CHAPTER

3

GENERAL PARTNERSHIP

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CHARACTERISTICS OF A PARTNERSHIP

A **general partnership** is generally defined as an association of two or more persons to carry on as co-owners a business for profit. The business partnership is usually a contractual relationship between two or more persons whereby they agree to enter business together on their negotiated terms to produce a profit. The law partnership has deep roots in ancient law and is closely related to the law of agency,[1] in that each partner is an agent for the other partners and for the partnership business. The **partnership agreement** is the most important element of the partnership, since it governs all rights and responsibilities between the partners with respect to the business affairs of the firm. Partnerships are found in businesses as small as a local newsstand, and in businesses as large as some multistate enterprises.

Traditionally, the partnership has many of the legal characteristics of the sole proprietorship. It is distinguished from the proprietorship primarily in that it is owned by two or more persons, rather than a single individual. Thus, in the pure form of partnership, each partner is personally responsible for the liabilities of the firm; management of the business affairs is vested in all partners equally; the partnership is dissolved upon the death of a partner; and partnership profits and losses are taxed as though received individually by the partners. Each of these concepts, which are explored in greater detail later, presupposes that the partnership is nothing more than an aggregation of persons who join together to own and conduct a business. In this respect, the general partnership is clearly distinguished from the corporation, which has always been recognized as an entity, separate and distinct from its composite members.

Aggregate and Entity Theories of Partnership

Under modern commercial law, the **aggregate theory** of partnership has eroded in recognition of the commercial reality of the partnership enterprise. Most partnerships operate as business entities, the activities of which are separate from the activities of the individual partners. For example, the firm's delivery trucks are treated as belonging to the firm, not to the individual partners; the partners frequently are employed by the firm and are paid wages or salaries for their services; and the partnership conducts business and titles business property in the firm name.

The Uniform Partnership Act, which was originally adopted in 1914 and governs general partnerships, has been adopted in all but a few states.[2] The National Conference of Commissioners on Uniform Laws has drafted a new Uniform Partnership Act to clarify and modernize the statutory laws of partnerships. States gradually are converting their statutes on partnerships to conform to the revised act. The original Uniform Partnership Act treats partnerships as having both **entity** and aggregate characteristics; authorities dispute which theory prevails in most partnership problems. The revised statute, however, clearly states that "a partnership is an entity."[3] For purposes of this book, the question of when each of these theories applies is left to be resolved by those who consider the problem a serious one. The materials in this text concentrate on the elements, advantages, and disadvantages of partnership, and on problems in forming and conducting business under the partnership organization.

This chapter is concerned primarily with general partnerships. Another commonly recognized form of partnership is the limited partnership, in which some partners enjoy limited liability in exchange for limited control over the business. Many of the elements of a limited partnership are similar to those of a general partnership, but limited partnerships are discussed separately in the next chapter because of variations in their formation and operation. Many states have recently enacted statutes permitting either general or limited partnerships to register as limited liability partnerships and to thus insulate all partners from personal liability

States that have adopted Uniform Partnership Act of 1914	States that have adopted Revised Uniform Partnership Act of 1997
Alaska	Alabama
Arkansas	Alaska
Colorado	Arizona
Georgia	Arkansas
Illinois	California
Indiana	Colorado
Kentucky	Connecticut
Maine	Delaware
Massachusetts	District of Columbia
Michigan	Florida
Mississippi	Hawaii
Missouri	Idaho
Nevada	Iowa
New Hampshire	Kansas
New York	Maryland
North Carolina	Minnesota
Ohio	Montana
Pennsylvania	Nebraska
Rhode Island	New Jersey
South Carolina	New Mexico
Utah	North Dakota
Wisconsin	Oklahoma
	Oregon
	South Dakota
	Tennessee
	Texas
	Virgin Islands
	Washington
	West Virginia
	Wyoming

for partnership obligations. The registration process is separately discussed in "Registration as a Limited Liability Partnership" later in this chapter.

Definition of a Partnership

Under the Uniform Partnership Act, a partnership is defined as "an association of two or more persons to carry on as co-owners a business for profit."[4] A few words on each element are essential to an understanding of this business form.

The *association of persons* has been generally recognized to be a question of intent—the persons must voluntarily intend to associate together in a business relationship. Their intent is usually expressed in an agreement, either written or inferred from their conduct. Under the revised statute, however, a partnership can be created regardless of whether the partners intend to form one.[5] Consequently, partnerships may be very informal, perhaps even an oral understanding, but the better practice requires a comprehensive written agreement between the parties that clearly specifies their rights and responsibilities to each other and to the business.

The *persons* involved in a partnership must number two or more. A one-person business is a sole proprietorship. The persons need not be natural persons (human beings) under the Uniform Partnership Act. Partners may include corporations, other partnerships, and other associations. The Model Business Corporation Act complements this provision by permitting a corporation to be a partner.[6]

Partners must be *co-owners* of the business, which means they have not only joint ownership of specific tangible assets, but also joint rights to profit and control. The licenses and property of the partnership are held in a firm name or in the partners' names jointly. The partners share profits and losses and exercise joint management privileges, the details of which are usually described in the agreement. Absent provisions to the contrary in an agreement, profits, losses, and control are divided equally among the partners by law.[7]

By definition, a partnership must be engaged in carrying on a business for profit. *Carrying on* implies the continuation of the operations of the business for a period of time through many transactions. In contrast, a **joint venture** is formed for a single project or transaction. For example, if you and your friend purchased an apartment building intending to rent it to students attending your college or university, you would be engaged in the carrying on of a business for profit and would be partners. If you and your friend purchased the apartment building to sell it to another for a profit, you would have formed your association for a single project—buying and selling the building—and you would have formed a joint venture. The *business* part of this definition is broadly defined as "every trade, occupation or profession."[8] The *profit* element of the partnership definition is intended to exclude charitable, religious, and fraternal groups. The drafters of the Uniform Partnership Act could have realistically stated that the business also may be operated at a loss and still be a partnership, since many partnerships do lose money. In any case, if the other elements are satisfied and a business is organized in *expectation of profit,* the business is considered a partnership.

EXAMPLE

Characteristics of Partnership

- An association
- Two or more persons
- Co-owners
  —joint title to property
  —joint sharing of profit
  —joint control
- Carrying on a business
- With an expectation of profit

PARTNERSHIP PROPERTY

In a sole proprietorship, although the division may be informal, it is usually possible to distinguish business assets from personal assets of the proprietor. Since the business is an extension of the proprietor's personal life, segregation becomes important only in case of a contractual provision specifically limiting liability to the business assets of the firm. In the case of partnerships, however, a clear distinction between firm property and personal assets of the partners is necessary. Although the personal assets of the individual partners may be vulnerable to partnership obligations, the property should be clearly divided for operating purposes. For example, in a law firm that operates as a partnership, the partners may have purchased furniture, library books, computers, and supplies in the name of the partnership, and these assets belong to the firm. A partner may use her personal automobile in traveling to and from court in performing the business of the partnership, but her automobile is still her personal asset. Consequently, it is important to distinguish, preferably by agreement, which assets belong to the firm and which assets belong to the individual partner.

Partnership property is first acquired from contributions by the individual partners. The contributions of cash or property by partners are called their **capital contributions** and the value of these contributions is the value of the partner's equity in the partnership. Partners may contribute specific assets to the firm, such as land, buildings, furniture, or patents; upon contribution, the assets become partnership property. A partner may contribute cash, which is used to purchase specific assets; the cash and the assets so purchased also become firm property. The Uniform Partnership Act provides that "unless the contrary intention appears, property acquired with partnership funds is partnership property."[9] It should follow that property purchased on credit by the firm is partnership property. For the most part, it is not difficult to ascertain which property has been purchased with firm funds, but it may be difficult to identify property that has been contributed to the partnership unless the partnership agreement accurately reflects the intention of the parties. If a court were asked to decide whether certain property belongs to the firm or to the individual partner, it would test the intention of the parties as expressed in their agreement and through other overt acts.

The best guide to the intention of the partners is their written agreement. Thus, a complete description and agreed value of the property partners contribute is essential to good drafting. It is normal practice to describe the property contributed in a separate schedule, which is attached to the partnership agreement and incorporated by reference.

EXAMPLE

Contribution of Property

Glenna McKelvy shall contribute certain property valued at five thousand dollars ($5,000.00). Such property is described in Schedule A attached hereto.

The contribution of property to the partnership may have certain tax consequences, which are explored in detail later.[10]

Just as it is important to accurately and thoroughly describe the property contributed to the partnership, it is also important to specify which property is merely "loaned" to the partnership for its use, with the intention of retaining title in the individual partner's name. A clause covering this point should include the period of time the firm shall be permitted to use the property, unless indefinite; any restrictions on the owner that are desirable or necessary to ensure the use of the asset by the firm; and any compensation to be paid to the partner for the use of the asset.

EXAMPLE

Property Loaned to Partnership

Craig Carver, as the owner of one 2004 Chevrolet pick-up truck, agrees to contribute to the partnership the use of such truck, with the understanding that it shall remain his separate property, and not in any event become an asset of the partnership. It is agreed that until the termination of the partnership, or until the death or retirement of Craig Carver, he will not, without the consent of all other partners, sell, assign, pledge, or mortgage such property. Craig Carver further agrees that any money or rights occurring from the sale or assignment of the truck shall belong to the partnership during the term of the operation of the partnership. For the purpose of computation of profits, and not for participation in the distribution of the assets, the sum of twenty thousand dollars ($20,000.00) shall be included in Craig Carver's capital account to represent the value of the truck.

Thus, for property contributed at the commencement of the partnership, the intent of the parties with respect to ownership may be clearly expressed in the agreement.[11]

The Uniform Partnership Act assists in determining the partners' intentions with respect to property subsequently acquired by the firm by creating the presumption that property purchased with partnership funds is firm property. The firm also may hold property in its own name. Nevertheless, it is also possible to title partnership property in the names of the individual partners and, in such cases, the partner who holds the title can transfer the property on behalf of the partnership. In such cases the agreement should provide for this arrangement and indicate that the assets so titled are held as partnership property.

EXAMPLE

Title to Property

Partnership property (including real estate) may, by unanimous consent of the partners, be acquired and conveyed in the name of any partner or other person as nominee for the partnership. Such property shall be recorded as partnership property in the partnership accounts.

In addition to the specific provisions in the agreement, legal counsel should be sensitive to the need to provide other indicia of intent to determine ownership of partnership property. Partnership property should be formally transferred to the partnership by a bill of sale or an assignment document. It should be identified in the firm's books, and all expenses, including repairs, insurance, taxes, interest on a mortgage, and so forth, should be paid by the firm. To be consistent, the firm should deduct these payments as expenses on its income tax return. Careful drafting and planning will avoid confusion regarding ownership of partnership property.

Historically, partners joined together as co-owners of a business, and most jurisdictions considered all assets to be owned in a classification known as **tenancy in common**. In the pure sense, tenancy in common, as its name indicates, stands for common ownership, with each owner entitled to a fraction of full title, and with each owner entitled to **partition**, or to sever his or her fractional ownership and assign or sell it to another without the consent of the other co-owners. As the law of partnership developed, it modified this right of partition and imposed the limitation that partnership assets first be used for partnership purposes (including satisfying obligations of the firm). No partner could sell his or her fractional interest in the property until partnership debts were fully paid.

The Uniform Partnership Act continues the theory that partners are co-owners of partnership property, but it creates a new ownership classification called **tenancy in partnership**,[12] which better conforms to the reality that a partnership is a commercial entity using its own property for business purposes.[13] All partnership assets are held under this form of title, and while partners are said to be co-owners, they have very limited ownership rights. In general, a partner may not possess firm property for other than partnership purposes without the consent of the other partners; a partner may not sell firm property (or any fractional interest in the

property) without the consent of the other partners; a partner's individual creditors cannot apply their claims against the partner to firm assets; and a partner's heirs have no interest in the partnership assets when the partner dies (the **surviving partners** are vested with the deceased partner's fractional ownership upon the partner's death). So, for example, if a three-person partnership owns a delivery truck that is used in the partnership's appliance business, no partner may use the truck to transport his family to a picnic without the other partners' consent. Similarly, all partners must agree to sell the truck; no single partner can sell his or her one-third interest in it. If one partner is being sued for a personal bill and refuses to pay, the creditor cannot use the truck to satisfy the judgment. Finally, if one partner dies, the truck belongs to the other two partners, and the deceased partner's heirs do not acquire the deceased partner's fractional ownership rights. The heirs are entitled to the deceased partner's "interest in the partnership," described below.

PARTNER'S INTEREST IN A PARTNERSHIP

Even though specific assets belong to the firm, and not to the individual partners, each individual partner is entitled to an **interest in the partnership**, which is best described as an intangible interest that includes a partner's proportionate share of the assets and liabilities together with an interest in profits and rights to management. With respect to assets and liabilities, for example, if an appliance partnership owns $1,000,000 in assets and owes $400,000 in liabilities, the total partnership interests equal $600,000. If the partnership agreement provides that each partner shares equally, each partner's interest in the firm is valued at $200,000. Thus, upon the death of one partner, the deceased partner's heirs are entitled to that partner's interest in the firm, meaning they have the right to be paid $200,000 from the two surviving partners. Typically, the partners purchase life insurance to pay the value of a deceased partner's interest in the partnership to the heirs of the deceased partner. Similarly, any living partner can **assign** her right to the $200,000 equity to any person outside the partnership who is willing to purchase it.

The partner's interest in the partnership is initially determined by the partner's capital contribution to the firm, which is one reason a value must be assigned to the contributions in the agreement. Thereafter, additional capital contributions increase the contributing partner's interest, and subsequent profits also increase the partner's interest, as they are distributed in the proportions specified in the agreement. Conversely, if a partner withdraws funds from the partnership, the interest is reduced.[14] To illustrate, suppose the partners in the appliance business began as follows:

Smith contributed his delivery truck, valued at $50,000;
Jones contributed $100,000 in cash to buy inventory and to lease a store; and
Williams did not contribute tangible property but agreed to manage the store.

The agreement provided that the partners would share equally in profits and losses.

At this point, each partner's interest would be equal to his or her contribution. Williams had no interest, since she had yet to contribute anything.

During the year, Smith contributed a cash register valued at $4,000, and Jones withdrew $5,000 in cash for personal reasons. At the end of the year, the business showed a profit of $30,000.

The partners' respective interests in the partnership now would be as follows:

Smith's interest would be $64,000, which includes the value of the truck and cash register, plus his share of profit;
Jones's interest would be $105,000, which includes her initial cash contribution, plus her profit, less her withdrawal; and
Williams's interest would be $10,000, all of which came from profit.

This intangible interest in the partnership is the partner's personal property right in the firm. It is considered to be a personal asset, which the partner owns just as one owns a home or other personal possessions. Consequently, this property interest passes to the partner's heirs

Exhibit 3–1.

Assignment of Partner's Interest in Firm

Know All Men by These Presents, that for and in consideration of the sum of One Dollar ($1) and other good and valuable considerations to me in hand paid, receipt of which is hereby acknowledged, I, ________, of ________, do hereby assign to ________, of ________, all of my right, title, and interest in and to a certain agreement of partnership bearing date the ______day of ________, 20___, made and entered into by and between ________, ________, and myself; and I do hereby authorize and direct ________ to account to and with for all profits, issues and income arising under the partnership agreement in the same manner and with the same force and effect as if such accounting were had and made with me personally.

In Witness Whereof, I have hereunto set my hand and seal this ________ day of ________, 20___.

______________________[*Seal*]

upon death and may be reached by the partner's individual creditors for unpaid obligations. Similarly, a partner may assign this interest to an outsider and thereby confer his or her proportionate rights to profits and the value of the assets on the assignee.[15] (See Exhibit 3–1, Assignment of Partner's Interest in Firm.) Note that an assignment of a partner's interest in the firm does not make the assignee a partner, since no person may become a partner without the express or implied consent of all other partners.[16] Nor does the assignee acquire any right to interfere with the management of the business. The assignee's sole right is to receive the profits and assets to which the assigning partner is entitled.[17]

MANAGEMENT OF A PARTNERSHIP

Right to Manage

The right to manage and control the affairs of the partnership is governed by the Uniform Partnership Act and by the agreement of the partners. In the absence of an agreement to the contrary, all general partners have equal rights in the management and conduct of partnership business.[18] It is also possible (and perhaps desirable) to specify by agreement the specific management responsibilities and limitations for each partner.

Since each partner is an agent for the partnership, every act a partner performs on behalf of the firm must be an authorized act. Under the revised Uniform Partnership Act, any act of a partner, including the execution of documents in the partnership name, for apparently carrying on the business of the partnership in the usual way binds the partnership, unless the partner has no authority to act for the partnership and the person with whom the partner is dealing knows or has been notified that the partner lacks authority.[19] Actual authority of a partner may come from specific provisions in the agreement itself, or from the vote of the partners in the manner specified in the agreement or by law. The Uniform Partnership Act provides that decisions regarding ordinary matters of partnership business are to be made by a majority vote of the partners.[20] Each partner, regardless of that partner's contribution or share of profits, has one vote on such matters. Thus, under the statute, even though one partner has contributed 95% of the capital and is entitled to 95% of the profits, that partner has an equal voice with the other partners in management matters.

If the statutory management scheme—that is, equal rights in management and rule by majority vote—is deemed desirable by the partners, a clause reciting this scheme should be included in the agreement so the partners do not have to refer to the law to understand the management structure.

EXAMPLE

Management

All partners shall have equal rights in the management of the partnership business. Decisions shall be by majority vote, each partner having one vote, except as otherwise provided in this Agreement.

On the other hand, if not all partners will be actively engaged in the management of the business, it may be appropriate to appoint a managing partner or partners to control business affairs. In drafting such an appointment, it is good practice to specify the authority of the managing partners with reasonable detail and to provide a method for the resolution of disagreement between multiple managing partners.

EXAMPLE

Managing Partners

The management and control of the partnership business shall be vested in Martha Loomis, James Lyons, and Scott Charlton. Such managing partners shall have and are hereby given the sole power and authority:

a) to contract and incur liabilities for and on behalf of the partnership;
b) to borrow for and on behalf of the partnership from time to time such sum or sums of money which in their sole discretion is necessary to the conduct of the business of the partnership, and to mortgage, pledge, or otherwise encumber its assets to secure the repayment of such monies so borrowed;
c) to make all contracts for and on behalf of the partnership generally in the conduct of its business;
d) to employ and discharge all employees, including any of the other partners who may be so employed in respect to the transaction of the partnership business;
e) to otherwise carry on and transact or cause to be carried on and transacted, under their sole supervision and control, all of the other business of the partnership; and
f) to determine whether at any accounting period the profits, if any, of the partnership shall be apportioned and distributed, in whole or in part, to the partners, or retained and continued in use in the business of the partnership.

In the event of disagreement among the managing partners, a decision by the majority of them shall be binding upon the partnership. If any one or two of the managing partners shall die or retire from the partnership business or become unwilling or unable to act as a managing partner, the management and control of the partnership business shall be vested in the remaining partner or partners.

It is understood and agreed that the managing partners shall consult and confer with the other partners before taking any steps resulting in any substantial change in the operation or policies of the partnership affairs, or the sale of any portion of the partnership assets other than in the usual course of business, or in any manner affecting the partnership business unusually as judged by the ordinary operation of the partnership business.

The Uniform Partnership Act prohibits certain acts outside the ordinary course of business unless all partners consent. Historically, by law and in many existing partnership agreements adopting the law, these acts include assignment of partnership property in trust for creditors, sale of the goodwill of the business, confession of judgment against the firm, submission of a partnership claim to arbitration, and any other act that would make it impossible to carry on the partnership business. Managing partners cannot accomplish these acts unless all partners approve. The revised statute, however, takes a different approach to this issue. Instead of prohibiting certain transactions by statute, the new act permits the partnership to file a **statement of partnership authority** that identifies the partners authorized to perform certain acts (such as transferring real estate owned by the partnership) and describes the authority (or limitations on the authority) of the various partners.[21] (See Exhibit 3–2, Statement of Authority.) The revised act also permits the filing of a statement of denial by an individual partner to deny his or her authority or status as a partner.[22] (See Exhibit 3–3, Statement of Denial of Partnership Authority.) In any case, it is advisable to require the managing partners to refer unusual matters affecting the business to a committee of the whole for resolution rather than granting the managers unfettered discretion in these matters.

It is possible to provide by agreement what partners may *not* do without the unanimous consent of the other partners. Such a provision usually includes acts specifically prohibited by state law, in addition to other specific acts deemed appropriate by the partners.

Exhibit 3–2.

Statement of Partnership Authority

STATEMENT OF PARTNERSHIP AUTHORITY

THIS STATEMENT OF PARTNERSHIP AUTHORITY, dated as of the _______ day of _________, 20____, pursuant to the Revised Uniform Partnership Act (hereinafter referred to as the "Act"), is presented to the office of the Secretary of State to state the authority and limitations upon authority of some or all of the partners to enter into transactions on behalf of the Partnership

FIRST: The name of the Partnership is Pyewacket General Partnership.

SECOND: The street address of the chief executive office of the Partnership is ____________________, Boise, Idaho.

