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“CONTROL” IN THE LIMITED PARTNERSHIP

INTRODUCTION

Although limited partnerships have existed in the United States for over 150 years, recently there has been a tremendous increase in the use of the limited partnership arrangement as a vehicle to attract capital. This rejuvenation is most readily cognizable in the field of multiple ownership of real estate, where the real estate syndicate employs the limited partnership to pool the resources of individual investors for the development of ventures such as office and apartment buildings, ranching and farming operations, hotels, motels, shopping centers, parking garages, and residential subdivisions.

The limited partnership arrangement offers several unique features which render it a desirable form in which to conduct business. Of fundamental importance is the fact that through the medium of the limited partnership, one may invest money in a limited partnership entity without incurring the inherent risk of unlimited liability encountered in the non-limited partnership. The limited partner’s interest is also assignable without dissolution of the partnership. But currently, the most attractive feature of the limited partnership is its favorable income tax treatment which is primarily responsible for its revival as a viable form of transacting business.

For income tax purposes the limited partnership is treated in the same manner as a partnership. The Internal Revenue Code provides that the partnership, itself, is not subject to income tax, but that the partners are liable for partnership income.

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1 The first limited partnership acts in the United States were adopted by New York (1822), Connecticut (1822), and Pennsylvania (1836). For a general history of limited partnerships see 2 S. ROWLEY, PARTNERSHIPS 549 (2d ed. 1960) and A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP 148 (1968).

2 With no centralized state records, the extent of the increased use of the limited partnership in Illinois cannot be determined. ILL. REV. STAT. ch. 106½, § 45(1)(b) (1973) requires the filing of a limited partnership certificate in the office of the county recorder of deeds.


5 Id. § 4.17.

6 Professor Crane in his renowned work on partnerships stated, “The limited partnership is no longer of much utility, except for formation of associations which cannot conveniently be incorporated, such as brokerage firms.” J. CRANE, PARTNERSHIPS 117-18 (2d ed. 1952). Professor Bromberg’s revision of that work, however, talks of the “extensive use” of the limited partnership in the 1950’s and 1960’s pointing to the special tax benefits as a major factor for this increase. A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP 149-51 (1968).

7 C. ROHRlich, supra note 4, § 4.14a.
'Control' in Limited Partnerships

in their individual capacities.\(^8\) The Code further provides that losses of the partnership pass through to the partners. This "conduit form" of partnership taxation is particularly appealing in the limited partnership context because the limited partner can use partnership losses to offset his income from all other sources and still maintain his limited liability.\(^9\) This is accomplished in many cases through the use of accelerated depreciation or depletion allowances which are taken at the partnership level.\(^10\)

One must note, however, that the status of limited partner is not without its disadvantages. The Uniform Limited Partnership Act\(^11\) explicitly states that a limited partner will not be held liable as a general partner unless he takes part in the control of the business.\(^12\) Thus, it is apparent that it may be necessary for the limited partner to relinquish a certain degree of control over his investment. The practitioner in advising clients has few guidelines by which to gauge the results of any potential litigation wherein the amount of control exercised by the limited partner is or may be at issue.

The purpose of this article is to present an analysis of case law on the issue of "control" under the U.L.P.A. and related areas, and to explore its implications in the modern limited partnership setting.

I. THE UNIFORM LIMITED PARTNERSHIP ACT

The limited partnership is exclusively a creature of statute. Generally speaking, strict compliance with the appropriate statutes is necessary in order for one to achieve tax advantages and limit his liability.\(^13\) In 1916 the Conference of Commissioners of Uniform State Laws adopted and recommended to the state legislatures the Uniform Limited Partnership Act. Since then the Act has been adopted by forty-five jurisdictions.\(^14\) In addition to its primary purpose of unifying the law of limited partnership, the Act was drafted to overcome precedents created by

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\(^8\) INT. REV. CODE OF 1954, § 701.

\(^9\) The INT. REV. CODE OF 1954, §§ 1371 et seq. (Subchapter S) may provide the corporation with the same type of tax advantages that the limited partnership achieves. However, Subchapter S is restrictive in nature since it is designed to provide tax neutrality for the closely held corporation.


\(^12\) U.L.P.A. § 7.

\(^13\) C. ROHRLICH, supra note 4, § 4.16.

\(^14\) Jurisdictions in which the act has been adopted include: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Is-
strict interpretations of prior statutes. The drafters felt that this decisional law was frustrating the purposes of the statutory limited partnership.

