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# The Uniform Limited Partnership Act: Are the Recent Changes Improvements?

Leonard Charles Schwartz\*

The 1985 amendments to the Uniform Limited Partnership Act (U.L.P.A.)<sup>1</sup> greatly reduced the importance of the certificate of a limited partnership and effected other significant changes in limited partnership law. Are these recent changes improvements? This article will illustrate that the 1985 amendments reduce the expense and inconvenience of creating and modifying limited partnerships; increase the flexibility of limited partnerships; and provide for equitable treatment of nonpartners. The author submits that most of these changes are desirable progressions of a trend in the law of limited partnership and corporations. Section I provides a historical background of the Act. Section II discusses the amendments that concern the regulation of the certificate of a limited partnership. Section III discusses those changes affecting the liability of partners to nonpartners. Section IV examines miscellaneous other changes.

## I. Historical Background

### A. *The Uniform Limited Partnership Act*

All states except Louisiana have adopted some version of

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1. Some confusion has arisen as to whether the current Act should be called the "Revised Uniform Limited Partnership Act" or simply the "Uniform Limited Partnership Act." In 1985, when the changes were initially approved, the National Conference of Commissioners of Uniform State Laws treated the changes as a separate new act called "the Uniform Limited Partnership Act (1985)." But in 1986 the Commissioner decided to treat the changes as merely an amended version of the Uniform Limited Partnership Act (1976). UNIFORM LIMITED PARTNERSHIP ACT historical note, 6 U.L.A. 211 (Supp. 1988). This vacillation has created problems regarding the proper title of these two versions, as well as their proper form of citation. (For an exposition of the standard rules of citation, see A UNIFORM SYSTEM OF CITATION § 12.8.4 (14th ed. 1986)). Since the new version is not a separate new act, calling it "the Uniform Limited Partnership Act (1985)" seems inappropriate. Nonetheless, the Commissioners themselves call it "the 1985 Act" and refer to previous versions as "the 1976 Act" and "the 1916 Act." UNIFORM LIMITED PARTNERSHIP ACT, 6 U.L.A. 210-365 (Supp. 1988). This article likewise calls the new version "the 1985 Act" [hereinafter U.L.P.A. (1985)] and refers to the previous versions as "the 1976 Act" [hereinafter U.L.P.A. (1976)] and "the 1916 Act" [hereinafter U.L.P.A. (1916)]. Where a provision of the 1976 Act remains unchanged by the 1985 amendments, this article will refer to that provision as U.L.P.A. § \_\_\_\_ (1976 & 1985).

U.L.P.A.<sup>2</sup> There are three versions of the Uniform Limited Partnership Act: the original 1916 Act; the 1976 version; and the most recent 1985 Act. The 1916 Act is especially confusing, primarily because it is often unclear about (1) whether its provisions apply only to disputes among the partners, or to disputes between the partnership and a nonpartner, or both; (2) whether its provisions create rules or merely presumptions; and (3) whether a variance from a presumption requires certain formalities in order to be effective.<sup>3</sup> The 1976 Act greatly clarified the law.<sup>4</sup> The 1985 Act made some further improvements, which are the subject of this article.

### B. Limited Liability

In the eighteenth century the owners of a business were personally liable for all the obligations of the business.<sup>5</sup> State governments, in the nineteenth century, began relaxing the burdens of liability by allowing limited partnerships and limited liability corporations. The states accomplished this first by passing special acts and later by enacting general limited partnership and incorporation statutes.<sup>6</sup> Originally, limited partners and shareholders did not obtain limited liability unless all the formalities of the statute were satisfied.<sup>7</sup> Presently, however, limited partners and shareholders may obtain limited liability if there is merely substantial (rather than exact) compliance with the formalities.<sup>8</sup> The growing leniency also has allowed many exceptions that protect investors even if there is no substantial compliance.<sup>9</sup>

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2. The 1916 Act is used in 14 jurisdictions: Alaska, District of Columbia, Georgia, Hawaii, Indiana, Kentucky, Maine, New Mexico, New York, Pennsylvania, Tennessee, Utah, Vermont, and the Virgin Islands. U.L.P.A. (1916), 6 U.L.A. 163 (Supp. 1988).

The 1976 Act is used in 17 states: Alabama, Arizona, Arkansas, California, Colorado, Idaho, Iowa, Massachusetts, Michigan, Missouri, Montana, Nebraska, New Jersey, North Dakota, Oklahoma, Wisconsin, and Wyoming. See U.L.P.A. (1976 & 1985), 6 U.L.A. 210-365 (Supp. 1988).

The 1985 Act is used in 20 states: Connecticut, Delaware, Florida, Illinois, Kansas, Maryland, Minnesota, Mississippi, Nevada, New Hampshire, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, South Dakota, Texas, Virginia, Washington, and West Virginia. *Id.*

3. See Schwartz, *Freedom of Contract Among the Owners of a Partnership or Limited Partnership*, 36 MERCER L. REV. 701, 703-08 (1985).

