Chapter 15

General Partnerships, Joint Ventures, Limited Partnerships and Limited Liability Companies

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Chapter 15

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15.1 General Partnerships And Joint Ventures

15.1.1 Existence of Partnership

***Dean v. Manus Homes, Inc.*, 546 S.E.2d 160 (N.C. Ct. App. 2001)**

Plaintiff filed suit against the defendant, claiming breach of the partnership agreement and requesting an accounting and dissolution of the partnership. The defendants denied the existence of a partnership in their answer, but in a counterclaim, they sought an accounting and the payment of one-half of the plaintiff's profits. The court found that a partnership can be formed orally or it can be implied by the parties' conduct. In this case, there was a letter that discussed plaintiff's duties under their agreement. The letter also stated that the parties were going to share profits. The court found that the sharing of profits was prima facie evidence that a partnership existed. The court also found that the defendants, through their counterclaim, were seeking a partnership remedy.

***Butler v. Sudderth*, 784 So.2d 125 (La. Ct. App. 2001), writ denied, 99 So.2d 125 (La. 2001)**

The plaintiff brought this malpractice suit against Dr. Sudderth. The plaintiff appealed a judgment that dismissed other doctors who plaintiff alleged were partners with Dr. Sudderth. The court affirmed the lower court's holding because the doctors did not share their income or the expenses of their individual practices and, as a result, there was no partnership among them.

***Harrell Oil Co. of Mount Airy v. Case*, 543 S.E.2d 522 (N.C. Ct. App. 2001)**

The defendants argued that they were not operating their business as a partnership. Although there was no express agreement to share profits or losses, the court found that there was a partnership because the defendants deposited the proceeds from the sale of the business into their own personal checking account.

***Wood v. Phillips*, 2001 WL 1637293 (Ala. 2001)**

Phillips, the owner of an FM radio station in Alabama, sued Wood, his FCC attorney in Washington, alleging the existence of a partnership between Wood and Phillips with respect to the ownership of two other radio stations. Because of FCC ownership restrictions, Wood obtained a broadcast construction permit under the name of Baldwin Broadcasting Co. in 1990 and filed papers claiming sole ownership of that entity. However, the evidence showed that Phillips located the studio site for the new station and hired the contractor to build it. Phillips rented tower space for the transmission antenna, installed the transmitter, managed the new station, hired staff, controlled programming, and conducted marketing efforts. He also invested over $130,000 in the station during his six years of management. Wood responded that Phillips was a mere employee of Baldwin Broadcasting Co., and the evidence reflected the existence of an employment agreement between Wood and Phillips. Baldwin acquired a second radio station in a different location about four years after the first station

commenced operations. Although Wood denied the existence of a partnership with Phillips, he filed a partnership tax return for Baldwin in 1997, despite Wood's contention that he could not have formed a partnership with Phillips to apply for the new FCC license frequency because it would have been illegal under then-applicable regulations. On Phillips's application for a receiver, the trial court found that there was a substantial likelihood that Phillips would prevail on his claim of the existence of a partnership and that a receiver should be appointed to prevent irreparable harm to the partnership assets, given Woods' mismanagement and subsequent bankruptcy. The Alabama Supreme Court affirmed the trial court's finding on the partnership issues, even though no written partnership agreement was ever executed.

***Roethke v. Sanger*, 2001 WL 1636797 (Ky. 2001)**

Plaintiff Roethke, the owner of a roofing company, sued, among other persons, Chris Sanger, "Sanger Crane Service" (Chris's alleged employer), and Larry Sanger (Chris's father and an alleged partner of Chris) for negligence in connection with personal injuries suffered as the result of the allegedly flawed supervision of a roofing installation job. The jury awarded the plaintiff judgments against Larry Sanger of over $2.6 million on the ground that Larry was vicariously liable for Chris's negligence on a partnership theory. The Court of Appeals reversed, holding that a directed verdict should have been entered in favor of Larry Sanger on the evidence presented. The Kentucky Supreme Court affirmed the Court of Appeals by a 4-3 vote. The Supreme Court found no evidence to support the conclusion that the Sangers were actual partners in the crane service business, because they did not share profits and were not co-owners of any property, and it specifically noted that Larry Sanger received none of the consideration paid to Chris Sanger by the plaintiff's company for work performed on the subject job. The Court likewise found that the Sangers were not partners by estoppel because the plaintiff was not injured while Chris was acting in the "ordinary course" of the crane service business, and the plaintiff did not hire Chris in reliance on Larry's being his partner. The Kentucky Supreme Court likewise found no liability on theories of "ostensible agency" and joint enterprise.

***Rigsby v. Rigsby*, 57 S.W.3d 206 (Ark. 2001)**

Harold Rigsby appealed from a trial court order finding that certain real property was owned jointly by himself and his son Brett as partners. In 1984, the parties together obtained a bank loan in order to build a new house on the subject property, and the son agreed to make the monthly loan payments while the father agreed to pay all other bills, such as taxes and utilities. In 1997, the son filed a complaint to the effect that he was entitled to an equitable one-half interest in the real property that was owned of record by his father. The complaint alleged that the son had jointly entered into a debt to acquire the property, had later made all payments on that debt, and had constructed substantial improvements on the property to increase its value. The father counterclaimed for ejectment. In reversing, the Arkansas Supreme Court agreed with the father that the trial court erred in finding that the parties formed a partnership with the requisite intent. Citing the traditional UPA definition of a partnership as an association of two or more persons to carry on as co-owners a business for profit, the Supreme Court found that the Rigsbys had not intended to form and operate a partnership when they obtained the bank loan in 1984. The appellate court was influenced by the father's retention of sole legal title to the property and by the lack of evidence that the agreement to build the house had any business purpose.

***Robbins v. Payne*, 55 S.W.3d 740 (Tex. App. 2001), review denied (Tex. App. 2002)**

Two founders of an internet business that dissolved within a year of its founding sued each other. The "equity" founder, Payne, sued the "techie" founder, Robbins, for breach of contract, while Robbins countersued for breach of a partnership agreement, breach of the duty of good faith, breach of an agreement to form a partnership, and various torts. The trial court directed a verdict for Payne on each claim. As to Robbins's contentions regarding the existence of a partnership, the Court of Appeals cited the definition of a partnership as "an association of two or more persons to carry on a business for profit as owners" and, construing the written contract between the two, it found that the agreement did not give Robbins an ownership interest sufficient to support a claim of partnership. Rather, the evidence showed an intent eventually to form a corporation for the venture, and a corporation actually was formed. The Court likewise found no fiduciary relationship between the two founders, deciding that it was simply an arms'-length contractual relationship and, even if there had been evidence of a simple fiduciary relationship, there was no evidence of a breach.

***Shipley v. Perlberg*, 780 A.2d 396 (Md. Ct. Spec. App. 2001), cert. denied, 785 A.2d 1293 (Md. 2001)**

The plaintiff sued the defendant, an officer and director of a corporation, for injuries caused by lead paint poisoning while the plaintiff resided in a property owned by the corporation. The Court of Special Appeals affirmed a grant of summary judgment in favor of the defendant. The defendant disclaimed any knowledge of the specific property in question, much less the rental or management of it. As to one of the plaintiff's claims, the Court found that the plaintiff had not shown that "Northern Brokerage Company," one of the defendant's businesses, was in fact a partnership, resulting in no vicarious liability for the defendant. There was no showing that the defendant was in a partnership with his brother, who was in charge of the rental operations of the family properties. Nor was there any evidence of partnership intent, the contribution of capital, or the sharing of profits and losses. The defendant testified that he was a corporate officer of Northern Brokerage and, although there was but sketchy evidence of its existence as a corporation, the Court concluded that uncertainty relating to corporate filings was no substitute for hard evidence of the existence of a partnership. The only evidence of the firm's business operations was a telephone listing under that name.

