.Y. 148, 150, 32 N.E. 1066, 1066 (1893).

23. E. C. Cropper & Co. v. Illinois Sewing Mach. Co., 100 Miss. 127, 128, 54 So. 849, 849 (1911).

24. Richardson v. Hogg, 38 Pa. 153, 156 (1861).

25. First Nat'l Bank v. Whitney, 4 Lans. 34, 37 (N.Y. Sup. Ct. 1871), *aff'd mem. sub nom.* Flour City Nat'l Bank v. Whitney, 53 N.Y. 627 (1873).

ment of the partnership's debts;[26] and a partnership agreement provided that the business of the partnership would be managed by directors elected by the limited partners.[27]

More interesting than the results of these cases are the occasional explanations by the courts for the statutory command that personal liability is the price limited partners must pay for "interference." Although few of the early jurists ventured a guess at the reason behind this rule, those who did explained that the rule was intended to protect creditors who otherwise might assume mistakenly that a limited partner who "interfered" in the management of the business was a general partner. For example, in *Lawson v. Wilmer*[28] the court stated: "The design [of the statute], no doubt, was to protect third persons, who were ignorant of the relations between the members of the partnership, and who might be led by the presence and intervention of the special partner, to believe that he was personally liable for the debts of the firm."[29] Similarly, in *Hanover National Bank v. Sirrett*[30] the court said:

> The interference by transacting business or acting as agent for the firm, upon which the penalty of liability as a general partner is imposed by the statute, means an interference by intrusion into the office of a general partner, and the performance of acts that pertain to the office of the general partner, and which might therefore *deceive the public* with the idea that he who so appears to be, is in fact a general partner.[31]

A discussion of the validity of this reason for imposing personal liability on limited partners appears in part III of this Article.

B. *The Control Rule Under the ULPA*

In 1916 the Commissioners approved the ULPA and recommended its adoption by the legislatures of the several states. The principal drafter of the ULPA, Professor William Draper Lewis, stated that the Commissioners' purpose in approving the ULPA was to respond to the perceived "failure of the [early] limited partnership acts to meet the business need for which they were designed."[32] Professor Lewis wrote that most of the differences be-

26. Farnsworth v. Boardman, 131 Mass. 115, 120 (1881).

27. Strang v. Thomas, 114 Wis. 599, 601, 91 N.W. 237, 238 (1902).

28. 3 Phila. 122, 15 Leg. Int. 133 (Phila. Common Pl. 1858).

29. *Id.* at 123, 15 Leg. Int. at 133. The reference in the opinion to the limited partner as a "special partner" is typical of the terminology of the early statutes and cases.

30. 15 Abb. N. Cas. 334 (N.Y. Sup. Ct. 1883).

31. *Id.* at 336 (emphasis added).

32. Lewis, *The Uniform Limited Partnership Act*, 65 U. PA. L. REV. 715, 718 (1917). In the Official Comment to § 1 of the ULPA, the Commissioners stated that the "business

tween the ULPA and the existing statutes reflected the drafters' desire to provide limited partners "with the same sense of security from any possibility of unlimited liability as the subscribers to the shares of a corporation."[33] Professor Lewis further noted:

> The act proceeds on the assumption that *no public policy requires a person who* contributes to the capital of a business, *acquires* an interest in the profits, and *some degree of control over the conduct of the business, to become bound for the obligations of the business,* provided creditors have no reason to believe at the times their credits were extended that such person was so bound.[34]

If, as Professor Lewis wrote, the Commissioners intended that limited partners be allowed to acquire some control over the business of the partnership without risk of incurring personal liability for the obligations of the partnership, the Commissioners chose an odd way to effect that intent. Rather than abolishing the interference rule, the Commissioners provided a substitute rule in section 7 of the ULPA: "A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business."[35] Thus, on its face, section 7 states the antithesis of the Commissioners' purported intent.

Just as the drafters of the early limited partnership acts did not define "interference," the Commissioners did not define "takes part in the control of the business" for purposes of section 7. Thus, the Commissioners left to the courts the task of divining the meaning of this phrase. While struggling with this problem, courts developed two basic tests for deciding when to impose liability on a limited partner for the obligations of the partnership.[36]

1. The Quantitative Power Test

In most of the reported decisions, courts decided whether to hold a limited partner liable for the obligations of the partnership

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reason for the adoption of acts making provisions for limited or special partners is that men in business often desire to secure capital from others," and that the early limited partnership acts failed "to meet the desire of the owners of a business to secure necessary capital under the existing limited partnership form of business association." 6 U.L.A. 562, 564 (1969).

33. Lewis, *supra* note 32, at 723.

34. *Id.* (emphasis added). This view is also stated in the Commissioners' Official Comment to § 1 of the ULPA. 6 U.L.A. 564 (1969).

35. 6 U.L.A. 582 (1969).

36. For a comprehensive analysis of the reported decisions under § 7 of the ULPA and a characterization of the test applied by the courts in each case, see Abrams, *supra* note 8, at 791-802.

by assaying the amount of the limited partner's involvement in the partnership's business: when the limited partner's involvement became too extensive, the limited partner was held personally liable. One commentator has described this test as the "quantitative power" test.[37]

Two cases from California illustrate the operation of the quantitative power test. The first, *Holzman v. de Escamilla*,[38] concerned a limited partnership engaged in the business of raising vegetables for márket. The partnership consisted of one general partner and two limited partners. The evidence showed that the three partners always conferred on what crops to plant and that sometimes the limited partners dictated the choice of crops over the dissent of the general partner. In addition, the partnership maintained two bank accounts upon which checks could be drawn only with the signatures of two partners; the general partner, therefore, could draw checks only with the signature of a limited partner but the limited partners could draw checks without the signature of the general partner. Finally, the limited partners requested that the general partner resign as the manager of the partnership business, and they appointed a new manager. After summing up the evidence, the court held that the circumstances "clearly" showed that the limited partners "took part in the control of the business of the partnership and thus became liable as general partners."[39]

The second California case applying the quantitative power test, *Grainger v. Antoyan*,[40] concerned a limited partnership engaged in the business of selling automobiles. Like the limited partnership in *Holzman*, the entity consisted of one general partner and two limited partners. The defendant limited partner was the sales manager of the limited partnership and was in charge of the new car sales department. In addition, the limited partner was authorized to cosign checks drawn on the partnership's checking account with the general partner and two employees of the partnership. The limited partner, however, cosigned checks only when the general partner was unavailable, and checks could be drawn on the partnership's account without the limited partner's signature. The limited partner had no authority to hire or fire employees, to purchase new cars, to set selling prices of new or used cars or

37. Abrams, *supra* note 8, at 791.
38. 86 Cal. App. 2d 858, 195 P.2d 833 (1948).
39. *Id.* at 860, 195 P.2d at 834.
40. 48 Cal. 2d 805, 313 P.2d 848 (1957).

trade-in allowances for used cars, to extend credit to customers, to operate the service department, or to maintain the partnership's books. The Supreme Court of California summarily concluded that the limited partner's activities did not subject him to liability under section 7. The *Grainger* court found this case factually distinguishable from *Holzman* "for the reason that in the present case defendant did not exercise control over the partnership, while in [*Holzman*] the limited partners in fact exercised control over the partnership."[41] Although the court was correct in saying that *Holzman* and *Grainger* were "factually distinguishable," neither decision is helpful to a California lawyer whose client is pressing for an articulation of the boundary beyond which a limited partner may not go without incurring liability for the obligations of the partnership.

An examination of other opinions that have employed the quantitative power test demonstrates further the problem that this test presents for a lawyer.[42] The test leads to decisions that form

41. *Id.* at 813, 313 P.2d at 853.