In order to guard against future strict interpretations, the U.L.P.A. provides that a limited partnership can be formed by full or even "substantial compliance in good faith" with the requirements of the Act. Among these requirements is the registration of a certificate of limited partnership which must be signed and sworn to by all members of the partnership, both limited and general. The essential function of the registration requirement is to give notice. With this in mind, the U.L.P.A. requires only a good faith attempt to comply with registration, and mere technical defects will not defeat the limited partnership.

In a limited partnership, management and control are vested almost exclusively in the general partner or partners. However, the U.L.P.A. enumerates seven acts which, in addition to the general partner's authority, require the written consent or ratification of the limited partners. In addition to these veto powers, the Act gives the limited partner the following rights: (1) to inspect and copy partnership books, (2) to have on demand full information regarding matters affecting the partnership, (3) to have the partnership dissolved by decree of the court, (4) to receive a share in the profits or other compensation, and (5) to receive the return of capital contributions on dissolution.

Under the provisions of the U.L.P.A., a limited partnership generally may carry on any business which a partnership without

land, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virgin Islands, Virginia, Washington, West Virginia, and Wisconsin.


16 U.L.P.A. § 2(2).

17 U.L.P.A. § 2(1).


20 U.L.P.A. § 9 provides: A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to (a) Do any act in contravention of the certificate, (b) Do any act which would make it impossible to carry on the ordinary business of the partnership, (c) Confess a judgment against the partnership, (d) Possess partnership property, or assign their rights to specific partnership property, for other than a partnership purpose, (e) Admit a person as a general partner, (f) Admit a person as a limited partner, unless the right to do so is given in the certificate, (g) Continue the business with partnership property on the death, retirement or insanity of a general partner, unless the right to do so is given in the certificate.

limited partners may engage in.\textsuperscript{22} Thus, the limited partnership may be used for a myriad of purposes, and its modern utilization is bounded only by the imagination of the promoter and his attorney.\textsuperscript{23}

Though the U.L.P.A. has been in existence for over fifty years, it is just now being revived from its state of dormancy. With its present widespread use as a vehicle for real estate projects and other business enterprises, many of its problems are just beginning to surface. One of the most troublesome provisions of the Act is section 7 which states, “A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business.” Unfortunately the Act does not define the term “control.” This problem is accentuated by the fact that there are very few cases which have interpreted and applied section 7.

Ambiguity in the term “control” is the greatest drawback of the U.L.P.A. and has, undoubtedly, frustrated the practical use of the limited partnership entity. In recognition of the difficulty under the U.L.P.A. of conferring affirmative powers of control on the limited partner by the partnership agreement, and at the same time allowing him to limit his liability to the extent of his investment, several states have amended section 7.\textsuperscript{24} These statutory modifications have followed the California example which provides:

(b) A limited partner shall not be deemed to take part in the control of the business by virtue of his possessing or exercising a power, specified in the certificate to vote upon matters affecting

\textsuperscript{22} U.L.P.A. § 3. Generally excluded are banking and insurance. \textsuperscript{6} U.L.A. 578 (1969).

\textsuperscript{23} For example, a limited partnership may be utilized in conjunction with a land trust. If the trustee holds title to land and a limited partnership is the beneficiary of such a trust:

(a) the flow through of deductions and income for federal income tax purposes would remain the same if other criteria stated in this article are met (see Rev. Rul. 64-220, 1964-2 CUM. BULL. 335);

(b) remedies of creditors may be limited to a creditor’s bill or to supplementary proceedings (ILL. REV. STAT. ch. 77, § 10; ch. 110, § 73 (1973); see Chicago Federal Savings and Loan Assn. v. Cacciatore, 25 Ill. 2d 535, 185 N.E.2d 670 (1962));

(c) transfer of a limited partner’s interest need not affect either legal or equitable title to the land (U.L.P.A. § 19; U.C.C. 9-203, 9-302(1) (c)); and

(d) the possibility of dual inheritance taxation and ancillary probate may be lessened if the land is located in states where the interest of the decedent beneficiary is held to be personal property (ILL. REV. STAT. ch. 120, §§ 375(3), 399a; see Duncanson v. Lill, 322 Ill. 528, 153 N.E. 618 (1926). But see ILL. REV. STAT. ch. 3, §§ 55, 188 et seq., Uniform Partnership Act § 26, and U.L.P.A. §§ 9, 18, 20, 21).