***Messer Griesheim Indus., Inc. v. Cryotech of Kingsport, Inc.*, 45 S.W.3d 588 (Tenn. Ct. App. 2001), appeal denied (Tenn. 2001)**

The plaintiff Messer Griesheim ("MG"), a seller of liquid carbon dioxide, sued Cryotech, the operator of a gas purification facility, for breach of contract and various products liability claims to recover damages sustained as a result of selling carbon dioxide contaminated with cyanide. MG also sued Cryotech's construction lender, Mellon, on theories of partnership and joint venture. The record reflected that Mellon was heavily involved in the design and construction of the Cryotech facility, and Mellon was also involved in negotiating the contractual relationships between Cryotech and its chief "feedgas" supplier and landlord, Eastman. The trial court nevertheless granted summary judgment to Mellon on the basis that it was neither a partner nor a joint venturer with either Cryotech or Eastman for purposes of the various tort and contract claims against those defendants. In support of its argument that

a partnership or joint venture existed, MG emphasized, among other things, Mellon's derivation of tax benefits as well as lease payments from Cryotech's sale of carbon dioxide; Mellon's participation in certain negotiations between Eastman and Cryotech regarding a right of first refusal on the financed property; Mellon's approval of contracts between Cryotech and its customers; the requirement of Mellon's consent for amendments to the basic supply contract between Eastman and Cryotech; Mellon's refusal to exercise certain contract rights once it learned that cyanide-infected carbon dioxide had been sold; and Mellon's alleged right to control the production of the product. The appellate court, however, agreed with Mellon that the various contract rights that it obtained from the other two defendants served only to protect its security interest in the subject purification facility, and that the expectation of profits by each defendant by virtue of the complex contractual relationships did not mean that they expected to share the profits of Cryotech's business. The fact of certain mutual obligations under the lending structure did not establish an intent to act as partners or joint venturers in the sale of carbon dioxide. The grant of summary judgment was therefore affirmed.

***Berke v. Hamby*, 719 N.Y.S.2d 280 (N.Y. App. Div. 2001)**

The plaintiff was hired by the defendant medical professional corporation ("P.C.") pursuant to a written employment agreement which provided that, upon its expiration, the parties might consider entering into a partnership agreement. The plaintiff continued to work for the P.C. for two years following expiration of the agreement, after which he filed an action alleging that he had entered into an oral partnership agreement with the individual physician and that he was entitled to an accounting of partnership assets. The appellate division affirmed the trial court's grant of a motion for summary judgment of dismissal. The medical practice of which the plaintiff claimed to have been a partner actually operated as a P.C., and the plaintiff never became a shareholder. The Court ruled that a partnership may not exist where the business is conducted in a corporate form and that parties cannot be partners between themselves while using the corporate form to shield themselves from personal liability to the third parties. Absent a fiduciary relationship, no accounting was available.

15.1.2 Partnership Agreements: Language and Consequences

***Posner v. Posner*, 720 N.Y.S.2d 465 (N.Y. App. Div. 2001)**

The partnership agreement gave the partners the right to buy out the interest of any partner, if the partner withdrew from the partnership, at book value. Defendant claimed that the plaintiff's commencement of this action, which sought the sale of the partnership's real property, evidenced plaintiff's withdrawal from the partnership. The court disagreed because the plaintiff specifically stated in his pleadings that the relief he was seeking did not include dissolution or withdrawal from the partnership.

***Lipsztein v. Donovan*, 734 N.Y.S.2d 130 (N.Y. App. Div. 2001)**

The New York appellate court upheld the trial court's decision that a document executed by two groups of physicians was merely a letter of intent, not a binding partnership agreement. The appellate court noted that the document referred to the future creation of a partnership relationship and identified a condition precedent that ultimately did not occur. The Court found that the document lacked the specificity that one would expect of a partnership

agreement for a long duration, and it also noted that the plaintiffs had not made any capital contribution and did not exercise control over the business.

***Lewis v. Edwards*, 554 S.E.2d 17 (N.C. Ct. App. 2001)**

Two accountants formed a partnership and entered into a written partnership agreement containing a provision that essentially precluded each partner from any other employment. After about 17 years, the plaintiff obtained employment at another company, and the parties agreed that the defendant would take over as managing partner of the partnership and would receive additional compensation for his increased management duties. Several months later, the plaintiff notified the defendant of the plaintiff's intent to dissolve the partnership. A year after the partnership was dissolved, and the defendant had not formally accounted to the plaintiff for his share of the assets, the plaintiff filed suit against the defendant for an accounting and for his share of the partnership property and earnings. The amended pleadings contained countercharges of breach of contract and breach of fiduciary duty. The Court of Appeals found, among other things, that the plaintiff had not breached his "partnership duties" by accepting employment with the other firm while still a partner in the partnership, because the defendant had agreed to such employment, resulting in a modification of the partnership agreement. The defendant never objected to the plaintiff's leaving the partnership to work for the other firm, nor did the defendant demand that the plaintiff's income from that firm be charged against the plaintiff's *pro rata* share of partnership income. The Court found that the defendant had accepted the additional weekly consideration for management, thus resulting in a further modification of the agreement. The Court of Appeals also affirmed the trial court's finding that the plaintiff was entitled to interest on the judicial accounting from the date of dissolution of the partnership rather from the later date of entry of judgment in the plaintiff's favor, because a specific North Carolina partnership statute governed the award of interest in such cases.

***Bartomeli v. Bartomeli*, 783 A.2d 1050 (Conn. App. Ct. 2001)**

One brother (Thomas) sued another brother (Raymond) and the brothers' corporation for fraud. In addition, Thomas alleged that Raymond had breached a promise to make him an equal partner in the corporation. The Court of Appeals affirmed the trial court's conclusion that Thomas was a *de facto* partner with his brother Raymond in the business of the corporation, on the basis that both men worked for the company, both contributed equipment to the company, both guaranteed notes for the purchase of company equipment, Raymond introduced Thomas to others as his partner, and Raymond denied Thomas his interest in the company after Thomas was removed as an officer. Although the business entity in question was technically a corporation, no shares were ever issued to Thomas, who considered himself a partner. While acknowledging that an entity could not simultaneously be a corporation and a partnership, the Court of Appeals found the evidence sufficient to support the trial court's finding that there was a partnership contract between the brothers.

15.1.3 General Partners: Fiduciary Duties

***Jones v. Wagner*, 108 Cal. Rptr.2d 669 (Cal. Ct. App. 2001)**

The parties formed a partnership to buy a beachfront townhouse. The Wagners paid the down payment for the house. Jones agreed to contribute some cash for the down payment

and to make all payments on the mortgage. Jones failed to make the payments on the mortgage and requested that the Wagners utilize funds from a joint bank account to make the mortgage payments. The Wagners refused. The bank foreclosed on the property and the Wagners purchased the property at the foreclosure sale. The court affirmed the trial court's ruling that (i) the Wagners did not breach their fiduciary duties by not using partnership funds to pay the mortgage because the Wagners had no legal or fiduciary obligation to use partnership funds to pay the individual liability of Jones for his capital contribution to the partnership; (ii) the Wagners did not have a duty to prevent the partnership property from going into foreclosure; and (iii) the Wagners were entitled to bid on and buy the property at the foreclosure sale through their pension trusts.