4. *Id.* at 708-10.

5. See H. HENN & J. ALEXANDER, *LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* §§ 12 & 28 (3d ed. 1983).

6. *Id.*

7. U.L.P.A. § 1 comment (1916); A. CONARD, *CORPORATIONS IN PERSPECTIVE* §§ 138-39 (1976).

8. U.L.P.A. § 2(2) (1916); U.L.P.A. § 201(b) (1976 & 1985); MODEL BUSINESS CORP. ACT § 56 (1979); REVISED MODEL BUSINESS CORP. ACT §§ 1.28, 2.03 (1984).

9. For exceptions regarding investors who erroneously believed they were limited partners, see U.L.P.A. § 11 (1916) and U.L.P.A. § 304 (1976 & 1985). See also *infra* note 66 and

Mere ownership of a business does not seem to be sufficient reason to hold an owner personally liable for the business' obligations. Several justifications exist for limiting liability: (1) An owner of a business should not be personally liable to a creditor of the business unless that creditor reasonably believed, at the time credit was extended, that the owner was personally liable.<sup>10</sup> (2) Imposing liability on the owners, merely because they are the owners, is inherently unfair to passive owner/investors.<sup>11</sup> (3) Limited liability of owners promotes capital formation and economic development.<sup>12</sup> (4) Limited liability reduces the cost of contract negotiation and serves to allocate risk to the party who is best able to bear the risk.<sup>13</sup> (5) Since the law of agency imposes liability upon the agent, the business (i.e., the principal), and sometimes upon both, imposing liability on the owners as well can lead to excessive administrative costs for the legal system.<sup>14</sup>

### C. Freedom of Contract Among the Partners

Freedom of contract gives owners of an enterprise flexibility in allocating their mutual rights and liabilities. Regulation, on the other hand, will protect investors from their own bad judgment in entering imprudent agreements.<sup>15</sup> The 1916 Act heavily regulated the internal affairs of a limited partnership.<sup>16</sup> The 1976 Act, however, eliminated almost all such regulations,<sup>17</sup> resulting in greater freedom of contract among the owners of a limited partnership.<sup>18</sup> Similarly, the freedom of contract among the owners of a corporation has gradually increased.<sup>19</sup> These changes have made the law of limited partnerships and corporations increasingly similar to the law of partnerships, for which there is virtually complete freedom of contract.<sup>20</sup> Now, with regard to disputes among partners, the primary

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accompanying text. For exceptions regarding "de facto corporations" and "corporations by estoppel," see H. HENN & J. ALEXANDER, *supra* note 5, §§ 139-45.

10. See U.L.P.A. § 1 comment (1916); U.L.P.A. § 303 comment (1985).

11. See U.L.P.A. § 1 comment (1916); U.L.P.A. § 303 comment (1985).

12. See R. POSNER, *ECONOMIC ANALYSIS OF LAW* §§ 14.2-5 (3d ed. 1986).

13. *Id.*

14. Administrative costs include the cost of investigation, litigation, and enforcement. The efficiency of a legal system is inversely related to the magnitude of the administrative costs. See *id.* § 21.1.

15. R. WINTER, *GOVERNMENT AND THE CORPORATION* 11-13 (1978); Schwartz, *supra* note 3, at 701.

16. Schwartz, *supra* note 3, at 703-08.

17. *Id.* at 708-10. The 1985 Act did not reimpose any restrictions.

18. *Id.*

19. A. CONARD, *supra* note 7, §§ 7-14.

20. Schwartz, *supra* note 3, at 702-03, 708.

function of the U.L.P.A. is merely to provide presumptions regarding partners' rights and duties.<sup>21</sup>

In addition to its extensive regulation of a limited partnership's internal affairs, the 1916 Act also required certain formalities. Partners were required to consent to a specific act, or to state contrary agreements in the certificate, in order to rebut several presumptions regarding the rights and duties of the partners.<sup>22</sup> The 1976 Act greatly reduced the formalities.<sup>23</sup> Likewise, the formalities for running a corporation have gradually decreased.<sup>24</sup> As a result, the law of limited partnerships and corporations has grown similar to the law of partnerships, for which there are no formalities.<sup>25</sup>

## II. The Certificate of a Limited Partnership

### A. *Mandatory Contents*

To create a limited partnership, the partners must file a certificate of limited partnership with a state government.<sup>26</sup> The partnership must amend the certificate promptly whenever the information contained therein changes.<sup>27</sup> The certificate is a public document.<sup>28</sup> The 1976 Act, like the 1916 Act, requires that the certificate state: (a) the general character of the business; (b) the name and address of each limited partner; (c) any agreement on contributions made (or to be made) by each partner, including a description and value of any contribution of property or services; (d) any agreement on the power of a limited partner to grant to an assignee the right to become a limited partner; (e) any agreement on a partner's right to withdraw from the business and on the method for determining the distribution to the partner; (f) any agreement on a partner's right to receive distributions; (g) any agreement on the right of any partner to receive, and the right of a general partner to make, distributions of a partner's contribution; (h) any agreement on conditions upon which the limited partnership will be dissolved; and (i) any agree-

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21. *Id.* at 709.