THIRD: The names and addresses of all of the general partners of the Partnership are as follows:

Partner Name	*Partner Address*
______________________	______________________
	______________________
	______________________
______________________	______________________
	______________________
	______________________
______________________	______________________
	______________________
	______________________

FOURTH: The name and address of the Partnership's appointed agent for transaction of the Partnership's lawful business, including the transfer of real property, within the State of Idaho is:

Agent's Name	*Agent's Address*
______________________	______________________
	______________________
	______________________

FIFTH: The extent of the authority of the partners is granted and limited as follows;

[Here describe specific authority and limitations on authority, identifying the partner of agent who has authority to act on behalf of the Partnership. If authority to transfer real property on behalf of the Partnership is granted to a specific partner or agent, specifically identify the extent or limitations upon such authority.]

Exhibit 3–2.

(continued)

SIXTH: The foregoing Statement of Authority shall be effective upon the filing of this Statement of Authority with the office of the Secretary of State. If the foregoing authority includes the authority to transfer real property on behalf of the Partnership, this Statement of Authority for that purpose shall be effective upon filing of this Statement of Authority with the office of the clerk and recorder where real property transactions are recorded.

IN WITNESS WHEREOF, the undersigned General Partners of the Partnership are authorized to sign and deliver this Statement of Authority under the Partnership Agreement for the Partnership as of the _______ day of _________, 20____ .

PYEWACKET GENERAL PARTNERSHIP

By: ________________________________
General Partner

By: ________________________________
General Partner

Exhibit 3–3.

Statement of Denial of Partnership Authority

STATEMENT OF DENIAL OF PARTNERSHIP AUTHORITY

THIS STATEMENT OF DENIAL OF PARTNERSHIP AUTHORITY, dated as of the _______ day of _________, 20____ , pursuant to Revised Uniform Partnership Act (hereinafter referred to as the "Act"), is presented to the office of the Secretary of State to deny and disaffirm authority of the undersigned person.

FIRST: The name of the Partnership is Pyewacket General Partnership.

SECOND: The street address of the chief executive office of the Partnership is____________________, Boise, Idaho.

THIRD: The undersigned hereby denies that he/she is a partner in the Partnership, having withdrawn from the Partnership effective as of __________________, 20____.

FOURTH: The undersigned hereby denies and disaffirms any of the following authority which was designated as his/her authority in a Statement of Authority filed by the Partnership with the office of the Secretary of State [and with the clerk and recorder of ____________________county]:

[Here describe specific authority that is being denied and disaffirmed.]

FIFTH: The foregoing Statement of Denial of Authority shall be effective upon the filing of this Statement of Denial of Authority with the office of the Secretary of State. If the foregoing authority includes the authority to transfer real property on behalf of the Partnership, this Statement of Denial of Authority for that purpose shall be effective upon filing of this Statement of Authority with the office of the clerk and recorder where real property transactions are recorded.

IN WITNESS WHEREOF, the undersigned person has signed and delivered this Statement of Denial of Authority as of the _______ day of _________, 20____.

____
General Partner

EXAMPLE

Limitations on Authority

Unless authorized by the other partners, one or more but less than all the partners have no authority to:

a) assign the partnership property in trust for creditors or on the assignee's promise to pay the debts of the partnership;
b) dispose of the goodwill of the business;
c) do any other act that would make it impossible to carry on the ordinary business of a partnership;
d) confess a judgment;
e) submit a partnership claim or liability to arbitration or reference;
f) make, execute, or deliver for the partnership any bond, mortgage, deed of trust, guarantee, indemnity bond, surety bond, accommodation paper, or accommodation endorsement;
g) borrow money in the partnership name or use partnership property as collateral;
h) assign, transfer, pledge, compromise, or release any claim of or debt owing to the partnership except upon payment in full;
i) convey any partnership real property;
j) pledge or transfer in any manner his or her interest in the partnership except to another partner; or
k) do any of the acts for which unanimity is required by other paragraphs of this Agreement.

Duties and Compensation

Partners are expected to devote their full time and attention to the activities of the partnership. This duty flows from a traditional reality that partners customarily participated in the conduct of the business, and it may have limited justification in modern practice. Moreover, the law denies partners the right to compensation for services performed on behalf of the firm,[23] since their remuneration is supposed to come from profits generated by their services and shared in a manner provided by the agreement.

If the parties desire a modification of the legal rule, matters such as salary and devotion to duty should be addressed in the partnership agreement.

EXAMPLE

Salaries and Duties

There shall be paid to each partner the following monthly salaries: To Anne Berardini, Two thousand dollars; to Michael Corrigan, One thousand five hundred dollars; etc. No increase in salaries shall be made without unanimous agreement. The payment of salaries to partners shall be an obligation of the partnership only to the extent that partnership assets are available therefor, and shall not be an obligation of the partners individually. Salaries shall, to this extent, be treated as an expense of the partnership in determining profits or losses.

EXAMPLE

Expense Allowance

An expense account, not to exceed Two thousand dollars ($2,000) per month, shall be provided for each partner for his or her actual, reasonable, and necessary expenses, in engaging in the business and pursuits of the partnership. Each partner shall be required to keep an itemized record of such expenses and shall be paid once each month upon the submission of such statements of records.

Devotion to duty may be covered by specifying the responsibilities of each partner. This is especially important if some or all of the partners have other employment or partnership obligations.

EXAMPLE

Devotion to Duty

Each partner shall devote his or her entire time and attention to the partnership business, except that each may devote reasonable time to civic, family, and personal affairs; and except that Peter McLaughlin shall be permitted to pursue the business of selling magazine subscriptions during his own time and at hours other than the business hours of the partnership business.

Standards of Conduct of Partners

Partners owe each other **fiduciary duties** because of their mutual agency relationship (principals to each other and agents of each other, as discussed in Chapter 1) and because of their joint control over the partnership's property and their joint authority over the partnership's affairs. These relationships traditionally have created a bundle of elaborate and frequently overlapping fiduciary duties. Justice Cardozo, one of the United States' preeminent jurists, once described the duties this way:

> Joint adventurers, like copartners, owe to one another . . . the duty of finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.[24]

The state statutes do not provide much statutory guidance regarding the scope of the fiduciary duties of a partner. The cases that have considered partner misconduct generally have concluded that partners must account for profits, care for partnership assets, not compete with the partnership business, faithfully serve the partnership business without diversions, fully disclose information relevant to partnership affairs, and act like reasonably prudent people in administering the partnership activities.[25] Careful drafters of partnership agreements address as many of these issues as possible to prevent any misunderstanding or confusion over the partners' rights and obligations to each other.

The Revised Uniform Partnership Act devotes statutory attention to the subject of fiduciary duties, presumably to avoid some of the traps for unwary lawyers in drafting partnership agreements, who have not read all of the cases under the original law. The revised statute provides that the only fiduciary duties a partner owes to the partnership and the other partners are the duties of loyalty and care.[26] The statute defines these duties as follows:

> A partner's duty of loyalty to the partnership and the other partners is limited to the following:
>
> (1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner, without the consent of the other partners, in the conduct and winding up of the partnership business or from a use or appropriation by the partner of partnership property or opportunity;
>
> (2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business, as or on behalf of a party having an interest adverse to the partnership without the consent of the other partners; and
>
> (3) to refrain from competing with the partnership in the conduct of the partnership business without the consent of the other partners before the dissolution of the partnership.
>
> A partner's duty of loyalty may not be eliminated by agreement, but the partners may by agreement identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable.
>
> A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.
>
> A partner shall discharge the duties to the partnership and the other partners under this [act] or under the partnership agreement, and exercise any rights, consistent with the obligation of good faith and fair dealing. The obligation of good faith and fair dealing may not be eliminated by agreement, but the partners may by agreement determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable.
>
> A partner does not violate a duty or obligation under this [act] or under the partnership agreement merely because the partner's conduct furthers the partner's own interest. A partner may lend money to and transact other business with the partnership. The rights and obligations of a partner who lends money to or transacts business with the partnership are the same as those of a person who is not a partner, subject to other applicable law.

Interestingly, the new act reverses the drafting process lawyers traditionally used in representing partnership clients. Under the original Uniform Partnership Act, the careful drafter defined and crafted the fiduciary duties of a partner, but the revised act does not permit the agreement to eliminate the duty of loyalty or the obligations of good faith and fair dealing. The revised act only permits modifications of the duty of care that do not “unreasonably reduce” that duty.[27]

PROFITS AND LOSSES

Sharing of profit is an important element of co-ownership, the crux of the partnership. A partner is not entitled automatically to compensation for services performed for the partnership. It is hoped that the partner’s reward is a rich share of profits from a successful business. Unfortunately, the right to enjoy profits carries with it the obligation to bear losses—perhaps the most distressing characteristic of co-ownership.

The agreement between partners usually states the proportion in which profits and losses will be shared, and these provisions may be as simple or as complex as the parties desire. If the partners have not specified any provision for profit sharing, the Uniform Partnership Act provides that profits shall be divided equally and losses shall be shared in the same proportion as profits.[28] For example, if the agreement provides that profits shall be shared in a 75%/25% proportion between two partners, losses will be shared in the same proportion. However, if the agreement provides that losses be shared in a 75%/25% proportion, and nothing is agreed as to the division of profits, profits will still be shared equally. (The agreement concerning the sharing of losses does not rebut the statutory presumption that profits are shared equally.)

There is no requirement that profit-loss sharing have any relationship to the respective capital contributions of the partners. For example, one partner may contribute all of the cash and property to the firm while the other contributes only services, but the partners may share profits and losses in any agreed proportion.

Unusual profit distribution formulas may be used in special cases. For example, the parties may agree that one partner should have a preference to profits for some compelling reason.

EXAMPLE

Preferential Distribution of Profit

As part of the consideration for Ted White joining the firm, it is understood that for a period of two years, in the annual distribution of profits, he shall receive a cumulative preference of ten percent on his share; that is, out of the annual profits, there shall first be a distribution to him up to ten percent on his share of the capital, and also to cover any deficiency from said ten percent in any previous years, and then a distribution pro rata to the other partners up to ten percent on their shares of the capital, and any surplus profits shall then be distributed among the partners according to their respective shares of the capital.

This example not only establishes a profit preference, but also requires that profit be distributed in the same proportions as capital contributions; note that although the partners are not required to distribute profits in the same proportion as they have contributed capital, they are permitted to do so if that is their agreement.

It is good practice to include provisions for computing **net distributable profit** to avoid later dispute among the partners, especially when the partnership is likely to incur unusual obligations that otherwise may not be included as expense items for profit computation.

EXAMPLE

Division of Profits and Losses and Computation

The net profits of the partnership shall be divided and the net losses of the partnership shall be borne in the following proportions: Pamela Owen, 25%; Michael Corrigan, 10%; etc. Net profits of the partnership for any period shall be made by deducting from the gross profits disbursements made by or on behalf of the partnership for the usual and customary expenses of conducting the business, taxes chargeable to and paid by the partnership, reserves for taxes accrued but not payable, interest on all interest-bearing loans of the partnership, salaries paid to employees and partners, reserves for depreciation of partnership property and contingencies, including bad debts, allowance for accruing liabilities, and any and all other disbursements made by the partnership during such period incidental to the conduct of the business, excepting, however, payments to the partners on account of partnership profits.

In drafting the partnership agreement, a distinction may be made between profits, losses, deductions, credits, and cash. All of these items may be allocated the same way among partners, but a **disproportionate allocation** may be appropriate among partners in some cases. First, although these allocable items are related to each other, they also are quite separate and distinct and have varying importance in the eyes of each partner. A business may operate "profitably" but, because of certain deductions (such as depreciation on buildings owned by the business), may incur losses for tax purposes, which are shared equally unless allocated differently in the agreement. Nevertheless, because revenues have exceeded expenses for which expenditures were required (depreciation not being such an expense since no cash need be expended until the depreciated property is actually replaced), there may be a surplus of cash in the business, which is available for distribution to partners. In addition, various tax credits might be available to the business, which are to be allocated and passed through to the partners.[29]

Add to these variations the preferences of the partners. Partner A may have contributed all or most of the capital of the partnership and may prefer to receive the contributed cash back as soon as possible with a disproportionately high allocation of distributable cash. Partner B may have a very low income and a high cash need, while Partner C may have a very high income and a low need for cash. Between them, it may be appropriate to give B more cash and profits and to give C more losses and credits, to maximize B's enjoyment of life and minimize the tax consequences C suffers because of C's high income. These disproportionate allocations are a method by which tax can be avoided, but the Internal Revenue Service is not in the dark about them. The service will not allow a disproportionate allocation without significant economic justification.[30]

For example, if Partner A contributed all of the cash to start the business, it may be justifiable economically to give A a preference to cash. If Partner B does most of the work managing the business, it may be justifiable economically to give B profits and cash in higher proportion than to the others. But what did Partner C do to justify the receipt of losses? There's the rub. *All* allocations must be justified or the Internal Revenue Service may reallocate items of profit, loss, deductions, and credits in a way that produces additional tax to the partners.

Examples of disproportionate allocations follow.

EXAMPLE

Allocations of Profits, Losses, Deductions, and Credits

Except as otherwise provided herein (dealing with the allocation of the proceeds upon sale or other disposition of the assets of the Partnership), ninety-five percent (95%) of the net profits and losses of the Partnership, and each item of income, gain, loss, deduction, or credit entering into the computation thereof, shall be allocated to the partners other than the managing General Partner in accordance with their respective capital contributions. Five percent (5%) of such net profits, and losses, and items of income, gain, loss, deduction, or credit entering into the computation thereof, shall be allocated to the Managing General Partner.

EXAMPLE

Distribution of Cash

One hundred percent (100%) of net cash, including amounts required to be retained by the Partnership pursuant to this Agreement, shall be allocated to the partners other than the Managing General Partner and no cash shall be allocated to the Managing General Partner until the partners other than the Managing General Partner have received cash distributions totaling $1,925,000. Thereafter, ninety-five percent (95%) of net cash shall be allocated to the partners other than the Managing General Partner and five percent (5%) of net cash shall be allocated to the Managing General Partner throughout the term of the Partnership. The Managing General Partner shall determine the net cash available for distribution after establishing a reasonable reserve for replacements, contingencies, and operating capital, and after satisfying other obligations of the Partnership then due and payable. The Managing General Partner shall distribute the next cash available for distribution no less frequently than quarterly.

LIABILITY OF PARTNERS

Like sole proprietorships, general partnerships suffer the disadvantage of unlimited liability for each partner. If the assets of the partnership are inadequate to pay partnership creditors, the personal assets of the individual partners may be reached to satisfy these obligations.[31] In one sense, there is an advantage to a partnership over a sole proprietorship because liabilities are apportioned to the partners pro rata and no one person is required to bear the full responsibility. On the other hand, since each partner has the capacity to bind the partnership, the potential risk of liability is proportionately increased.

The element of unlimited liability is a substantial disadvantage to hazardous and speculative enterprises, and it further imposes an unwelcome burden on a partner who enjoys substantially greater personal wealth than the other partners. It is possible, as with a sole proprietorship, to insure against potential liability whenever it may be anticipated. Moreover, the partnership may negotiate agreements with outsiders which provide that liability on the contract shall be limited to the partnership assets and will not extend to the individual assets of the partners. Additional protection for the partner's individual assets is provided by a rule called **marshaling of assets**, which requires that firm creditors must first look to firm property for satisfaction of their obligations, and that only if partnership assets are inadequate may they pursue the individual assets of the partners. Nevertheless, a partnership's potential unlimited liability, which cannot be completely circumscribed by insurance, agreement, or rule for priority of assets, limits the desirability of the partnership form of business enterprise.

Partly because of the significant disadvantage of personal liability in general partnerships and partly because of the availability of limited liability in new entities that function like partnerships, such as the limited liability company (discussed in Chapter 5), many states have now permitted general partnerships to register as limited liability partnerships to provide significant limited liability protection for general partners who choose to operate their businesses in the general partnership form. See "Registration as a Limited Liability Partnership" later in this chapter.

When a partner has been required to pay expenses or liabilities of the partnership personally, the Uniform Partnership Act creates an obligation of the partnership to **indemnify** a partner who has paid expenses or incurred liability in the ordinary course of partnership business.[32] Thus, if a particular partner uses individual assets to pay firm creditors, that partner is entitled to be reimbursed for the appropriate share of the other partners. Although the law grants this right of indemnification, the specific authority for indemnification should be specified in the agreement.

EXAMPLE

Indemnification

The partnership shall promptly indemnify each partner in respect of payments reasonably made and personal liabilities reasonably incurred by him or her in the ordinary conduct of its business, or for the preservation of its business or property.

A partner who leaves the firm, by retirement or withdrawal or for some other reason, remains individually liable for debts incurred while that partner participated in the firm.[33] As discussed in detail later, whenever a partner leaves the firm, a technical **dissolution** of the partnership occurs.[34] If the remaining partners are to continue the business, certain notice is necessary to persons who transacted business with the former firm in order to relieve the withdrawn partner from future liability. Personal notice must be given to persons or companies who extended credit to the firm while the retiring partner was a member (see Exhibit 3–4, Personal Notice of Dissolution of Partnership). Notice by publication will suffice for other persons who dealt with the firm (see Exhibit 3–5, Notice of Dissolution of Partnership by Publication).[35] Usually the remaining partners agree to indemnify the withdrawing partner from any further liability for firm obligations. An indemnification clause as provided in the preceding example creates the obligation to indemnify if included in the original partnership agreement.

The Revised Uniform Partnership Act handles the retirement or withdrawal of partners in a different manner than that in which they were treated in the original statute. Such persons are called **dissociated partners** and they remain liable for transactions entered into by the partnership while they were partners and for transactions entered into within two years after they have dissociated from the firm if the other party to the transaction reasonably believes that the dissociated partner is a partner at the time of the transaction and does not otherwise have notice of the partner's dissociation.[36] Notice can be accomplished by actual notice to the creditor that the partner has dissociated, by the filing of a limitation of the partner's authority to act in regard to the particular transaction, or by the filing of a "statement of dissociation" to warn creditors that the partner is no longer a member of the firm.[37] (See Exhibit 3–6, Statement of Dissociation.)

Exhibit 3–4.

Personal Notice of Dissolution of Partnership

To: ________________ Date: ________

Please be advised that the partnership between A.B., C.D., and E.F. was dissolved on the ________ day of ________, 20___, and that E.F. is no longer a member of the firm. Your account, in the amount of $________, according to our books, will be settled with A.B. and C.D. who will continue the business under the firm name of B. & D.

[*Signatures of the partners*]

Exhibit 3–5.

Notice of Dissolution of Partnership by Publication

Notice is hereby given that the partnership between A.B., C.D., and E.F. was dissolved on the ________ day of ________, 20___, so far as relates to E.F. All debts due to the partnership, and those due by them, will be settled with and by the remaining partners who will continue the business under the firm name of B. & D.

[*Date*] [*Signatures of the partners*]

Exhibit 3–6.

Statement of Dissociation from a Partnership

THIS STATEMENT OF DISSOCIATION, dated as of the ___________ day of __________, 20 ____, pursuant to the Revised Uniform Partnership Act (hereinafter referred to as the "Act"), is presented to the office of the Secretary of State to provide notice that the undersigned, a former general partner in the named Partnership, has dissociated from the Partnership.

FIRST: The name of the Partnership is Pyewacket General Partnership.

SECOND: The street address of the chief executive office of the Partnership is _________________, Boise, Idaho.

THIRD: The undersigned dissociated from the Partnership on ____________, 20____. This Statement Dissociation shall be effective upon the filing of this Statement with the office of the Secretary of State.

IN WITNESS WHEREOF, the undersigned person has signed and delivered this Statement of Dissociation as of the ___________day of __________, 20____.

____

General Partner

Under both the original and the revised Uniform Partnership Acts, new partners to the firm are individually liable for obligations existing when they join only if they specifically agree to such liability. Absent an assumption of these obligations, their individual assets may not be reached to satisfy existing obligations. They are, however, liable to lose their investment in the firm for obligations of the firm that are asserted after they join the partnership and they are individually liable for any obligations incurred after they become partners.[38]

DISSOLUTION AND TERMINATION OF A PARTNERSHIP

Most state laws currently provide that the partnership enterprise is dissolved whenever any partner ceases to be associated with the partnership business. In this respect, a partnership is very much like a sole proprietorship, where the business entity expires when the proprietor retires, dies, or is otherwise disassociated from the business. However, the partnership is an association of two or more persons, which adds an element of continuity to the partnership business, since dissolution does not necessarily require termination of the business. In fact, the partnership may be technically dissolved, yet the remaining partners may continue the business without the partner who has been disassociated from the business. By a strict interpretation of partnership law, a new partnership is created immediately and is governed essentially by the terms of the original agreement. In many cases, however, dissolution of the partnership requires termination and **winding up** of the business.

The Revised Uniform Partnership Act acknowledges that a partner may dissociate from the firm without causing a dissolution, and the remaining partners may continue the business without dissolution by causing the dissociated partner's interest to be purchased at a buyout price determined by the statute, if the partners have not agreed to a different purchase price in their agreement.[39]

This section explores the circumstances that cause dissolution under current statutes and the specific statutory authority to continue the partnership business without winding it up. The partnership agreement plays an important role in these matters, and thus specific clauses are discussed.