\textsuperscript{24} The states which have amended section 7 are California, Oregon and Washington.
the basic structure of the partnership, including the following matters or others of similar nature:

(I) Election or removal of general partners.
(II) Termination of the partnership.
(III) Amendment of the partnership agreement.
(IV) Sale of all or substantially all of the assets of the partnership.

(c) The statement of powers set forth in subdivision (b) shall not be construed as exclusive or as indicating that any other powers possessed or exercised by a limited partner shall be sufficient to cause such limited partner to be deemed to take part in the control of the business within the meaning of subdivision (a).25

While subsection (b) is helpful in setting forth certain matters which will not constitute control, subsection (c) makes it clear that there may be other affirmative acts which may be reserved to the limited partners by the partnership agreement.

According to one commentator, the U.L.P.A. is based on two fundamental assumptions: (1) that no public policy requires a person who contributes to the capital of a business, and acquires an interest in the profits and some degree of control over the conduct of the business, to become bound for the obligations of the business, provided that creditors have no reason to believe at the time of extending credit that such person was bound; and (2) that persons who are liable without limit for the business obligations should be able to associate with others who contribute capital and acquire rights of ownership.26 Keeping these assumptions in mind, a review of case law demonstrates that the U.L.P.A. has been only partially successful in meeting its broad objectives.

II. CASE LAW INTERPRETING "CONTROL"

Under the U.L.P.A.

In determining whether a limited partner has or has not taken part in the "control" of the business under the U.L.P.A., it is apparent that courts do not restrict the limited partner merely to his statutory rights. Rather, decisions approach each new fact situation on its merits, determining as a matter of judicial discretion the legal impact of the limited partner's acts. Although the cases commenting on the question of control by limited partners are not numerous, there are enough from which to draw some firm conclusions.

First, it is clear that section 7 precludes a limited partner from active domination over day-to-day operations of the limited partnership or from taking an active and substantial role in decisions which determine business policy.

In the landmark case of Holzman v. de Escamilla,27 the two limited partners of a three man partnership were held liable to creditors as general partners. The limited partnership involved a farming operation. Twice a week the limited partners visited the farm and on at least two occasions overruled decisions of the general partner concerning what crops were to be planted. Checking accounts maintained by the partnership required the signatures of any two partners to withdraw funds. Thus, the limited partners had absolute power to withdraw all partnership assets from the bank without the knowledge or consent of the general partner. The California court considered these factors to be particularly significant in its decision that the limited partners had the right to "control" and on occasion had exercised it.28

The shield of limited liability was also denied in Bergeson v. Life Insurance Corp. of America,29 where a limited partnership had been formed for the sole purpose of organizing and operating a corporation. The limited partners became officers and directors of the subsequently formed corporation and were active participants in its management. Capital stock of the corporation was sold to the public without indication that money and property contributed to the corporation by the partnership would be enforced as a liability of the company. The directors issued to the partnership paid stock which was allegedly in satisfaction of these obligations. In a derivative stockholder's action against the directors to recover the market value of the stock, the claim of limited liability by the defendants under the limited partnership agreement was rejected. The district court stated:

In this case the limited partners participated in the management of the partnership. The only business of the partnership was the organization and operation of the corporation. All of the partners actively participated. The defendants did so to the extent of becoming directors of the corporation. They cannot now rely on the form of this legal entity when they have heretofore disregarded the spirit of it.30

Even though liability was based on fraud for failure to disclose to prospective shareholders the true capital position of the corporation, the case clearly indicates that such actions by limited partners constitute control, subjecting them to liability as general partners.

It should be emphasized, however, that the courts have acquiesced to the limited partner exercising some influence in the policy and management of partnership affairs. In Plasteel

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28 Id. at 860, 195 P. 2d at 834.
30 170 F. Supp. at 159.
Products v. Helman the limited partners had authority to select the general sales manager who had joint control with the general partner over certain financial aspects of the business. Plaintiff contended that this selection of the general sales manager led to control by the limited partners. The court, however, noted that this general manager could have been discharged at any time by the general partner in his sole discretion. The court recognized that in this situation the general partner had the ultimate control. Hence, the ground relied upon to charge the defendants with general liability was insufficient. Liability of the limited partners was therefore limited to the extent of their investment.