22. *Id.* at 703-08.

23. *Id.* at 708-10.

24. See A. CONARD, *supra* note 7, §§ 97-104.

25. Schwartz, *supra* note 3, at 702-03.

26. U.L.P.A. § 2 (1916); U.L.P.A. § 201(a) (1976 & 1985).

27. U.L.P.A. § 24 (1916); U.L.P.A. § 202 (1976 & 1985). Under the 1976 Act and the 1985 Act, the limited partnership generally must file amendments within 30 days. *Id.* § 202(b).

28. See U.L.P.A. § 105 comment (1976) & § 201 comment (1976 & 1985).

ment on the right of general partners to continue the business.<sup>29</sup>

The 1985 Act eliminates the requirement that the certificate contain the above information.<sup>30</sup> As a result, it eliminates the requirement that a limited partnership file an amendment when this information changes. Instead, the 1985 Act requires the partnership to keep at its registered office a current record of much of this information.<sup>31</sup> The information kept at the registered office is not public.<sup>32</sup> The 1985 Act only requires that the certificate include: (a) the name of the limited partnership; (b) the name and address of its agent for service of process; (c) the name and address of each general partner, and (d) the latest date upon which it is to dissolve.<sup>33</sup>

The legal trend toward nondisclosure in the formation of limited partnerships is similar to the trend regarding formation of corporations. In order to form a corporation, its creators must file articles of incorporation.<sup>34</sup> The corporation is required to amend its articles promptly whenever the information it contains changes.<sup>35</sup> The document is a public one<sup>36</sup> and, under older corporation statutes, must disclose substantial information about the corporation.<sup>37</sup> Under modern corporation statutes, however, the articles must divulge very little information.<sup>38</sup>

To summarize, the changes to the U.L.P.A. make the law of limited partnerships similar to the law of partnerships. While a limited partnership still must file a certificate under the 1985 Act, the required disclosure is minimal, especially in comparison to the requirements of earlier versions of the Act. This legal trend, requiring less disclosure as a prerequisite to limited partnership formation,

29. Compare U.L.P.A. § 2 (1916) with U.L.P.A. § 201(a) (1976).

30. See U.L.P.A. §§ 201-02 (1985).

31. U.L.P.A. § 105(a) (1985).

32. See U.L.P.A. § 105 comment (1985).

33. U.L.P.A. § 201 (1985). The 1916 Act requires the address of the limited partnership rather than the name and address of its agent. U.L.P.A. § 2 (1916). The 1976 Act does not require the inclusion of a latest date for dissolution. U.L.P.A. § 201(a) (1976). The rationale for requiring a latest date for dissolution is unclear, because a limited partnership could theoretically last forever.

34. MODEL BUSINESS CORP. ACT § 54 (1979); REVISED MODEL BUSINESS CORP. ACT §§ 2.02-.03 (1984).

35. MODEL BUSINESS CORP. ACT § 58 (1979); REVISED MODEL BUSINESS CORP. ACT § 10.01 (1984).

36. See H. HENN & J. ALEXANDER, *supra* note 5, §§ 118, 133.

37. Traditionally, the articles must include (in addition to the items listed *infra* note 38) the duration, the purpose, the information on preferred and special classes of shares, the information on preemptive rights, the number of directors, and the names and addresses of the initial directors. MODEL BUSINESS CORP. ACT § 54 (1979).

38. Under modern laws, a corporation must include only its name, the number of authorized shares, the name and address of its registered agent, and the name and address of each incorporator. See REVISED MODEL BUSINESS CORP. ACT § 2.02 (1984).

mirrors the trend in corporate law, in which modern laws require less and less information to be included in the articles of incorporation.

### B. Significance

The 1985 Act's amendments increase flexibility of limited partnerships. The partners can modify the rights and liabilities of the business without the expense and inconvenience of filing and processing amendments to the certificate.<sup>39</sup> A partner's access to such information is not adversely affected by this change, however, because each still has a right to obtain this information.<sup>40</sup> The 1985 Act's amendments thus reflect a change in philosophy regarding the role of the certificate and the partnership agreement. Whereas the primary source of information to partners under the 1916 and 1976 Acts is the certificate, the source under the 1985 Act is the partnership agreement — or other records that a partner has a right to obtain.<sup>41</sup> Since the 1985 Act affects only nonpartners' access to the partnership, the partnership itself may create or change its internal structure quickly and without public disclosure in the certificate. The partnership thus may preserve the secrecy of its internal affairs.