Causes of Dissolution

Dissolution of partnership may result from a variety of causes. Since a partnership is created by agreement of the partners, it may also be dissolved by agreement. This agreement may state a specific date for termination of the business, or may provide that the business should be dissolved upon the happening of a contingent event.[40] For example, the parties may agree that the partnership will be dissolved on July 1, 2010, or if the business sustains operating losses for five consecutive months, whichever occurs first. The latter contingency may be a realistic agreement insofar as the parties usually seek to avoid operating a business at a loss. The former provision, specifying a date for dissolution, is unrealistic and uncommon, since most partnerships hope to generate profits from a continuing business and the abrupt termination because of a specific provision in the original agreement could result in considerable loss of "Going concern" values.

EXAMPLE

Dissolution Contingent upon Results of Operations

If the operation of the business over a period of five consecutive months or more discloses an average net monthly profit of less than $50,000, the managing partner is hereby authorized and empowered to negotiate a sale, exchange, or other disposition of the entire partnership business upon the best possible terms available at such time, and in the event of such disposition of the partnership business the proceeds derived therefrom after the payment of the necessary costs and expenses of such disposition of the business shall be applied first to the payment of the debts of the business according to their respective legal priority, and if any balance of such proceeds shall remain after the payment and satisfaction of the debts, obligations, and liabilities of the business, the same shall be divided equally between the partners. Either partner may become a purchaser of the business at any such sale.

Whether or not the original agreement contains any provision for dissolution, all partners may unanimously agree to dissolve the firm at any time.[41] Better practice requires that an agreement of the partners to dissolve the firm be reduced to writing.

EXAMPLE

Agreement to Dissolve

The partnership heretofore subsisting between us, the undersigned Michael Corrigan, Karen Burn, and Anne Berardini, under and pursuant to the within articles of partnership, is hereby dissolved, except so far as may be necessary to continue the same for the liquidation and settlement of the business thereof. The said Michael Corrigan [*or* each of the undersigned] is authorized to sign in liquidation.
Dated __________, 20_____.

Signatures

Since a primary element of a partnership is that it be a "voluntary association" of persons, any partner who no longer desires to be associated with the firm may withdraw at will, and thereby cause a dissolution.[42] If the original agreement provided that the partnership would continue for a specified term, the willful withdrawal of a partner may result in liability to the other partners for breach of the agreement, but the partnership is nevertheless dissolved. However, if the original agreement between the partners was indefinite regarding the duration of the partnership, this right or power to withdraw at will may be fully exercised, without regard to the harm it may cause to the business or the other partners. The law does require that the withdrawing partner act in good faith to escape a surprise dissolution with impunity.

A partner may not have the choice of leaving the firm if the agreement provides that he or she may be expelled by the other partners. Such provisions may be drafted in the original agreement and usually are conditioned upon some misconduct by a party, such as neglecting the business, refusing to pay an assessment, and so on. The **expulsion** provision may be as

Exhibit 3–7.

Preliminary Notice of Expulsion to Partner

To [*Name and address of partner*]

We hereby give you notice that we propose to exercise the power given to us by paragraph ______ of the agreement of partnership, dated the ______ day of ______, 20___, under which we are now carrying on business in partnership with you, of terminating the partnership so far as you are concerned on the ground that you have acted in a manner inconsistent with the good faith observable between partners [*or* that you have been guilty of conduct such as would be a ground for an application to the court for a dissolution of the partnership].

In order to afford you an opportunity of explaining and, if possible, satisfying us that no good cause of complaint exists, we hereby invite you to attend a meeting of the partners, to be held at ______, on ______ next, at ______ o'clock.

If you are unable to attend such meeting, we must ask you to arrange for another meeting with us, to be held at an early date and in any case within [*one week*] from the date of this notice.

Dated ______, 20___. [*Signatures of partners*]

Exhibit 3–8.

Notice of Expulsion to Partner

To [*Name and address of partner*]

Referring to our notice to you, dated the ______ day of ______, 20___, and to the meeting of the partners held pursuant to such notice on the ______ day of ______, 20___, [*or* and in view of the fact that you neither attended the meeting to which we invited you in such notice nor have taken any other steps to meet us or explain matters], we regret to inform you that we are unable to accept as satisfactory the explanations offered by you at such meeting after hearing from us exactly what was our cause of complaint against you, and accordingly, we hereby give you notice that in exercise of the power for this purpose given to us by paragraph ______ of the agreement of partnership, dated the ______ day of ______, 20___, under which we have heretofore carried on business in partnership with you, we hereby terminate the partnership so far as you are concerned as of the date of this notice on the ground generally that [*repeat the ground as stated in the preliminary notice and add*] and more particularly on the ground that [*state the facts relied on as constituting the general ground previously stated*].

Dated ______, 20___. [*Signatures of partners*]

general and broad as the parties desire, but provisions permitting expulsion "without cause" or "in the best interests" of the partnership are rare. If an expulsion provision is included in the agreement, the "innocent" partners may cause a dissolution of the firm by exercising their right to expel a partner. (See Exhibit 3–7, Preliminary Notice of Expulsion to Partner, and Exhibit 3–8, Notice of Expulsion to Partner.)

Dissolution also may be required by operation of law. The partnership business may be declared unlawful, as was the case for liquor stores operated as partnerships when prohibition was imposed. More frequently, the partnership is dissolved when a partner dies or becomes individually bankrupt.[43] Both of these events cause dissolution because the partner's interest in the firm, which was once the partner's personal property, becomes the property of the partner's heirs or a trustee in bankruptcy, none of whom are partners. In both cases, the partner has withdrawn from the firm in a sense.

Finally, dissolutions may be decreed by a court whenever any partner becomes legally incompetent or incapable of furthering the partnership business, or if a partner acts in a manner so that it is impracticable to carry on the business, or in any other case that renders a dissolution equitable under the circumstances.[44] Thus, when partners simply cannot agree on the

proper operation of the business and their constant disagreement is detrimental to the success of the business, a court may, on application by a partner, dissolve the partnership. In some cases of disagreement between partners, dissolution by a court may be the only available remedy, since even though a partner may terminate the partnership at will, that partner may be risking liability for breach of the partnership agreement by causing dissolution.

EXAMPLE

Causes of Dissolution of Partnership

- Agreement
  —definite time in advance
  —at the time of dissolution
- Termination by a partner at will
- Expulsion of a partner
- Operation of law
  —business unlawful
  —partner dies
  —partner is bankrupt
- Decree of court

Continuation of a Partnership Despite Dissolution

As a general rule, the dissolution of a partnership requires the winding up and termination of the business and the liquidation of the firm's assets. There are two major exceptions to this rule: The business may be continued by the remaining partners if the dissolution was wrongful or if the partners' original agreement so provided.[45]

A **wrongful dissolution** results when a partner causes a dissolution without having the right to do so. If a partner is expelled from the firm for misconduct or a violation of the partnership agreement, the resulting dissolution is wrongful, and the remaining partners are permitted to continue the business without liquidation. Similarly, a partner who causes a dissolution by withdrawing from the firm in violation of the agreement causes a wrongful dissolution. Whether withdrawal is wrongful depends upon whether the agreement specifies the duration of the partnership. The partner causing the wrongful dissolution will be entitled to the value of his or her interest in the partnership, less the damages caused by the wrongful dissolution.

Whenever the business is continued by the remaining partners following a wrongful dissolution, the remaining partners are required to compensate or to ensure compensation to the dissociated partner for that partner's interest in the firm and to indemnify the dissociated partner from partnership liabilities.[46]

Even when the dissolution is innocent, continuation of the partnership business may be desirable; for example, in the case of the untimely death of a partner, liquidation following dissolution might result in unnecessary adverse tax consequences and other economic loss to the remaining partners. Continuation following an innocent dissolution requires an agreement to that effect between the parties. The agreement may be concluded legally after dissolution has occurred, but it is far better to provide for continuation in the detached negotiations of the original agreement of the parties.

First, the agreement should contain a continuation provision authorizing the remaining partners to proceed with the business.

EXAMPLE

Right to Continue the Business

In the event of a dissolution caused by the retirement, death, withdrawal, permanent disability, or bankruptcy of a partner, the remaining partners shall have the right to continue the partnership business under the same name by themselves or with any other person or persons they may select, but they shall pay to the other partner or his or her legal representatives the value of his or her interest in the partnership as of the date of dissolution.

Second, a method for computing the value of the outgoing partner's interest and a method of payment should be specified. The various methods of providing for payment of outgoing interests, be they the result of death, withdrawal, or other act dissolving the partnership, have different tax consequences, which are sufficiently complex to be avoided here. An enterprising student may explore these various methods in detail by referring to other sources.[47] Frequently used methods of settling the payment of the outgoing interest include (1) the purchase of the interest of the outgoing partner by the continuing partners, and (2) liquidating distributions from the partnership to the outgoing partner, both of which, in effect, result in the sale of the partner's interest to the firm itself. The second method may provide for guaranteed periodic payments or payments out of partnership profits or partnership property.

EXAMPLE

Payments for Partnership Interest

For the interest of a retiring or deceased partner in the partnership property, including goodwill, the partnership shall pay to the retiring partner, or to the successor in interest of the deceased partner, $20,000 in each of the five years following the retirement or death of a partner, which amount may not be prepaid except with the consent of the payee. It is the intention of the partners that the payments provided under this paragraph shall qualify under 26 U.S.C.A. § 736(a), and shall constitute ordinary income to the recipient and reduce the taxable income of the continuing partners.[48]

The agreement will specify the methods to be used in disposing of the partner's interest and in computing the compensation to the partner. An example of a provision permitting the purchase of the outgoing partner's interest by the remaining partners follows.

EXAMPLE

Purchase of a Partner's Interest

Upon the death, withdrawal, or insolvency of either of the partners during the existence of the partnership, the surviving or remaining partner shall purchase all the right, share, and interest of the deceased, withdrawn, or insolvent partner in all the partnership business and property, and shall assume all the then existing liabilities of the partnership. The price to be paid for such purchase is hereby fixed and agreed upon as follows: It shall be the amount stated as the net value of the share in the partnership of the deceased, withdrawn, or insolvent partner in the balance sheet of the first of January next preceding his or her death or withdrawal or insolvency, together with interest thereon from the date of said balance sheet at the rate of ten percent per annum until paid. Such purchase price shall be paid as follows: fifty percent thereof within six months from the date of such death, withdrawal, or insolvency, and the remainder at such times and in such amounts as may suit the convenience of the surviving or remaining partner; provided, that the whole thereof shall be paid within two years. The estate of the deceased partner, or the withdrawing or insolvent partner, shall not be entitled to share in any increase or profits gained, nor be liable for any losses incurred, in the business after the first of January next preceding his or her death, withdrawal, or insolvency, but all such profits shall belong to, and such losses be borne by, the purchasing partner.

One other item must be considered in regard to the purchase of a deceased partner's interest: life insurance. If the partnership agreement provides for the purchase of a deceased partner's interest, life insurance funding ensures that money will be available to consummate the intention of the parties when a partner dies. Life insurance can also be purchased to compensate the partnership for the loss of revenue produced by a deceased partner. The partnership may apply for and purchase life insurance on the lives of the partners, or the partners may individually apply for and purchase insurance on each other. The former is commonly called an **entity purchase plan**, and the latter is referred to as a **cross purchase plan**. Such insurance agreements usually are executed separately and are not a part of the partnership agreement. However, since they are intended to fund the purchase of the deceased partner's interest, the

provisions of the insurance agreement and the insurance acquired thereby should be consistent with the buy-out arrangements specified in the partnership agreement.[49]

In addition to permitting the continuation of the business and the disposition of the withdrawing or deceased partner's interest, a properly drafted agreement also should require the continuing partners to assume and pay all existing partnership obligations. Moreover, since creditors are likely to have extended credit to the firm before the partner's withdrawal, and the withdrawing partner may remain liable for future obligations unless proper notice is given, the agreement should specifically require such a notice.

EXAMPLE

Notice of Dissolution

Actual notice of dissolution shall be given to all persons who have had dealings with the partnership during the two years prior to dissolution.

Finally, it may be desirable to include a non-competition clause, to prevent, as much as possible, the withdrawing partner from competing against the firm or divulging the firm's trade secrets.

EXAMPLE

Noncompete Agreement

The retiring partner shall not for a period of two years from the date of his or her retirement, either alone, or jointly with or as agent for any person, directly or indirectly, set up, exercise, or carry on the trade or business of metal processing and plating within 500 miles from Denver, Colorado, and shall not set up, make, or encourage any opposition to the said trade or business hereafter to be carried on by the other party or his or her representatives or assigns, nor do anything to the prejudice thereof, and shall not divulge to any person any of the secrets, accounts, or transactions of or relating to the partnership.

It is recognized that damages, in the event of a breach by the retiring partner of the obligations and duties under this covenant, would be difficult to ascertain, and it is, therefore, agreed that the partnership in addition to, and without limiting any other power, remedy or right it may have, shall have the right to seek an injunction or other equitable relief in any court of competent jurisdiction, seeking to enjoin any such breach, and the retiring partner hereby waives any and all defenses he may have on the ground of lack of jurisdiction or competence of the court to grant such an injunction or other equitable relief. The existence of this right shall not preclude any other powers, rights, and remedies at law, in equity or otherwise which the partnership may have, but shall be in addition to, and cumulative with, any other remedy available to the partnership at law, in equity or otherwise.[50]

The continuation of a partnership business despite dissolution under the Revised Uniform Partnership Act involves many of the same considerations involved under the original law. An important additional feature of the revised act is **deferred dissolution**, which is a ninety-day period following a partner's withdrawal from the firm during which, if there is no agreement among the partners stating otherwise, the business of the partnership continues and the partner who is withdrawing may waive the right to have the partnership business wound up.[51] One can only imagine the pressure that might be placed on a withdrawing partner by fellow partners to encourage a waiver during the period. If there is no waiver during the ninety days, the partnership is regarded as dissolved, and its business must be wound up. During this deferred dissolution period, the withdrawing partner may not participate in management, is liable for obligations incurred (as though he or she were a "dissociated" partner), receives profits earned, and is charged with losses suffered (but only to the extent of the profits credited).[52]

Termination and Winding Up

In the event that the remaining partners do not desire to continue the business, a dissolution requires that the partnership be terminated and wound up. For these purposes, the remaining partners have the right to complete all pending partnership business and thereafter collect and

dispose of the assets, pay the firm's creditors, and enjoy whatever is left. Depending upon the number of partners in the partnership, it may be desirable to appoint one partner to liquidate the business. Any remaining partner is eligible. If a liquidating partner is named in the original agreement, a successor should also be named in the event of that person's death. In any case, following a dissolution, a partner's authority to act for the partnership is limited to acts necessary to wind up the firm's affairs.[53]

State laws typically provide that in winding up a partnership, the partners must distribute the assets of the firm to pay the claims of

1. creditors other than partners;
2. partners other than for capital and profits;
3. partners in respect of capital; and
4. partners in respect of profits.[54]

The partners may agree to vary this distribution priority in any manner, except that partnership creditors, who are not bound by the terms of the partnership agreement, must always be completely satisfied before the partners are entitled to share the assets among themselves.

TAX CONSIDERATIONS OF A GENERAL PARTNERSHIP

A major consideration in the selection of the partnership as the appropriate form for a business enterprise is income taxation. The partnership itself pays no federal income tax. Instead, each partner is required to declare a share of the partnership income on his or her individual tax return. The partnership is thus treated as an aggregation of individuals for tax purposes, much like the sole proprietorship. The only difference is that the business income is divided among the partners in their respective proportions, rather than being applied completely to one person.

The partnership files an information tax return with the federal government on Form 1065. (See Exhibit 3–9, Form 1065.) The individual partners are furnished Schedule K-1 for their proportionate share of profits, losses, and other incidents of taxation. (See Exhibit 3–10, Schedule K-1.) These tax returns are used to ascertain whether the partners have declared and paid tax on their proportionate shares of income. It does not matter whether the profits have actually been distributed to the partners during the year. Even if profits are retained in the business, the partners must declare them as though they were distributed. When losses are considered, this rule can operate as an advantage of partnership taxation; all losses from the business are attributed personally to the partners and may be offset against personal income produced from other similar sources.

Because of the similarity of a partnership to a sole proprietorship for tax purposes, the sole proprietorship is not a viable alternative for tax advantage. A corporation, however, is taxed as an entity at special corporate rates, and a choice between a partnership and a corporation may depend on the tax differences. Under recent amendments to the Internal Revenue Code, a partnership could affirmatively elect to be taxed as a corporation (See Exhibit 3–11 Entity Classification Election), thus allowing it to achieve corporate tax advantages, such as the ability to accumulate profits to expand the business without requiring the individual partners to pay taxes on profits they have not received.[55] The comparison of corporate tax rates with individual tax rates is complicated because two or more persons are involved in the partnership. The business form that may be most desirable for one person may work as a disadvantage to the others. Each partner may have different incidents of taxation that are important in comparison to other partners who may not have the same types of income; for example, one partner may have significant amounts of income from other sources that are subject to minimum alternative taxes, or one partner may have substantial passive income that can be offset by passive losses from the partnership. Consequently, the only general statement that may be safely advanced regarding partnership tax considerations is that each case must be evaluated

Exhibit 3–9.

Form 1065

Form **1065**
Department of the Treasury
Internal Revenue Service

U.S. Return of Partnership Income
For calendar year 2002, or tax year beginning ...., 2002, and ending ...., 20....
See separate instructions.

OMB No. 1545-0099
2002

A Principal business activity	**Use the IRS label. Otherwise, print or type.**	Name of partnership	**D Employer identification number**
B Principal product or service		Number, street, and room or suite no. If a P.O. box, see page 14 of the instructions.	**E** Date business started
C Business code number		City or town, state, and ZIP code	**F** Total assets (see page 14 of the instructions) $

G Check applicable boxes: **(1)** ☐ Initial return **(2)** ☐ Final return **(3)** ☐ Name change **(4)** ☐ Address change **(5)** ☐ Amended return
H Check accounting method: **(1)** ☐ Cash **(2)** ☐ Accrual **(3)** ☐ Other (specify) ....
I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year ....

Caution: *Include **only** trade or business income and expenses on lines 1a through 22 below. See the instructions for more information.*

Income

1a Gross receipts or sales	**1a**		
b Less returns and allowances	**1b**		**1c**
2 Cost of goods sold (Schedule A, line 8)			**2**
3 Gross profit. Subtract line 2 from line 1c			**3**
4 Ordinary income (loss) from other partnerships, estates, and trusts *(attach schedule)*			**4**
5 Net farm profit (loss) *(attach Schedule F (Form 1040))*			**5**
6 Net gain (loss) from Form 4797, Part II, line 18			**6**
7 Other income (loss) *(attach schedule)*			**7**
8 **Total income (loss).** Combine lines 3 through 7			**8**

Deductions (see page 15 of the instructions for limitations)

9 Salaries and wages (other than to partners) (less employment credits)			**9**
10 Guaranteed payments to partners			**10**
11 Repairs and maintenance			**11**
12 Bad debts			**12**
13 Rent			**13**
14 Taxes and licenses			**14**
15 Interest			**15**
16a Depreciation (if required, attach Form 4562)	**16a**		
b Less depreciation reported on Schedule A and elsewhere on return	**16b**		**16c**
17 Depletion **(Do not deduct oil and gas depletion.)**			**17**
18 Retirement plans, etc.			**18**
19 Employee benefit programs			**19**
20 Other deductions *(attach schedule)*			**20**
21 **Total deductions.** Add the amounts shown in the far right column for lines 9 through 20			**21**
22 **Ordinary income (loss)** from trade or business activities. Subtract line 21 from line 8			**22**

Sign Here
Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than general partner or limited liability company member) is based on all information of which preparer has any knowledge.

Signature of general partner or limited liability company member   Date

May the IRS discuss this return with the preparer shown below (see instructions)? ☐ **Yes** ☐ **No**

Paid Preparerís Use Only

Preparer's signature	Date	Check if self-employed ☐	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code		EIN	
		Phone no. ( )	

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separately, based upon the potential profit or loss, the expected distributions from the business, and the individual financial positions and sources of income of the parties.

The sale of a partner's interest in the partnership usually results in a capital gain or loss much the same as does a shareholder's sale of corporate stock. When partnership property is sold, the capital gain or loss is attributable to the individual partner in the same proportion as are profits, unless altered by agreement. Since contributed property is partnership property, a special problem may arise with respect to its valuation for determining gain or loss. To illustrate the problem, consider the following case.

Murlin and Short formed a partnership with equal rights to profits. Murlin contributed $50,000 in cash and Short contributed a machine that had a fair market value of $50,000, but an adjusted basis (the cost to Short plus improvements by him) of $40,000. The basis of that

Exhibit 3–10.