42. *See* Plasteel Prods. Corp. v. Helman, 271 F.2d 354 (1st Cir. 1959) (holding limited partners *not* liable for the obligations of a partnership when the partnership agreement named an individual as general sales manager of the partnership and provided for the purchase of the interests of certain limited partners if the employment of that individual were terminated by the general partner), *aff'g* Plasteel Prods. Corp. v. Eisenberg, 170 F. Supp. 100 (D. Mass. 1959); Mursor Builders, Inc. v. Crown Mountain Apartment Assocs., 467 F. Supp. 1316 (D.V.I. 1978) (holding limited partners liable for the obligations of the partnership when they were also officers of the corporate general partner of the partnership); Bergeson v. Life Ins. Corp. of Am., 170 F. Supp. 150 (D. Utah 1958) (holding limited partners liable for the obligations of a partnership that was formed to organize an insurance company and to receive commissions on sales of policies by the insurance company when the limited partners served as directors of the insurance company), *aff'd in part and rev'd in part*, 265 F.2d 227 (10th Cir.), *cert. denied*, 360 U.S. 932 (1959); Silvola v. Rowlett, 129 Colo. 522, 272 P.2d 287 (1954) (en banc) (holding a limited partner *not* liable for the obligations of a partnership when that limited partner acted as a foreman in the partnership's automobile repair shop and sometimes gave his opinion on business questions when asked by the general partner); Stone Mountain Properties, Ltd. v. Helmer, 139 Ga. App. 865, 229 S.E.2d 779 (1976) (holding limited partners *not* liable for the obligations of a partnership when they merely indicated their desire to sell or not to sell certain unspecified items); Trans-Am Builders, Inc. v. Woods Mill, Ltd., 133 Ga. App. 411, 210 S.E.2d 866 (1974) (holding limited partners *not* liable for the obligations of a partnership when they attended meetings with the general partner at which financial difficulties were discussed, visited a project owned by the partnership, and complained to the general contractor's superintendent about the way certain work was done); Delaney v. Fidelity Lease Ltd., 526 S.W.2d 543 (Tex. 1975) (holding limited partners liable for the obligations of the partnership when they were also officers of the corporate general partner); *see also* Gast v. Petsinger, 228 Pa. Super. 394, 323 A.2d 371 (1974) (reversing summary judgment in favor of two limited partners employed by a partnership as consultants and having the title of "project managers"). According to Abrams, the court in *Gast* actually applied a refinement of the "quantitative power" test, which Abrams called the "day-to-day powers" test. Under this test a court would hold a limited

no discernible pattern and that are nearly useless in predicting the outcome of the next case. To purloin a sentence from another context, "[i]f there is any silver thread of consistency running through these decisions, it has escaped the observation of this writer."[43]

Under the quantitative power approach, once a limited partner's activity crosses some metaphysical threshold, liability is automatic. Whether a creditor relied upon the limited partner's conduct and mistook the limited partner for a general partner or even knew of the limited partner's conduct at the time the creditor extended credit to the partnership is therefore irrelevent. In *Delaney v. Fidelity Lease Ltd.*,[44] for example, the Texas Supreme Court explicitly rejected the limited partners' contention that section 7 of the ULPA required that the court determine "whether the plaintiffs relied upon the limited partners as holding themselves out as general partners."[45] The court reasoned from the absence of any explicit mention of a reliance test in section 7 that reliance by the plaintiffs was not part of the control rule.[46]

2. The Specific Reliance Test

On the other hand, in a few reported cases arising under section 7 of the ULPA, courts have applied what one commentator has called the "specific reliance" test.[47] Courts that have accepted this test have explained that liability for a partnership's obligations to a creditor should not be imposed upon a limited partner who takes part in the control of the business unless, as a result of

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partner liable for the obligations of the partnership if the limited partner's conduct constituted the continual, day-to-day exercise of power over the operation of partnership affairs. *See* Abrams, *supra* note 8, at 793-99.

43. Prosser, *Open Price in Contracts for the Sale of Goods*, 16 MINN. L. REV. 733, 736 n.6 (1932).

44. 526 S.W.2d 543 (Tex. 1975).

45. *Id.* at 545. The limited partners argued:

> [B]efore personal liability attaches to limited partners, two elements must coincide: (1) the limited partner must take part in the control of the business, and (2) the limited partner must have held himself out as being a general partner having personal liability to an extent that the third party, or plaintiff, relied upon the limited partners' personal liability.

Id. (citations omitted).

46. *Id.* The opinion states:

> Section 8 of Article 6132a simply provides that a limited partner who takes part in the control of the business subjects himself to personal liability as a general partner. The statute makes no mention of any requirement of reliance on the part of the party attempting to hold the limited partner personally liable.

Id.

47. Abrams, *supra* note 8, at 799-802.

the limited partner's conduct, the creditor believed that the limited partner was a general partner.[48] The justification advanced for requiring a creditor to show reliance is that the purpose of imposing liability on a limited partner under section 7 is to "protect third parties from dealing with the partnership under the mistaken assumption that the limited partner is a general partner with general liability."[49] Regardless of the merits of the specific reliance test,[50] the Texas Supreme Court correctly pointed out in the *Delaney* decision[51] that section 7 does not by its terms require creditor reliance as a predicate for holding a limited partner liable.[52]

Despite the fact that the Commissioners approved the ULPA nearly seventy years ago and that at one time forty-nine states, the District of Columbia, Guam, and the Virgin Islands had adopted the Act, there is amazingly little reported case law interpreting section 7.[53] Nonetheless, analysis of the few existing decisions lends weight to the conclusion expressed by one appellate court that

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48. Perhaps it is more than coincidental that no court that has used the specific reliance test has held a limited partner liable for the obligations of the partnership under § 7 of the ULPA. *See* Western Camps, Inc. v. Riverway Ranch Enters., 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (1977); Delaney v. Fidelity Lease Ltd., 517 S.W.2d 420 (Tex. Civ. App. 1974), *rev'd*, 526 S.W.2d 543 (Tex. 1975); Frigidaire Sales Corp. v. Union Properties, Inc., 88 Wash. 2d 400, 562 P.2d 244 (1977); Rathke v. Griffith, 36 Wash. 2d 394, 218 P.2d 757 (1950).

49. Frigidaire Sales Corp. v. Union Properties, Inc., 14 Wash. App. 634, 641, 544 P.2d 781, 785 (1975), *aff'd*, 88 Wash. 2d 400, 562 P.2d 244 (1977).

50. Section 5 of the ULPA makes a limited partner whose surname appears in the partnership name "liable as a general partner to partnership creditors who extend credit to the partnership without actual knowledge that [the limited partner] is not a general partner." 6 U.L.A. 580 (1969). Similarly, § 6 of the ULPA makes any partner who knows that the certificate of limited partnership contains a false statement liable to "one who suffers loss by reliance on such statement." 6 U.L.A. 581 (1969). By contrast, § 7 does not by its terms make the state of mind of a creditor an element of the creditor's claim. Feld, *supra* note 8, at 1479-80.

51. *See supra* note 46. After the *Delaney* decision the Texas legislature amended the state's version of § 7 to provide that a limited partner who takes part in the control of the business is liable "only to a person who transacts business with the partnership reasonably believing that the limited partner is a general partner." TEX. REV. CIV. STAT. ANN. art. 6132a, § 8(a) (Vernon Supp. 1985).

52. Various commentators have suggested other tests that might be applied to determine liability under § 7 of the ULPA. *See* Abrams, *supra* note 8, at 808-24 (advocating an "effects" test); Feld, *supra* note 8, at 1480 (suggesting an "estoppel" test). Courts have not embraced these suggestions.

53. The cases cited *supra* in notes 38, 40, 42, & 48 are all the reported decisions construing § 7 when the plaintiff was a partnership creditor. *Cf.* Weil v. Diversified Properties, 319 F. Supp. 778 (D.D.C. 1970) (holding that a general partner may not invoke § 7 of the ULPA to enlarge the liability of the limited partners). According to Professor Feld, this scarcity of reported decisions is a reflection of the chilling effect that § 7 has had on limited partners and their counsel who might, but for the control rule, negotiate more aggressively for input into certain business decisions. *See* Feld, *supra* note 8, at 1484.

each case was decided on its own facts and provides little assistance in formulating rules or standards. The court concluded:

> In each case, it was not the position of the limited partner that was stated as permissible, but the actual role and degree of participation that each had in relation to the general partner. A reading of those cases reinforces the belief of this Court that the determination must be made on an *ad hoc* basis . . . .[54]

C. The Control Rule Under the RULPA

1. Section 303

In 1976 the Commissioners approved the RULPA and recommended its adoption by the legislatures of the several states.[55] According to the Commissioners' Comment to section 303 of the RULPA, the provision "makes several important changes in Section 7 of the prior uniform law."[56] Although section 303 of the RULPA is undoubtedly an improvement over section 7 of the ULPA, section 303 is not without its own problems.[57]

Section 303(a) contains two sentences. The first sentence reiterates the control rule of section 7 of the ULPA.[58] The second sentence identifies two classes of potential creditor-plaintiffs to whom a limited partner may be liable: those who know of the limited partner's participation in the control of the business and those who do not. The consequence of this distinction is a bifurcated standard of liability for the limited partner: "[I]f the limited partner's participation in the control of the business is not suhstantially 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."[59] The Com-

54. Gast v. Petsinger, 228 Pa. Super. 394, 402, 323 A.2d 371, 375 (1974).

55. The adoption process is well under way. *See supra* note 3.

56. 6 U.L.A. 246 (West Supp. 1985).