The reduced certificate requirements — paralleled by the modern trend regarding requirements of articles of incorporation — reflect a change in philosophy as to the role of these public documents in protecting potential creditors from the risk that a debtor enterprise may become insolvent. The traditional view was based on the concept that potential creditors could better judge the creditworthiness of a business if they had automatic access to mandatorily disclosed information in the certificate or articles.<sup>42</sup> The modern view is based on the reality that potential creditors rarely bother to read certificates and articles.<sup>43</sup> Mandatory disclosure, therefore, does not protect these potential creditors. Additionally, much information

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39. U.L.P.A. prefatory note (1985), 6 U.L.A. 211-13 (Supp. 1988). The partners bear most of the expenses of amending the certificate. To the extent that filing fees do not cover the full cost of processing amendments, however, part of the cost is borne by the taxpayers. Regardless of who bears the costs, they are economically inefficient because they use resources that could be employed for more productive purposes.

40. U.L.P.A. §§ 105 & 305 (1976 & 1985). For a discussion of possible limitations to a partner's right to obtain information, see Schwartz, *supra* note 3, at 709.

41. Compare U.L.P.A. § 201 comment (1976) with U.L.P.A. § 201 comment (1985). To provide each partner with some protection against fraudulent claims of an oral partnership agreement, the 1985 Act states that agreements on some types of terms (previously required to be in the certificate) are enforceable only if in writing. *E.g.*, U.L.P.A. §§ 401, 402, 502, 503, 504, 603 & 801 (1985). Furthermore, no partner is liable to make a contribution unless the partner signs a writing stating the obligation. U.L.P.A. § 502 (1985).

42. See U.L.P.A. § 201 comment (1976).

43. See U.L.P.A. § 201 comment (1985).

that businesses governed by the 1916 and 1976 Acts are required to disclose provides scant help to potential creditors in judging creditworthiness.<sup>44</sup> A potential creditor that is concerned with the creditworthiness of an enterprise can demand to see financial information as a condition for awarding the loan; mandatory disclosure, therefore, is not necessary to protect most creditors.<sup>45</sup> Furthermore, disclosure cannot benefit *involuntary* creditors, such as the victims of torts.<sup>46</sup>

The 1985 Act's amendments reflect not only a change regarding the protection of creditors, but also a philosophical change regarding the protection of equity holders of a limited partnership from unauthorized transactions by its managers. At one time, persons who contracted with a limited partnership were expected to know the contents of the certificate and thus could not enforce agreements that were inconsistent with its provisions.<sup>47</sup> Similarly, persons who made agreements with a corporation were expected to know the contents of the articles and, under the traditional view, could not enforce agreements that were inconsistent with its scope.<sup>48</sup> This was known as the *ultra vires* doctrine.<sup>49</sup> Under the modern approach, however, persons who contract with a limited partnership are not expected to know the contents of the certificate and can enforce agreements despite inconsistencies with the certificate.<sup>50</sup> Thus, limited partnerships reflect the similar trend of corporation law, under which persons who make agreements with a corporation are not deemed to know the contents of the articles and can enforce agreements even if they are inconsistent with the articles.<sup>51</sup>

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44. For limited partnerships, the mandatory provisions provide limited information on capital, but no other financial information. Furthermore, since limited partners have limited liability and the partnership agreement does not affect the rights of nonpartners, information on the names and addresses of limited partners and on the partnership agreement is only tangentially related to creditworthiness. For corporations, the mandatory provisions do not relate to creditworthiness.

45. U.L.P.A. § 201 comment (1985).

46. See R. POSNER, *supra* note 12, § 14.3. Involuntary creditors, by definition, do not choose their debtors; rather, their credit is the result of fortuitous events. Disclosure of any kind, therefore, is of no avail to them.

47. See U.L.P.A. § 9 (1916).

48. "If the transaction was beyond the scope of the business as defined in the articles of incorporation, some cases have suggested that the other party was chargeable with a knowledge of lack of corporate authority, since this appeared as a matter of public record (the filed articles of incorporation)." H. HENN & J. ALEXANDER, *supra* note 5, § 184 at 477.

49. *Id.*

50. A certificate of limited partnership that is filed with the Secretary of State serves as notice only that the partnership is a limited partnership and that the designated persons are general partners, but not of any other fact. U.L.P.A. § 208 (1985). See also U.L.P.A. § 208 (1976).

51. "[A]n *ultra vires* contract not otherwise illegal is not void, but is enforceable under



The modern view realistically assumes that persons rarely bother to read the certificates of limited partnerships or the articles of corporations.<sup>52</sup> Persons should not be held responsible to know the contents of the certificates and articles because it wastes time and fails to reflect the realities of business practices.<sup>53</sup> Also, the elimination of the *ultra vires* doctrine reduces the administrative cost of litigating disputes over whether an agreement violates the certificate or articles and disputes over quasi-contract remedies when the agreement is deemed unenforceable.