Second, the courts may examine whether in fact the plaintiff has relied upon a belief that a limited partner's actions constituted control.

In Rathke v. Griffith, the bylaws of the limited partnership provided that the affairs of the partnership were to be handled by a board of directors composed of three members of the partnership. Defendant Griffith, a limited partner, had been named as one of the directors. At trial the evidence showed, however, that he never carried out the duties of this office and was a director in name only. On several occasions Griffith negotiated loans for the partnership and signed partnership contracts along with the general partners. Recognizing these factors, the court nevertheless held that Griffith had not exercised sufficient control to become liable as a general partner. The court reasoned that since the plaintiff was not acquainted with these facts at the time of extending credit, the creditor could not show he had relied to his detriment on Griffith's apparent status as a general partner.

As the above analysis of Holzman v. de Escamilla indicated, that decision was based on actual control. It did not deal expressly with the issue of reliance by creditors on the limited partner's apparent relationship or interference in normal partnership operations. However, it seems reasonable to infer that implicit in the decision was a recognition that the creditors did rely on the ostensible relationship of the limited partners.

Third, it would appear that a limited partner can transact and deal with the partnership on an equal footing with any outsider, provided that at the time of the transaction the partnership possesses sufficient assets to satisfy all existing debts.

Grainger v. Antoyan involved a limited partnership which

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31 271 F.2d 354 (1st Cir. 1959).
32 96 Wash. 2d 394, 218 P.2d 757 (1950).
34 48 Cal. 2d 805, 313 P.2d 848 (1957).
was formed in 1951. Defendant, a limited partner, held a chattel mortgage on certain partnership assets and additionally owned the building in which the business was conducted. He also possessed restricted powers in the partnership checking account. Prior to dissolution of the limited partnership in 1953, defendant purchased partnership assets at their fair market value. At the time of the sale, the firm had sufficient assets to pay all creditors. The limited partnership subsequently discontinued active business, and the defendant established a similar business on the same premises under a different name. In 1954 the limited partnership was adjudicated a bankrupt. Actions were brought by the trustee in bankruptcy and by a creditor seeking to hold the defendant liable as a general partner. The court held that the mere purchase by a limited partner of partnership assets is insufficient to constitute the control requisite for a finding of general partner liability. Furthermore, the court noted that the defendant had no control over the prices, purchases, extension of credit and other aspects of the business, and therefore could not be held liable on other grounds as a general partner.\footnote{Id. at 813, 813 P.2d at 853.} For purposes of the transaction in question, he was viewed as a stranger to the partnership.

It should be noted that under the U.L.P.A., a limited partner may lend money to and transact business with the partnership.\footnote{U.L.P.A. § 13.} Pursuant thereto, a limited partner may receive and hold any partnership property as collateral security if at the time of the transaction the partnership assets are sufficient to discharge partnership obligations to non-member creditors. Thus, the \textit{Grainger} decision is in full accord with the U.L.P.A. provisions.

Fourth, case law does permit limited partners to give counsel and advice to general partners without such action constituting control. \textit{Weil v. Diversified Properties}\footnote{319 F. Supp. 778 (D.D.C. 1970).} was an equitable action in which the general partner sought to have the limited partners declared general partners. The general partner, Weil, served as a salaried manager of the partnership property. After a year and a half of operation, the partnership encountered financial difficulties and the day-to-day management of the partnership was turned over to two independent persons on a commission basis in an effort to salvage the enterprise. From this point forward, Weil took no active part in the management, but the limited partners conferred daily among themselves and with the new managers. Noting that the general partner had the remedy...
of dissolution, the court refused to invoke section 7 in his behalf. The court said:

It is well established that just because a man is a limited partner in an enterprise he is not by reason of that status precluded from continuing to have an interest in the affairs of the partnership, from giving advice and suggestions to the general partner or his nominees, and from interesting himself in specific aspects of the business. . . . Certainly common sense dictates that in times of severe financial crisis all partners in such an enterprise, limited or general, will become actively interested in any effort to keep the enterprise afloat and many abnormal problems will arise that are not under any stretch of the imagination mere day-to-day matters of managing the partnership business. 38

The question of whether advice and counsel constituted control also arose in *Sivola v. Rowlett* 39 which involved the liability of a limited partner who often discussed important business transactions with the general partner. The court stated that by virtue of his status as a limited partner, the defendant had not forfeited the right to make suggestions or to express his opinions as to the advisability of transactions when his suggestions or opinions were solicited by the general partner. 40 Since in this case the general partner had actively sought the advice and counsel of the limited partner, the Supreme Court of Colorado held that the limited partner was not liable as a general partner.