57. For a penetrating analysis and critique of § 303 of the RULPA, 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, 47-60 (1978).

58. The first sentence of § 303(a) provides:

> Except as provided in subsection (d), a limited partner is not liable for the obligations of a limited partnership unless he is also a general partner or, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business.

6 U.L.A. 245-46 (West Supp. 1985). Section 303(d), which is referred to in § 303(a), states that a limited partner who knowingly permits his or her name to be used in the name of the limited partnership, except under certain circumstances, is "liable to creditors who extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner." *Id.* at 246.

59. *Id.* at 246.

missioners' Comment to section 303 explains the rationale for this distinction:

> The first sentence of Section 303(a) carries over the basic test from former Section 7—whether the limited partner "takes part in the control of the business"—in order to insure that judicial decisions under the prior uniform law remain applicable to the extent not expressly changed. The second sentence of Section 303(a) reflects a wholly new concept. Because of the difficulty of determining when the "control" line has been overstepped, it was thought it [sic] unfair to impose general partner's liability on a limited partner except to the extent that a third party had knowledge of his participation in control of the business. On the other hand, in order to avoid permitting a limited partner to exercise all of the powers of a general partner while avoiding any direct dealings with third parties, the "is not substantially the same as" test was introduced.[60]

Under section 303, therefore, a limited partner who takes part in the control of the partnership's business is potentially liable to all the creditors of the partnership if the limited partner's participation is "substantially the same as the exercise of the powers of a general partner." This "substantially the same as" test is a new concept, and its meaning is not evident from either the text of section 303 or the Commissioners' Comments.[61] In 1976 the Commissioners, therefore, presented yet another amorphous concept with which the courts must struggle; the results of the struggle have not yet begun to appear in the reporters.

A limited partner may incur liability to a smaller group of creditors—those with knowledge of the limited partner's participation in partnership control—even if the limited partner's participation does not rise to the level of being "substantially the same as the exercise of the powers of a general partner."[62] Significantly, the terms of the statute do not require, as a condition to a limited partner's liability, that a creditor have mistaken the limited partner for a general partner. The only requirement is that the creditor have "actual knowledge" of the limited partner's participation in

60. *Id.*

61. Courts may well apply the "day-to-day powers" test described by Abrams to determine whether a limited partner's participation in the control of the business is "substantially the same as the exercise of the powers of a general partner" for purposes of § 303(a). *See supra* note 42.

62. If the Commissioners intend that the courts employ the "day-to-day powers" test to determine the liability of a limited partner to a creditor who has no knowledge of the limited partner's participation in the control of the business, *see supra* note 61, then presumably the Commissioners intend that a limited partner who participates in the control of the business *without* meeting the "day-to-day powers" test nonetbeless can be liable to a creditor of the partnership who has actual knowledge of tbe limited partner's participation in control.

control.[63]

Section 303(b) of the RULPA then provides a nonexclusive[64] list of safe harbor activities[65] in which a limited partner may engage without being deemed to have participated in the control of the business. The safe harbor rules allow a limited partner to be a contractor, agent, or employee of the partnership or of a general partner; to consult with and advise a general partner; to be a surety for the partnership; to approve or disapprove amendments to the partnership agreement; and to vote on matters concerning the dissolution and winding up of the partnership, the transfer of all or substantially all the partnership's assets not in the ordinary course of business, the incurrence of partnership indebtedness not in the ordinary course of business, a change in the nature of the partnership's business, or the removal of a general partner.[66]

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63. In this respect, the Commissioners' Prefatory Note to the RULPA, which states that § 303 imposes liability only upon a limited partner who is in effect a "silent general partner" or who bas "somehow permitted third parties to be misled to their detriment as to the limited partner's true status," is inconsistent with the terms of the statute. 6 U.L.A. 201 (West Supp. 1985). By comparison, the second sentence of the Delaware version of § 303(a) provides that "if the limited partner does participate in the control of the business, he is liable only 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." DEL. CODE ANN. tit. 6, § 17-303(a) (Supp. 1984); *see also* CAL. CORP. CODE § 15632(a) (West Supp. 1985) (providing that a limited partner is "not liable to persons who transact business with the limited partnership unless they do so with actual knowledge of that partner's participation in control and reasonably believing that partner to be a general partner").

64. That the provisions of § 303(b) of the RULPA are nonexclusive is made clear by § 303(c), which provides: "The enumeration in subsection (b) does not mean that the possession or exercise of any other powers by a limited partner constitutes participation by him in tbe business of the limited partnership." 6 U.L.A. 246 (West Supp. 1985).

65. The safe harbor approach to the problem of defining control is not unique to those states that have enacted the RULPA. A few of the states in which the ULPA remains in effect have enacted nonuniform variations of § 7 providing that certain specified activities of the limited partners do not constitute taking part in the control of the business. *See* FLA. STAT. ANN. § 620.07 (West Supp. 1985); N.Y. PARTNERSHIP LAW § 96 (McKinney Supp. 1984); OR. REV. STAT. § 69.280 (Supp. 1983); TENN. CODE ANN. § 61-2-107 (Supp. 1984); and TEX. REV. CIV. STAT. ANN. art. 6132a, § 8 (Vernon Supp. 1985).

66. 6 U.L.A. 246 (West Supp. 1985). Section 303(b) provides:

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

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

(2) consulting with and advising a general partner with respect to tbe business of the limited partnership;

(3) acting as surety for the limited partnership;

(4) approving or disapproving an amendment to the partnership agreement; or

(5) voting on one or more of the following matters:

(i) the dissolution and winding up of the limited partnership;

(ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or sub-

Notwithstanding the safe harbor for voting on certain matters, the Commissioners clearly indicated that the possession or exercise of voting powers by limited partners can, at some undefined point, rise to the level of taking part in the control of the business within the meaning of section 303(a). Section 302 of the RULPA provides: "*Subject to Section 303*, the partnership agreement may grant to all or a specified group of the limited partners the right to vote (on a per capita or other basis) upon any matter."[67] The Commissioners' Comment to section 302 explains that "[i]f such [voting] powers are granted to limited partners beyond the 'safe harbor' of Section 303(b)(5), a court may hold that, under the circumstances, the limited partners have participated in 'control of the business' within the meaning of Section 303(a)."[68]

As indicated above, section 303 of the RULPA was a modest improvement over section 7 of the ULPA. To the extent of the "safe harbor" provisions of section 303(b), the Commissioners made clear that certain activities by limited partners did not constitute taking part in the control of the partnership business. On the other hand, the Commissioners created a new concept, the "substantially the same as" test, without providing any guidance to judges or lawyers regarding the meaning of that concept. Furthermore, the Commissioners retained the rule that a limited partner might incur personal liability for partnership obligations if he took part in control of the partnership business without resolving the fundamental problem of discriminating between those non-"safe harbor" activities that would result in personal liability and those that would not.

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stantially all of the assets of the limited partnership other than in the ordinary course of its business;

(iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business;

(iv) a change in the nature of the husiness; or

(v) the removal of a general partner.

Id. A number of the states that have adopted the RULPA have enacted nonuniform variations of § 303(b) to expand the number of safe harbor powers or activities available to limited partners. *See* ALA. CODE § 10-9A-42 (Supp. 1984); CAL. CORP. CODE § 15632 (West Supp. 1985); COLO. REV. STAT. § 7-62-303 (Supp. 1984); Del. Revised Unif. Limited Partnership Act, H.R. 191, § 17-303 (Apr. 30, 1985) (to be codified at DEL. CODE ANN. tit. 6, § 17-303); IOWA CODE ANN. § 545.303 (West Supp. 1985); KAN. STAT. ANN. § 56-1a203 (1983); MICH. COMP. LAWS ANN. § 449-1303 (West Supp. 1985); NEB. REV. STAT. § 67-251 (Supp. 1982); NEV. REV. STAT. § 88.19 (Supp. 1985); WASH. REV. CODE ANN. § 25.10.190 (Supp. 1985).