***Conner v. Hart*, 555 S.E.2d 783 (Ga. Ct. App. 2001)**

Ms. Conner sued Mr. Hart, her business partner, for fraud and breach of fiduciary duty in connection with the sale of two Subway sandwich shops in Georgia. The Court of Appeals affirmed a directed verdict for the defendant on the breach of fiduciary duty and fraud claims. As to the first store, the Court found that the defendant had not concealed the proposed sale from the plaintiff as alleged, and it further found that the plaintiff never objected to the sale even after the defendant told her that she would receive no proceeds. Because the transaction challenged by the plaintiff never closed, and the property was ultimately sold pursuant to a court-approved procedure pursuant to which the plaintiff received 50% of the proceeds, the Court found that she had not been damaged. As to the second store, the directed verdict in favor of the defendant was likewise sustained. Once again, the plaintiff showed no evidence of actual damage, the original transaction never closed, and the property was actually sold pursuant to a judicially approved procedure pursuant to which the plaintiff received 50% of the proceeds. The Court rejected the plaintiff's claim for nominal damages on the basis that, under Georgia law, fraud required a showing of actual damages.

***Madison Realty Partners 7, LLC v. AG ISA, LLC*, 2001 WL 406268 (Del. Ch. 2001)**

A general partnership had two partners. One was responsible for managing the partnership and the other was responsible for providing capital funding. Following the funding partner's refusal to provide any additional capital, the managing partner brought suit against the funding partner claiming, among other things, breach of contract and a breach of fiduciary duty. The Court dismissed the fiduciary duty claims, holding that such claims "relate to obligations that are expressly treated in the Partnership Agreement" and are governed by contract principles.

15.1.4 Partner Liabilities

***Great Western Bank v. Kong*, 108 Cal. Rptr.2d 266 (Cal. Ct. App. 2001)**

The partnership defaulted on its mortgage. The creditor filed a foreclosure action, sold the property and obtained a deficiency judgment against the partnership and its partners. The creditor assigned the deficiency judgment to the partnership and some of the partners, in exchange for an undisclosed amount of consideration. The partners who settled with the creditor attempted to enforce the deficiency judgment against the partner who did not participate in the settlement. The trial court held that the settling partners could enforce the

judgment against the non-settling partner. The non-settling partner (the "appellant") appealed. On appeal, the court held that when the deficiency judgment was assigned to the partnership and the partners, the debt was extinguished, and the partners did not acquire the creditor's right to collect the balance of the judgment from the appellant. However, the court said that as a partner, the appellant was liable for his proportionate share of the sums the other partners actually paid toward the partnership debt. Therefore, the settling partners had a cause of action for contribution against the appellant.

***QAD Investors, Inc. v. Kelly*, 776 A.2d 1244 (Me. 2001)**

Two individuals, Kelly and MacKenzie, formed a joint venture to acquire a parking lot adjacent to a tavern in which they had an ownership interest. QAD, the plaintiff, loaned the venture $20,000 in exchange for a 1/3 interest in the parking lot. The loan was evidenced by a promissory note that named MacKenzie and Kelly individually but was signed only by MacKenzie. Kelly disclaimed knowledge of the existence of the promissory note, although he made a number of payments to QAD pursuant to it. He also denied MacKenzie's authority to sign the note for Kelly personally or for their partnership. The Maine Supreme Court found that the trial court did not commit "clear error" in determining that the defendants' conduct would lead a reasonable third party to believe that MacKenzie was acting as the agent of the partnership and with the requisite authority to bind Kelly. The Court found that Kelly had attended meetings with a representative of QAD and MacKenzie during which the loan was discussed, and MacKenzie gave Kelly's personal financial statement to QAD. Moreover, the Supreme Court concluded that Kelly's subsequent conduct following execution of the note by MacKenzie ratified MacKenzie's authority to sign the note on behalf of the partnership, because Kelly made payments in the exact amount specified by the note and met with QAD on several occasions to renegotiate the payment schedule. Moreover, Kelly never stated to anyone that he did not believe that he or the partnership was bound by the note.

15.1.5 Dissolution

***Investor Assocs. v. Copeland*, 546 S.E.2d 431 (Va. 2001)**

A partnership was dissolved when two of its partners filed for bankruptcy. The partners disputed who should wind up the partnership's affairs. The bankrupt partners argued that the non-bankrupt partners should not be entitled to wind up the partnership's affairs because they would invoke the statute of limitations to eliminate their individual liability for debts owed to the partnership. The court found that there was no merit to this contention because it had discretion to select the partners who would wind up, giving preference to partners who were not bankrupt. As a result, the court found that the non-bankrupt partners should wind up the affairs of the partnership. The court also noted that partners owe each other a fiduciary duty in winding up the partnership affairs.

***Laue v. Estate of Elder*, 25 P.3d 1032 (Wash. Ct. App. 2001)**

After dissolution, a partner generally cannot bring a suit at law against a former partner regarding partnership liabilities without first bringing an accounting action. A cause of action for an accounting accrues at dissolution. In this case, because the plaintiff's partnership claim arose from an alleged unwritten partnership agreement, it was subject to a

three-year statute of limitations. The statute of limitations did not begin to run until dissolution or the exclusion of the complaining partner from participation in the affairs of the partnership. The court found that the plaintiff's claim was time-barred because he was excluded from the partnership more than three years before filing his claim.

Chaney v. Burdett, 548 S.E.2d 407 (Ga. Ct. App. 2001)

The partnership was dissolved by the death of one of the partners. The partner's widow brought this action seeking to liquidate the partnership's assets. The court found that the legal representative of a deceased partner has the right to satisfy partnership obligations using partnership assets unless the partners agree to continue the business of the partnership. In this case, the defendant was the only remaining partner, and he chose to continue the business of the partnership. If the business is continued, the legal representative of the deceased partner is a general creditor of the dissolved partnership, not a partner. As a result, the plaintiff did not have the right to compel liquidation of the partnership assets. As the legal representative of her husband's estate, the plaintiff had the right to an accounting of her husband's interest in the partnership. As a non-partner, the plaintiff did not have the right to invoke the buy-sell agreement contained in the partnership agreement.

Horton v. Kimbrell, 2001 WL 1346445 (Ala. 2001)

Three brothers formed a logging partnership without a written partnership agreement. In August 1995, Max informed his brother Walter that he could no longer work for the partnership because of other commitments. The other two brothers, Walter and Wiley, continued the operations of the partnership. About a month later, Walter told Max that the partnership would pay his insurance premiums for the month of September. The very next day, Max was killed in an auto accident. Later, his wife filed a complaint for an accounting against the surviving brothers, alleging that Max had a one-third interest in the partnership at the time of his death. The trial court found that the partnership was actually dissolved a month before Max's death, when he voluntarily withdrew from the partnership, and that he had no interest in the surviving partnership as of the date of his death. The Alabama Supreme Court reversed. Although the Supreme Court agreed with the trial court that dissolution occurred on Max's voluntary retirement, the Court found that that retirement had resulted in a dissolution which, as of the date of the plaintiff's death, was a "chose in action" representing a right to receive the cash equivalent of the amount due to him on a liquidation and accounting. On Max's death, that right passed to his widow as his personal representative. The Supreme Court rejected the surviving brothers' argument that Max's conversation with Walter about the payment of insurance premiums constituted a waiver of Max's right to an accounting.

Ziegler v. Zevnik, 729 N.Y.S.2d 487 (N.Y. App. Div. 2001)

Withdrawing partners sought the dissolution of a law firm and related relief for breach of contract and fraud. The partnership was organized under District of Columbia law. The plaintiffs were dissatisfied with the firm's income and with representations made to them about their individual income. The trial court granted the motion to dismiss the dissolution claim, because the partnership agreement provided that the partnership would continue even after a partner's withdrawal. However, applying District of Columbia law, the Appellate Division reinstated the dissolution claim. The Court acknowledged the existence of the partnership agreement provision that "countermanded" the ordinary rule that a partnership at

will dissolves upon a partner's withdrawal. However, the plaintiff had alleged sufficient misconduct by his co-partners which, if found, would mandate judicial dissolution, that reinstatement of the claim was required.