Since mandatory disclosure does not reduce the risk to potential creditors that an enterprise's debts may become uncollectable, or the risk to the owners that unauthorized agreements by managers of the enterprise may jeopardize their investment, mandatory disclosure no longer serves a useful purpose. By reducing the expense in time and money attendant with mandatory disclosure, the 1985 amendments reduce the expense and inconvenience of creating and modifying a business, and concomitantly increase the flexibility.<sup>54</sup>

### C. Execution of Certificates and Amendments

The 1976 Act requires that all partners sign the original certificate and that amendments be signed by at least one general partner and any new partner or one whose contribution increases.<sup>55</sup> The 1985 Act eliminates the requirement that limited partners sign certificates,<sup>56</sup> but preserves the requirement that amendments be signed by at least one general partner and by any new general partner.<sup>57</sup> By

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certain circumstances, *viz.* where one party has received benefits and is therefore estopped from setting up the defense of *ultra vires*." H. HENN & J. ALEXANDER, *supra* note 5, § 184.

52. See U.L.P.A. § 201 comment (1985).

53. See *id.* See also U.L.P.A. § 208 comment (1985); REVISED MODEL BUSINESS CORP. ACT § 3.04 (1984).

54. See *supra* note 39.

55. U.L.P.A. § 204(a)(1)-(2) (1976). "Section 204 prohibits blanket powers of attorney for the execution of certificates in many cases, since those conditions under which a partner is required to sign have been narrowed to circumstances of special importance to the partner." *Id.* § 204(b) comment. If a person whose signature is necessary does not sign, any partner (or any assignee of a partnership interest) who is adversely affected may petition for execution by judicial act. *Id.* § 205. The 1916 Act, by contrast, requires all partners to sign the original certificate and all amendments. See U.L.P.A. §§ 2, 25 (1916).

56. See U.L.P.A. § 204(a)(1) (1985).

57. U.L.P.A. § 204(a)(2) (1985). Unlike the 1976 Act, a general partner can use a blanket power of attorney, except that, "a power of attorney to sign a certificate relating to the admission of a general partner must specifically describe the admission." *Id.* § 204(b). See *supra* note 55. Additionally, the 1985 Act allows any person who is adversely affected by the lack of a necessary signature on the original certificate to petition for execution by judicial act. *Id.* § 205. This differs from the 1976 Act, which spoke to adverse effects upon a partner or an assignee of a partnership interest. See *supra* note 55.

eliminating limited partners' duty to sign certificates and amendments, the expense and inconvenience of creating and modifying a limited partnership is thus reduced.<sup>58</sup> The amendments again bring the law of limited partnership closer to the law of partnerships and corporations. A partnership, being an informal business organization, does not require any formalities for formation or change.<sup>59</sup> For a corporation, the original articles and subsequent amendments generally require only the signature of any officer or the chairman of the board of directors.<sup>60</sup>

### III. Liability of Partners to Nonpartners

#### A. *Liability of a Partner for Inaccuracies in the Certificate*

One who relies to his detriment on an inaccurate statement in a certificate of limited partnership generally can recover damages from (1) any partner who executes the certificate knowing that it is inaccurate or (2) any general partner who knows or should know that the certificate is or has become inaccurate.<sup>61</sup> By reducing the information to be included in the certificate and the number of partners required to execute certificates, the 1985 Act thereby reduces the risk that a partner will be liable for inaccuracies.<sup>62</sup>

#### B. *Liability of a Partner Who Is Erroneously Listed as a General Partner*

Under the 1976 Act, a partner is a general partner unless the certificate of limited partnership states that he is a limited partner.<sup>63</sup> Conversely, under the 1985 Act, a partner is a limited partner unless the certificate states that the partner is a general partner.<sup>64</sup> This change reduces the likelihood that a person will be wrongly consid-

58. See *supra* note 39.

59. See H. REUSCHLEIN & W. GREGORY, *HANDBOOK ON THE LAW OF AGENCY AND PARTNERSHIP* § 180 at 259 (1979).

60. REVISED MODEL BUSINESS CORP. ACT § 1.20 (1984).

61. Section 207 of the 1976 and 1985 Acts states:

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

(1) any person who executes the certificate . . . and knew, and any general partner who knew or should have known, the statement to be false at the time the certificate was executed; and

(2) any general partner who thereafter knows or should have known that any . . . fact described in the certificate has changed . . . .

U.L.P.A. § 207 (1976 & 1985).