67. 6 U.L.A. 245 (West Supp. 1985) (emphasis added).

68. *Id.*

2. New Section 303

In August 1985 the Commissioners approved a number of amendments to subsections 303(a) and 303(b).[69] Although new section 303 is considerably longer than its predecessor, the unmistakable intent of the Commissioners in recommending to the states the adoption of the new section is to relax, but not abolish, the control rule.

Like its predecessor, new section 303(a) contains two sentences. The first sentence retains the control rule with a small change in wording: under new section 303(a), a limited partner becomes liable for the partnership's obligations if the limited partner "participates" (rather than "takes part") in the control of the business.[70] It seems unlikely that the Commissioners intend any change in the substance of the control rule by this rephrasing alone although the reason for this change is not certain.[71]

However, the Commissioners significantly amended the second sentence of section 303(a). New section 303(a) abandons the bifurcated liability standard and the confusing "substantially the same as" test introduced in 1976. Pursuant to the second sentence of new section 303(a), a limited partner who particiates in the control

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69. In addition to approving amendments to § 303, the Commissioners approved amendments to other sections of the RULPA which, if adopted by the states, should generally facilitate the use of the limited partnership form by large businesses. The 1985 amendments significantly streamline the certificate of limited partnership by eliminating many of the matters which the RULPA required to be disclosed in the certificate, by no longer requiring that the certificate be signed by the limited partners (a change that also will relieve limited partners from potential liability for false statements in the certificate pursuant to § 207), and by specifically authorizing the filing of restated certificates. In addition, the Commissioners amended § 401 of the RULPA to enable partners validly to agree tbat new general partners may be admitted to limited partnerships without the contemporaneous unanimous consent of all the partners. For a discussion of the rule requiring the unanimous consent of the limited partners for the admission of an additional or substitute general partner, 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.

70. The first sentence of new § 303(a) provides: "Except as provided in subsection (d), a limited partner is not liable for the obligations of a limited partnership unless he is also a general partner or, in addition to the exercise of his rights and powers as a limited partner, he participates in the control of the business." UNIF. LIMITED PARTNERSHIP ACT § 303(a) (1985) [hereinafter cited as ULPA (1985)]. Although the ULPA (1985) is not yet available in published form, it will likely be included in West's 1986 pocket part for volume six of UNIFORM LAWS ANNOTATED, which will be distributed in January or February of 1986.

71. A possible reason for the change is to conform the language of new § 303(a) to that of § 303(b) which used the langnage "participate" rather than "take part." *See supra* note 66. At the time of this writing the revised Commissioners' Comments to new § 303 were not yet available. *See supra* note 70. The revised Comments may well answer some or all of the questions raised by this Article concerning new § 303.

of the business is liable only 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."[72] The effect of this change should be to reduce substantially the number of plaintiffs who can qualify to sue a limited partner for participating in the control of the business.

The Commissioners also amended section 303(b) to add a number of safe harbor activities in which limited partners may engage without being deemed to participate in the control of the business. Among the specific safe harbor activities added by new section 303(b) are provisions that allow a limited partner to be an officer, director, or shareholder of a general partner that is a corporation; to guarantee or assume one or more specific obligations of the limited partnership; to take any action required or permitted by law to bring or pursue a derivative action in the right of the limited partnership; to request or attend a meeting of partners; to wind up the limited partnership under certain circumstances; or to propose, approve or disapprove, by voting or otherwise, the transfer of all or substantially all the partnership's assets (whether or not in the ordinary course of business), the admission of a general partner, the admission or removal of a limited partner, or a transaction involving an actual or potential conflict of interest between a general partner and the limited partnership or the limited partners.[73]

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72. The second sentence of new § 303(a) provides: "However, if the limited partner particpates in the control of the business, he is liable only 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." ULPA (1985) § 303(a). See also the Delaware and California versions of former § 303(a), *supra* note 63, which also employ a reasonable reliance test.

73. New § 303(b) provides:

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

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

No list of specific safe harbor activities can be complete; one always can think of at least one more activity in which a limited partner might wish to engage that would be missing from even the most carefully crafted safe harbor list. Examples of such activities that are not on the expanded safe harbor list of new section 303(b) include proposing, approving, or disapproving the sale or lease of specific assets, but less than substantially all assets of the partnership; the incurrence of indebtedness in the ordinary course of the partnership's business; or the refinancing or payment of indebtedness.[74] In recognition of the inexhaustiveness of the specific safe harbor list, the Commissioners approved perhaps the most useful of the amendments to section 303—new section 303(b)(6)(ix). Specifically, this amendment provides a safe harbor for "proposing, approving, or disapproving, by voting or otherwise . . . matters related to the business of the limited partnership not otherwise enumerated in this subsection (b), which the partnership agreement states in writing may be subject to the approval or disapproval of limited partners."

New section 303(b)(6)(ix) is potentially a shallower and foggier safe harbor than it may appear on first reading. In order to fit within the protection of this new section, a partnership agreement provision must satisfy two requirements. First, the provision must

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(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 (b), 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 (b).

ULPA § 303(b) (1985).

74. For an example of a state that has included these activities in its safe harbor list, see Del. Revised Unif. Limited Partnership Act, H.R. 191, § 17-303(b)(8)b-(8)c (Apr. 30, 1985) (to be codified at DEL. CODE ANN. tit. 6, § 17-303(b)(8)b-(8)c). Of course, because new § 303(b) is a nonexclusive list of safe harbor activities for limited partners, a court nevertheless could hold that engaging in one or more of these unlisted activities does not constitute participation in the control of the business. *See supra* note 64.

be "in writing." The writing requirement is not mere surplusage because the RULPA contemplates oral partnership agreements.[75] The policy reason for the writing requirement is not obvious. On the other hand, this requirement should be easy to satisfy in practice. Second, the provision must concern a "matter related to the business of the limited partnership." This latter requirement means that it may be possible for a written partnership agreement provision to be outside the safe harbor protection of new section 303(b)(6)(ix) if the provision gives limited partners the right to approve or disapprove matters that are not related to the business of the limited partnership.[76] In this regard, it is significant that the Commissioners did not amend section 302, which continues to provide that partnership agreement voting provisions for limited partners are "[s]ubject to Section 303."[77]

New section 303 is certainly an improvement over its predecessor. The new section discards the former two-tiered standard of liability under section 303, reduces the potential number of plaintiffs about whom limited partners need to worry, and adds some new safe harbor provisions, including new section 303(b)(6)(ix), which, if adopted by the states, should be very useful in practice. On the other hand, by adopting new section 303 the Commissioners have manifested their refusal to abandon the time-honored premise that, at least in some circumstances, a limited partner who participates in the control of the business must sacrifice the benefit of limited liability. Retaining even a watered-down version of the control rule leads inevitably to ambiguity. A careful examination of the theoretical underpinnings of the control rule demonstrates its flaws.

III. A Critique of the Control Rule

When the Commissioners, in 1916, first recommended the control rule for imposing liability for partnership obligations on limited partners, limited partnerships were generally small organiza-

75. *See* RULPA § 101(9), 6 U.L.A. 217 (West Supp. 1985).

76. *Compare* Del. Revised Unif. Limited Partnership Act, H.R. 191, § 17-303(b)(8) (Apr. 30, 1985) (to be codified at Del. Code Ann. tit. 6, § 17-303(b)(8)) (providing a safe harbor for limited partners who "propose, or approve or disapprove, by voting . . . or otherwise . . . *such . . . matters as are stated in the partnership agreement.*") (emphasis added). For further discussion of the failure of § 303(b)(6)(ix) to provide a clear assurance of limited liability to limited partners engaging in certain practices, see *infra* text accompanying note 84.