Johnson v. Foulk Rd. Med. Ctr. P'ship, 2001 WL 1563693 (Del. Ch. 2001)

The plaintiff sought a judicial dissolution of a general partnership. The defendant moved to dismiss on the ground that the dissolution claim was required to be submitted to arbitration pursuant to the partnership agreement's broad arbitration clause. In granting the motion to dismiss, the Court rejected the plaintiff's argument that, notwithstanding the arbitration provision, each partner had an absolute right to seek a judicial dissolution in Court. The Court noted that a claim for dissolution could be fully and fairly litigated in an arbitration proceeding.

15.1.6 Litigation Issues: (Standing, Remedies, Service of Process and Judgments)

Ex parte John R. Ambrose, Jr., 2001 WL 586969 (Ala. 2001)

The plaintiffs argued that venue was proper in the county where the partnership property was located, which the plaintiffs claimed was the subject matter of their complaint. The court held that venue should be determined by the residence of the parties rather than by the location of the partnership assets.

Morris v. Crawford, 722 N.Y.S.2d 296 (N.Y. App. Div. 2001)

The court made an exception to the general rule that partners cannot sue each other at law unless there is an accounting. The purpose behind the general rule is to avoid judicial intervention into the management of the partnership. The general rule was not applied in this case because the parties had not conducted business as partners since 1992, which limited the period of time that the accounting had to cover and obviated the need for judicial intervention into the management of the partnership.

Benedict v. Whitman Breed Abbott & Morgan, 722 N.Y.S.2d 586 (N.Y. App. Div. 2001)

Defendants argued that one of the plaintiffs did not have standing to maintain the claims. The plaintiff was a partner in the partnership. The defendants argued that a partnership cause of action belongs only to the partnership or to the partners jointly and that an individual member of the partnership may only sue and recover on a partnership obligation on the partnership's behalf. The plaintiff admitted that the injuries complained of were injuries to the partnership, but he alleged that the other equal partner participated in the wrongdoing with a third party. As a result, the court held that an individual partner is permitted to sue in its individual capacity and recover its own damages.

Dembitzer v. Chera, 728 N.Y.S.2d 78 (N.Y. App. Div. 2001)

Defendant moved to disqualify plaintiff's counsel where plaintiff's counsel had an on-going attorney-client relationship with a partnership and the defendant was the 50% general partner

of the partnership. The court disqualified plaintiff's counsel because a partnership is not a separate entity existing independent of its partners.

***Fogel v. Neiman*, 733 N.Y.S.2d 482 (N.Y. App. Div. 2001)**

Fogel, a partner in a partnership, brought an action on behalf of the partnership for rent due it. After Fogel died, his widow and executrix was substituted as a plaintiff in the action. Pursuant to the partnership agreement and the New York partnership law, the partnership was dissolved upon Mr. Fogel's death. The New York appellate court affirmed the trial court's ruling dismissing the claim for rent, because the cause of action was partnership property and the partner's estate had no right to continue the action which, at the partner's death, vested in his co-partners.

***Wadley v. Walton*, 2001 WL 1299244 (Ala. Civ. App. 2001)**

One partner of an Alabama general partnership sued for dissolution of the partnership, an accounting, and added a consolidated claim for legal relief based upon a promissory note. The plaintiff's action was tried to a court, while the defendants' tort counterclaims were separately tried to a jury. The trial court entered a judgment after a non-jury trial on the dissolution action and entered a judgment on the jury verdict on the counterclaims. The Court of Appeals reversed both judgments. As to the first, the appellate court noted that the trial court should have conducted the accounting and made the requisite findings concerning date of dissolution, the determination of assets and liabilities, and a determination of partnership property before proceeding to hear the separate legal action on the promissory note. The Court of Appeals found that the judgment on the counterclaims was erroneous for similar reasons: those tort counterclaims should not have been tried until partnership accounts had been settled through an accounting action.

***Dame v. Williams*, 727 N.Y.S.2d. 816 (N.Y. App. Div. 2001)**

The plaintiff's decedent entered into a written partnership agreement with two other individuals (the defendants) to form a general partnership for the purpose of investing in and managing real properties. The partnership agreement was amended after a few years to provide expressly that, in the event of a death of a partner, the partner's executor would be substituted in place of the deceased partner but would take no active part in the conduct of the partnership business. The plaintiff's decedent managed the partnership for 15 years, after which one of the defendants took over for him. After the decedent's death, the plaintiff sued the successor manager for breach of fiduciary duty and for dissolution, and sought an accounting from both remaining partners. The defendants moved to dismiss the complaint except for the accounting claim. The trial court denied the motion to dismiss, but the appellate court reversed. The appellate court noted that the plaintiff, as the survivor of a deceased partner, had no right to participate in the partnership's business or to seek its dissolution. The Court added that, under New York partnership law, the plaintiff had only the economic interest in the partnership that her decedent would have had if he had survived. The Court specifically found that the amendment to the partnership agreement gave her no rights greater than those to which the statute entitled her.

***Lifshutz v. Lifshutz*, 61 S.W.3d 511 (Tex. App. 2001), review denied**

In this divorce action, the Court of Appeals ruled that the trial court had improperly "pierced the partnership veil" to award a non-partner spouse a specific interest in partnership assets.

The appellate court found the "veil piercing" violative of Texas partnership law, which precluded a court from awarding specific partnership assets to such a spouse in the event of a divorce. Rather, the trial court was only empowered to award the non-partner spouse an interest in the partnership. The appellate court ruled that the plaintiff spouse had no community property right in the specific partnership property.

15.1.7 Agency Issues and Miscellaneous

***Northmon Investment Co. v. Milford Plaza Assocs.*, 727 N.Y.S.2d 419 (N.Y. App. Div. 2001), leave to appeal dismissed, ____ N.E.2d ____, No. 1-10, 1231 (N.Y. 2001) (Table)**

Partners did not have the authority to enter into a 99-year lease even if such lease were deemed to be in the ordinary course of the partnership's business. A partner's authority to bind the partnership to transactions in the ordinary course of the partnership's business does not affect the right of partners as between themselves to prevent transactions with third parties, or otherwise to assert their equal rights in the management and conduct of the partnership business.

15.1.8 Joint Ventures

***Blackburn v. Columbia Med. Ctr. of Arlington Subsidiary, L.P.*, 58 S.W.3d 263 (Tex. App. 2001)**

The plaintiff in a medical malpractice case appealed from the grant of summary judgment in favor of the defendant medical center. The plaintiff had sued the hospital, Columbia, on a "joint enterprise" theory based on the contention that one of the allegedly negligent radiologists was employed by a group radiology practice in the hospital's radiology department. Under Texas law, there were four elements of the doctrine of joint enterprise: an agreement among the members of the group, a common purpose to be carried out by the group, a community of pecuniary interest in that purpose among the members, and an equal right to a voice in the direction or control of the enterprise. The Court of Appeals agreed with the trial court that the plaintiffs had not demonstrated the element of a community of pecuniary interest. The Court distinguished a joint enterprise from a joint venture, in which the sharing of profits and losses was an essential element. The absence of an agreement to share profits and losses was not fatal to the plaintiff's theory of joint enterprise. However, the plaintiff was unable to show any other evidence of a community of pecuniary interest sufficient to support a joint enterprise theory, because the terms of the agreement between the hospital and the group practice supported an independent contractor relationship that was designed to promote the convenience of both parties: the hospital had the convenience of an "in-house" referral group for radiology patients, while the group benefited from the access to the machinery owned and maintained by the hospital. Each party incurred its own costs and received separate benefits: the practice billed patients for its doctors' professional services, while the hospital billed the practice for the use of the equipment and facilities. Summary judgment was affirmed.