Form K-1

SCHEDULE K-1 (Form 1065)
Department of the Treasury
Internal Revenue Service

Partner's Share of Income, Credits, Deductions, etc.
See separate instructions.
For calendar year 2002 or tax year beginning , 2002, and ending , 20

OMB No. 1545-0099
2002

Partner's identifying number | **Partnership's identifying number**

Partner's name, address, and ZIP code | Partnership's name, address, and ZIP code

A This partner is a ☐ general partner ☐ limited partner ☐ limited liability company member
B What type of entity is this partner? ....
C Is this partner a ☐ domestic or a ☐ foreign partner?
D Enter partner's percentage of: (i) Before change or termination / (ii) End of year
Profit sharing .... % .... %
Loss sharing .... % .... %
Ownership of capital .... % .... %
E IRS Center where partnership filed return:

F Partner's share of liabilities (see instructions):
Nonrecourse . . . . $ ....
Qualified nonrecourse financing . $ ....
Other . . . . $ ....
G Tax shelter registration number . ...
H Check here if this partnership is a publicly traded partnership as defined in section 469(k)(2) . . . . . ☐
I Check applicable boxes: (1) ☐ Final K-1 (2) ☐ Amended K-1

J Analysis of partner's capital account:

(a) Capital account at beginning of year	(b) Capital contributed during year	(c) Partner's share of lines 3, 4, and 7, Form 1065, Schedule M-2	(d) Withdrawals and distributions	(e) Capital account at end of year (combine columns (a) through (d))
			( )	

	(a) Distributive share item		(b) Amount	(c) 1040 filers enter the amount in column (b) on:
Income (Loss)	1 Ordinary income (loss) from trade or business activities . . .	1		See page 6 of Partner's Instructions for Schedule K-1 (Form 1065).
	2 Net income (loss) from rental real estate activities	2		
	3 Net income (loss) from other rental activities	3		
	4 Portfolio income (loss):			
	a Interest	4a		Sch. B, Part I, line 1
	b Ordinary dividends	4b		Sch. B, Part II, line 5
	c Royalties	4c		Sch. E, Part I, line 4
	d Net short-term capital gain (loss)	4d		Sch. D, line 5, col. (f)
	e (1) Net long-term capital gain (loss).	4e(1)		Sch. D, line 12, col. (f)
	(2) 28% rate gain (loss)	4e(2)		Sch. D, line 12, col. (g)
	(3) Qualified 5-year gain	4e(3)		Line 5 of worksheet for Sch. D, line 29
	f Other portfolio income (loss) *(attach schedule)*	4f		Enter on applicable line of your return.
	5 Guaranteed payments to partner	5		See page 6 of Partner's Instructions for Schedule K-1 (Form 1065).
	6 Net section 1231 gain (loss) (other than due to casualty or theft)	6		
	7 Other income (loss) *(attach schedule)*	7		Enter on applicable line of your return.
Deductions	8 Charitable contributions (see instructions) *(attach schedule)* . .	8		Sch. A, line 15 or 16
	9 Section 179 expense deduction	9		See pages 7 and 8 of Partner's Instructions for Schedule K-1 (Form 1065).
	10 Deductions related to portfolio income *(attach schedule)* . . .	10		
	11 Other deductions *(attach schedule)*.	11		
Credits	12a Low-income housing credit:			
	(1) From section 42(j)(5) partnerships	12a(1)		Form 8586, line 5
	(2) Other than on line 12a(1)	12a(2)		
	b Qualified rehabilitation expenditures related to rental real estate activities	12b		See page 8 of Partner's Instructions for Schedule K-1 (Form 1065).
	c Credits (other than credits shown on lines 12a and 12b) related to rental real estate activities.	12c		
	d Credits related to other rental activities	12d		
	13 Other credits	13		

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machine to the partnership, for computing gain or loss, is the same as the basis to the individual: $40,000. If, during the year, the machine is sold at its fair market value of $50,000, the partnership receives a capital gain of $10,000, which is attributable to the partners in their respective proportions. Thus, both partners must claim a $5,000 capital gain that year. This should concern Murlin, who has now paid half the tax on Short's contributed asset. If Short had sold the machine when he owned it as an individual and contributed cash to the partnership, Short would have been individually responsible for the $10,000 gain.

Similarly, the rule may work a hardship on Short. Suppose the adjusted basis of the asset was $70,000 and Short contributed the machine when its fair market value was $50,000. When the machine is sold, the capital loss of $20,000 is shared between the partners. Murlin thereby acquires a tax benefit that Short really deserves.

Exhibit 3–11.

Form 8832
Entity Classification Election

Form **8832**
(Rev. September 2002)
Department of the Treasury
Internal Revenue Service

Entity Classification Election

OMB No. 1545-1516

Type or Print

Name of entity | **EIN**

Number, street, and room or suite no. If a P.O. box, see instructions.

City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country.

1 **Type of election** (see instructions):

a ☐ Initial classification by a newly-formed entity.

b ☐ Change in current classification.

2 **Form of entity** (see instructions):

a ☐ A domestic eligible entity electing to be classified as an association taxable as a corporation.

b ☐ A domestic eligible entity electing to be classified as a partnership.

c ☐ A domestic eligible entity with a single owner electing to be disregarded as a separate entity.

d ☐ A foreign eligible entity electing to be classified as an association taxable as a corporation.

e ☐ A foreign eligible entity electing to be classified as a partnership.

f ☐ A foreign eligible entity with a single owner electing to be disregarded as a separate entity.

3 **Disregarded entity information** (see instructions):

a Name of owner ....

b Identifying number of owner ....

c Country of organization of entity electing to be disregarded (if foreign) ....

4 Election is to be effective beginning (month, day, year) (see instructions) . . . . ___/___/___

5 Name and title of person whom the IRS may call for more information

6 That person's telephone number ( )

Consent Statement and Signature(s) (see instructions)

Under penalties of perjury, I (we) declare that I (we) consent to the election of the above-named entity to be classified as indicated above, and that I (we) have examined this consent statement, and to the best of my (our) knowledge and belief, it is true, correct, and complete. If I am an officer, manager, or member signing for all members of the entity, I further declare that I am authorized to execute this consent statement on their behalf.

Signature(s)	Date	Title

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In cases like this one, complicated matters arise in determining the fair allocation of depreciation on the asset between the parties. The Internal Revenue Code formerly offered a solution to the problem by permitting the parties to agree to the manner in which depreciation, depletion, gain, or loss of contributed property would be allocated between the partners to account for variations of this sort.[56] However, current tax law requires that all income, gain, loss, and deductions from property contributed to the partnership be shared among partners so as to account for variations between the basis of the property to the partnership and the property's fair market value at the time of contribution, regardless of the partners' desires as specified in the partnership agreement.[57] A clause in the agreement should address this issue so that partners are not surprised by the tax consequences that may result from contributed property.

EXAMPLE

Allocation of Tax-related Items

The partners understand that for income tax purposes the partnership's adjusted basis of property contributed by Maynard Short differs from the fair market value at which such property was accepted by the partnership at the time of its contribution. The partners recognize and understand that in determining the taxable income or loss of the partnership and the distributive share of each partner's depreciation or gain or loss with respect to such contributed property, the Internal Revenue Code requires that such items be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution.

Many other tax considerations apply to the partnership form, most of which are complicated because the partnership operates as an entity, acquiring property and earning money as an apparently separate legal unit, but is treated merely as an aggregation of individuals for tax purposes. Thus, the distribution of current assets or of assets during liquidation, the determination of the partnership's taxable year, and the transfer of partnership interests all pose unique tax problems that are beyond the scope of this text but are ably covered by other authors[58] (See Exhibit 3–11, Form 8832).

FORMATION AND OPERATION OF A GENERAL PARTNERSHIP

In many respects, the formation of a general partnership parallels the formation of a sole proprietorship. The obvious difference is the most important formality for the partnership: the agreement.

Selection of a Name

A partnership may operate under any name it chooses, provided the name is not deceptively similar to that of another company so as to constitute a deceptive trade practice. As with sole proprietorships, most states require registration of any fictitious partnership name under the assumed name statutes.[59]

If all of the partners' surnames are used in the firm name, the name is not considered to be fictitious; if fewer than all of the partners' names are used in the firm title, the name is fictitious. Thus, a partnership formed by Levine, Conviser, and Chess may use all names without registration, but if the firm name is Levine and Chess, registration is required. Similarly, the name Levine & Co. would require registration.

The sanctions imposed on a partnership for failure to file the assumed name information are the same as those imposed upon sole proprietors.[60]

Governmental Formalities

Partnerships may conduct any legal business in the same manner as may a natural person. Where state law imposes particular licensing requirements, the partnership must conform. Consequently, sales tax licenses must be obtained where appropriate, and the partnership must obtain any necessary licenses peculiar to the particular business conducted.

Tax identification numbers are necessary for partnerships, since informational returns are filed annually with federal and state authorities. If employees are hired, social security and unemployment compensation laws must be considered.

Interstate Business

Partnerships are not usually subject to any peculiar formalities for doing business in states other than the state in which the firm is formed. They must, however, comply with local licensing requirements, and the name of the firm must be registered appropriately with the foreign state. A few states, including California and New Hampshire, require qualification of a **foreign partnership**—a registered office and statutory agent (who accepts receipt of impor-

tant documents, like service of process) must be present within the state, and a fee must be paid for the privilege of doing business in that state.[61] This qualification procedure is not popular, however, and is clearly a minority approach to interstate general partnership business.

The Agreement

Without the partnership agreement, the simple organizational formalities for the partnership would be extremely attractive. The partnership is organized in essentially the same manner as the sole proprietorship. It is even possible to form a partnership with nothing more than a handshake agreement to do business together. However, as the previous discussions of the nature of the partnership have demonstrated, that informality is usually a fatal oversight.

An old axiom states that one should never be a partner with a friend, recognizing the common tendency of human nature toward disagreement in business transactions. Eventually there will be some discord (or at least a friendly disagreement) between the parties, and an informal agreement offers no guidance whatever in the resolution of such disputes. Thus, the only proper practice requires the drafting of a comprehensive agreement between the parties, carefully specifying their purposes, contributions, management authority, voting powers, duties, rights, and responsibilities.

The partnership agreement, which is occasionally called the **articles of partnership**, must be tailored to the specific desires of the future partners. The following checklist with examples and references to the detailed discussions in this chapter may be used as a guide for preparing the agreement.[62]

Checklist

1. Names and addresses of the partners.

EXAMPLE

Agreement

Agreement made this ____ day of __________, 20____, between James A. Murlin, whose address is 526 Park Avenue, New York, New York, and Maynard P. Short, whose address is 1901 K Street, N.W., Washington, D.C., (hereinafter referred to as individuals or collectively as "Partners").

2. **Recitals—**The background of the partners' business relationship may be stated in order to explain the agreement. Recitals of such information are inserted at the beginning of the agreement. The recitals further serve to state the intent to form a partnership and may explain the business objectives of the enterprise. They recite the factual background of the agreement.

EXAMPLE

Recitals

WHEREAS, Murlin has acquired certain business expertise in the manufacturing and marketing of rubber bicycle tires; and

WHEREAS, Short has the financial ability to contribute certain sums of money for the manufacturing and marketing of rubber bicycle tires; and

WHEREAS the parties intend to operate a business for the manufacture and marketing of rubber bicycle tires and desire to do so under the form of a partnership;

NOW, THEREFORE, it is agreed:

3. **Name of the partnership—**If the firm name does not contain the surnames of the individual partners, a trade name affidavit is required (see "Selection of a Name" earlier in this section).

EXAMPLE

Name

The name of the Partnership shall be Shoylin Associates.

4. **Place of business—**The proposed offices of the firm should be stated, with permission for the partners to establish other offices as appropriate. If the firm will operate branch offices and their locations are known, those locations should be specified. If a multistate business is contemplated, the partners should have authority to establish offices in other states.

EXAMPLE

Place of Business

The principal place of business of the firm shall be located at 526 Park Avenue, New York, New York, or such other place as shall be designated by the partners from time to time. Branch offices may be located at 156 Cayuga Street, Ithaca, New York, and at a street address to be determined by agreement of the partners in Albany, New York. The partnership shall be authorized to conduct business and to establish offices in locations to be selected by agreement of the partners in the states of Connecticut, Rhode Island, and Pennsylvania.

5. **Purposes—**The description of the partnership business should be included in general terms, unless restrictive language is dictated by the partners' objectives. Any intended restrictions upon the scope of the partnership's business should be detailed, or, following a specific description of the contemplated purposes, the agreement may provide that the partnership will operate "no other business." Be certain to include a provision that allows the partners to *agree* to enter into other ventures so the agreement will not be unduly restrictive.

EXAMPLE

Nature of Business

The partnership shall engage in the business of manufacturing and marketing rubber bicycle tires, and in such other lawful business as is permitted in the jurisdiction of formation and as may be agreed upon from time to time by the partners.

[*or*]

The partnership shall engage in the business of manufacturing and marketing rubber bicycle tires, and shall not engage in any other business or activity except as shall be directly related and incident to such business or except as shall be agreed upon from time to time by the partners.

6. **Duration—**
   (a) The partnership may be formed for a definite term.
   (b) The partnership may be subject to termination by mutual agreement.
   (c) The partnership may be terminable at will when one partner gives the specified notice to the other partners.
   (d) The partnership may be terminated upon the completion of its purposes (e.g., the sale of a parcel of real estate).
   (e) The partnership may be terminated upon the happening of a contingent event (e.g., continuous losses for a specified period).
   (f) The partnership may be terminated under any combination of the preceding conditions.

EXAMPLE

Duration

The partnership shall begin on May 1, 2005, and shall continue for the term of ten years thereafter.

[*or*]

The partnership shall continue for the full term of five years from the date of this agreement, and thereafter until thirty days' written notice is given by any of the partners to the others.

7. **Capital—**The capital contributions of the partners should be described in detail. There are many possible variations of contributions (see "Partnership Property" and "Tax Considerations of a General Partnership" earlier in this chapter), but the following situations are most typical.
   (a) The partners' contributions will be cash. The agreement should specify the amount of the contribution and the time of payment.

EXAMPLE

Capital

The capital of the partnership shall be contributed in cash by the partners as follows:
James A. Murlin $50,000
Maynard P. Short $30,000
Such contribution shall be paid in full on or before May 10, 2005.

   (b) One or more of the partners will contribute services. The value of the services and the treatment of the respective capital accounts should be discussed.

EXAMPLE

Contribution of Services

James A. Murlin shall not be required to make a cash or property contribution to the partnership but shall devote his entire time to the partnership, and for such he shall be entitled to twenty percent (20%) of the profits to be divided [*term for division*] among the partners. In the event that his monthly share of the profits shall exceed thirty thousand dollars ($30,000), he shall contribute the excess to his capital account of business until the total amount of such contributions shall equal the capital contributions made by each of the other partners.

   (c) One or more of the partners will contribute tangible property. The agreed value of the property should be specified. Further, if the cost of the property to the contributing partner and the agreed value of the contribution are different, it is appropriate to consider and describe the tax consequences of the precontribution gain or loss in the agreement (see "Tax Considerations of a General Partnership" earlier in this chapter).

EXAMPLE

Contribution of Property

Maynard P. Short shall contribute property which the partners agree will be valued at ten thousand dollars ($10,000). Such property is described in Schedule A attached hereto.

   (d) The partners may be required to furnish additional capital. The agreement should specify the circumstances under which additional contributions may be assessed (e.g., in the event of continuous losses for a specified period, or upon the vote of the majority of the partners). The partners' respective proportions for additional contributions and the procedure by which the partners will be notified of the contributions should be specified.

EXAMPLE

Additional Capital Contributions

In the event that the cash funds of the partnership are insufficient to meet its operating expenses, the partners shall make additional capital contributions, in the same proportions in which they share the net profits of the firm.

The managing partner, after determining a cash deficit, shall notify the other partners in writing at least ten (10) days prior to the date upon which such cash funds are needed, and each partner shall be required to make such additional contributions on the date specified in the notice, or if none, on the tenth day after the date of the notice.

(e) Excess contributions may be construed as advances and may be treated as loans to the firm. The authority to make such loans comes from the agreement, which should specify the need for the consent of the other partners, the amount of the loan, and any desired restriction on the frequency of such advances.

EXAMPLE

Loans and Advances

Any of the partners may, from time to time, with the consent of all of the other partners, advance sums of money to the partnership by way of loan, and each such advance shall bear interest at the rate of twelve percent (12%) per annum.

(f) Profits may be accumulated as capital.

EXAMPLE

Accumulated Profits

Each of the partners shall be required to allow to remain in the business each year as a contribution to net worth of the partnership capital, an amount equal to thirty percent (30%) of the partnership profits which would otherwise be distributed to him or her. Such contributions shall be allocated to or reserved in accounts for each of the partners, and shall remain in the business and be employed as capital for the business subject to further direction and order of the partners.

(g) Capital may accumulate interest if the agreement so provides. If the partners agree that capital contributions should not accumulate interest, a statement to that effect should be included.

EXAMPLE

Interest on Capital

No interest shall be paid to the partners on any contributions to capital.

[*or*]

Each of the partners shall be entitled to interest at the rate of ten percent (10%) per annum on the amount of his or her respective contributions, payable semiannually, on June 1 and December 1, of each calendar year.

(h) If withdrawal of capital contributions is to be permitted, the agreement should detail the circumstances of withdrawal, limitations upon the amount of the withdrawal, if any, and any requirements for replenishing the capital account at specified times.

EXAMPLE

Withdrawal of Capital

Each of the partners may withdraw from the partnership, for his or her own use, a sum not exceeding seven thousand dollars ($7,000) per month. If, at the close of each fiscal year, it is found that any partner's share withdrawn by him or her is in excess of his or her distributive share for that fiscal year, he or she shall forthwith refund the difference within a period not exceeding five days from the time of such determination.

(i) If one partner allows profits to accumulate in a greater proportion than do the others, the excess may be described as a debt owed to that partner, and the agreement may provide an interest rate to be applied to the excess amount so that the partner is compensated for disproportionately leaving his or her profits to be invested in the business.

EXAMPLE

Individual Accumulation of Profit

All profits of the partnership during the year shall be allocated to the partners in their respective proportions in an income account which shall be subject to withdrawal by any partner from time to time. If a partner does not withdraw all of his or her income account during the year, the excess amount, not withdrawn, shall be treated as a loan to the partnership by the partner, and shall accumulate interest at the rate of ten percent (10%) per annum on the amount of the income account not withdrawn at the close of each calendar year, so long as such amount shall remain in the income account and is not withdrawn by the partner.

8. **Salaries and expenses—**
   (a) Since partners are not ordinarily entitled to remuneration for their services (see "Management of a Partnership"), the authority to pay salaries must be established by the agreement. Salaries may be contingent upon profits, or may be fixed by the agreement.

EXAMPLE

Salaries

There shall be paid to each partner the following monthly salaries: To James A. Murlin, three thousand dollars; to Maynard P. Short, five thousand dollars; *etc.* No increase in salaries shall be made without unanimous agreement. The payment of salaries to partners shall be an obligation of the partnership only to the extent that partnership assets are available therefor, and shall not be an obligation of the partners individually. Salaries shall, to this extent, be treated as an expense of the partnership in determining profits or losses.

   (b) Expense accounts are common in business partnerships. The agreement should establish a maximum periodic amount, a procedure for submitting expenses, and a procedure for reimbursement. The agreement also should specify that only expenses incurred in furtherance of the partnership business will be reimbursed.

EXAMPLE

Expenses

An expense account, not to exceed one thousand dollars ($1,000) per month, shall be provided for each partner for his or her actual, reasonable, and necessary expenses in engaging in the business and pursuits of the partnership. Each partner shall be required to keep an itemized record of such expenses and shall be paid once each month upon the submission of such statements of records.

9. **Profits, losses, deductions, and credits—**The agreement should establish a method for determining profit and loss. Simply providing for a determination of profit or loss by the partnership's accountant (or bookkeeper) using generally accepted accounting principles creates an objective standard for the determination that should avoid most disputes. However, the phrase "generally accepted accounting principles" sometimes baffles even the accountants who use it, if it is necessary for those accountants to justify the methods upon which they have determined financial information. It may be preferable to select a method of accounting, such as cash or accrual, and to specify that method as the partnership accounting procedure. Frequently, partnership agreements provide that income and loss will be determined on the same basis as that required for federal income tax purposes, so that accountants do not have to create separate financial statements for a partnership's internal use and for federal income tax reporting purposes. It may be desirable to allow for any partner to question a profit and loss determination by permitting another accountant (at the challenging partner's expense) to determine, independently, profits or

losses, and then permitting arbitration (or some other objective determination) if the results vary more than a stated percentage from the original amount.

In some cases, extraordinary expenses are involved, such as legal fees for litigation or unusual travel and entertainment in the start-up period of the business. These expenses may be detailed in the agreement and excluded from the normal profit and loss computation so that they may be shared in some other agreed proportion. Profits, losses, deductions (reductions of taxable income), and credits (reductions of tax) are usually shared in the same proportions, but not necessarily.[63] This clause is especially tailored to the desires of the partners. Some common schemes are as follows:

(a) sharing profits, losses, deductions, and credits equally;
(b) sharing profits, losses, deductions, and credits according to the proportion of capital contributions;
(c) allocating all items primarily to the partner who provides financial backing until he or she receives profits (or tax benefits) equal to the capital contributed, then making a primary allocation to the managing partner who is producing those profits;
(d) requiring that losses caused by the willful neglect or default of a partner be borne by that partner; and
(e) guaranteeing profits for certain partners, which usually requires the other partners to contribute any deficiency if the annual profit distribution does not exceed a certain amount.