In conclusion, a limited partner does not, from the mere fact that his contribution is limited, cease to have some voice in either the management or the disposition of partnership property. 41

Finally, it seems clear that the determination of "control" is a factual one in every instance. 42 Despite the lack of clear guidelines, courts consistently attempt to assess the total situation in an equitable manner, taking into consideration all the surrounding circumstances. 43

**Control in Related Areas of the Law**

The lack of litigation on the issue of "control" under the U.L.P.A. makes it necessary to examine the concept of control as it has been applied in other areas of the law. A brief discussion of cases in related areas will prove helpful in ascertaining

38 Id. at 782.
40 Id. at 528, 272 P.2d at 290-91.
43 For example, Higgins v. Shenango Pottery Co., 256 F.2d 504 (3d Cir. 1958) used a totality of circumstances approach. The limited partners were required to make restitution of distributed profits where their liability was based on a breach of the fiduciary duty owed the plaintiff by a co-partner.
the parameters of the limited partner's permissible activities.

The case of *Minute Maid Corp. v. United Foods, Inc.* illustrates that the concept of control may be determinative in finding a partnership arrangement despite the lack of a partnership agreement. Cold Storage furnished financing and warehouse facilities to United. Such activities enabled United to maximize profits from its relationship as a direct buyer of Minute Maid products. Under this financing agreement both United and Cold Storage exercised control over the enterprise. The arrangement was found to constitute a partnership by estoppel and not the relationship of debtor and creditor. Accordingly, Cold Storage was held liable to Minute Maid for unpaid purchases.

The determining factor in the case was that the arrangement vested joint control of the business operations in both Cold Storage and United. The court stated:

> There can be no question but that the parties had joint control over this enterprise. This follows from the fact that United initially determined how much to buy but such determination was subject to Cold Storage's right to determine whether the proposed collateral would be 'acceptable.' Also, it was provided that in case of pending price increases, which the court found would offer the opportunity to speculate on inventory, the parties would agree on the volume to be purchased.... [W]e think the operation... was clearly within the joint control of the parties.

Generally speaking, a partnership arises only when there is an agreement between or among associates that a partnership shall exist. Such an agreement may be express or implied, and though no single test is conclusive, the existence of a partnership depends on (1) the intention of the parties, (2) the community of interest in the business conducted, and (3) an arrangement to share profits. *Minute Maid* clearly shows that control may be an additional factor in determining whether the true relationship of the parties constitutes a partnership. Not unlike a limited partner who is trying to protect his investment by retaining some degree of control, Cold Storage was attempting to safeguard the return of its investments.

A court may also look to control in determining whether there has been a sale of a security. *Sire Plan Portfolios, Inc. v. Carpentier* involved a situation wherein a corporation sold fractional undivided interests in income producing property

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44 291 F.2d 577 (5th Cir. 1961).
45  *Id.* at 588.
47  On the same general question, no liability was found in *Martin v. Peyton*, 246 N.Y. 218, 158 N.E. 77 (1927). For a discussion in this area see *Painter, Partnership by Estoppel*, 16 VAND. L. REV. 327 (1963).
which was to be held in trust for the purchasers. The defendant contended that since the owners of the alleged securities had the right to remove the trustees or terminate the trust by a sixty percent vote there was retention of control. This control, if actually retained by the investors, would enable the corporation to circumvent the registration requirements of the Illinois Securities Law. The court held that the alleged control was "illusory." It went on to review the requirements of an investment contract and quoted from S.E.C. v. W. J. Howey Co.:

[A]n investment contract for purposes of the securities acts means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of a promoter or a third party. . . . The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.

It should be noted at this point that the sale of limited partnership interests may constitute the sale of securities within the meaning of state blue sky laws and federal securities acts. Because of the broad definition of "security," a thorough examination of the securities requirements is necessary in any public offering of limited partnership interests. There may be exemptions under which registration requirements may be circumvented; however, such a discussion is beyond the scope of this article.