15.2 Limited Partnerships

15.2.1 Formation and Agreements

Franz v. Calaco Dev. Corp., 751 N.E.2d 1250 (Ill. App. Ct. 2001)

A limited partner brought an action against a general partner for breach of the limited partnership agreement. The limited partner alleged that the general partner breached the partnership agreement by selling the partnership's real property (residential lots) to an entity affiliated with the general partner, without the written consent of the limited partner and for prices less than that set forth in the partnership agreement. The limited partner filed a motion for a preliminary injunction because it claimed irreparable harm in that the partnership assets were being depleted and insufficient funds would remain to satisfy a judgment. The limited partner sought to enjoin the general partner from selling, conveying, or otherwise transferring any residential lots pending a hearing for a permanent injunction. The trial court granted the preliminary injunction motion. The appellate court reversed and held that, based on the partnership agreement, the limited partner was entitled only to profits in the partnership, not to an interest in its real estate.

Coastal Liquids Transp., L.P. v. Harris County Appraisal Dist., 46 S.W.3d 880 (Tex. 2001)

The plaintiff was a Delaware limited partnership that was formed in 1993. The plaintiff transacted business in Texas since 1993. The plaintiff did not apply for registration as a foreign limited partnership with the Texas secretary of state until 1995, and it listed July 1, 1995, as the first date it intended to transact business in the state. The court held that the plaintiff lacked the capacity to maintain the lawsuit for its claims for the 1994 and 1995 tax years, because it failed to prove that it properly registered with the Texas secretary of state as a foreign limited partnership.

Meredith v. Caldwell Communications Corp., 786 So.2d 257 (La. Ct. App. 2001)

The limited partners appealed from a judgment in favor of the general partner, which recognized its right to be paid for managing the partnership and for attorneys' fees. The court held that under the partnership agreement, the general partner was entitled to be paid for its services. The court noted that the general partner was incorporated for the sole purpose of running the limited partnership, and that all of its expenses were related to the business of the partnership. The court also held that the fees were authorized by the partnership agreement, which provided that the general partner must be reimbursed by the partnership for all expenses incurred by it in connection with the business of the partnership. The court also found that distribution and liquidation of the partnership were functions properly delegated to the general partner.

***Delor Corp. v. Quigley, Langer, et al.*, 732 N.Y.S.2d 252 (N.Y. App. Div. 2001)**

The general partner of a New York limited partnership filed a suit against Advanced Health Care as the successor-in-interest to a limited partner, Sonal Corp. On the date that Sonal purchased additional shares in the limited partnership, Sonal allegedly signed a letter agreement agreeing not to vote for the removal of the plaintiff as general partner. Sonal's interest in the partnership was acquired by Advanced Health Care after a merger. The limited partners then called a special meeting for the purpose of voting to remove the plaintiff as general partner. The plaintiff filed suit seeking a declaration that Advanced Health Care must abide by the terms of the letter agreement that had allegedly been signed by Sonal. The appellate court sustained the trial court's ruling that there was no evidence that the letter agreement was supported by consideration independent of the plaintiff's consent to Sonal's purchase of additional shares of the partnership. Because there was insufficient consideration for Sonal's agreement, the plaintiff's claim based on that agreement was properly rejected.

***Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 2001 WL 846054 (Del. Ch. 2001) (appeal pending)**

Plaintiff Gotham Partners L.P. ("Gotham") filed this suit challenging a series of transactions (the "Reverse Split," "Option Plan," and "Odd Lot Offer") consummated by Hallwood Realty Partners L.P. (the "Partnership"). As a result of the challenged transactions, Hallwood Group Inc. ("HGI"), the controlling shareholder the Partnership's general partner, Hallwood Realty Corp. ("HRC"), increased its holdings of the Partnership from 5% to more than 29%. This increase was important because it allegedly gave HGI control over the Partnership through HRC, as the partnership agreement required a supermajority vote (66%) to remove the general partner. In its complaint, Gotham alleged that that the general partner and its directors breached their fiduciary and contractual duties in effecting the challenged transactions. The fiduciary duty claims were dismissed in a previous summary judgment decision because the provisions of the partnership agreement supplanted the default fiduciary duties. In this post-trial opinion, the Court addressed whether HRC and its directors breached the partnership agreement by orchestrating the transactions that allegedly gave HGI control over the Partnership at a discount price. The Court first concluded that the Reverse Split and the Option Plan were conducted in conformity with the contractual provisions that vested broad discretion in the General Partner. The Odd Lot Offer, however, was not. The Court determined that the Odd Lot Offer was not an issuance of units as defendants argued, but a resale. As a result, the partnership agreement required that the defendants satisfy certain procedural requirements: 1) the terms of the transaction had to be as favorable to the Partnership as could have been obtained from an unaffiliated third party, and 2) the transaction had be reviewed and approved by general partner's audit committee. The Court found that the defendants failed to comply with these requirements and, therefore, the transaction was a breach of the partnership agreement. Further, the Court held that the breach was not excused by any statutory (specifically Section 17-1101(d) of the Delaware Revised Uniform Limited Partnership Act) or contractual safe harbor. The Court ruled that the defendants could not rely on their affirmative defense that the partnership agreement shielded them from liability under the provision allowing exculpation where the general partner relied on the advice of counsel in taking action. The Court found that the attorney in

question was representing both the buyer (HGI) and seller (the Partnership) in the transaction and, as such, was conflicted, not independent, as contemplated by the partnership agreement. Moreover, the defendants did not follow the advice they were given. The defendants (with the exception of the general partner) next argued that the general partner's liability was based solely on its purported breach of the partnership agreement (because that agreement supplanted the general partner's fiduciary duties) and that they could not be liable under contract law because there was no such thing as aiding and abetting a breach of contract. The Court rejected this argument and held that where the directors and controlling stockholder caused the general partner to breach its substitute contractual duties, they enjoyed no immunity from joint and several liability. Finally, in determining the appropriate damage award, the Court rejected Gotham's demand for rescission, concluding that it would be "too harsh" because Gotham waited to file the suit until well after the transaction was consummated.

15.2.2 Fiduciary Duties

***LID Assocs. v. Dolan*, 756 N.E.2d 866 (Ill. App. Ct. 2001), appeal denied, ___ N.E.2d ___ (Ill. 2001) (Table)**

Limited partner investors in a cablevision limited partnership brought an action against the general partners for breach of fiduciary duty involving three financing transactions. Three sub-partnerships were formed and sold to investors to finance the operations of the main limited partnership, which was in constant financial difficulty in its early years. In order to satisfy the requirements of outside lenders, the general partner was forced to enter into high-interest subordinated loans with various affiliates. The record reflected that the main outside bank refinancing and the affiliated loans permitted the partnership to remain in business and to recover from its initial financial difficulties. When the main partnership was sold in 1995, all indebtedness was paid off, resulting in the payment of $51 million to the general partners in excess of the costs incurred by them or their affiliates in keeping the partnership financially viable for the previous 16 years. The limited partners, on the other hand, received only the amount of their initial investment plus a small profit. Angered by the discrepancy in returns, the limited partners filed suit. The Court of Appeals first ruled that the plaintiffs' expert provided impermissible testimony as to the applicable fiduciary standards governing the general partner's conduct, which testimony differed from the instructions given by the trial court to the jury, thus confusing the jury and requiring a new trial for the defendants. The Court also found that the loans with the general partners' affiliates were permissible under the partnership agreement and that the defendants had provided adequate disclosure of those loans in the annual financial statements. The Court also found reversible error in the plaintiffs' prejudicial damage calculations, which were based on the cost of capital actually paid by the general partner and its affiliates for their loans, because the evidence reflected that the loans made to the partnership by the general partners' affiliates complied with the partnership agreement's requirement that the terms could not have been less favorable to the partnership than loans from unaffiliated third parties. However, although the Court of Appeals seemed to agree that the challenged loans satisfied partnership agreement provisions concerning affiliated transactions, the accrual of interest on management fees and affiliated transactions, and the payment of interest to partners, it refused to enter judgment for the defendants as a matter of law on those grounds. However, claims based on one of the

challenged loans were dismissed as time-barred. Finally, the Court of Appeals concluded that the only way the plaintiffs could prevail on their breach of fiduciary duty claims was to proceed derivatively and that they could not pursue individual actions for damages to their respective interests in the limited partnership, because the partnership's alleged payment of excessive interest was an injury to the partnership itself.