EXAMPLE

Allocations of Profits, Losses, Deductions, and Credits

Seventy percent (70%) of the net profits and losses of the partnership, and each item of income, gain, loss, deduction, or credit entering into the computation thereof, shall be allocated to the partners other than the Managing General Partner in accordance with their respective capital contributions. Thirty percent (30%) of such net profits and losses, and items of income, gain, loss, deduction, or credit entering into the computation thereof, shall be allocated to the Managing General Partner.

10. **Cash distributions—**A partnership is a unique entity that allows for accumulations of cash when the business is actually producing a “paper” loss. For example, if the partnership operates an apartment building, depreciation and interest may reduce the profits of the partnership (and may actually produce a loss) even when rental receipts exceed operating expenses. The agreement should provide for distributions of cash to the partners in certain proportions, and this determination can be made separately from the distribution of profits, losses, deductions, and credits. Again, the specific desires of the partners should be observed. Some common methods of cash distribution include the following:
    (a) in the same proportion as profits, losses, deductions, and credits are shared;
    (b) to the partners who contributed cash or property as capital contributions, to the exclusion of any partner who is contributing only services, until a certain proportion of the contributed amount has been recovered;
    (c) to the partner who needs it the most, at least for a period of time; and
    (d) to the partner who will be required to pay the most taxes as a result of partnership operations, thereby permitting that partner to pay the taxes from the cash distributed.

EXAMPLE

Cash Distributions

One hundred percent (100%) of the net cash of the partnership shall be allocated to the partners other than the Managing General Partner in accordance with their respective capital contributions for the first three years of the operation of the business, and no cash shall be allocated to the Managing General Partner during that time. Thereafter, twenty percent (20%) of the net cash of the partnership shall be allocated to the partners other than the Managing General Partner, and eighty percent (80%) of the net cash shall be allocated to the Managing General Partner.

11. **Books and records—**
   (a) The **fiscal year** of the partnership must be established. The taxable year of the partnership is determined, for tax purposes, as though the partnership were a taxpayer. Normally this means that the taxable year must be the same for the partnership as for the partners who have an interest in the partnership profits and capital of greater than 50%. If the partners are individuals, that means the partnership's taxable year is the calendar year. The partnership can have a different taxable year only if it establishes a legitimate business purpose for a fiscal year different from the calendar year.

EXAMPLE

Fiscal Year

The fiscal year of the partnership shall be from November 1 until October 31.

[*or*]

The fiscal year of the partnership shall be the calendar year.

   (b) The method of accounting for the firm (accrual or cash) should be established. The agreement should provide that while generally accepted accounting principles will govern any matters not specifically covered by its terms, the method of accounting used for federal income tax purposes will be used for reports to partners. This avoids the cost of converting the accounting entries from the tax-basis reporting to generally accepted accounting principles when the accounting rules are different.

EXAMPLE

Method of Accounting

The partnership shall keep accounts on the accrual [*or* cash] basis. The accounts shall readily disclose items which the partners take into account separately for income tax purposes. As to matters of accounting not provided for in this agreement, generally accepted accounting principles shall govern.

   (c) The location of the firm's books and records must be established, and the partners' access to the books should be considered. Any restrictions upon a partner's right to inspect or copy books and records will be included here. For example, if an investment partner were also the owner of a supplying business, the agreement might limit that partner's access to the firm's vendor lists.

EXAMPLE

Location of Books

The partnership books shall be kept at the principal place of business of the partnership, and every partner shall at all times have access to and may inspect and copy any of them. [*Or,* all partners shall have access to such books and records only upon 72 hours prior written notice to the managing partner and during normal business hours.]

   (d) The bank accounts and other banking arrangements are stated in the agreement, including the persons authorized to sign checks, to borrow funds, and to otherwise conduct banking transactions on behalf of the firm.

EXAMPLE

Banking Arrangements

The partnership shall maintain such bank accounts as the partners shall determine. Checks shall be drawn for partnership purposes only and may be signed by any partner or partners designated by the partners. All moneys received by the partnership shall be deposited in such account or accounts.

(e) Provisions should be included for the rendering of periodic reports to partners (e.g., monthly, quarterly, semiannually, or annually). The partners may be required to sign and verify the reports, subject to objection for manifest errors within a specified period of time.

EXAMPLE

Reports of Operations

The managing partner shall provide reports of cash activity, profit or loss, and the current balance sheet of the partnership to each partner at least quarterly, within 15 days following the close of the calendar quarter of the partnership. Each partner shall be required to signify his or her receipt of such reports by signing a duplicate copy of the reports and returning the same to the managing partner within ten days following receipt of such reports. Any objections or questions concerning such reports must be addressed to the managing partner within 30 days following the receipt of the reports by each partner or the reports shall be deemed to be correct as to the matters presented therein.

(f) The person responsible for keeping the partnership books should be named.

EXAMPLE

Responsibility for Records

The managing partner shall be responsible for the partnership books and records and shall maintain the same at the principal place of business of the partnership. The managing partner may, upon notice to the other partners, delegate persons to assume the obligations of keeping the partnership records.

(g) An audit by independent certified public accountants may be appropriate for some financially complicated businesses, and the agreement will authorize such an audit.

EXAMPLE

Audit of Books and Records

As soon as practical after the close of the partnership's calendar year, the managing partner shall engage an independent certified public accountant to audit the partnership books and records, and shall provide copies of the audit report furnished by such accountant to each of the partners.

[*or*]

Each partner shall be entitled to engage the services of an independent certified public accountant to audit the books and records of the partnership following the close of the partnership's calendar year. The partner so desiring such audit shall pay all expenses and fees of the accountant, and no such expenses shall be assessed against the partnership, unless the results of the audit indicate a variance of over or under ten percent of the profit and loss reported to the partners by the managing partner in any calendar year, in which event the expenses of the audit shall be borne by the partnership as a partnership expense.

12. **Meetings—**Partners' meetings may be established on a regular basis by the agreement, specifying the time and place for such meetings. Special meetings may be called in accordance with the agreement. A clause authorizing special meetings should consider the parties who are entitled to call special meetings, the notice required, and whether the notice must specify the purpose of the meeting.

EXAMPLE

Meetings

Partners' meetings will be held on the second Tuesday of each month at 5:00 p.m. at the principal place of business of the partnership. No notice shall be required for the regular meetings of the partnership. A special meeting may be called by any partner upon giving three days' written notice to the other partners, specifying a time and place for the meeting and the purpose of the meeting.

13. **Management—**

(a) Method of management (see "Management of a Partnership" earlier in this chapter)—The management of the business affairs of the firm must be conducted in accordance with the agreement. One or more of the partners may have a specialized business skill, and this should not be overlooked. Many variations are possible for management activities, including the following:

(1) Each partner has an equal voice in management.
(2) Some partners (usually those with larger capital contributions) have a greater vote than others.
(3) A committee of partners is established to make certain decisions.
(4) A managing partner (or partners) is appointed to control the daily business affairs of the firm.
(5) Some partners, usually called *dormant* or **silent partners**, have no management activities under the agreement.

EXAMPLE

Equal Management

Management and the conduct of the business of the partnership shall be vested in all partners, and no partner shall be solely responsible for management functions. The partners shall have an equal vote on all partnership matters, and all issues to be resolved in the partnership shall be determined by a majority vote.

EXAMPLE

Other-Than-Equal Management

Management and the conduct of the business shall be vested in all Partners, and no Partner shall be solely responsible for management functions. The Partners shall have the following votes on Partnership matters:

Peter J. McLaughlin	11
James T. Johnston	33
Steve Forness	11
John Anderson	11
Thomas Stubbs	33
Michael Theisen	1

A quorum shall be the presence at a meeting of 51 votes. No Partnership matter may be approved except at a meeting in which a quorum of votes is represented in the manner provided in this Paragraph, or as otherwise provided in this agreement.

(b) **Management duties—**

(1) If a managing partner is used, the managing partner's duties should be specified in the agreement. Moreover, any management decisions that are to be referred to all of the partners should be described.

EXAMPLE

Duties of a Managing Partner

a) The affairs of the Partnership shall be managed and conducted by the Managing General Partner in accordance with the provisions of the Colorado Uniform Partnership Act, as amended, and subject to the terms and provisions of this Agreement.

b) The Managing General Partner shall devote such of his or her time as may be necessary to select, at his or her sole discretion, and to acquire master recordings for the Partnership; to retain a distributor for the recordings owned by the Partnership; to supervise the activities of the distributor and to hire replacement or additional distributors if deemed necessary by the Managing General Partner; to make inspections of any physical assets owned by the Partnership and to see to it that such assets are being properly maintained; to prepare or cause to be prepared all reports of operations which are to be furnished to the Partners or

EXAMPLE

(continued)

which are required by any government agencies; and to do all other things which may be necessary to supervise the affairs and businesses of the Partnership in a prudent and businesslike manner in the best interest of the Partners.

c) The Managing General Partner is hereby authorized, on behalf of the Partnership, to execute any contracts, notes, or other documents that may be required in connection with the acquisition, financing, and operation of the assets and business described in this Agreement.

d) The Managing General Partner, in addition to the other powers and rights granted to him or her and subject to the specific limitations imposed by this Agreement, shall have the right, upon such terms and conditions as he or she may deem proper, to (1)borrow money on the general credit of the Partnership for use in the Partnership business, including the right to borrow money from himself or herself and to charge the Partnership interest on funds so borrowed, provided the interest rate to be charged by the Managing General Partner for such borrowed funds shall not exceed the rate available from commercial lenders, and provided the Managing General Partner shall not further encumber any master recordings acquired by the Partnership after their initial acquisition, other than in the ordinary course of business, without the approval of the Partners; (2)purchase personal property for use in connection with the business of the Partnership and finance such purchases, in whole or in part, by giving the seller or any other person a security interest in the property purchased; (3)make reasonable and necessary capital expenditures and improvements with respect to the assets of the Partnership and take all action reasonably necessary in connection with the management thereof; (4)establish a reasonable reserve for contingencies and operating capital from available cash flow of the Partnership; (5)contract with himself or herself and affiliated persons on terms competitive with those which may be obtained in the open market for property or services required by the Partnership, provided, however, that the Managing General Partner shall not receive from himself or herself, or affiliated persons, or grant to himself or herself, or affiliated persons, any rebates, kickbacks, or give-ups, directly or indirectly, in such transactions or agreements; (6)make reasonable and necessary expenditures for the maintenance and operation of the assets of the Partnership; and (7)enter into agreements for the management of the assets of the Partnership.

e) The Managing General Partner shall assume a fiduciary responsibility for the safekeeping and use of all Partnership funds and assets, whether or not in his or her immediate possession or control, and shall not employ, or permit another to employ, such funds or assets in any manner except for the exclusive benefit of the Partnership. Partnership funds shall not be commingled with the funds of any other person or entity.

f) The Managing General Partner shall not cause the Partnership to purchase interests in other business organizations, underwrite the securities of any other businesses, offer Partnership interests in exchange for anything other than cash or notes, or make loans to other persons or entities.

g) Except where power or duties are reserved to the Managing General Partner, other Partnership matters shall be determined by the unanimous vote of the Partners.

EXAMPLE

Limitations on Powers of the Managing General Partner

The Managing General Partner shall have full, exclusive, and complete discretion in the management of and control over the affairs of the Partnership; provided, however, the Managing General Partner shall not take any of the following actions without the consent of all Partners:

a) sale, exchange, or other disposition of all or substantially all of the Partnership's assets other than in the ordinary course of business;

b) refinancing, recasting, increasing, modifying, or extending any loans secured in whole or in part by master recordings owned by the Partnership, other than in the ordinary course of business;

c) sale, assignment, or encumbrance of the Managing General Partner's interest in the Partnership;

d) admission of a Successor Managing General Partner to the Partnership;

e) admission of additional Partners to the Partnership;

f) engagement of the Partnership in a business other than that specified in this Agreement; and

g) amendment or modification of this Agreement unless that amendment or modification is otherwise permitted under this Agreement without action of all Partners.

(2) All partners are expected to devote their time and energies to the partnership business.[64] Any deviation from this rule must be detailed in the agreement.

EXAMPLE

Outside Activities

No partner shall engage in, or invest or deal in the securities of, any business that in any wise competes with that of this firm, nor shall he or she give any time or attention to any outside business, except that of bank director, without the written consent of his or her copartners.

(3) Each partner should be required, upon request, to account to the other partners regarding all transactions relating to the partnership business of which that partner has knowledge.

EXAMPLE

Reports of Activities

The managing partner shall, at least ten days prior to the regular meeting of the partnership, specify which of the partners are to report on areas of the partnership business within their control and responsibility. Such reports may be furnished orally at the meeting, unless the managing partner requires a written report in the notice, in which case a copy of the report shall be distributed to the partners at the meeting and appended to the minutes of the partnership meeting.

(4) The agreement may require certain partners to provide a bond for faithful performance of their management duties. For example, if certain partners were delegated the responsibilities of accounting for trust funds for clients of the partnership, it may be appropriate to insure against the possibility of their theft of the funds.

EXAMPLE

Fidelity Bond

The managing partner shall, at the expense of the partnership, acquire and maintain a fidelity bond in the amount of $1,000,000 with an insurance company acceptable to a majority of the partners. The bond shall provide for the payment upon such bond for any willful failure or neglect of the managing partner to perform his or her duties hereunder, upon defalcation or embezzlement by the managing partner, upon the loss to the partnership of any asset as a result of the negligence of the managing partner, and upon such other terms and conditions as may be required by the majority of the partners.

(c) **Management formula—**Depending upon the management method selected (e.g., equal voice, managing partner, etc.), the agreement will state a formula for determining partnership action. For example, if all partners have an equal voice, the formula may require a majority, two-thirds, or unanimous vote to carry action on behalf of the firm. The decision of a managing partner is usually final on matters within his or her control. In certain cases, unanimity of partners will be required by law.[65]

(d) **Disputes—**In case of a deadlocked dispute on management matters, the agreement usually requires submission of the dispute to an independent third party or to arbitration.

EXAMPLE

Arbitration

All disputes and questions whatsoever which shall, either during the partnership or afterwards, arise between the partners or their respective representatives, or between any partners or between a partner and the representative of any other or others, touching these articles, or the construction or application thereof, or any clause or thing herein contained, or any account, valuation, or division of assets, debts, or liabilities to be made hereunder, or as to any act, deed, or omission of any partner, or as to any other matter in any way relating to the partnership business or the affairs thereof, or the rights, duties, or liabilities of any person under these articles, shall be referred to a single arbitrator in case the parties agree upon one; otherwise to two arbitrators, one to be appointed by each party to the difference, or in case of their disagreement to an umpire, to be appointed by said arbitrators.

(e) **Prohibited activities—**[66]

(1) Certain matters affecting the partnership must be decided by all partners, including assignment of the partnership property in trust for creditors, sale of the goodwill of the business, confession of judgment against the firm, submission of a partnership claim to arbitration, and other acts that would make it impossible to carry out the partnership business.

EXAMPLE

Limitation on a Partner's Authority

No partner shall, without the unanimous consent of the other partners, do any of the following acts:

a) assignment of the partnership property in trust for creditors;
b) sale of the goodwill of the business or substantially all of the assets of the business;
c) confess a judgment against the partnership or its assets;
d) submit a partnership claim to arbitration; or
e) commit any other act that would make it impossible to carry out the partnership business.

(2) Partners may be further restricted in their power to bind the firm. An individual partner usually is not permitted to extend credit, pledge the partnership property, hire and fire employees, cause an attachment of firm property, or release debts without the appropriate consensus of the other partners.

EXAMPLE

Further Limitations on a Partner's Authority

No partner shall, without the consent of the others, borrow or lend money on behalf of the partnership; sell, assign, or pledge his or her interest in the partnership; or execute any lease, mortgage, security agreement, or endorsement on behalf of the partnership. No purchase or other contract involving a liability of more than five thousand dollars, nor any importation from abroad, shall be made, nor any transaction out of the usual course of the retail business shall be undertaken, by either of the partners without the previous consent and approval of the other partner.

(3) It may be desirable to govern the private lives of the partners in certain respects, for example, to forbid any partner from going into debt except for living necessaries, to restrict a partner's ability to deal in securities on margin, to demand that a partner discharge any filed liens against that partner's property within a thirty-day period, and so on.

EXAMPLE

Limitation on Extraordinary Debts

In order to protect the property and assets of the Partnership from any claim against any Partner for personal debts owed by such Partner, each Partner shall promptly pay all debts owing by him or her and shall indemnify the Partnership from any claim that might be made to the detriment of the Partnership by any personal creditor of such Partner.

(4) The partners may be restricted in their sale or assignment of any or all of their interests in the partnership.[67] Common restrictions include the requirement of consent by the other partners, or a right of first refusal for the other partners, permitting them to purchase the interest at the offered price.

EXAMPLE

Sale of a Partner's Interest

In the event that a Partner desires to sell, assign, or otherwise transfer his or her share of interest in the Partnership hereby created and has obtained a bona fide offer for the sale thereof made by some person not a member of this Partnership, he or she shall first offer to sell, assign, or otherwise transfer the said interest to the other Partners at the price and on the same terms as previously offered him or her, and each other Partner shall have the right to purchase his or her proportionate share of the selling Partner's interest. If any Partner does not desire to purchase the said interest on such terms or at such price, no other Partner may purchase any part of the interest, and the selling Partner may then sell, assign, or otherwise transfer his or her entire interest in the Partnership to the person making the said offer at the price offered. The intent of this provision is to require that the entire interest of a Partner be sold intact, without fractionalization. A purchaser of an interest of the Partnership shall not become a Partner without the unanimous consent of the nonselling Partners.

14. **Partnership property—**
    (a) The name in which partnership property will be titled is established by the agreement.

EXAMPLE

Title to Property

All assets of the partnership shall be titled in the name of the partnership, Shoylin Associates.

(b) If any property is loaned to the firm by a partner, it should be separately described and the agreement should detail the duration of the loan, any restrictions upon the disposition of the property by the partner, and any compensation to be paid to the partner for the use of the asset.[68]

EXAMPLE

Loans of Property by a Partner

Maynard P. Short has loaned to the partnership, and by this agreement, agrees to the exclusive use of the partnership, all of the property listed and described on Exhibit B, attached to this agreement and incorporated herein by reference. The partnership shall have exclusive use and enjoyment of the property for a period of one year from the date of this agreement, and for successive annual periods, unless, prior to the expiration of an annual term, Mr. Short gives written notice of at least 30 days to the partnership of his intention to reacquire the possession and use of the property. So long as the partnership shall be in possession of the property, Mr. Short shall not assign, sell, encumber, or otherwise deal with such property, and any such action by Mr. Short shall be deemed to be a breach of this agreement. The partnership shall pay Mr. Short the sum of $10,000 per year in equal quarterly installments for the use of the property described on Exhibit B.

(c) Accounting procedures for partnership property, including the treatment of depreciation, repairs, insurance, taxes, interest, and other expenses, should be considered.

EXAMPLE

Method of Accounting for Assets

All accounting for partnership assets shall be done according to generally accepted accounting procedures, using the most conservative methods of accounting for depreciation, investment tax credits, etc. The managing partner shall be directed to provide for depreciation, repairs, insurance, taxes, interest, and other reserves as necessary for partnership operations in order to meet such operating and capital expenses when they are incurred.

15. **Causes of dissolution—**[69]
    (a) **Retirement or withdrawal—**
        (1) The agreement may describe the circumstances under which a partner may retire. Most agreements permit the partner to retire and withdraw at any time after a certain date or after the partner has reached a certain age.

(2) Notice of retirement or withdrawal is usually required to be given to the other partners.
(3) A noncompetition clause may be appropriate to restrict the business activities of a retiring or withdrawing partner.[70]
(4) The agreement should provide for indemnification of the retiring or withdrawing partner for all existing liabilities if the remaining partners elect to continue the business.
(5) If the withdrawal of a partner is wrongful, any penalties to be imposed as a result of wrongful withdrawal should be specified in the agreement.

EXAMPLE

Retirement or Withdrawal

A Partner shall have the right, at any time during the continuance of this agreement and of the Partnership created hereby, to withdraw or retire from the said Partnership by giving three (3) months' notice to the other Partners at the Partnership's place of business.

Upon giving notice, the withdrawing or retiring Partner shall be entitled to payment of his or her interest in the Partnership, the amount of which and method of payment is determined by this agreement with reference to purchase of an expelled Partner's interest. Upon the receipt of such payment, the interest of the withdrawing or retiring Partner in the Partnership shall cease and terminate.

Notwithstanding the provisions above, if the remaining Partners shall decide not to continue the business upon withdrawal or retirement of a Partner, the remaining Partners may elect to terminate and dissolve the Partnership, in which case the withdrawing or retiring Partner shall only be entitled to his or her interest in liquidation, as stated in this agreement with reference to voluntary termination.