62. See *supra* note 60 and accompanying text.

63. U.L.P.A. § 101(5) (1976).

64. See U.L.P.A. § 101(6) (1985).

ered to be a general partner and, consequently, subject to unlimited liability.<sup>65</sup> This change has little practical significance because a partner who erroneously believed that he or she was a limited partner can correct the error and thereby avoid unlimited liability (except in the case of creditors who believed in good faith that the partner was a general partner).<sup>66</sup>

### C. *Significance of a Compromise of a Partner's Obligation*

A partner's obligation to the partnership can be comprised with the consent of the partners.<sup>67</sup> Under the 1976 Act, a creditor who extends credit, or whose claim arises, before the certificate reflects the compromise can enforce a partner's original obligation.<sup>68</sup> Under the 1985 Act, a creditor can enforce a partner's original obligation if the creditor extends credit or otherwise acts in reliance on a writing that is signed by the partner and reflects the obligation.<sup>69</sup> This

65. See U.L.P.A. §§ 101 comment & 304 comment (1985).

66. Section 304 of the 1976 and 1985 Acts states:

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

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

(2) withdraws from future equity participation in the enterprise by executing and filing . . . a certificate declaring withdrawal under this section.

(b) A person who makes a contribution of the kind described in subsection (a) is liable as a general partner to any third party who transacts business with the enterprise . . . , but . . . only if the third party actually believed in good faith that the person was a general partner at the time of the transaction.

U.L.P.A. § 304 (1976 & 1985).

Under the 1916 Act, a partner who erroneously believes that he is a limited partner could avoid unlimited liability only by withdrawing from the enterprise. U.L.P.A. § 11 (1916). A partner's erroneous belief that he is a limited partner arises not only when the partner is erroneously listed as a general partner, but also when the enterprise does not substantially comply with the statutory formalities for limited partnerships. See *supra* notes 7-9 and accompanying text.

67. U.L.P.A. § 502 (1976 & 1985). A compromise must be approved by all partners unless the partnership agreement provides otherwise. U.L.P.A. § 502(a) (1976), U.L.P.A. § 502(b) (1985).

68. Section 502(b) of the 1976 Act states:

Notwithstanding the compromise, a creditor of a limited partnership who extends credit, or whose claim arises, after the filing of the certificate of limited partnership or an amendment thereto which . . . reflects his obligation, and before the amendment . . . thereof to reflect the compromise, may enforce the original obligation.

U.L.P.A. § 502(b) (1976).

69. Section 502(c) of the 1985 Act states: "Notwithstanding the compromise, a creditor of a limited partnership who extends credit, or otherwise acts in reliance on that obligation

change does not affect creditors who detrimentally rely on the certificate or a writing signed by the partner, but affects only those creditors who did not rely on a writing signed by the partner. Such creditors can enforce the writing under the 1976 Act but not under the 1985 Act.<sup>70</sup>

This change is likely to have little practical significance, because a partner's contribution is no longer required to be stated in the certificate and creditors generally do not bother to read the certificate or the partnership agreement to discover the contributions of the partners.<sup>71</sup> Furthermore, this change is not unfair to creditors, because liability is and should be based on the creditor's reasonable reliance.<sup>72</sup>

#### *D. Limited Partner Who Participates in the Control of the Business*

Under the 1976 Act, a limited partner who participates in the control of the business generally assumes liability for the obligations of the business.<sup>73</sup> If a limited partner's participation is substantially the same as that of a general partner, the limited partner is liable for all the obligations of the business.<sup>74</sup> If a limited partner's participation is *not* substantially the same as that of a general partner, however, the limited partner is liable only to those persons who transact business with the limited partnership with knowledge of the limited partner's participation.<sup>75</sup>

The 1985 Act eliminates the distinction between participation that is substantially the same as that of a general partner and participation that is not substantially the same.<sup>76</sup> This change thus eliminates litigation on whether participation is substantially the same as

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after the partner signs a writing which reflects the obligation, and before the amendment . . . thereof to reflect the compromise, may enforce the original obligation." U.L.P.A. § 502(c) (1985).

70. Compare U.L.P.A. § 502(b) (1976) with U.L.P.A. § 502(c) (1985).

71. See *supra* notes 29-54 and accompanying text.

72. See U.L.P.A. prefatory note and §§ 201 comment, 207, & 303 comment (1985).

73. Section 303(a) of the 1976 Act states:

[A] limited partner is not liable for the obligations of a limited partnership unless he [or she] . . . takes part in the control of the business. However, if the limited partner's participation in the control of the business is not substantially the same as the exercise of the powers of a general partner, he [or she] is liable only to persons who transact business with the limited partnership with actual knowledge of his participation in control.

U.L.P.A. § 303(a) (1976).