***Miller v. American Real Estate Partners, L.P.*, 2001 WL 1045643 (Del. Ch. 2001)**

The plaintiffs, who were limited partners of American Real Estate Partners, alleged that the general partner breached its fiduciary duties by taking certain actions to benefit itself (and its affiliates) at the expense of the limited partners. The defendants responded that the partnership agreement eliminated the default fiduciary duties. The Court, however, held that the clause that allegedly eliminated the general partner's fiduciary duties was not drafted clearly enough to prevent a fiduciary duty claim. Although the agreement contained language that purported to limit the obligations of the general partner and provided that certain decisions were within its "sole discretion," the agreement failed to state explicitly that application of the default principles of fiduciary duty to the general partner was precluded. The Court noted that, in each of the recent cases finding that the fiduciary entire fairness standard was inapplicable (see *Gotham Partners, L.P. v. Hallwood Realty Corp.*, 2001 WL 846054 (Del. Ch. 2001), *Gotham Partners, L.P. v. Hallwood Realty Corp.*, 2000 WL 1521371 (Del. Ch. 2000), and *Gelfman v. Weeden Investors, L.P.*, 2001 WL 1018760 (Del. Ch. 2001)), the contract at issue specifically stated that default principles of fiduciary duty would be supplanted if they conflicted with the operation of the contract's sole discretion standard. The provision in *Miller* stated that the sole discretion provision overrode other standards in the partnership agreement or other agreements contemplated by the partnership agreement, but it fell short of eliminating the default fiduciary duties. The Court emphasized that restrictions on fiduciary duties must be set forth clearly and unambiguously. The Court then analyzed the plaintiffs' claims and concluded that the plaintiffs failed to allege facts that stated a cognizable claim for breach of fiduciary duty. The Court determined, however, that the plaintiffs had alleged facts indicating the potential for abuse of the unitholders that could lead to a cognizable claim and, therefore, dismissed the action without prejudice.

***Cantor Fitzgerald, L.P. v. CF Group Mgmt., Inc.*, 2001 WL 1456494 (Del. Ch. 2001)**

Cantor Fitzgerald, L.P. ("CFLP") and CF Group Management, Inc. ("CFGM") sought a declaratory judgment that they neither violated Delaware law nor breached any fiduciary duties in connection with an exchange of CFLP Units for "eSpeed Units" (the "Exchange Offer"). Notably, the limited partners could participate in the Exchange Offer only if they consented to 33 amendments to the partnership agreement. In addition to stating that the plaintiffs were not entitled to the requested declaratory judgment, the defendants asserted several counterclaims challenging the Exchange Offer. The Court first determined that the Exchange Offer, which was structured as a distribution of partnership property, was valid under the partnership agreement and did not implicate a violation of the general partner's fiduciary duty. In fact, the partnership agreement specifically empowered the general partner to distribute partnership property. The Court next decided that the 33 amendments to the partnership were "facially" valid, and that defendants' contention that the amendments may be invalid if and when they are applied in the future to specific factual settings was

"premature." The defendants' final challenge to the amendments was based on the method by which the amendments were adopted. The Court held, however, that the bundling of the 33 amendments for the vote by the unitholders did not violate the partnership agreement. The Court also concluded that requiring the limited partners to approve the amendments in order to participate in the Exchange Offer was not tantamount to vote-buying or coercion, because each limited partner was able to evaluate the transaction to determine whether voting for the amendments would be in his or her best interests, and each limited partner had the ability to reject the Exchange Offer "at all times."

***R.S.M., Inc. v. Alliance Cap. Mgmt. Holdings, L.P.*, 2001 WL 379573 (Del. Ch. 2001)**

Plaintiffs brought an action challenging a reorganization of a public limited partnership ("Holdings"), which separated the formerly publicly traded partnership into two separate entities -- a private partnership ("Capital") and Holdings, which remained a public partnership. Plaintiffs argued that the reorganization was structured and consummated for the sole benefit of the majority unitholder of Holdings ("Equitable"), which also was the sole owner of Holdings' general partner. The reorganization and related changes to the partnership agreement were approved by a majority of the public unitholders unaffiliated with Equitable. The plaintiffs alleged that the unitholders' approval of the reorganization and amendments was induced by a deceptive and coercive strategy implemented by the defendants in breach of their fiduciary duties. The plaintiffs also argued that, because one of the amendments approved by the unitholders required unanimous consent (which was not obtained), all of the amendments were invalid. The defendants moved to dismiss the complaint. Notwithstanding that all of the amendments were presented for a single vote, the Court held that the unanimous consent requirement did not apply to all amendments. Thus, with the exception of the one amendment requiring unanimous consent, the Court held that all of the amendments were valid. The defendants moved to dismiss the fiduciary duty claims on the ground that the partnership agreement restricted the application of default fiduciary duties because a specific contractual procedure was set forth with respect to an asset transfer with an entity related to the general partner. Although the agreement contained no language that expressly restricted the operation of default fiduciary duties, the Court noted that, in the case, "the partnership agreement and fiduciary duties intersect at a precise and legally relevant point." Specifically, the partnership agreement required that the reorganization be approved by a majority of the minority unitholders. Similarly, in the corporate context, the Court noted that a transaction between a controlling stockholder and the corporation could be ratified by the informed consent of the minority stockholders, thus obviating an inquiry into the fairness of the transaction. The Court held that compliance with the vote requirement (assuming that the limited partners were provided with adequate and non-coercive disclosures) created a "safe harbor" that was outcome determinative, but if the safe harbor did not apply, the defendants could face liability under both contractual and fiduciary theories. Although it dismissed some of plaintiffs' disclosure claims, the Court concluded that other claims were sufficiently pled to survive a motion to dismiss. Therefore, the Court denied defendants' motion to dismiss the breach of fiduciary duty claims.

15.2.3 Partner Liabilities

***Beal Bank, SSB v. Lucks*, 2001 WL 220252 (Del. Ch. 2001)**

Plaintiff sought to recover damages from both the limited partnership and one of its general partners. The general partner asserted that, pursuant to Rule 19 (dealing with indispensable parties), the claim against him should be dismissed because the plaintiff had failed to join the other general partner (who had declared bankruptcy). The general partner's argument was based on the fact that, at the time the obligations were incurred, the statutory liability of general partners of a Delaware limited partnership was defined as "joint," rather than "joint and several." The Court held, however, that to the extent obligations of the bankrupt partner had been discharged in his bankruptcy, he need not be joined in the case. The Court further noted that, even if the claim against the bankrupt partner had not been discharged, Rule 19(b) did not require dismissal because the general partner could have joined his partner in the litigation either through a cross-claim or a third-party claim. Additionally, the Court rejected the general partner's claim that the action should be dismissed because the limited partners had not been named as defendants. The Court found there was no record evidence suggesting that the limited partners either acted as a general partner or controlled the partnership. Thus, the defendants' argument was rejected as frivolous.