(b) **Expulsion of a partner—**
(1) The circumstances justifying expulsion of a partner must be specifically detailed.
(2) A method for deciding upon expulsion and a procedure for notifying the expelled partner should be established. If a hearing will be permitted, the procedure for conducting the hearing should be described.
(3) The agreement should provide for indemnification of the expelled partner for all existing liabilities if the remaining partners elect to continue the business.

EXAMPLE

Expulsion

A partner of this partnership may, upon the affirmative vote of the other partners, be expelled for the following acts:
a) committing a felony under the laws of the state in which this partnership is organized;
b) failing to cure any default or breach of this agreement after receipt of a notice of such default or breach from the other partners in writing;
c) committing an act that is deemed to be detrimental to the business or reputation of the partnership;
d) adjudication of insanity of the partner; or
e) competing with the business of the partnership for his or her personal account.

The partners so voting for expulsion shall give notice of expulsion, specifying the reasons therefor, to the expelled partner, who, upon receipt of such notice, shall have ten (10) days to request in writing a hearing on the matters specified in the notice. If a hearing is requested, the partner subject to expulsion shall appoint an impartial third party, and the other partners shall appoint an impartial third party, and each such third party shall appoint another impartial third party to hear such evidence or other matters as the expelled partner wishes to present on his or her behalf. Following such hearing, this panel shall determine whether the partner shall be expelled, and their decision shall be final.

The remaining partners may continue the business without the expelled partner and without liquidation of the partnership by paying the expelled partner his or her capital account, and by furnishing such indemnification and hold harmless documents as may be reasonably requested by the expelled partner for obligations of the partnership that come due following an expulsion.

(c) **Bankruptcy of a partner—**

(1) Provisions should be included for the continuance of the business in case of the bankruptcy of an individual partner.

(2) The purchase of the individual partner's interest in the partnership must be authorized.

EXAMPLE

Bankruptcy of a Partner

Upon the adjudication of bankruptcy of a partner, or the assignment by a partner for the benefit of his or her creditors, or the appointment of a receiver or conservator for the disposition of a partner's debts, the other partners shall have the right either to purchase the bankrupt partner's interest in the partnership or to terminate and liquidate the partnership business. If the remaining partners elect to purchase the bankrupt partner's interest, they shall serve notice of such election upon the trustee in bankruptcy, receiver, conservator, or assignees of the bankrupt partner within twenty (20) days following such event, and shall pay to such person or persons the value of the bankrupt partner's interest in the partnership determined as of the day before such event occurred. If the remaining partners do not elect to purchase the bankrupt partner's interest, and instead elect to terminate the business, they shall appoint a managing partner who shall proceed with reasonable promptness to sell the property of the partnership and to liquidate the business of the partnership. The bankrupt partner's estate shall thereafter share in the proceeds of liquidation in accordance with his or her pro rata share of the proceeds thereof.

(d) **Death of a partner—**

(1) Provisions should be included for the continuance of the business when one partner dies.

(2) If the deceased partner's estate is to participate in profits of the business, the agreement should describe the extent of participation. This clause should discuss the amount of profits to be distributed to the estate, the period during which such distributions are to be made, and whether profit distributions are guaranteed.

(3) The agreement should establish the authority for the purchase of life insurance on the partners. The partners may purchase life insurance on each other (cross-purchase plan) or the firm may purchase the insurance (entity purchase plan). The amount of the insurance to be maintained and the type of plan should be described in the agreement.

(4) If the life insurance plan is to be administered by a trustee, the trustee is named and his or her power and duties should be defined in the agreement.

EXAMPLE

Death of a Partner

Upon the death of any Partner, the surviving Partners shall have the right either to purchase the decedent's interest in the Partnership or to terminate and liquidate the Partnership business. If the surviving Partners elect to purchase the decedent's interest, they shall serve notice in writing of such election, within three (3) months after the death of the decedent, upon the executor or administrator of the decedent's estate, or if at the time of such election no legal representative has been appointed, upon any one of the known legal heirs of the decedent at the last known address of such heir. The closing of the purchase shall be within thirty (30) days of the notice of such election.

If the surviving Partners elect to purchase the decedent's interest, the purchase price and method of payment shall be as stated in this agreement with reference to purchase of an expelled Partner's interest, except in the event insurance is in effect with respect to decedent the method of payment is provided in this section. The period from the beginning of the fiscal year in which decedent's death occurred until the end of the calendar month in which his or her death occurred shall be the period used for purposes of calculating his or her share of Partnership profits and losses in the year of death. The decedent's share of profits and losses shall also include his or her share of profits and losses of the Partnership during the period between the end of the calendar month in which death occurred and the end of the calendar month preceding the closing of purchase.

EXAMPLE

If the surviving Partners do not elect to purchase the decedent's interest, and instead elect to terminate the business, they shall appoint a managing partner who shall proceed with reasonable promptness to sell the real and personal property owned by the Partnership and to liquidate the business of the Partnership. The surviving Partners and the estate of the deceased Partner shall share in their respective proportions stated during the period of liquidation, except that the decedent's estate shall not be liable for losses in excess of the decedent's interest in the Partnership at the time of his or her death. The managing Partner shall be entitled to reasonable compensation for services performed in liquidation. Except as otherwise stated herein, the procedure as to liquidation and distribution of the Partnership assets shall be the same as stated in this agreement with reference to voluntary termination.

The Partnership may contract for life insurance protection on the lives of each of the Partners, in any amount not disproportionate to the value of each Partner's interest. Each Partner may designate the beneficiary for such life insurance. In the event of death of a Partner, insurance proceeds paid to the Partnership will be used to purchase the decedent's interest, at the purchase price determined above, except that the payment of such price to the decedent's representatives or heirs shall be made within thirty (30) days following receipt of the insurance proceeds. Any surplus in insurance proceeds not required to purchase the decedent's interest shall be retained in the Partnership and proportionately added to the capital account of the surviving Partners. If the surviving Partners elect to liquidate the business in lieu of purchasing the decedent's interest, the proceeds of any life insurance shall be treated as an asset of the Partnership for liquidation.

(e) **Other disabilities—**The partnership may be dissolved when an individual partner becomes disabled, insane, or otherwise incapable of continuing in the business relationship. These special incidents of dissolution should be considered in the agreement, with provisions for continuation of the business and purchase of the former partner's interest.

EXAMPLE

Disability of a Partner

In the event a partner becomes disabled, is adjudicated insane, or is otherwise unable to perform the duties required by this agreement, the remaining partners shall have the right either to purchase the disabled partner's interest in the partnership or to terminate and liquidate the disabled partner's interest in the partnership. If the surviving partners elect to purchase the disabled partner's interest, then the procedure described in this agreement for the purchase of a deceased partner's interest in the partnership shall apply. If the remaining partners elect to terminate and liquidate the business, they shall appoint a managing partner who shall proceed with reasonable promptness to terminate the business, sell the property of the partnership, and distribute the proceeds of such liquidation, after payment to creditors, in the manner provided for dissolution and liquidation in this agreement.

16. **Continuation of the business—**Following a dissolution, the remaining partners have the authority to continue the business if the dissolution was wrongful. In other cases of dissolution, the business may be continued only if the agreement so provides. A specific clause granting the remaining partners the right to continue business is appropriate. Notice of the intent to continue the business may be required to be given to the former partner or to the former partner's estate. In all cases, the withdrawing, retiring, or disabled partner or the estate of the deceased partner should be indemnified from business liabilities.
17. **Purchase of the partner's interest—**If a partner has caused a dissolution and the remaining partners intend to continue the business, the interest of the withdrawing, disabled, or deceased partner will be purchased by the firm or by the other partners.[71]
    (a) The agreement may provide that the former partner's interest will be purchased by the other partners jointly or individually in an established proportion.
    (b) The agreement may provide for liquidating distributions to the former partner, resulting in a purchase of that partner's interest by the firm.

(c) The value of the partner's interest should be ascertained in accordance with a formula specified in the agreement. Independent public accountants may be necessary to make the computations under the formula. The following typical alternatives are available:
   (1) a return of the capital contribution plus interest;
   (2) a stipulated value as described in the agreement;
   (3) a formula based upon historical earnings of the partnership (**earnings multiple formula**);
   (4) a formula based upon the value of the assets of the partnership (**book value formula**); and
   (5) an appraisal by an independent third party.[72]
(d) The extent to which goodwill is to be used to compute the value of the former partner's interest is established by the agreement. Goodwill may be ignored, or it may be considered an asset and appraised in determining the value of the interest.
(e) Payment terms should be established in the agreement. The period of time for installment payments, whether a promissory note is to be executed, and whether the obligation will be secured by assets of the partnership are appropriate topics for this provision.
(f) A fund may be withheld for a period of time for contingent claims arising before the dissolution.
(g) The treatment of the purchased interest should be discussed. The interest may be divided among partners in their remaining proportion of capital contributions, equally, or by some other formula.

EXAMPLE

Continuation of Business and Purchase of Partner's Interest

The Partners may elect to continue the business despite a dissolution of the partnership, by purchasing the deceased, disabled, expelled, or bankrupt Partner's interest; in such case, the purchase price shall be equal to the deceased, disabled, expelled, or bankrupt Partner's capital account as of the date of the notice required by this agreement, plus his or her income account as of the end of the prior fiscal year, increased by his or her share of Partnership profits, or decreased by his or her share of Partnership losses, computed to the date of the notice, and decreased by withdrawals such as would have been charged to his or her income account during the present year to the date of the purchase of his or her interest. The purchase price is subject to set-off for any damages incurred as the result of the expelled or bankrupt Partner's actions, and nothing in this paragraph is intended to impair the Partnership's right to recover damages for such reasons.

The date of the notice, referred to above, shall be the date personal notice is received, or the date the certified mail is postmarked, in the case of a breach of this agreement.

18. **Liquidation and winding up** (see "Dissolution and Termination of a Partnership" earlier in this chapter)—If the business will not be continued following dissolution, liquidation and winding up must follow in accordance with the agreement.
(a) A full and general account of the firm's assets, liabilities, and transactions should be authorized. An independent certified public accountant may be necessary for this purpose.
(b) A liquidating partner or committee of partners should be named. Since partners may receive remuneration for services in liquidation, the value of these services should be fixed by agreement.
(c) If the assets are capable of distribution to the partners, this may be authorized in the agreement, following the payment of business debts. Otherwise, the agreement should authorize the sale of the assets (usually in the discretion and good judgment of the liquidating partner) and the distribution of the cash received.
(d) The order of distribution of the assets is set by law.[73] If the order of distribution is to be altered, the agreement must specifically describe the new order of distribution.
(e) If the partnership has sustained a loss, so that one or more of the partners will be required to make additional capital contributions to facilitate distribution of assets, a period of time in which such payments are to be made and the manner of payment (cash, promissory note, etc.) should be specified.

EXAMPLE

Distribution on Termination

Upon termination of the Partnership, its affairs shall be concluded in the following manner:

a) The Managing General Partner shall proceed to the liquidation of the Partnership, and the proceeds of the liquidation shall be applied and distributed in the following order of priority:

1) to the payment of all debts and liabilities of the Partnership;

2) to the setting up of any reserve that the Managing General Partner shall deem reasonably necessary to provide for any contingent or unforeseen liabilities or obligations of the Partnership; provided, however, that at the expiration of such period of time as the Managing General Partner shall deem advisable, the balance of such reserve remaining after the payment of such contingency shall be distributed in the manner set forth in this section;

3) to the payment to the partners other than the Managing General Partner of an amount which, when added to any amount previously distributed to the partners other than the Managing General Partner pursuant to this agreement hereof, will equal their aggregate capital contributions to the Partnership;

4) any balance then remaining shall be distributed as follows:

i) ninety percent (90%) of such balance to the partners other than the Managing General Partner;

ii) ten percent (10%) of such balance to the Managing General Partner;

b) A reasonable time shall be allowed for the orderly liquidation of the assets of the Partnership and the discharge of liabilities to creditors; and

c) Each Partner shall be furnished with a statement certified by the Partnership's independent accountants which shall set forth the assets and liabilities of the Partnership as of the date of the complete liquidation.

REGISTRATION AS A LIMITED LIABILITY PARTNERSHIP

The most significant disadvantage to the general partnership form of doing business is the fact that the general partners have personal liability for partnership obligations. Many states have now authorized the formation of registered limited liability partnerships in which this personal liability can be avoided.[74] A **limited liability partnership** is an existing general partnership that is converted or a new partnership that is formed in which the individual partners are shielded from personal liability, except to the extent that the debt or liability arises from the partner's own conduct or as otherwise provided in the partnership agreement or a writing signed by the partner.

The partner causing the liability usually remains personally liable for the consequences of his or her actions. This is the same rule that applies to agents: the agent is personally liable for the agent's own conduct. The advantage of a limited liability partnership, therefore, is that the *other* partners will not be liable for the conduct of their fellow partners. Although agency and partnership law would attribute the liability of one partner to the others, the registration as a limited liability partnership cuts off the vicarious liability of the other partners.

In most states authorizing the limited liability partnership, a partner can still *agree* to be liable for the other partners' conduct, either in a written partnership agreement or otherwise. If a partner agrees to assume responsibility for partnership obligations, the limited liability feature of the entity is ignored because of the agreement. Thus, when an existing general partnership seeks to register for limited liability protection, counsel must be careful to review and amend the existing partnership agreement to eliminate any reference to individual liability or contributions if the partners are to receive the full benefits of limited liability.

Limited liability partnerships must file a registration statement with the Secretary of State or other state filing officer (see Exhibit 3–12, Certificate of Limited Liability Partnership) typically containing:

1. the name of the registered limited liability partnership (which must contain the words "registered limited liability partnership," "limited liability partnership," or the initials "L.L.P.," "LP," "R.L.L.P.," or "RLLP;"

Exhibit 3–12.

Certificate of Limited Liability Partnership (Maine)

Filing Fee $125.00

DOMESTIC
LIMITED LIABILITY PARTNERSHIP
STATE OF MAINE

CERTIFICATE OF
LIMITED LIABILITY PARTNERSHIP

(Mark box only if applicable)

☐ This is a professional limited liability partnership formed pursuant to 13 MRSA Chapter 22-A to provide the following professional services:

____

____
(type of professional services)

____
Deputy Secretary of State

A True Copy When Attested By Signature

____
Deputy Secretary of State

Pursuant to 31 MRSA ß822, the undersigned executes and delivers the following Certificate of Limited Liability Partnership:

FIRST: The name of the registered limited liability partnership is:

____.
(The name must contain one of the following: "Limited Liability Partnership", "L.L.P." or "LLP"; ß803-A.1)

SECOND: The name of its Registered Agent, an individual Maine resident or a corporation, foreign or domestic, authorized to do business or carry on activities in Maine, and the address of the registered office shall be:

____
(name)

____
(physical location - street (not P.O. Box), city, state and zip code)

____
(mailing address if different from above)

THIRD: The name and business, residence or mailing address of the contact partner is:

NAME	ADDRESS
____________________	______________________________

FOURTH: Other provisions of this certificate, if any, that the partners determine to include are set forth in Exhibit ____ attached hereto and made a part hereof.

FORM NO. MLLP-6 (1 of 2)

2. the address of the partnership's principal office;
3. the address of the registered office and the name and address of a registered agent for service of process if the address at the principal office is not located in the state;
4. the date of formation of the partnership;
5. a description of the partnership's business; and
6. other matters required by statute or that the partnership wishes to include.

By filing the registration statement, the partnership will remain a registered limited liability partnership and the partners will enjoy limitations on their individual liability until the partnership elects to withdraw its registration statement or the registration is revoked by the state for failing to pay fees or file required reports.

Several state statutes provide that the limited liability for registered limited liability partnerships is to be treated and interpreted the same as the shield of limited liability for

Exhibit 3–12.

(continued)

PARTNER(S)* **DATED** ______________________

______________________ (signature) ______________________ (type or print name)

______________________ (signature) ______________________ (type or print name)

______________________ (signature) ______________________ (type or print name)

For Partner(s) which are Entities

Name of Entity ______________________

By ______________________ (authorized signature) ______________________ (type or print name and capacity)

Name of Entity ______________________

By ______________________ (authorized signature) ______________________ (type or print name and capacity)

Name of Entity ______________________

By ______________________ (authorized signature) ______________________ (type or print name and capacity)

Acceptance of Appointment of Registered Agent

The undersigned hereby accepts the appointment as registered agent for the above-named limited liability partnership.

REGISTERED AGENT **DATED** ______________________

______________________ (signature) ______________________ (type or print name)

For Registered Agent which is a Corporation

Name of Corporation ______________________

By ______________________ (authorized signature) ______________________ (type or print name and capacity)

Note: If the **registered agent does not sign**, Form MLLP-18 (ß807.2) must accompany this document.

---

*Certificate **MUST** be signed by:
(1) one or more **partners** who are authorized **OR**
(2) any duly authorized person.
The execution of this certificate constitutes an oath or affirmation under the penalties of false swearing under Title 17-A, section 453.

Please remit your payment made payable to the Maine Secretary of State.

SUBMIT COMPLETED FORMS TO: CORPORATE EXAMINING SECTION, SECRETARY OF STATE,
101 STATE HOUSE STATION, AUGUSTA, ME 04333-0101
TEL. (207) 624-7740

FORM NO. MLLP-6 (2 of 2) Rev. 7-1-2003

corporations, including the application of corporate case law to determine the conditions and circumstances under which the limited liability veil can be pierced.[75]

To protect creditors, partners of a registered limited liability partnership are usually not entitled to receive distributions from the partnership unless the fair value of the partnership's assets exceed the liabilities of the partnership after giving effect to the distribution. Similarly, a partner is not entitled to receive a return of his or her capital contribution to the extent that a distribution reduces the partner's share of the fair value of the net assets below the value of the partner's undistributed contribution as of the date of the distribution. The consequence of these limitations is to require that the partnership retain enough assets in the business to be able to pay known creditors. Of course, if the partnership were to suffer a significant liability, such as from an unsuccessful lawsuit resulting from a defective product or negligence in providing a service, the victim may not be able to recover fully if the assets of the partnership

Exhibit 3–13.

Foreign Limited Liability Partnership Application (Utah)

State of Utah
DEPARTMENT OF COMMERCE
Division of Corporations & Commercial Code

Non-Refundable Processing Fee:
[ ] New Filing $22.00

Application for Foreign Limited Liability Partnership

Registration of this name does not guarantee exclusive right to disregard protection against unauthorized use of this name, (U.C.A. Section 48-1-42). When approved, your Limited Liability Partnership is registered for one (1) year. The last words of the name must be "Limited Liability Partnership" (LLP). An Original Certification of Fact or Good Standing from the Office of the Secretary of State, or other responsible Authority of the State in which the Limited Liability Partnership is formed, must accompany this application. Return fees with two (2) copies of this application.

1. Limited Liability Partnership name:________________________
(Name of Limited Liability Partnership in the Home State)
2. Is a Limited Liability Partnership registered in the U.S.? If so, list state:________________
3. Registered on the _____ day of _______________, ____.
4. Purpose of Limited Liability Partnership:________________________
5. Principal Address:________________________
Street Address Only City State Zip
6. Minimum 2 Partners:_____ 7. Phone Number:________________

8. Registered Agent: [ ] Check this box if the name on line 8 is the agent only.

Print Name of Registered Agent | Signature of Registered Agent | Daytime Phone Number

Utah
Street Address City Zip

Authorized Partner(s) ***attach additional pages if needed*****:**
Under penalties of perjury and as an authorized partner, I declare that this application, and if applicable, the statement of change of registered office and/or agent, has been examined by me and is, to the best of my knowledge and belief, true, correct, and complete.

Print Name Signature
Street Address City State Zip
Print Name Signature
Street Address City State Zip

The Limited Liability Partnership shall use as its name in Utah:________________________.
Must be the same as number (1) unless the name is not available in Utah.

Where to file: You may file in person, by mail or by fax. Means of payment are, cash, check or money order payable to the "State of Utah". Please include one (1) self addressed envelope with application. **If you are faxing you must include, on cover sheet, the number of a Visa or MasterCard with the date of expiration.**

Mail In: PO Box 146705
Salt Lake City, UT 84114-6705
Walk In: 160 East 300 South, Main Floor
Information Center: (801) 530-4849
Toll Free: (877) 526-3994 (within Utah)
Fax: (801) 530-6438
Web Site: http://www.commerce.utah.gov

Revised 09/02

Under GRAMA {63-2-201}, all registration information maintained by the Division is classified as public record. For confidentiality purposes, the business entity physical address may be provided rather than the residential or private address of any individual affiliated with the entity.

are inadequate to pay the liability. Even if the partnership has not made distributions to the partners, it may not have enough money to pay a large liability. The creditor is not allowed to pursue the personal assets of the individual partners, however, if the partnership has registered as a limited liability partnership.

The election to register as a limited liability partnership usually requires the unanimous consent of the general partners, unless the partnership agreement provides otherwise.

When a limited liability partnership seeks to do business in states other than where it is formed, it is usually necessary to register and qualify the partnership in the other states in which business is to be conducted. By registering locally, the partnership is giving notice to the citizens of the other states that it is a limited liability partnership. (See Exhibit 3–13, Foreign Limited Liability Partnership Application.)