74. *Id.*

75. *Id.*

76. See U.L.P.A. § 303(a) (1985).

that of a general partner<sup>77</sup> and improves partners' abilities to predict the legal consequences of their actions. Under the 1985 Act, a limited partner who participates in the control of the business assumes liability only to persons who transact business with the limited partnership reasonably believing, based on the limited partner's conduct, that the limited partner was a general partner.<sup>78</sup>

The only significant impact of this change occurs when the limited partner's participation is substantially the same as that of a general partner, yet the creditor does not reasonably believe that the limited partner is a general partner. In such a case, a limited partner would face personal liability under the 1976 Act, but not under the 1985 Act.<sup>79</sup> As a matter of policy, the amendments to the 1985 Act are not unfair to creditors. In fact, this change is an improvement on the U.L.P.A. because it is a better statement of the rule that the law should base liability upon a creditor's reasonable reliance.<sup>80</sup>

One other change in the 1985 Act should be mentioned regarding a limited partner's liability for the partnership's obligations. There has been much litigation in states where the 1916 Act has been enacted with regard to what conduct by a limited partner constitutes participation in the control of the business. In an attempt to reduce litigation in this area, the 1976 Act lists some "safe harbor" activities that would not constitute participation in the control.<sup>81</sup> The

77. The efficiency of a legal system is inversely related to the cost of litigation. See *supra* note 14.

78. Section 303(a):

[A] limited partner is not liable for the obligation of a limited partnership unless he [or she] . . . participates in the control of the business. However, if the limited partner participates in the control of the business, he [or she] 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.

U.L.P.A. § 303(a) (1985).

79. Compare U.L.P.A. § 303(a) (1976) with U.L.P.A. § 303(a) (1985).

80. See U.L.P.A. prefatory note and §§ 201 comment, 207, & 303 comment (1985).

81. The 1976 Act's safe harbor activities are:

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

or

- (5) voting on one or more of the following matters:
  - (i) the dissolution and winding up of the limited partnership;
  - (ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership other than in the ordinary course of business;
  - (iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of business;

1985 Act increases the number of safe harbor provisions.<sup>82</sup> The increased list should not only reduce the amount of litigation as to what constitutes participation, but should also serve as a laundry list to limited partners (and their counselors) as to what they *cannot* do.

#### IV. Other Changes

##### A. Name of a Limited Partnership

The 1976 Act states that a limited partnership's name cannot be inconsistent with the purpose stated in the certificate.<sup>83</sup> The 1985 Act eliminates the requirement that the certificate state a purpose and eliminates the prohibition of an inconsistent name if the purpose is stated.<sup>84</sup> This change increases the flexibility of limited partnerships and removes substantially useless formality. The partners can

- (iv) a change in the nature of the business; or
- (v) the removal of a general partner.

U.L.P.A. § 303(b) (1976).

82. Under the 1985 Act, the safe harbor activities are:

(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 a surety for the limited partnership or guaranteeing or assuming one or more specific obligations of the limited partnership;

(4) taking any action required or permitted by law to bring or pursue a derivative action in the right of the limited partnership;

(5) requesting or attending a meeting of partners;

(6) proposing, approving, or disapproving, by voting or otherwise, one or more of the following matters:

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

(ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership;

(iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of 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] . . . .

U.L.P.A. § 303(b) (1985).

83. U.L.P.A. § 102(3) (1976).

84. See U.L.P.A. §§ 102 & 201(a) (1985).

modify the purpose of the business without the expense and inconvenience of filing and processing amendments to the certificate.<sup>85</sup> Moreover, creditors are not detrimentally affected by this change, because (1) creditors are not expected to read the certificate to discover the purpose of the business,<sup>86</sup> and (2) a limited partnership cannot avoid liability by using a misleading name.<sup>87</sup> This change makes the law of limited partnerships more similar to the law of partnerships, which as informal enterprises, may choose any name or no name at all.<sup>88</sup>

### B. Admission of a General Partner

Under the 1976 Act, an additional general partner could be admitted only with the specific written consent of each partner.<sup>89</sup> Under the 1985 Act, an additional general partner can be admitted as provided in writing in the partnership agreement or with the written consent of each partner.<sup>90</sup> This change also increases a limited partnership's flexibility. For example, the partnership agreement can provide that the partnership can admit additional general partners with the consent of the majority of the general partners. Such a provision would reduce the risk of deadlock and eliminate the expense and inconvenience of seeking specific written consent of the limited partners.

### C. Rebuttal of U.L.P.A. Presumptions

The 1976 Act creates many presumptions that can be rebutted by contrary provisions in the certificate, but not by contrary provisions in the partnership agreement. Among these presumptions are: (1) a general partner who becomes insolvent ceases to be a general partner;<sup>91</sup> (2) a partner's duty to make a contribution is not discharged by the partner's inability to perform because of death, disability, or any other reason;<sup>92</sup> (3) a limited partner has the right to

85. See *supra* note 39.

86. See *supra* notes 42-54 and accompanying text.

87. The liability of a limited partnership is based on the law of agency and partnership. U.L.P.A. §§ 403 & 1105 (1976 & 1985); UNIFORM PARTNERSHIP ACT §§ 4 & 9 (1914).

88. See H. REUSCHLEIN & W. GREGORY, *supra* note 59, at § 180. Under modern corporation law, a corporation generally need not state a purpose in its articles. If a purpose is stated, however, the name cannot be inconsistent with the purpose. See REVISED MODEL BUSINESS CORP. ACT §§ 3.01 & 4.01.