15.2.4 Dissolution

***Hullett v. Cousin*, 32 P.3d 44 (Ariz. Ct. App. 2001)**

An Arizona limited partnership sold its only asset, an apartment complex, and was deemed to be dissolved after it distributed the net proceeds of the sale to its partners. A partnership creditor sued the limited partnership and its general partner in tort for claims arising before dissolution, but as to which the limited partners had no notice. The creditor obtained an uncollectable default judgment against the limited partnership and the general partner. The creditor then sued the limited partners, alleging a voidable transfer of assets to them. The Court of Appeals reversed a trial court entry of summary judgment in favor of the limited partners. In applying the Arizona Uniform Fraudulent Transfer Act, the Court of Appeals found that the limited partners' capital contributions and ownership interests in the partnership that were returned to them after dissolution were assets of the partnership, rather than antecedent debts, for purposes of that statute. The Court added that, under Arizona limited partnership law, a limited partner was not entitled to distributions from the limited partnership to the extent that the distribution would cause the limited partnership's liabilities, other than those to partners on account of their partnership interests, to exceed the fair value of the limited partnership's assets. Therefore, the final distributions of the partnership to the limited partners were inappropriate under limited partnership law and were made without reasonably equivalent value passing to the partnership, rendering the partnership insolvent for purposes of the fraudulent conveyance statute. The Court of Appeals directed an entry of judgment in favor of the creditor on remand. The Court also ruled that the creditor's claim arose before dissolution, when the acts underlying the misrepresentation claim were committed.

15.2.5 Litigation Issues: (Standing, Judgments and Remedies)

***Ballen-Stier v. Hahn & Hessen, L.L.P.*, 727 N.Y.S.2d 421 (N.Y. App. Div. 2001), leave to appeal dismissed, ____ N.E.2d ____, No. 1-14, 1366 (N.Y. 2002) (Table)**

A partner in a law firm was not barred from suing the law firm for sexual harassment that occurred while she was an associate.

***Maine v. Jay Street Realty Assocs.*, 722 N.Y.S.2d 726 (N.Y. Sup. Ct. 2001)**

Under New York law, service upon a limited partnership may be made by delivery of process to a person of suitable age and discretion at the residence of a general partner.

***Nolan Road West, Ltd. v. PNC Realty Holding Corp. of Georgia*, 544 S.E.2d 750 (Ga. Ct. App. 2001)**

Venue was found appropriate in any county where the partners reside.

***Cantor Fitzgerald, L.P. v. Cantor*, 2001 WL 536911 (Del. Ch. 2001)**

In a previous decision, the Court held that the defendant partners committed an "egregious breach of the partnership agreement" and violated their duty of loyalty to the partnership, and awarded damages in the amount of the plaintiffs' legal fees and expenses. The defendants filed a motion challenging the Court's award of damages. In denying the defendants' motion, the Court explained that the award of the fees and expenses was a "damages" award and should not be confused with fee shifting, which the defendants argued was not permitted under the partnership agreement. The Court found that the plaintiffs' harm was identifiable but non-quantifiable. Thus, the Court used its discretion to fashion the remedy. The Court cautioned, however, that the remedy was limited to this specific case and the special circumstances surrounding the egregious nature of the defendants' actions, and should not be read as a general rule on damage awards. Additionally, because the defendants raised the issue, the Court stated that fee shifting would have been appropriate in this case given the "bad faith" conduct of the defendants, regardless of the contrary language in the partnership agreement.

Warburg, Pincus Ventures, L.P. v. Schrapper, 774 A.2d 264 (Del. 2001)

The defendant, a Delaware limited partnership, moved to dismiss the case on *forum non conveniens* grounds. The Delaware Supreme Court affirmed the trial Court's decision to deny the defendant's motion because the defendant failed to establish that litigating the matter in Delaware created an overwhelming hardship. The fact that the only Delaware connection was the defendant's status as a Delaware limited partnership and that all witnesses and evidence were in Germany or England was held insufficient to establish the requisite overwhelming hardship.

***Gelfman v. Weeden Investors, L.P.*, 2001 WL 1018760 (Del. Ch. 2001)**

Denying the defendants' motion to dismiss, the Court of Chancery found the defendants' actions in creating and selling new partnership units and enacting certain amendments to the partnership agreement (which were allegedly designed to shift ownership from non-employee unitholders to control persons and their affiliates) created an inference that the general

partner acted in bad faith. Although the partnership agreement supplanted traditional fiduciary duties in situations where the general partner was acting under the "sole and complete discretion" standard, the partnership agreement also maintained contractual liability for the general partner where its actions amounted to "wanton and willful misconduct," gross negligence, or bad faith. Here, the general partner's actions raised a litigable issue of bad faith. The Court also concluded that, at least at this early stage, the general partner's decision to subject the amendment to approval of the unitholders would not provide a ratification "safe harbor" because it was difficult to conclude that the vote was uncoerced, given that many of the unitholders were at-will employees whose supervisors wanted the amendments approved. Finally, the Court refused to dismiss the claims against the general partner's directors and officers at this early stage of the litigation, noting that the directors of a corporate general partner may bear fiduciary liability where the directors' actions cause the general partner to breach a fiduciary or contractual duty.

***Bigelow/Diversified Secondary Partnership Fund 1990 v. Damson/Birtcher Partners*, 2001 WL 1641239 (Del. Ch. 2001)**

Plaintiff, a limited partner in several real estate limited partnerships, filed an action asserting that the defendants' involvement in selling the partnership's real estate assets breached the partnership agreements and their fiduciary duties to the plaintiff. The moving defendants, certain "upstream" entities and individuals affiliated with the general partners, filed a motion to dismiss based on lack of personal jurisdiction and failure to state a claim upon which relief could be granted. The Court held that the moving defendants waived their right to challenge personal jurisdiction because they were real parties in interest to an earlier motion seeking permission to communicate with the putative class members. Although the moving defendants did not bring the earlier motion, their counsel signed the motion on their behalf and the Court's ruling on the motion benefited all of the defendants. After concluding that it had jurisdiction over the moving defendants, the Court dismissed the breach of contract claim asserted against them because they were not parties to the contract at issue, but had signed the contract only in their representative capacities for the non-moving defendants. As to the plaintiffs' claims that the moving defendants breached their fiduciary duties, the Court denied the motion to dismiss because the amended complaint could be read as alleging that the moving defendants controlled the general partners and engaged in self-dealing transactions at the expense of the limited partners, thus stating a cognizable claim.

15.2.6 Derivative Litigation: Rules and Standing

***Brickell Partners v. Wise*, 2001 WL 1006642 (Del. Ch. 2001)**

The plaintiff, a limited partner, brought a derivative action alleging a breach of fiduciary duties in connection with limited partnership's purchase of an entity that had been a subsidiary of the general partner's corporate parent. The complaint challenged the fairness of the transaction to the partnership and the procedure used to approve the transaction. The partnership agreement contained a "resolution of conflicts of interest clause," which purported to insulate the general partner from liability if "Special Approval" by the conflicts and audit committee (the "committee") was obtained in a conflict of interest situation. The limited partnership obtained Special Approval for the challenged transaction. The committee that approved the transaction consisted of two members who were also members of the

general partner's board of directors. Also, one of the members of the committee was a former employee of the general partner's corporate parent. In granting the defendants' motion to dismiss, the Court held that the unambiguous language of the partnership agreement displaced the traditional default fiduciary duties. As a result, the Court held that the plain language of the partnership agreement compelled dismissal of the complaint, unless the plaintiff pled facts suggesting that the defendants did not act in compliance with the agreement. The Court determined, however, that the defendants had complied with the agreement. The Court found, based on the language of the agreement, that the plaintiff could reasonably expect that the committee members would be non-management directors of the general partner. The Court also held that the allegation that one of the committee members was a former employee of the general partner's parent, without more, was insufficient to invalidate the effect of the Special Approval.