States that permit the formation of a Limited Liability Partnership

Alabama
Alaska
Arizona
Arkansas
California
Colorado
Connecticut
Delaware
District of Columbia
Florida
Georgia
Hawaii
Idaho
Illinois
Indiana
Iowa
Kansas
Kentucky
Louisiana
Maine
Maryland
Massachusetts
Michigan
Minnesota
Mississippi
Missouri
Montana
Nebraska
Nevada
New Hampshire
New Jersey
New Mexico
New York
North Carolina
North Dakota
Ohio
Oklahoma
Oregon
Pennsylvania
Rhode Island
South Carolina
South Dakota
Tennessee
Texas
Utah
Virginia
Washington
West Virginia
Wisconsin

KEY TERMS

general partnership
partnership agreement
aggregate theory
entity theory
joint venture
capital contribution
tenancy in common
partition
tenancy in partnership
surviving partner
interest in partnership
assignment of interest
statement of partnership authority
statement of denial
fiduciary duty
net distributable profit
disproportionate allocation
marshaling of assets
indemnification
dissolution
dissociated partner
winding up
expulsion
wrongful dissolution
entity purchase plan
cross purchase plan
deferred dissolution
foreign partnership
articles of partnership
fiscal year
silent partners
earnings multiple formula
book value formula
limited liability partnership

WEB RESOURCES

The partnership agreement is the principal document required for the general partnership, and, to the extent that a limited liability partnership is desired, forms must be filed with a public filing officer, usually the Secretary of State, to register the limited liability partnership. Other issues in forming partnerships include the use of an assumed name, which will be registered in a public office, and licensing issues relating to professions and occupations upon which states have imposed licensing and regulatory requirements, such as law partnerships and medical practices.

Various sources exist for sample partnership agreements that may be tailored to the specific desires of the client. For example, partnership agreements can be found on the following sites:

<http://www.ilrg.com>
<http://www.law.com>
<http://www.lectlaw.com>
<http://www.legalwiz.com>
<http://www.findlaw.com>

Access to state laws regarding licensing and regulatory requirements may be obtained through the Legal Information Institute maintained at the Cornell Law School:

<http://www.law.cornell.edu>

The National Association of Secretaries of State maintains links directly to the offices of the Secretaries of State in all states. Most states requiring registration of limited liability partnerships provide forms for that purpose through the Secretary of State or Department of Commerce Web sites. These can be accessed through

<http://www.nass.org>

Tax forms, including the federal income tax returns and schedules, and the Classification of Entity tax elections may be accessed on line through

<http://www.irs.gov>

The Small Business Administration offers on-line information and assistance in forming, operating, and financing the activities of small partnerships:

<http://www.sba.gov>

Searching and locating trade names can be accomplished through various services offered on the Internet. Most of these services charge a fee for useful searches. They include

<http://www.tmexpress.com>
<http://www.trademark-search-services.com>

CASES

TARNAVSKY v. TARNAVSKY

147 F.3d 674
June 10, 1998
JOHN R. GIBSON, CIRCUIT JUDGE

I.

Before 1976, Mary Tarnavsky, with the help of her three sons, T. R., Morris, and Edward, controlled and operated a 2,840 acre ranch (Mary's ranch) in McKenzie County, North Dakota. Of these 2,840 acres, Mary individually owned 2,200 acres, Mary and Morris jointly owned 480 acres, and Edward owned 160 acres. In 1967, Mary, Morris, and T.R. jointly purchased 1,890 acres of adjoining land, referred to as the Christ place. Mary paid 50% of the purchase price as a down payment, and the parties assumed an existing contract for deed to the Christ place. T.R. and Morris opened a bank account, the Tarnavsky Brothers account, which was used to make payments on the Christ place contract for deed, to pay the Christ place property taxes, and to purchase cattle, equipment and related supplies and services under the partnership name. T.R. alleges that upon acquiring the Christ place, he and Morris orally agreed to form Tarnavsky Brothers partnership to operate the Christ place ranch with T.R. and Morris equally sharing the profits and losses of the partnership.

Since the acquisition of the Christ place in 1967, the parties have operated the entire 4,730 acres (the Christ place and Mary's ranch) as one unit, commingling cattle and farming operations. When cattle were sold, Mary received one-half the proceeds and T.R. and Morris received the other half. Grain proceeds were also distributed in this manner until 1973, the year Edward returned from college and began raising the grain on both ranches. At this point, Edward began receiving ten percent of grain proceeds, Mary received 45%, and Tarnavsky Brothers received 45%. On each of these occasions, Morris and T.R.'s share of the proceeds was deposited in the Tarnavsky Brothers bank account.

In 1980, Mary decided that she no longer wanted to receive proceeds from the sale of grain or cattle. Thereafter, Tarnavsky Brothers received 100% of the cattle proceeds, and 90% of the grain proceeds. Edward still did the farm work and received 10% of the grain proceeds.

Since 1967, Morris has worked full time on the ranch. In addition to handling other ranching responsibilities, Morris has been in charge of handling the livestock. Edward has worked full time on the ranch since he returned from college in 1973. Along with performing other tasks, Edward has been in charge of planting and harvesting grain on the ranch.

In 1967, T.R. lived in Bozeman, Montana, which is located about 500 miles from the ranch. In addition to occasionally working on the ranch, T.R. was in charge of bookkeeping. T.R. remained in Bozeman until 1977, when he and his wife moved to Sidney, Montana, which is about 75 miles from the ranch. At this point, T.R. spent more time working on the ranch, but the parties strongly dispute the amount of T.R.'s participation. In 1988, T.R.'s wife began to suffer severely from cancer. Thereafter, T.R. stopped being the "bookkeeper" and spent very little time working or participating in ranch activities.

After Mary's death in 1991, T.R. spent little or no time at the ranch. In March of 1992, Morris sent T.R. a Notice of Dissolution of Partnership. After attempts to settle the partners' accounts were unsuccessful, T.R. filed suit,

claiming he and Morris had a partnership and requesting an accounting and payment of his partnership assets. The district court concluded that Morris and T.R. were partners, and ordered judgment of $220,000 in favor of T.R.

II.

On appeal, Morris and Edward argue that the district court erred in concluding that a partnership existed between T.R. and Morris. The existence of a partnership is a mixed question of law and fact. *See Frankel v. Hillier,* 16 N.D. 387, 113 N.W. 1067, 1070 (1907). There is no challenge to the district court's factual findings, and the ultimate conclusion of whether a partnership existed is a question of law, which we review de novo. *See In Matter of Newman,* 875 F.2d 668, 670 (8th Cir.1989).

Under North Dakota law, a partnership is "an association of two or more persons to carry on as co-owners a business for profit. *Gangl v. Gangl,* 281 N.W.2d 574, 579 (N.D.1979); N.D.Cent.Code. 45-13-01(4) (1997). "The existence of a partnership is not governed by one conclusive criterion but by the facts and circumstances of each case." *See Gangl* 281 N.W.2d at 579. However, certain elements are critical to the existence of a partnership. *Id.* These elements are: (1) an intention to be partners; (2) co-ownership of the business; and (3) profit motive. *Id.*

* * *

Morris and T.R.'s intent to be partners is established by the evidence. Although not determinative, it is uncontradicted that T.R. and Morris reported their farming activities on state and federal partnership income tax returns for over twenty years. From 1967 through 1987, T.R. prepared the "Tarnavsky Brothers" partnership tax returns, which Morris signed, showing a 50/50 allocation of profit and losses to T.R. and Morris. When Morris took the "bookkeeping" over from T.R. in 1988, he had an accountant prepare the "Tarnavsky Brothers Ranch" partnership tax returns for 1988, 1989, and 1990, which continued to show a 50/50 allocation of profit and losses to T.R. and Morris. This is strong evidence of Morris and T.R.'s intent to be partners. In addition to filing Tarnavsky Brothers partnership returns, appellants concede that Morris and T.R. opened a joint bank account entitled Tarnavsky Brothers. From this account, they made the Christ place property payments, purchased cattle, seed, and related supplies. Appellants also concede that T.R. and Morris purchased cattle and equipment and borrowed money under the name Tarnavsky Brothers. Furthermore, T.R. and Morris jointly engaged in a cow share arrangement with another farmer, and later jointly purchased his share of the calves. These actions by Morris and T.R. evidence their intent to be partners.

Co-ownership, the second element necessary for a partnership, includes the sharing of profits and losses as well as the power of control in the management of the business. *See Gangl* 281 N.W.2d at 580.

Morris and Edward argue that T.R. and Morris did not "share" profits because neither party took profit distributions from the Tarnavsky Brothers account. This argument is without merit. It is undisputed that after completing a sale of cattle or grain, the brothers would deposit their share of the income in their joint account. From this account, the brothers jointly paid expenses and used the remaining money (the profit) to purchase machinery, cattle, and make land payments on the Christ place property. Any remaining profit stayed in the joint ac count, accumulating over time. Although the money was not distributed, jointly purchasing land and machinery with profits is a form of profit sharing. *See Gangl,* 281 N.W.2d at 579. Further evidence that the brothers shared profits is that at the end of each year, Morris and T.R. would allocate the year's profits on the partnership income tax return equally between themselves, with each party being liable for his share of profits on his personal income tax return. This sharing of profits is further evidence that Morris and T.R. were partners. *See* N.D. Cent.Code § 45-14-02(3)(c) (Supp.1997).

Morris and Edward also argue that Morris and T.R. did not have the power of control over the management of the business. They argue that the Christ place was melded into the overall operation of the family ranch subject to Mary's control, and that the power to make decisions and to distribute income rested solely with Mary, and not with T.R. or Morris. This argument is also without merit.

Appellants concede that from the beginning purchase of the Christ place Morris and T.R. opened a joint bank account, took out joint partnership loans, and jointly purchased cattle and machinery in the partnership name. Appellants also admit in their brief that both Morris and T.R. were involved in working with banks to secure loans for cattle and equipment purchases, and that both T.R. and Morris handled "marketing the cattle" and performed various administrative functions, such as the discussion of rations. Furthermore, appellants state in their brief that Morris was "in charge" of livestock production and "administered" equipment purchases, and that T.R. was "in charge" of paperwork and finances. This is strong evidence that T.R. and Morris both had the power of control over management of the business. The argument that Mary controlled all business decisions is even less forceful for the period after 1980, when Mary's involvement in the ranch diminished, and all proceeds from grain and cattle were distributed either to the Tarnavsky Brothers account or the Tarnavsky Ranch account. Appellants make numerous arguments that any authority Morris and T.R. appeared to have was purely illusory, granted to T.R. and Morris by Mary so that Mary could accomplish certain objectives. These arguments were rejected by the district court. Although Mary may have been the lead figure in the "com-

mingled" ranching operation until 1980, ample evidence illustrates that Morris and T.R. had the power to control business decisions relating to Tarnavsky Brothers partnership. Control, when combined with profit sharing, strongly suggests the evidence of a partnership. *See Gangl,* 281 N.W.2d at 580.

The final critical element of a partnership is profit motive, and there is no dispute that the farming business was operated with such motive.

We thus conclude that the district court's findings and the uncontested facts recited by appellants are sufficient to support a finding of the three critical elements necessary for the existence of a partnership. These facts, considered together, amply support the districts court's conclusion that T.R. and Morris were partners, and the district court did not err in so holding.

MACARTHUR COMPANY v. STEIN

282 Mont. 85, 934 P.2d 214
March 25, 1997
TRIEWEILER, JUSTICE

FACTUAL BACKGROUND

Karl Stein has operated Midland Roofing in Billings since 1974. Prior to July 1991, Midland Roofing was a sole proprietorship owned solely by Stein.

In the summer of 1991, several hail storms occurred in the Billings area. As a result, the demand for roofing services increased significantly in the late summer and fall of 1991. Stein recognized an opportunity to increase his profits because of the sudden demand for roofing services. He sought to take advantage of the business opportunity by seeking a line of credit at a local financial institution, but was unable to secure financing.

John L. Potter and Jesse Beebe approached Stein in late June or early July 1991 with the idea of expanding Stein's business to take advantage of the increase in roofing demand. Both Potter and Beebe were out-of-state businessmen who engaged in "storm tracking"—the business of traveling to areas where there was increased roofing activity due to storm damage. In early negotiations, Potter asserted that he could handle the general operation of a roofing business and that a third party, Bill Evans, could handle sales and material acquisition. In addition, Beebe represented that he had the ability to secure credit for the expanded business.

In early July, the parties entered into an agreement, some of which was in writing and some of which was not, but which was confirmed by subsequent actions of the parties. Pursuant to the agreement, Stein, Beebe, and Potter agreed to create a new entity which would operate under the name of Midland Roofing and Gutters. The parties expressly intended that the business name would be so similar to Stein's business name, Midland Roofing, that the public and customers would be unable to distinguish between the two businesses. In addition, both Midland Roofing and the new entity, Midland Roofing and Gutters, were to use the same telephone number and all calls to that number were to be answered by employees of Midland Roofing and Gutters. The parties agreed that a record would be made of all telephone calls and that Stein would be given a first right to accept any potential roofing job. Midland Roofing and Gutters had the option to complete any other jobs.

As part of the parties' initial written agreement, Stein's compensation was equal to three percent of total gross charges for all "nail-on roofing" jobs and ten percent of gross charges for "hot roofing" jobs performed by Midland Roofing and Gutters. Midland Roofing and Gutters also agreed to pay one of Stein's employees a portion of his salary for inspection work and to set aside $.50 per roofing square to be set up in a two-signature account, which would bear the signatures of Stein and Beebe, to cover any warranty work necessary after Midland Roofing and Gutters ceased operation.

In August 1991, Jesse Beebe arranged a line of credit for Midland Roofing and Gutters from MacArthur Company. Stein had previously been denied credit by the company. His purchases from MacArthur were on a "cash only" basis. On the credit application, Beebe listed Midland Roofing and Gutters as the company seeking credit, and named himself as the "principal or officer." Neither Stein nor Midland Roofing was mentioned on the credit application, and MacArthur was not advised of Stein's association with Midland Roofing and Gutters. Based solely on Beebe's credit references, MacArthur granted Midland Roofing and Gutters a line of credit and supplied the company with materials from August 1991 through January 1992.

In January 1992, Jesse Beebe, John Potter, and Bill Evans departed the Billings area without notice, and left an unpaid balance to MacArthur Company in the amount of $39,75.27. On May 12, 1994, MacArthur Company filed a complaint in the Thirteenth Judicial District Court in Yellowstone County against Karl Stein, Midland Roofing, Midland Roofing and Gutters, and John Does 1 and 2. MacArthur alleged that each of the defendants, as partners in Midland Roofing and Gutters,

was jointly and severally liable for the outstanding debt to MacArthur.

Following a hearing on January 11, 1995, the District Court concluded that Stein was a partner of Midland Roofing and Gutters at the time the debt to MacArthur was incurred. The District Court therefore concluded that, pursuant § 35-10-307, MCA, Stein was "jointly liable for all . . . debts and obligations of the partnership." Based on its conclusions, the court ordered Stein to pay $39,875.27, plus interest and attorney fees, for the debt owed to MacArthur by Midland Roofing and Gutters.

DISCUSSION

Section 35-10-201(1), MCA (1991), defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit." Section 35-10-202, MCA (1991), provides:

In determining whether a partnership exists, these rules shall apply:

> (1) Except as provided by 35-10-308 persons who are not partners as to each other are not partners as to third persons.
>
> (2) Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not itself establish a partnership, whether such co-owners do or do not share any profits made by the use of the property.
>
> (3) The sharing of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived.
>
> (4) The receipt by a person of a share of the profits of a business is prima facie evidence that such person is a partner in the business, but no such inference shall be drawn if such profits were received in payment:
>
> (a) as a debt by installments or otherwise;
>
> (b) as wages of an employee or rent to a landlord;
>
> (c) as an annuity to a surviving spouse or representative of a deceased partner;
>
> (d) as interest on a loan, though the amount of payment varies with the profits of the business;
>
> (e) as the consideration for the sale of a goodwill of a business or other property by installments or otherwise.

This Court established the elements for the determination of the existence of a partnership in *Bender v. Bender* (1965), 144 Mont. 470, 480, 397 P.2d 957, 962; (1) the parties must clearly manifest their intent to associate themselves as a partnership; (2) each party must contribute something that promotes the enterprise; (3) each party must have a right of mutual control over the subject matter of the enterprise; and (4) the parties must agree to share the profits of the enterprise. We have consistently held that each of the four *Bender* requirements must be established in order to prove the existence of a partnership. [Citations omitted].

In this case, the District Court analyzed the alleged partnership of Stein, Beebe, Potter, and Evans pursuant to both § 35-10-202, MCA (1991), and the elements of partnership set forth in *Bender.* The court found that the parties' actions and conduct were sufficient to establish their intent to associate themselves as a partnership. In addition, the court found that each party had contributed something that promoted Midland Roofing and Gutters, that each had a joint proprietary interest and a right of mutual control over the enterprise, and that each had received a share of the profits of the enterprise. Based on its findings, the court concluded that Stein, Beebe, Potter, and Evans had created a partnership and that that partnership was in existence at the time the debt to MacArthur Company was incurred. The court therefore concluded that, as a partner in Midland Roofing and Gutters, Stein was liable "jointly for all . . . debts and obligations of the partnership," pursuant to § 35-10-307, MCA (1991).

The initial test for the determination of whether a partnership exists is the intent of the parties, *Antonick,* 236 Mont. at 284, 769 P.2d at 1242. At trial, Stein testified that he did not intend to create a partnership through his negotiations with Beebe and Potter. However, as this Court noted in *Truck Insurance Exchange v. Industrial Indemnity Co.* (1984), 212 Mont. 297, 300, 688 P.2d 1243, 1244-45:

> [I]f the facts bring the arrangement within the definition of a partnership, the parties cannot escape liability incident to that relationship merely by saying that no such thing exists. If the intended action of the parties creates a partnership in fact, what the parties call their arrangement or intend their arrangement to be is irrelevant.

(Citation omitted.) Therefore, where intent cannot be directly ascertained, it must be established from all the facts, circumstances, actions, and conduct of the parties. *Antonick, 236 Mont. at 284, 769 P.2d at 1242. In this case, then, it is not necessary that Stein intended to be a partner in Midland Roofing and Gutters; it is only necessary that he intended his actions and that his actions created a partnership in fact.*

In this case, the District Court found that, regardless of Stein's intentions, the parties had created a partnership in fact through their actions and conduct. Specifically, the court found that the remaining three elements *Bender*—contribution, joint interest and control, and the right to share profits—had been proven and were indicative of the parties' intent to establish a partnership.

Pursuant to *Bender,* in addition to the requirement of intent, each of the purported partners must contribute something that promotes the enterprise. *Bender,* 144 Mont. at 480, 397 P.2d at 962. In this case, the District Court found that each of the parties had made a contribution to Midland Roofing and Gutters sufficient to indicate the cre-

ation of a partnership. Specifically, the court found that Stein had contributed to Midland Roofing and Gutters the name of his business, his business license, and his goodwill in the community. In addition, the court noted that Stein had agreed to warrant work completed by Midland Roofing and Gutters. The other parties, the court found, had contributed roofing skills, start-up revenue, and sales skills. Based on the substantial contributions of each of the parties, the District Court found that the elements of contribution had been established.

The uncontroverted evidence at trial established that Stein lent his business name, his telephone number, his business leads, his good will, his business license, and his expertise to Midland Roofing and Gutters. We hold that such contribution was promotive of the enterprise of Midland Roofing and Gutters. We therefore conclude that the District Court's finding that the element of contribution had been established is supported by substantial, credible evidence and is not clearly erroneous.

A further requirement of *Bender* is that each party to an enterprise have a joint proprietary interest in, and right of control over the subject matter of the enterprise. *Bender,* 144 Mont. at 480, 397 P.2d at 962. In this case, the District Court found that Stein did have such interest and control. Specifically, the court found that, pursuant to the parties' agreement, Stein had the right to exercise quality control over the work performed by Midland Roofing and Gutters and, after inspection, could have required that the work conform with his standards. In addition, the court found that Stein had agreed to perform future warranty work for Midland Roofing and Gutters and had established a joint account for the payment for that work. Finally, the court found that Stein had reserved the right to discontinue the parties' arrangement and prohibit Midland Roofing and Gutters from using his telephone number and business license. Although the court noted that Stein did not specifically hire the employees of Midland Roofing and Gutters or arrange for their work schedule or payment, the court found that "there are sufficient indices of control and proprietary interest to determine that he was in fact a partner."

In addition to the District Court's specific findings regarding Stein's proprietary interest and right of control, the record reflects that Stein was involved in the oversight of the day-to-day workings of Midland Roofing and Gutters. Stein testified at trial that he visited Midland Roofing and Gutter job sites and gave advice on local building code requirements. In addition, Stein testified that he was in the offices of Midland Roofing and Gutters on a daily basis and answered the phones for that entity. Moreover, the evidence presented at trial established that Stein and Midland Roofing and Gutters worked together to contact the general public. This evidence was clearly indicative of Stein's interest in and control of Midland Roofing and Gutters. We therefore hold that the District Court's finding of Stein's right of mutual control and joint proprietary interest is supported by substantial credible evidence and is not clearly erroneous.