89. U.L.P.A. § 401 (1976).

90. U.L.P.A. § 401 (1985). The written consent need not be for the admission of a *specific* general partner.

91. U.L.P.A. § 402(4)-(5) (1976).

92. *Id.* § 502.

withdraw from the limited partnership by giving at least six month's notice to each general partner;<sup>93</sup> (4) a partner has a right to receive distributions in cash, but not in kind;<sup>94</sup> and (5) a partnership is dissolved upon the withdrawal of a general partner.<sup>95</sup>

The 1985 Act continues these presumptions. They can be rebutted, however, by contrary provisions in the partnership agreement.<sup>96</sup> Partners thus can modify their relations without the expense and inconvenience of filing and processing amendments to the certificate.<sup>97</sup>

#### *D. Sharing of Profits, Other Distributions, and Losses*

The 1976 Act creates a presumption that profits, other distributions, and losses are shared in proportion to the relative contributions of each partner as stated in the certificate.<sup>98</sup> The 1985 Act creates a presumption that profits, other distributions, and losses are shared in proportion to the contributions stated in the records required to be kept in the registered office.<sup>99</sup> This minor change mainly reflects the corresponding amendment that eliminates the requirement that a certificate contain information on contributions.<sup>100</sup> If contributions are stated in the certificate, however, and are inconsistent with the records required to be kept at the registered office, the records at the registered office are controlling.

#### *E. Rights and Liabilities of an Assignee*

While the right of an assignee to become a limited partner is governed by the certificate under the 1976 Act,<sup>101</sup> this right is governed by the partnership agreement under the 1985 Act.<sup>102</sup>

An assignee who becomes a limited partner acquires some of the liabilities of the assignor along with his new equity interest. Under the 1976 Act, an assignee is liable for liabilities (1) known to the assignee at the time the assignee became a limited partner or (2)

93. *Id.* § 603.

94. *Id.* § 605.

95. *Id.* § 801(3).

96. See U.L.P.A. §§ 402(4)-(5), 502, 603, 605, 801 (1985). Each of these sections provides that contrary provisions in the partnership agreement generally must be in writing. If the certificate and the agreement are inconsistent, the agreement is afforded more weight. U.L.P.A. § 201 comment (1985). The 1976 Act, on the other hand, is sometimes unclear as to whether the certificate is more important than the agreement. See Schwartz, *supra* note 3, at 709.

97. See *supra* note 39.

98. U.L.P.A. §§ 503-04 (1976).

99. U.L.P.A. §§ 503-04 (1985).

100. See *supra* notes 29-33 and accompanying text.

101. U.L.P.A. § 704(a) (1976).

102. U.L.P.A. § 704(a) (1985).



ascertainable from the certificate.<sup>103</sup> Under the 1985 Act, however, an assignee is liable only for liabilities known to the assignee at the time the assignee became a limited partner.<sup>104</sup> This change mainly reflects the new provision that the certificate no longer must include information on contributions,<sup>105</sup> but the assignee is no longer expected to know if contributions are stated in the certificate. This change again reflects the view that persons generally do not bother to read the certificate.<sup>106</sup>

#### *F. Dissolution*

Under the 1976 Act, a limited partnership automatically dissolves upon the happening of an event specified in the certificate of limited partnership.<sup>107</sup> Under the 1985 Act, a limited partnership is dissolved upon the happening of an event specified in writing in the partnership agreement.<sup>108</sup> This change further increases the flexibility of limited partnerships. The partners can modify the grounds for dissolution without the expense and inconvenience of filing and processing amendments to the certificate.<sup>109</sup>

#### V. Summary

Most of the recent changes in the Uniform Limited Partnership Act reduce the importance of the certificate of limited partnership. This reduction reflects a change in philosophy regarding the inherent role of the certificate. Under the 1976 Act, the certificate was the primary source of information to partners and nonpartners. Under the 1985 Act, however, the primary source of information to the partners is the partnership agreement and other information to which partners have access. Similarly, the primary source of information to nonpartners under the 1985 Act is information supplied by the partnership rather than that found in the certificate.<sup>110</sup> These changes reduce the expense and inconvenience of creating and modifying a limited partnership, increase the flexibility of limited partnerships, and are not unfair to nonpartners such as creditors. The

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103. U.L.P.A. § 704(b) (1976).

104. U.L.P.A. § 704(b) (1985).

105. See *supra* notes 26-29 and accompanying text.

106. See U.L.P.A. § 201 comment (1985).

107. U.L.P.A. § 801 (1976).

108. U.L.P.A. § 801 (1985).

109. See *supra* note 39.

110. See U.L.P.A. § 201 comment (1985).

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recent changes in the Uniform Limited Partnership Act, therefore, are welcome improvements.