15.2.7 Derivative Litigation

***Fate v. Owens*, 27 P.3d 990 (N.M. Ct. App. 2001), cert. denied, 27 P.3d 476 (N.M. 2001)**

The limited partner plaintiffs appealed the trial court's ruling that their claims for accounting, partnership dissolution, appointment of a receiver, breach of fiduciary duty, fraud and constructive trust were derivative claims, rather than direct claims. The Court of Appeals reversed and held that the plaintiffs' breach of fiduciary duty claim contained an individual element, and that they could bring the claim individually because the plaintiffs claimed direct injury and requested relief appropriate to their injury as individuals. Specifically, the plaintiffs' breach of fiduciary duty claim was based on the general partner's failure to disclose her interest in certain partnership transactions. The court noted that a partner is required to disclose fully to the other partners all material facts and information relating to partnership affairs, even if the other partners have not asked for the information. Moreover, a partner has a duty to disclose transactions in which that partner is interested, and other partners have a right to consent or withhold consent to such transactions. The court concluded that the plaintiffs' breach of fiduciary duty claim was individual because it involved their right to consent to self-interested general partner transactions. The court also held that claims for accounting and dissolution can be asserted individually, noting that an accounting and dissolution were traditional remedies for breach of fiduciary duty.

***Fujimoto v. Au*, 19 P.3d 699 (Haw. 2001), reconsideration denied (Mar. 14, 2001)**

The court found that the plaintiffs had a valid derivative claim on behalf of the limited partnership despite the fact that the certificate of limited partnership was never filed. The court found that the purpose of the certificate of limited partnership is to put third parties on notice and the failure to file the certificate does not affect the rights of the parties to the partnership agreement. As a result, the partnership agreement established the existence of a limited partnership between the partners, pursuant to which the limited partners may maintain a derivative action against the general partners on behalf of the limited partnership. The plaintiffs were excused from making a demand on the managers of the partnership because the wrongdoing alleged in the complaint was not the product of a valid exercise of business judgment and the managers were not disinterested. Moreover, the plaintiffs were

excused from making a demand because the plaintiffs had not received a response to their inquiries and were unable to enforce the partnership's rights.

15.2.8 Miscellaneous

***111-115 Broadway, L.P. v. Minter & Gay*, 721 N.Y.S.2d 346 (N.Y. App. Div. 2001)**

Partners could not be held liable for an insolvent limited partnership's debt beyond the liability "cap" reflected by personal guarantees.

***Booth v. Attorneys' Title Guaranty Fund, Inc.*, 20 P.3d 319 (Utah 2001)**

A general partner and a limited partnership filed for bankruptcy. The general partner was designated as the manager of the partnership while it was in bankruptcy. The plaintiffs purchased the partnership's primary asset, a Travelodge motel, and brought this suit to recover for failure to deliver marketable title. The plaintiffs claimed that the general partner needed permission from the bankruptcy court, where the general partner's bankruptcy was pending, to sell the Travelodge. The court held that the general partner had an interest in the partnership's assets, but the partnership's assets were excluded from the general partner's bankruptcy estate. The general partner's bankruptcy estate included his interest in the partnership (i.e., the right to receive his share of any partnership profits). Therefore, the bankruptcy court had no jurisdiction over the Travelodge, consent by the bankruptcy court was unnecessary and the lack of consent did not affect the marketability of the Travelodge title. The plaintiffs also alleged that the general partner did not have the authority to act on behalf of the partnership because the partnership was dissolved when the general partner filed for bankruptcy. The court disagreed because the limited partnership agreement provided that the partnership would not be dissolved by the bankruptcy of the general partner.

***MP Assocs. v. Liberty*, 771 A.2d 1040 (Me. 2001)**

General partners were found primarily liable for all debts and obligations of the limited partnership. The court held that the plaintiffs were suing defendants in their role as general partners of a failed limited partnership, not in their role as guarantors.

5.3 Limited Liability Companies

***Matjasich v. State Dep't. of Human Res.*, 21 P.3d 985 (Kan. 2001)**

The Kansas Department of Human Resources determined that, under Kansas law, members of a foreign limited liability company doing business in Kansas were personally liable for unpaid wages. The trial court affirmed the Department's finding of personal liability. The Kansas Supreme Court reversed in part, noting that the Kansas wage payment law's definition of an employer did not include a limited liability company, but the subject limited liability company was organized under Utah law. The Kansas Supreme Court found that the LLC members were not personally liable for wages under either the Kansas limited liability

company act or the Kansas wage payment law. However, citing the provision of the Kansas limited liability company act requiring application of the local law of the foreign jurisdiction to the organizational and member liability of a foreign limited liability company doing business in Kansas, the Supreme Court upheld the member's liability for unpaid wages under the Utah wage law.

***Halley v. Barnabe*, 24 P.3d 140 (Kan. 2001)**

Two men formed a Kansas limited liability company in 1995 as member-managers and 50% co-owners. The LLC's operating agreement acknowledged the right of the managers to engage in other businesses so long as they did not compete with the business of the LLC. A dispute arose between the two principals, resulting in three lawsuits between the parties for breach of contract, breach of fiduciary duty and other torts. In 1999, the Kansas limited liability company statute was specifically amended to authorize derivative litigation to be filed on behalf of the LLC by a member. The Kansas Supreme Court reversed the dismissal of two of the 1998 lawsuits, finding that the 1999 amendments authorizing derivative litigation were procedural and hence retroactive in nature, thus "revitalizing" the ostensibly derivative claim that had been dismissed below. The Court expressed no opinion on the merit of those claims.

***Dawson v. Atlanta Design Assocs., Inc.*, 551 S.E.2d 877 (N.C. Ct. App. 2001), review denied, 553 S.E.2d 910 (N.C. 2001)**

The plaintiff, a dentist, appealed from an order requiring him to substitute the limited liability company of which he was a member as the party plaintiff in his personal suit against the architectural firm that designed his dental facility. The trial court had dismissed the action on the basis that the LLC owned the land and building for which the design services of the defendant had been provided and, accordingly, the plaintiff himself lacked standing. In reversing, the Court of Appeals held that the dentist individually, rather than the LLC, was the real party in interest in the action against the contractors. The Court noted that the plaintiff did not allege any injuries to the LLC, and the record did not reflect that the LLC itself was injured as the result of the defendant's breach of contract and professional negligence. The Court of Appeals added that the plaintiff's individual contract with the defendants created a "special duty" to the plaintiff, permitting him to bring those claims directly instead of derivatively.

***PacLink Communications Int'l., Inc. v. Superior Court*, 109 Cal. Rptr. 2d 436 (Cal. Ct. App. 2001)**

Three individual members of a California limited liability company sued several other businesses and individuals, alleging fraudulent transfers of the LLC's assets to successor entities. The individual defendants were the remaining five members of the initial LLC. The trial court denied a motion to dismiss, finding that claims for fraudulent transfer, conspiracy to defraud creditors and to commit conversion, and for the imposition of a constructive trust were individual, not derivative. Applicable California law provided that the principles of derivative lawsuits applicable to corporations likewise governed LLCs. The Court of Appeals ruled that the gravamen of the plaintiffs' claims was the assets of the LLC were fraudulently transferred without any compensation to the entity, thus constituting an injury to the LLC itself and requiring claims to be brought derivatively. The Court found that the real injury suffered was a reduction in the value of the plaintiffs' membership interests in the

entity caused by the allegedly fraudulent transfers. The Court rejected the plaintiffs' argument that they were suing as creditors of the LLC instead of as members, simply because the LLC had been formally dissolved at the end of 1997 and the challenged transfers were made thereafter. As the Court of Appeals read the complaint, the plaintiffs were suing not as members entitled to a post-dissolution distribution, but for financial injury resulting from the fraudulent transfers of assets.

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