77. *See supra* notes 67-68 and accompanying text.

tions consisting of a few members and conducting business on a local scale. Under such circumstances, the control rule may have been relatively unobjectionable. Assuming that there is something pernicious about limited partners telling a general partner to plant watermelons, peppers, and eggplant, instead of beans[78] (an assumption whose validity is not beyond question), the control rule may have been appropriate to discourage such officiousness.

Today, however, limited partnerships are often large organizations consisting of many members and conducting business on an interstate or even national scale.[79] Modern limited partnerships are organized by sophisticated promoters as vehicles to raise capital for major business ventures. Investors can purchase limited partnership interests in "orange groves, satellite transponders, timber stands and movie productions, to name just a few."[80] The modern day limited partner is unlikely to have the occasion, or the desire, to direct the general partners to plant watermelons. More likely, a limited partner in a modern limited partnership will seek the right to exercise control over those decisions that, in the limited partner's judgment, may have a material effect on the value of the limited partner's investment. Whatever merit the control rule once had, if the rule has become an obstacle to a limited partner's ability to negotiate such partnership agreement provisions, then the rule is ill suited to modern business conditions.

The control rule has spawned at least two unfortunate consequences. First, the rule creates uncertainty for potential limited partners and their counsel. Specifically, the rule makes it very difficult for a potential limited partner to know *a priori* whether partnership agreement provisions requiring a general partner to share decision-making authority with the limited partner (at least those provisions that are not protected by a clear safe harbor provision) will result in the limited partner's liability for partnership obligations.

Consider the following three hypothetical partnership agreement provisions:

> (1) a written partnership agreement for a real estate limited partnership providing that the general partners may not, without the consent of the hold-

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78. *See* Holzman v. de Escamilla, 86 Cal. App. 2d 858, 195 P.2d 833 (1948); *see also supra* text accompanying notes 38-39 (discussing *Holzman*).

79. *See generally Publicly Traded Limited Partnership: An Emerging Financial Alternative to the Public Corporation*, 39 BUS. LAW. 709 (1984).

80. Lipman, *Real Estate Syndicators Dream Up Exotic Deals to Win Back Investors*, Wall St. J., Jan. 25, 1985, at 23, col. 4.

ers of two-thirds of the limited partnership interests, enter into a long-term lease for more than twenty-five percent of the partnership's rental space;

(2) a written partnership agreement providing that the partnership is to be managed by a committee of three persons who may, but need not be, partners and further providing that the management committee is to be elected by vote of all the partners;

(3) a written partnership agreement providing that the general partners may not make any charitable contribution without the consent of the holders of fifty-one percent of the limited partnership interests.

If the limited partners exercised the right to consent or to vote under any of these provisions, the limited partners literally would be "taking part" or "participating" in the control of the business and presumptively would incur liability for the partnership's obligations under section 7 of the ULPA or former or new section 303(a) of the RULPA.[81]

No reported decision has addressed whether a limited partner's possession or exercise of the right to vote or consent pursuant to such partnership agreement provisions would constitute taking part in the control of the business within the meaning of the ULPA or the RULPA.[82] Moreover, the possession or exercise of such consent or voting rights by a limited partner is not within any of the safe harbor provisions of section 303(b) of the RULPA.[83] Thus, a lawyer would be hard pressed to opine confidently that, under the law of a state that has adopted section 7 of the ULPA or section 303 of the RULPA, a potential limited partner who sought to negotiate such partnership agreement provisions would not risk incurring liability for partnership obligations.

Unfortunately, even the adoption by the states of new section 303 may not clarify the limited partner's situation in every case. A lawyer drafting a partnership agreement for a limited partnership organized under the laws of such a state might argue that each of

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81. As indicated in the text accompanying notes 59-63, if the limited partnership were organized under the laws of a state that has adopted § 303(a), assuming that the decision to give or to withhold consent pursuant to the partnership agreement provisions is not "substantially the same as the exercise of the powers of a general partner," the limited partners would be liable, if at all, only "to persons who transact business with the partnership with actual knowledge of [the limited partner's] participation in control." RULPA § 303(a), 6 U.L.A. 246 (West Supp. 1985). Furthermore, as indicated in *supra* notes 51, 63 & 72, if the limited partnership were organized in California, Delaware, Texas, or a state that adopts new § 303(a), the limited partners would be liable, if at all, only "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." ULPA (1985) § 303(a).

82. Indeed, as pointed out *supra* note 53, in the majority of jurisdictions there is no reported decision of any kind interpreting the control rule. *But see Strang v. Thomas, supra* note 27 and accompanying text.

83. *See supra* note 66.

the provisions would be within the safe harbor of new section 303(b)(6)(ix). That argument should prevail with respect to the first provision, but with respect to the second and third provisions the result is not clear. A creditor may argue that neither provision is a "matter related to the business of the limited partnership." By its terms new section 303(b)(6)(ix) seems intended to enable limited partners to obtain the right to propose or to veto transactional decisions specified in the partnership agreement such as entering into a lease, transferring an asset, or making a loan. In contrast, the election of a management committee relates to the selection of the managers of the partnership's affairs but not to any specific business decision.[84] The third hypothetical provision is even more troublesome because the making of charitable contributions is by definition not the "business of the limited partnership."

One final hypothetical demonstrates the futility of trying to "fix" the control rule by redrafting it. Suppose that two persons form a limited partnership pursuant to a written partnership agreement which contains the following provision: "The general partner shall not commit the limited partnership to any matter related to the business of the limited partnership without the prior approval of the limited partner." From the foregoing discussion, it is clear that such a provision would seriously risk running afoul of section 7 of the ULPA or former section 303 of the RULPA. However, the provision would literally be sheltered by the safe harbor of new section 303(b)(6)(ix). The question is whether a court would so construe this new section. If new section 303(b)(6)(ix) really does shelter such a provision, one wonders why the Commissioners bothered to retain the control rule at all. On the other hand, if, as one suspects, such a provision is beyond the intent of new section 303(b)(6)(ix), one is left with the question of how close one can draft to such a provision without losing the benefit of the new section. For example, would new section 303(b)(6)(ix) protect a written partnership agreement provision that read, "The general partner shall not commit the limited partnership to any matter relating to the business of the limited partnership involving the expenditure of more than $1,000,000 without the prior approval of the limited partner"? What if the threshold were reduced to $10,000? $100? A limited partner who approaches the "safe har-

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84. Even if the right to vote in the election of a management committee would he sheltered by new § 303(b)(6)(ix), heaven help the limited partner with the hubris to be elected to the committee.

bor" of new section 303(b)(6)(ix) should be prepared to encounter the tricky currents and hidden shoals created by the retention of the control rule.

Both academicians and practitioners have bemoaned the control rule's inherent uncertainty. Professor Alan Feld has observed that "[t]he control test . . . presents substantial interpretive problems in cases falling between the extreme of the wholly passive investor and the partner who manages the business on a day-to-day basis."[85] Messrs. George Coleman and David Weatherbie of the Texas bar have stated that in their experience "[p]robably the most serious problem encountered in drafting and carrying out a limited partnership agreement is that of determining what constitutes taking part 'in the control of the business' of a limited partnership . . . . [S]ome recent cases in attempting to solve the issue have only made it worse."[86] Professor Alan Bromberg offered the following comment on this unhappy situation:

> Neither the [ULPA] nor the decisions under it are very helpful on the critical question of how much review, advisory, management selection, or veto power a limited partner may have without being regarded as taking part in control. The resulting uncertainty is probably the greatest drawback of the limited partnership form.[87]

The control rule's uncertainty could be mitigated in large part if state legislatures adopted new section 303(a), the second sentence of which codifies the specific reliance test. If personal liability were imposed only upon a limited partner whose conduct caused a creditor to believe mistakenly that the limited partner was a general partner, then limited partners with partnership agreement voting rights over specific types of decisions by general partners should have less cause for concern. A creditor probably could not demonstrate that the possession or exercise of a limited partner's voting rights caused the creditor to mistake the limited partner for a general partner (although the limited partner's risk escalates the closer he comes to the type of sweeping partnership agreement provision discussed above). By engrafting a specific reliance test, however, onto new section 303(a), the Commissioners have made all of new section 303 either totally superfluous or terribly confusing.

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85. Feld, *supra* note 8, at 1473.

86. Coleman & Weatherbie, *Special Problems in Limited Partnership Planning*, 30 Sw. L.J. 887, 897 (1976) (footnote omitted).