The final element of *Bender* requires that there must be an agreement to share profits in order to establish a partnership. *Bender,* 144 Mont. at 480, 397 P.2d at 962. In this case, the District Court found that Stein was entitled to receive a percentage of Midland Roofing and Gutters' profit. Specifically, the court noted that both the written agreement formalizing the parties' arrangement and its subsequent modification entitled Stein to a percentage of the gross revenue on all work done by Midland Roofing and Gutters. In addition, the court noted that, according to testimony at trial, Stein earned between $75,000 and $92,000 in both cash and materials from his agreement with Midland Roofing and Gutters. As the District Court correctly stated, "[t]he receipt by a person of a share of the profits of a business is prima facie evidence that such person is a partner in the business." Section 35-10-202(4), MCA (1991). Based on the evidence at the trial, which clearly established that Stein was entitled to share the profits of Midland Roofing and Gutters, we hold that the District Court's finding that the final element of *Bender* had been satisfied is not clearly erroneous.

Because we uphold the District Court's findings regarding the establishment of the four elements of a partnership, we hold that the court's conclusion that Stein, Beebe, Potter, and Evans had created a partnership is correct. The only remaining question, then, is whether Stein is liable, as a partner, for Midland Roofing and Gutters' debt to MacArthur Company.

Section 35-10-307(2), MCA (1991), provides that "[a]ll partners are liable . . . jointly for all . . . debts and obligations of the partnership." In this case, because we hold that Stein was a partner in Midland Roofing and Gutters, we further conclude he was jointly liable for the partnership's debt to MacArthur Company. We do not address the issue of whether that makes him individually liable for the entire partnership debt because that issue has been neither raised nor briefed by the parties. Furthermore, we reject Stein's contention that he is not liable to MacArthur because MacArthur was not aware of his relationship with Midland Roofing and Gutters when it extended credit to the company. Reliance is an element of partnership by estoppel; it is not necessary to the establishment of liability of a partner in fact. Therefore, we hold that the District Court was correct in its conclusion that, pursuant to § 35-10-307, MCA (1991), Stein was jointly liable for the partnership's debt to MacArthur Company.

We affirm the judgment of the District Court.

IN RE ESTATE OF JOHNSON

129 Ill.App.3d 22, 472 N.E.2d 72 (Ill.App. 1984)
TRAPP, JUSTICE

In 1942, Edmund Johnson and his brother, Wendell, became partners in a business known as Johnson & Johnson, which previously had been operated by their uncle. The partnership handled insurance, real estate, and a loan business. In 1943, the brothers reduced their partnership agreement to writing. [Article XII of the agreement, as amended, stated:

> "Upon the death of either partner, all interest of the deceased partner shall immediately be and become property of the surviving partner, and the surviving partner shall have the right to continue to operate the business as a sole proprietorship under the partnership name. In lieu of said partnership interest, the surviving partner shall be and he is hereby obligated to pay to the estate of the deceased partner the sum of $10,000 plus the amount, if any, payable to the deceased Partner, as shown by all ledger sheets for accounts of said deceased Partner with the partnership. Said payment shall be in full satisfaction for the interest of the deceased partner in the partnership business, property, and assets, and in full of all demands by the estate of said deceased partner, his executors, administrators, heirs, devisees, legatees, successors, or assigns.
>
> It is agreed that payment of said sum shall be an accounting in full to the executor or administrator of the estate of the deceased partner, for all interest of said deceased partner, and the surviving partner shall be relieved of any obligation for filing an inventory of the assets of the partnership in the Probate Court in which Letters are issued on the estate of the deceased partner."]

* * *

Besides the partnership business, both brothers maintained individual business interests. Edmund had a separate life insurance, appraisal, and income tax business. While he reported income from this business on his individual tax returns rather than partnership returns, records for the separate business were kept on the partnership ledgers. Wendell had comparable accounts kept on the partnership ledgers.

Edmund died on May 6, 1980, and was survived by his wife, Lois, and son, Steven. In accordance with his will, George Bauer and Wendell became the executors of Edmund's estate. Wendell paid the estate $10,000 plus an additional $20,963.60 for Edmund's individual business and partnership interests.

* * *

Defendants contend the trial court erred in holding that payment of $10,000 was sufficient to purchase the entire value of Edmund's interest in the partnership. They point out that Wendell received the entire good will of the business because he can continue to operate it under the name Johnson & Johnson. There is no valid reason, however, why partners cannot contract to transfer one partner's interest to the other for a set price, especially where no lack of mutuality or unconscionable conduct is present. (*In re Estate of Streck* (1962), 35 Ill.App.2d 473, 480, 183 N.E.2d 26, 30-31.) Partners may also provide by contract for the continuation of the business along with the purchase of the deceased partner's interests. *Keller v. Keller* (1972), 4 Ill.App.3d 89, 280 N.E.2d 281.

A partnership is controlled by the terms of the agreement under which it is formed. (*Harmon v. Martin* (1947), 395 Ill. 595, 612-13, 71 N.E.2d 74, 83.) Because a partnership is a contractual relationship, the principles of contract law fully apply to it. (*Allen v. Amber Manor Apartments Partnership* (1981), 95 Ill.App.3d 541, 549, 51 Ill.Dec. 26, 32, 420 N.E.2d 440, 446.) In construing an agreement, the court's primary objective is to ascertain the intent of the parties as evidenced by the language used. If the terms are unambiguous, then the intent of the parties must be ascertained solely from the words used; the agreement is not rendered ambiguous simply because the parties fail to agree upon its meaning. *Schoeneweis v. Herrin* (1982), 110 Ill.App.3d 800, 806, 66 Ill.Dec. 513, 518, 443 N.E.2d 36, 41.

The issue, therefore, is whether the partnership agreement is ambiguous. Ambiguity is a question of law for the court to decide. *URS Corp. v. Ash* (1981), 101 Ill. App.3d 229, 233, 56 Ill.Dec. 749, 753, 427 N.E.2d 1295, 1299.

Defendants assert article XII of the partnership agreement is ambiguous. Specifically, they contend the phrase "plus the amount, if any, payable to the deceased Partner, as shown by all ledger sheets for accounts of said deceased Partner with the partnership" creates an ambiguity. Defendants give conflicting interpretations to the phrase. At trial and in their briefs, they contended the brothers had intended to require the surviving partner to pay the deceased's estate $10,000 plus the value of the deceased's interest in the partnership, including the value of good will. At oral argument, they maintain the $10,000 represented payment for good will, but the survivor still had to pay for the deceased's capital interest in the partnership.

Plaintiffs contend the phrase plainly refers to accounts of the partners' individual business interests which were kept on the partnership books. They argue the agreement does not call for valuation of partnership assets, and the $10,000 fixed sum represents an easily ascertainable amount that allows the survivor to continue to operate the business.

Defendants first point to the third sentence in article XII, which says that surviving partner's payment shall be in full satisfaction of the deceased's interest in the partnership business. They conclude the payment is

only for the partnership interest and cannot include nonpartnership interest. Besides being in full satisfaction of a partner's interest in the partnership, however, the third sentence also states the payment shall be "in full of all demands by the estate of said deceased partner." This would include nonpartnership interest kept on the partnership books.

Defendants contend other articles of the agreement establish the partners' intent to require the survivor to pay the entire value of the deceased's partnership interest. Article X states:

> "Before either partner shall sell his interest in the partnership, the same shall be offered to the other partner or member of the firm, at the price the partner expects to sell his interest, and the other partner given a chance to purchase the same before any sale is made to an outsider."

Therefore, a partner had to pay the market value of the other's interest to buy him out during his lifetime. Defendants assert the same price should be paid at a sale caused by a partner's death. They conclude, therefore, the $10,000 figure is a minimum, not a fixed, price. Article X, however, was included in the original agreement. Under that agreement, a partner could purchase the deceased partner's interest for a flat sum. The brothers clearly differentiated between an *inter vivos* sale and a sale after a partner's death. The price for each sale was not to be calculated in an identical manner as defendants suggest.

* * *

Finally, defendants argue the $10,000 represents a fixed sum for the value of good will only. They maintain the phrase "accounts of said deceased partner" refers to the partner's share of the partnership capital. The partnership ledger sheets, however, could not show the firm's capital as payable to a deceased partner. Capital is partnership property, and thus it belongs to the partnership, not the individual partners. (*People v. Zangain* (1921), 301 Ill. 299, 304, 133 N.E. 783, 785.) A partner's interest in the partnership is his share of the profits and surplus. (Ill.Rev.Stat.1981, ch. 106 1/2, par. 26.) Capital, therefore, is payable only to the partnership, not to the individual partners.

The partnership agreement is not ambiguous. Article XII refers to accounts of the deceased partner with the partnership and not to partnership accounts. Although evidence extraneous to the agreement is necessary to determine the value of these accounts, the agreement clearly refers to accounts of a partner's individual business interests. Defendants are in effect asking for the payment of $10,000 plus one-half of the value of the partnership. To determine the value of the partnership, they desire an accounting of the partnership assets. Yet the second paragraph of article XII states the survivor is relieved of any obligation to account for the partnership assets. Rather, the partners intended the surviving partner to purchase the deceased's partnership interest for a flat sum of $10,000.

* * *

PROBLEMS

1. Under the Revised Uniform Partnership Act (in Appendix D), what are the elements of a partnership?
2. What is the difference between the "aggregate" theory and the "entity" theory in partnerships, and what difference does the use of one or the other make as a practical matter?
3. A has contributed $100,000 to a partnership; B has contributed $30,000 to the partnership; and C has contributed services in running the partnership business. There is no written agreement for the partnership, but the parties have agreed to run the business together. Answer the following questions:
   a. How are profits of the business shared?
   b. How are decisions made?
   c. How are losses of the business shared?
   d. What happens to the business if C dies?
   e. If the business is liquidated and $200,000 in assets remain after all creditors are paid, what distributions will be made to A, B, and C?
   f. How much is C entitled to be paid for the services rendered to the business?
   g. If B withdraws from the partnership when the business owes its creditors $50,000, for how much will B be personally liable?
   h. If D joins the partnership when the business owes its creditors $50,000, for how much will D be personally liable?
4. Name the three types of property typically associated with a partnership business. Describe what each type of property includes and explain how that property or the rights to that property may be transferred in the absence of any agreement.
5. State the differences, if any, between a partnership, a joint venture, and a sole proprietorship.

PRACTICE ASSIGNMENTS

1. Review your local statutes and find the law of partnerships. Compare the Revised Uniform Partnership Act (in Appendix D), with your local law and describe how your state's partnership rules vary from the uniform act.
2. A partnership agreement among A, B, C, D, E, and F was entered into on January 19, 2004, for a business to be known as "The Long Branch Investments." The location of the partnership's principal place of business is 1234 Main Street, Deadwood, South Dakota. In addition, the partnership will be carrying on certain activities in Houston, Texas. Prepare the appropriate documents to register the partnership's name.
3. Kathryn Blue, Pamela Owen, and Tory Church are opening an apparel store for high fashion clothing. Each partner will contribute $50,000 in cash and will work in the store. All partners want to be involved in major decisions. They are willing to share everything equally, but if one partner loans money to the business, they want the loan to be repaid before any profits are distributed. If a partner dies, is disabled, withdraws, or files for bankruptcy, the other partners want to be able to purchase that partner's interest for a fair value and continue the business. The address of the partnership will be 8383 South Michigan Avenue, Chicago, Illinois. The name of the partnership will be "Blowtorch."

   a. List the additional issues you would like to discuss with, and facts you would need to know from, Kathryn, Pamela, and Tory to be able to prepare their agreement based upon the sample form, Form I-1, in Appendix I.

   b. Prepare a partnership agreement, using answers and facts you have assumed in (a), by tailoring the sample form, in Exhibit I-1, in Appendix I.
4. Jerry Jones, Kevin Burr, and Bill Schmatz are accountants and are partners in a partnership formed under the Uniform Partnership Act for their accounting practice, called "Jones, Burr and Schmatz, CPAs." Bill has lost his license to practice accounting because of tax fraud, and Jerry and Kevin intend to expel him from the partnership. Prepare the forms necessary or desirable to expel Bill from the partnership and to give notice of the dissolution of the partnership to the firm's creditors.

ENDNOTES

1. For general discussions of the law of agency and partnerships, see J.W. Callison, Partnership Law and Practice §§ 1.01, 1.02 (1992); J. Crane and A. Bromberg, Law of Partnership §§ 2, 49-56, 68-72 (1968); W. Seavey, Agency §§ 10A, 14A, 59 (1964); Chapter 1 of this volume.

2. 6 U.L.A. 1 (1969 and Supp. 1980). The Uniform Partnership Act (hereafter cited as U.P.A.) has not been adopted in Georgia and Louisiana.

3. Revised Uniform Partnership Act (R.U.P.A.) § 201.

4. U.P.A. § 6(1).

5. R.U.P.A. § 202(a).

6. Model Business Corporation Act (hereafter cited as M.B.C.A.) § 3.02(9).

7. U.P.A. § 18(a), (e).

8. U.P.A. § 2; R.U.P.A. § 101(1).

9. U.P.A. § 8(2).

10. See "Tax Considerations of a General Partnership" later in this chapter.

11. R.U.P.A. § 204 provides greater statutory clarity on the determination of property as partnership property:

WHEN PROPERTY IS PARTNERSHIP PROPERTY.

(a) Property is partnership property if acquired:

(1) in the name of the partnership; or

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

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

(1) the partnership in its name; or

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

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

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

12. U.P.A. § 25.

13. R.U.P.A. § 203 provides that partnership property is owned by the partnership, rather than by the individual partners, which avoids the paradox found in the concept of "tenancy in partnership," which makes the partners nominal owners of partnership property but effectively negates the partners' ownership rights.

14. R.U.P.A. § 401(a) accomplishes these computations by requiring capital and income accounts to account for a partner's share of assets and profits. The section provides:

(a) A partnership shall establish an account for each partner which must be credited with an amount equal to the cash plus the value of any other property, net of the amount of any liabilities, the partner contributes to the partnership and the partner's share of the partner-

ship profits. Each partner's account must be charged with an amount equal to the cash plus the value of any other property, net of the amount of any liabilities, distributed by the partnership to the partner and the partner's share of the partnership losses.

15. U.P.A. § 27.

16. U.P.A. § 18(g); R.U.P.A. § 401(i).

17. See R.U.P.A. § 503.

18. U.P.A. § 18(e); R.U.P.A. § 401(f).

19. R.U.P.A. § 301(1).

20. U.P.A. § 18(h); R.U.P.A. § 401(j).

21. R.U.P.A. § 303.

22. R.U.P.A. § 304.

23. U.P.A. § 18(f); R.U.P.A. § 401(h).

24. Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545, 546 (1928).

25. See J. W. Callison, Partnership Law and Practice § 12.01 (1997).

26. R.U.P.A. § 404.

27. R.U.P.A. § 103(b).

28. U.P.A. § 18(a); R.U.P.A. § 401.

29. Partnership taxation is *pass-through* taxation, which means that each individual partner is taxed on the partner's pro rata share of each item of profit, loss, deductions, and credits. See "Tax Considerations of a General Partnership" later in this chapter.

30. Internal Revenue Code of 1986, 26 U.S.C.A. § 704(b). The regulations under section 704(b) of the code (adopted before the Tax Reform Act of 1976) outline several relevant considerations in making a determination in regard to whether a special allocation will be recognized for federal income tax purposes. Among these factors are (1) the presence of a business purpose for the allocation; (2) whether related items of income, gain, loss, deduction, or credit from the same source are subject to the same allocation; (3) whether the allocation was made without recognition of normal business factors; (4) whether it was made only after the amount of the specially allocated items could reasonably be estimated; (5) the duration of the allocation; and (6) the overall tax consequences of the allocation.

31. General partners are jointly and severally liable for damages caused by any tort or breach of trust committed by a partner within the scope of the partnership business. They are jointly liable for all other partnership obligations. U.P.A. § 15. Under R.U.P.A. § 306, all liability of partners is joint and several, and that change eliminates the creditors' efforts of finding and suing all partners for joint liability. Nevertheless, R.U.P.A. § 307(d) prevents execution of the assets of a partner to satisfy a judgment based upon a partnership claim without first levying unsuccessfully against the partnership assets. This rule is called an "exhaustion" rule: individual partners are protected from personal liability until after firm assets have been "exhausted" to pay creditors.

32. U.P.A. § 18(b); R.U.P.A. § 401(c).

33. U.P.A. § 36(1).

34. See "Dissolution and Termination of a Partnership" later in this chapter.

35. U.P.A. § 35(1)(b).

36. R.U.P.A. § 703.

37. R.U.P.A. §§ 303(e), 703(b), 704.

38. U.P.A. § 17; R.U.P.A. § 309.

39. R.U.P.A. § 701. The "buyout" price under R.U.P.A. § 701(b) is the amount that would have been distributable to the dissociating partner if the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based upon a sale of the entire business as a going concern without the dissociated partner and the partnership were wound up as of that date. In either case, the sale price of the partnership assets must be determined on the basis of the amount that would be paid by a willing buyer to a willing seller, neither being under any compulsion to buy or sell, and with knowledge of all relevant facts. Damages caused by the dissociating partner can be offset against the buyout price. R.U.P.A. § 701(c).

40. U.P.A. § 31(1)(a).

41. U.P.A. § 31(1)(c). The R.U.P.A. similarly provides for dissolution and winding up by the "express will of all the partners." R.U.P.A. § 801(2)(ii).

42. U.P.A. § 31(1)(b)(2).

43. U.P.A. § 31(3), (4), (5).

44. U.P.A. §§ 31(6), 32. The R.U.P.A. provides, in section 801(5) and (6), that a partnership may be dissolved by a court under the following circumstances:

a. The economic purpose of the partnership is likely to be unreasonably frustrated;

b. Another partner has engaged in conduct relating to the partnership business that makes it not reasonably practicable to carry on the business in partnership with that partner;

c. It is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement;

d. On the application by a transferee of a partner's transferable interest, whenever it is equitable to wind up the partnership business.

45. U.P.A. § 38(1).

46. U.P.A. § 38(2)(b). A dissociated partner is also entitled to indemnification from the continuing partnership under the R.U.P.A. for all liabilities incurred before the dissociation, except liabilities unknown to the partnership, and against all liabilities incurred after the dissociation, except liabilities caused by the dissociated partner. R.U.P.A. § 701(c).

47. See J. W. Callison, Partnership Law and Practice § 15.42 (1997).

48. Other examples of liquidating distributions may be found in article V, sections C and D, of the Complex Partnership Agreement, Form I-1, in Appendix I.

49. See also "Share Transfer Restrictions and Buyout Agreements" in Chapter 13.

50. See also "Trade Secret Protection" and "Covenants Not to Compete" in Chapter 11.

51. R.U.P.A. § 802.

52. R.U.P.A. § 802(c).

53. U.P.A. § 33; R.U.P.A. § 805.

54. U.P.A. § 50. The R.U.P.A. makes the distributions to partners more understandable by providing for "settlement of accounts" in R.U.P.A. § 808. The priority of distributions in that section provides:

a. Payments to discharge partnership obligations to creditors, including partners who are creditors;

b. Payment *to* the partners for any positive balances in their capital and income accounts (after allocating profits and losses resulting from the liquidation of assets); and

c. Payments *from* the partners who have a negative balance in their capital and income accounts (after allocating profits and losses resulting from the liquidation of assets).

55. Treas. Reg. § 301-7701-1 through 7701-8.

56. Internal Revenue Code of 1986, 26 U.S.C.A. § 704(c) (2).

57. Internal Revenue Code of 1986, 26 U.S.C.A. § 704(c).

58. See, e.g., J. W. Callison, Partnership Law and Practice §§ 4.01-.29 (1997).

59. Examples of trade name affidavits and certificates appear as forms in Chapter 2.

60. See "Formation and Operation of a Sole Proprietorship" in Chapter 2.

61. The qualification of a *foreign partnership* is patterned after the requirements for qualification of foreign corporations, discussed in Chapter 14.

62. Other helpful references include J. W. Callison, Partnership Law and Practice (1992); and M. Volz, C. Trower, and D. Reiss, The Drafting of Partnership Agreements, American Law Institute (1986).

63. See "Profits and Losses" earlier in this chapter.

64. See "Management of a Partnership" earlier in this chapter.

65. See “Management of a Partnership” earlier in this chapter.

66. See “Management of a Partnership” earlier in this chapter.

67. See “Partner’s Interest in a Partnership” earlier in this chapter.

68. See “Partnership Property” earlier in this chapter.

69. See “Dissolution and Termination of a Partnership” earlier in this chapter.

70. See “Covenants Not to Compete” in Chapter 12.

71. See “Dissolution and Termination of a Partnership” earlier in this chapter.

72. See also “Share Transfer Restrictions and Buyout Agreements” in Chapter 13.

73. See “Dissolution and Termination of a Partnership” earlier in this chapter.

74. See Me. Rev. Stat. Ann § 31-804.2; Colo. Rev. Stat. §§ 7-60-102(7) and 7-60-144.

75. See Colo. Rev. Stat. § 7-60-153.