87. A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP 147 (1968) (footnotes omitted).

Even if a state were to repeal its version of section 7 or section 303 and decline to adopt new section 303, the specific reliance test would remain as part of the law of limited partnerships. Any person holding himself out as a general partner may be held liable to a creditor who acts in reliance on such representation under section 16(1) of the Uniform Partnership Act (UPA):[88]

> When a person, by words spoken or written or by conduct, represents himself, or consents to another representing him to any one, as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such person to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and if he has made such representation or consented to its being made in a public manner he is liable to such person, whether the representation has or has not been made or communicated to such person so giving credit by or with the knowledge of the apparent partner making the representation or consenting to its being made.[89]

Because the UPA applies to limited partnerships to the extent that the ULPA or the RULPA does not provide inconsistent rules,[90] without regard to new section 303(a), a limited partner who holds himself out as a general partner "by words . . . or by conduct" is personally liable to a creditor of the limited partnership who has extended credit "on the faith" of such representation.[91] If new section 303(a) says no more than section 16(1) of the UPA already provides, the new section is at best redundant.[92] On the other hand, if the Commissioners intend by new section 303(a) something other than what is already provided by section 16(1) of the UPA, then the meaning of the new section is elusive indeed.

In addition to the uncertainty that the control rule creates, the rule further disadvantages limited partners by giving general partners a potent weapon in negotiations over partnership agreement provisions. When limited partners seek partnership agreement provisions requiring general partners to share managerial authority with the limited partners, counsel for the general partners

88. The Commissioners approved the UPA in 1914, and 49 states (Louisiana is the only exception), the District of Columbia, the Virgin Islands, and Guam have adopted the act.

89. 6 U.L.A. 195 (1969).

90. UPA § 6(2), 6 U.L.A. 22 (1969) ("[T]his act shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith."); RULPA § 1105, 6 U.L.A. 290 (West Supp. 1985) ("In any case not provided for in this Act the provisions of the Uniform Partnership Act govern.").

91. *See also* Barrows v. Joseph F. Downs & Co., 9 R.I. 446, 454 (1870) (holding on the basis of common law principles that a limited partner who represented himself to be a general partner was personally liable to creditors of the partnership).

92. *Cf.* Abrams, *supra* note 8, at 804-05.

can brandish the sword of personal liability to frighten off the limited partners and their counsel. Given the uncertain meaning of section 7 and both former and new section 303(a), this sword, dull though it may be, is likely to have the intended intimidating effect.

Academic commentators and practicing lawyers have noted the control rule's usefulness to well-advised general partners. Prior to the promulgation of the RULPA,[93] Professor Feld suggested that "counsel could not confidently permit a regular practice of 'advice'" by a limited partner with a significant investment in a limited partnership when the "advice" may, "as a practical matter, [take on] the color of a command in the partnership."[94] Mr. Barry Feldman of the Connecticut bar has concluded that the absence of litigation in this area reflects limited partners' concern with exerting too much control over partnership business.[95] Mr. Feldman further added: "The uncertainty caused by the ambiguity of Section 7 and the inconsistent constructions thereof, and the extreme caution of the limited partners are severe limitations and deterrents to the formation of limited partnerships."[96] Similarly, Mr. Stephen Burr of the Massachusetts bar, after reviewing the state of the law under section 7 and section 303, concluded, "[F]ew generalizations are possible, and lawyers [who represent limited partners] are well advised in counseling their clients to err on the side of caution."[97]

The general partners of the world may well argne that they are entitled to relatively unfettered control of the business of the partnership as consideration for their assumption of personal liability for the partnership's obligations. Conceding the persuasiveness of this argument, one nevertheless may ask why the issue of general partners' compensation for the risk of personal liability should be the subject of a mandatory rule of law rather than part of the negotiation process among the partners.

In view of the disadvantages of the control rule, one would assume that some strong, countervailing policy considerations support its continued existence. Courts and commentators have sug-

93. Both § 303(b)(2) of the RULPA and new § 303(b)(2) of the ULPA (1985) create a "safe harbor" for limited partners who merely advise a general partner with respect to the business of the limited partnership. *See supra* notes 66 & 73.

94. Feld, *supra* note 8, at 1477.

95. Feldman, *supra* note 8, at 213; *see also supra* note 53.

96. Feldman, *supra* note 8, at 213.

97. Burr, *The Potential Liability of Limited Partners as General Partners*, 67 MASS. L. REV. 22, 29 (1982).

gested four reasons for the rule. The most frequently stated justification for the control rule is that it protects creditors from mistaking a limited partner who is active in the management of the partnership's business for a general partner.[98]

At the outset it should be noted that a creditor who mistakes a limited partner for a general partner is not necessarily harmed by this mistake. The creditor is harmed only when the creditor mistakes a limited partner for a general partner *and extends credit to the partnership based upon the credit-worthiness of that limited partner*, and the partnership thereafter defaults. Viewed in this light, the control rule is neither well suited nor necessary to protect creditors.

If the purpose of section 7 and section 303(a) is to protect creditors from being misled, it is odd that neither provision by its terms requires that a creditor seeking recovery from a limited partner actually believe, or even have reason to believe, that the limited partner is a general partner.[99] A person who becomes a creditor of the partnership as a result of slipping and falling at the partnership's place of business could, under the law of states that have adopted section 7 or section 303, look to a limited partner who takes part in the control of the business. In this situation, the control rule does not protect the creditor's expectations regarding the limited partner's liability because the creditor has no such expectations. Furthermore, although new section 303(a) requires that the plaintiff reasonably believe, based upon the limited partner's conduct, that the limited partner is a general partner, the new section seeks to protect too large a class of creditors. If the section were designed to protect those creditors who arguably needed protection, new section 303(a) would restrict the potential plaintiffs to those creditors who have extended credit in reliance on the creditworthiness of a limited partner whom the creditor mistook to be a general partner.[100] In any event, as noted above, if a limited partner actually held himself out as a general partner, the limited

98. *See supra* text accompanying notes 28-32 & 49; *see also* Feld, *supra* note 8, at 1479; Sell, *An Examination of Articles 3, 4 and 9 of the Revised Uniform Limited Partnership Act*, 9 St. Mary's L.J. 459, 463 (1978).

99. Compare the Texas version of § 7 and the California and Delaware versions of § 303(a), *supra* notes 51 & 63, respectively.

100. *Cf.* Del. Revised Unif. Limited Partnership Act, H.R. 191, § 17-304(b) (Apr. 30, 1985) (to be codified at Del. Code Ann. tit. 6, § 17-304(b)) (making a general partner who erroneously and in good faith believes he is a limited partner liable as a general partner only to those third parties who believed in good faith that he was a general partner and extended credit to the partnership in reasonable reliance on that partner's credit).

partner could be held liable as a general partner under section 16(1) of the UPA.[101]

Finally, justifying the control rule on creditor protection grounds implicitly assumes that creditors of limited partnerships form expectations regarding the personal liability of the agents of the partnership with whom the creditors deal. Whether limited partnership creditors in fact form such expectations is highly questionable.

For purposes of testing this assumption, one can divide creditors into three groups. One group consists of tort creditors—those persons who become creditors of a limited partnership as the result of a compensable injury to their persons or property. As demonstrated by the foregoing hypothetical, these persons typically become creditors involuntarily and thus have no expectations regarding the personal liability of the partners. A second group consists of institutional creditors, such as banks. These creditors typically are represented by counsel who, prior to the extension of credit to the partnership, will review a number of legal documents, including the certificate of limited partnership. Institutional creditors, therefore, know precisely against whom they will have recourse in the event of default by the limited partnership;[102] the identity of the persons who purport to take part in the control of the partnership business does not mold these creditors' expectations. The third group consists of trade creditors who supply goods or services to the partnership on credit. Although I know of no relevant empirical study, it seems highly doubtful that a person who agrees to sell 500 widgets to a limited partnership on thirty days' credit does so with the expectation that the person who places the order will be liable for the debt. On the contrary, because section 102(1) of the RULPA[103] requires that the name of a limited partnership organized under the act contain the words "limited partnership," the trade creditor is more likely to assume that the debtor is a limited liability entity. Trade creditors are far more likely to protect themselves by asking for credit agency ratings and by refusing to deal with slow paying customers than by relying on the assumption that they will be able to attach the personal assets of the individuals

101. *See supra* text accompanying notes 88-92.

102. The certificate of limited partnership must disclose, *inter alia*, the name and address of each general partner. ULPA § 2(1)(a) IV., 6 U.L.A. 568 (1969); RULPA § 201(a), 6 U.L.A. 230 (West Supp. 1985).

103. 6 U.L.A. 220 (West Supp. 1985).

who appear to be taking part in the control of the business.[104]

A second justification for the control rule was suggested by Clement Bates, a nineteenth century commentator on the law of limited partnerships. Bates theorized:

> The public are entitled to have the business conducted under the uncontrolled judgment and skill of the general partner; for they may not have been willing to trust the firm where the general partner or the business is governed by the special partner. Doubtless this is the reason why the special partner is liable *in solido* for an interference, even if it be secret and unknown to the public.[105]

Initially, one might wonder what Bates meant by his reference to the "public." Conceivably, he may have intended to describe the public in general, potential creditors of a limited partnership, or actual creditors of a limited partnership. In any event, Bates evidently believed that some persons other than the partners had a legally protected interest in the identity of the individuals who managed the partnership business. One searches the UPA, the ULPA, and the RULPA in vain, however, for any evidence of such a legally protected interest. A general partner has the power unilaterally to withdraw from a limited partnership at will, regardless of the terms of the partnership agreement.[106] An additional or substitute general partner may not be admitted to the limited partnership without the consent of all the limited partners,[107] but the law does not require the consent of any creditor. Moreover, under the RULPA, a vote by limited partners to remove a general partner does not constitute participation in the control of the business within the meaning of either former or new section 303(a).[108] The Commissioners' drafting, therefore, consistently reflects the conclusion that the identity of the partnership's managers is the business of no one except the partners.[109]

A third possible rationale for the control rule is that those whose participation in the management of a business causes its insolvency should be personally liable to the injured creditors. Because the management of a limited partnership is the responsibility of the general partners, they are personally liable to the creditors of the partnership. When limited partners participate in

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104. *See* B. MANNING, A CONCISE TEXTBOOK ON LEGAL CAPITAL 91-94 (2d ed. 1981).

105. C. BATES, *supra* note 10, at 133.

106. UPA § 31, 6 U.L.A. 376 (1969); RULPA § 602, 6 U.L.A. 260 (West Supp. 1985).

107. ULPA § 9(1)(e), 6 U.L.A. 586 (1969); RULPA § 401, 6 U.L.A. 252 (West Supp. 1985). *But see supra* note 69.

108. *See supra* notes 66 & 73.

109. *See* Hecker, *supra* note 57, at 51.

the control of the partnership's business and insolvency ensues, this theory holds the meddling limited partners personally liable.[110] Although this explanation for the control rule may appeal to one's sense of retributive justice, it is hardly a bedrock principle of American business law that managerial power goes hand in hand with personal liability. For example, although the business and affairs of a corporation are managed by, or perhaps under the direction of, the board of directors,[111] the members of the board, even when they are stockholders, generally are not personally liable for the obligations of the corporation. Indeed, courts ordinarily will refuse to review the merits of a good faith business decision of the board of directors of a corporation, even when a stockholder claims that the decision resulted in a loss to the corporation.[112] Why personal liability should be the price of managerial power in the case of a limited partnership and not in the corporate context defies comprehension.

Finally, one commentator has suggested that the control rule is justified as a prophylactic against the improvidence of the limited partners:

> Principles of sound business practice would seem to dictate that the control of the management of a business should repose in those who shoulder the greatest risk of financial loss in the event of business failure. Theoretically at least, a person guaranteed a limited liability to business creditors would, if allowed to direct and control the destinies of the business, be inclined to favor speculative ventures to the possible detriment of his associates upon wbom the law imposes unlimited personal liability.[113]

This explanation for the control rule is flawed for two reasons. First, it simply does not follow that a limited partner who is immune from personal liability has nothing to lose if, by participating in the control of the business, the limited partner causes the business to fail. The limited partner has an equity investment at stake and the risk of business failure presumably will deter the limited partner from running amok. Second, the deterrence of speculative ventures is not a policy that sustains any rule of American business law. Indeed, there are obvious policy reasons why the law is not so oriented.

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110. *Id.*; Abrams, *supra* note 8, at 796, 808-11.

111. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (1983).

112. *See, e.g.*, Shlensky v. Wrigley, 95 Ill. App. 2d 173, 237 N.E.2d 776 (1968); Kamin v. American Express Co., 86 Misc. 2d 809, 383 N.Y.S.2d 807 (Sup. Ct.), *aff'd mem.*, 54 A.D.2d 654, 387 N.Y.S.2d 993 (1976).

113. Bayse, *A Survey of the Limited-Partnership Form of Business Organization*, 42 OR. L. REV. 35, 49 (1962).

In short, as one commentator observed, no "explicit theoretical basis for the liability imposed by section 7,"[114] former section 303(a), or new section 303(a) justifies the control rule's continued vitality. Indeed, in view of the lack of any sound theoretical reason for the control rule, one legitimately wonders why the Commissioners have consistently striven so mightily to retain it. The rule imposing personal liability on a limited partner who takes part in the control of the business of the partnership is supported by nothing but its own hoariness.

IV. An Abgument for the Abolition of the Control Rule

Despite the disadvantages of the control rule and the lack of a compelling rationale for its retention, commentators have not generally urged its abolition. Of the few who have even suggested that the rule should be repealed, most have done so almost parenthetically and with the feeling that the quest may be quixotic.[115]

Although the Commissioners have recommended to the states an erosion of the control rule by the approval of new section 303 and, therefore, have taken a positive step in reforming limited partnership law, there is no sound reason to retain any remnant of the rule. The control rule should be abolished. Because limited liability is a significant inducement to investment in limited partnerships, potential limited partners must be able to assess accurately the risk of personal liability for the obligations of a particular partnership. Not surprisingly, in the almost seventy years that the control rule has been part of the law of American limited partnerships, courts have been unable to articulate an interpretation of the rule that enables potential limited partnership investors and their counsel to make that assessment confidently.[116]

The fault lies not with the courts but with the drafters of the limited partnership statutes who have laid an impossible task at

114. Hecker, *supra* note 57, at 47.

115. *See* Donnell, *An Analysis of the Revised Uniform Limited Partnership Act*, 18 Am. Bus. L.J. 399, 409 (1980); Kempin, *The Problem of Control in Limited Partnership Law: An Analysis and Recommendation*, 22 Am. Bus. L.J. 443, 465-66 (1985); Kessler, *The New Uniform Limited Partnership Act: A Critique*, 48 Fordham L. Rev. 159, 166-67 (1979); Comment, *Limited Partner Control and Liability Under the Revised Uniform Limited Partnership Act*, 32 Sw. L.J. 1301, 1326 (1979).

116. The specific reliance test approved by the Commissioners in new § 303(a) may, if enacted by the states, enable limited partnership investors and their counsel to predict more accurately the outcome of potential disputes arising under new § 303(a), but the specific reliance tcst either makes new § 303 essentially superfluous or renders the section hopelessly confusing. *See supra* text accompanying notes 88-92.

the courthouse steps. If, as Professor Lewis asserted, the Commissioners intended in 1916 to propose a statute that would enable investors in limited partnerships to invest with the same sense of freedom from potential personal liability that stockholders enjoy,[117] the Commissioners should have done so. The time has come for the Commissioners (or the individual state legislatures) finally to clarify this needlessly confused area of the law by abolishing the control rule.

The drafting necessary to effect this reform is quite simple. The legislatures need only replace the local version of section 7 or subsections 303(a), (b), and (c)[118] with the following provision:

> Limited partners shall not be personally liable for the payment of the limited partnership's debts except if they are also general partners or as they may be liable by reason of their own acts.[119]

The principal advantage of the proposed statute is the elimination of the disadvantages of the control rule. Under the proposed statute, potential limited partners who seek to negotiate the right to exercise control over general partners' decisions would not risk incurring personal liability as a result of possessing or exercising those control rights. Moreover, negotiations between general partners and limited partners over the allocation of managerial power no longer would be stacked in favor of the general partners by a mandatory rule of law.

Under the proposed statute, a limited partner would not be absolutely immune from liability for the obligations of the partnership just as stockholders are not absolutely immune from liability for corporate obligations. A limited partner could become liable for the obligations of the partnership under three circumstances. First, a limited partner would be personally liable for the obligations of the partnership if he were also a general partner.[120] Second, a limited partner could become liable for the obligations of the partner-

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117. *See supra* text accompanying note 33.

118. This Article takes no position on whether limited partners should continue to have potential liability under §§ 5 and 6 of the ULPA or §§ 207 or 303(d) of the RULPA. *See supra* notes 4 & 69. If the decision were made to retain the rules of those sections, some minor tinkering with the statute proposed in the text would be necessary.

119. *Cf.* DEL. CODE ANN. tit. 8, § 102(b)(6) (1983) (using similar language to denote when stockholders or members of a corporation are personally liable for payment of the corporation's debts).

120. Both the ULPA and the RULPA expressly provide that a person can be both a limited partner and a general partner at tbe same time. ULPA § 12, 6 U.L.A. 596 (1969); RULPA § 404, 6 U.L.A. 256 (West Supp. 1985). In practice general partners often purchase limited partnership interests for investment.

ship by his own acts. For example, a limited partner expressly could agree to be personally liable by guaranteeing the partnership's obligations. In addition, if a limited partner were employed by the partnership and committed a tort while acting within the scope of that employment, both the partnership (under the doctrine of *respondeat superior*) and the limited partner as tortfeasor would be liable for any obligations to the victim of the tort. Third, a court could ignore the statute and impose personal liability on a limited partner when required by equity under the standards that courts sometimes use to impose personal liability on stockholders by "piercing the corporate veil."[121]

At least three possible objections might be raised to the proposed statute. The first is that the proposed statute goes too far. Under the proposed statute, a limited partner could secure partnership agreement control provisions relating to significant business decisions and also interfere to the extent of ordering the general partners to plant watermelons instead of beans. The answer to this objection is: "Let them plant watermelons." As argued above, no good reason exists for precluding limited partners from day-to-day participation in the control of the partnership business. Creditors are not likely to have reasonable expectations about the personal liability of limited partners regardless of the degree of the limited partners' involvement in the business,[122] and if a limited partner were actually to hold herself out as general partner, the limited partner would be subject to section 16(1) of the UPA.[123]

The second possible objection to the proposed statute is that limited partnerships could be formed and operated with inadequate capitalization to the detriment of creditors; limited partners could form a limited partnership with a very small investment, employing a single corporate general partner with few assets. Creditors of such a partnership would be left to squable over a very small pot of assets and would have no effective right to seek recovery against any partner.

There are three answers to this objection. First, the asserted evil is not unique to the proposed statute. Neither the ULPA nor the RULPA as presently written contains any provision imposing personal liability on the limited partners of undercapitalized limited partnerships, provided that the limited partners do not take

121. *See infra* note 126 and accompanying text.

122. *See supra* text accompanying notes 102-04.

123. *See supra* text accompanying notes 89-92.

part in the control of the business. The control rule is not, and was not intended to be, an effective prophylactic against the possible formation of thinly capitalized limited partnerships. Second, the Treasury Department's regulations under the Internal Revenue Code make it unlikely as a practical matter that such a partnership would be formed. Under those regulations, if the corporate general partner does not have substantial assets that could be reached by a creditor of the partnership, other than its interest in the partnership, the limited partnership has the corporate characteristic of limited liability,[124] thus jeopardizing the treatment of the organization as a partnership for federal income tax purposes.[125] Finally, courts would have no difficulty in dealing with such an abuse. Courts have not hesitated to impose personal liability upon stockholders of a corporation that is grossly undercapitalized when necessary to avoid injustice.[126] Presumably the courts would address abusive limited partnerships in a similar manner.

Finally, it may be argued that a limited partnership formed under the proposed statute would look so much like a corporation that the partnership would be treated as a corporation, rather than as a partnership, for federal income tax purposes. Undoubtedly, if the proposed statute created this result, the attractiveness of the limited partnership as an investment vehicle would be seriously undermined. Nevertheless, under present Treasury regulations, the proposed statute should not lead to this result.

For a limited partnership to be treated as a partnership rather than as a corporation for federal income tax purposes, the Treasury's regulations require that the partnership have no more than two of the following four corporate characteristics:[127] continuity of

124. Treas. Reg. § 301.7701-2(d)(2), T.D. 6503, 1960-2 C.B. 409, 416. The Internal Revenue Service will not issue an advance ruling that such an organization will be treated as a partnership for federal income tax purposes unless the net worth of the general partner (excluding its interest in the partnership and accounts and notes receivable from and payable to the partnership) is at least (a) the lesser of $250,000 or 15% of the total contributions to the partnership if total contributions to tbe partnership are less than $2,500,000 or (b) 10% of tbe total contributions to the partnership if total contributions to the partnership are $2,500,000 or more. Rev. Proc. 72-13, 1972-1 C.B. 735.

125. *See infra* text accompanying notes 127-34.

126. *See, e.g.*, Minton v. Cavaney, 56 Cal. 2d 576, 364 P.2d 473, 15 Cal. Rptr. 641 (1961); Automotriz Del Golfo De California v. Resnick, 47 Cal. 2d 792, 306 P.2d 1 (1957); Western Rock Co. v. Davis, 432 S.W.2d 555 (Tex. Civ. App. 1968).

127. Treas. Reg. § 301.7701-3(b) (1985). Of course, Congress could alter the present classification rules by statute. The Treasury recently proposed legislation that, if enacted, would treat limited partnerships with more than 35 limited partners as corporations for federal income tax purposes. *See* 2 DEPARTMENT OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY AND ECONOMIC GROWTH 146-50 (1984).

life,[128] free transferability of interests,[129] limited liability,[130] and centralization of management.[131] Clearly the proposed statute would not result in a partnership's having the corporate characteristics of continuity of life or free transferability of interests. With respect to limited liability, the Treasury's regulations provide that a limited partnership does not have the corporate characteristic of limited liability if the partnership has at least one partner with personal liability for the partnership's obligations.[132] The regulations specifically provide that in the case of a limited partnership, personal liability exists with respect to each general partner other than general partners that are corporations without substantial assets.[133] Thus, the personal liability of the general partners (which would not be affected by the proposed statute), not the potential personal liability of the limited partners, prevents the organization from possessing the corporate characteristic of limited liability.

Regarding centralization of management, most tax lawyers would concede that the typical modern limited partnership, which has many limited partners and in which managerial authority is concentrated in one or a few general partners, has the corporate characteristic of centralized management.[134] By contrast, under the proposed statute, limited partners would be free to negotiate for as much management authority as they could wrest from the general partners without the risk of incurring personal liability for the obligations of the partnership. As a result, some limited partnerships organized under the proposed statute may actually lack the corporate characteristic of centralized management and, therefore, could have fewer corporate characteristics than limited partnerships presently organized under the ULPA and the RULPA.

V. Conclusion

The rule imposing personal liability on limited partners who take part in the control of the business of the partnership creates planning problems for limited partners and prejudices the ability

128. Treas. Reg. § 301.7701-2(b), T.D. 6503, 1960-2 C.B. 409, 414.
129. Treas. Reg. § 301.7701-2(e), T.D. 6503, 1960-2 C.B. 409, 417.
130. Treas. Reg. § 301.7701-2(d), T.D. 6503, 1960-2 C.B. 409, 416.
131. Treas. Reg. § 301.7701-2(c), T.D. 6503, 1960-2 C.B. 409, 415.
132. Treas. Reg. § 301.7701-2(d)(1), T.D. 6503, 1960-2 C.B. 409, 416.
133. *Id.*
134. Treas. Reg. § 301.7701-2(c)(1), T.D. 6503, 1960-2 C.B. 409, 415. As noted in the text, however, having as many as two corporate characteristics will not result in a limited partnership's being treated as a corporation for federal income tax purposes.

of limited partners to negotiate for a meaningful voice in the management of the business of the partnership. This cost is not justified by any benefit not obtainable under other existing legal doctrines. Therefore, while the adoption of new section 303 by the states generally would be a positive step in the direction of limited partnership law reform, there is little to gain from retention of the control rule and much to be said for its outright abandonment.