Today, the franchise is frequently used by the franchisor as a means of expanding his market for goods and services. The franchisor sells a package consisting of a name and a method of doing business. Whether franchise agreements are investment contracts which require federal or state registration depends upon a consideration of the amount of control retained by the franchisor. Where the franchisee participates actively in the business and the franchisor provides only goods and services, the California Attorney General takes the position that there is not a sale of a security. However, where the franchisee is only a passive investor, and thus a nominal participant, the opposite conclusion attaches. Similarly, where the franchisor secures the requisite capital, there is the sale of a security.

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49 ILL. REV. STAT. ch. 121½, §§ 137.1 et seq. (1953).
50 328 U.S. 293 (1946).
52 Depending on the amount of capital involved and the number of investors, exclusions may be available to the limited partnership. 15 U.S.C. § 77c (1964); ILL. REV. STAT. ch. 121½, § 137.3 (1973). For an analysis of potential conflicts between U.L.P.A. § 7 and securities exchange requirements, see 26 OKLA. L. REV. 289 (1973).
53 R. JENNINGS AND H. MARSH, supra note 3, at 320.
54 49 OP. CAL. ATT’Y GEN. 124, 126 (1967).
55 Id. at 127.
With the preceding case law concepts in mind, some of the potential problems that may be encountered in today's limited partnership will now be examined.

III. IMPLICATIONS

The issue of whether control has been exercised by a limited partner may arise in a multitude of situations. Although each factual situation will give rise to distinct questions, the following examples illustrate the nature and extent of the problems that may be involved. (1) If the partnership articles provide that the limited partners can remove a general partner, does it necessarily follow that courts will construe such provision as retention of control under section 7 of the U.L.P.A., therefore subjecting them to liability as general partners? (2) If the general partner is a corporation, what standards must be complied with to defeat a charge of inadequate capitalization of the corporation? If the limited partners are shareholders or directors of the corporate general partner, will they lose their protected status? (3) Since the sale of securities requires compliance with the state blue sky laws and the federal securities acts, how can the promoter give sufficient control to the purchaser of the limited partnership interest to insure that the arrangement will be construed as a sale of property? (4) May limited partners terminate the partnership without the consent of a general partner and wind up the affairs of the business without being deemed to have exercised control?

The Removal Power

Several factors support the conclusion that a limited partner's power to remove general partners should not affect his limited liability. First, while the removal power may give the limited partner some degree of control over long term policy objectives, it does not give him the right to transact the day-to-day business of the partnership. Second, for the most part, case law dealing with control under section 7 stresses that limited partners are liable as general partners only where creditors are led to believe that they are acting as general partners. The removal power is designed only to affect the internal structure of the partnership, and in most cases should not give creditors the impression that the limited partner is exercising control. Third, the removal power is consistent with the rights and powers granted to the limited partner by the U.L.P.A. One of these rights, as noted in Weil v. Diversified Properties, 339 F. Supp. 778 (D.D.C. 1970); Grainger v. Antoyan, 48 Cal. 2d 805, 313 P.2d 848 (1957); Rathke v. Griffith, 36 Wash. 2d 394, 218 P.2d 757 (1950).
is dissolution. But such a drastic remedy might be unnecessary if the proposed removal power could be utilized. In California all doubt as to whether removal power is control has been eliminated by the modification of section 7 which expressly negates such a conclusion. 59

The Corporation as a General Partner

The use of a corporation as the sole general partner combines the primary advantages of both the partnership and the corporation — direct receipt of profits and losses by the limited partners without taxation at the entity level, and limited liability for all investors. In most jurisdictions today, a corporation can serve as a general partner. In such organizations, the corporate general partner is the only member of the partnership exposed to unlimited liability. The shareholders, of course, are liable only to the extent of their capital contribution. Because of these benefits, corporations are being used more frequently by promoters of limited partnerships. 60 Since ownership of a significant percentage of corporate stock could constitute control of the corporation, section 7 problems may arise if the limited partners are stockholders in the corporate general partner. For example, in Bergeson v. Life Insurance Corp. of America, 61 where a limited partnership was formed for the sole purpose of organizing and operating a corporation, the limited partners were held liable as general partners because they exercised complete control over the corporation.

In recognition of these inherent problems, the Internal Revenue Service has issued Revenue Procedure 72-13, which establishes criteria for determining whether a limited partnership with a corporation as the sole general partner is a partnership for purposes of taxation. 62 In order to be classified as a partnership, the following conditions must be met: (1) The limited partners may not, directly or indirectly, individually or in the aggregate, own more than twenty percent of the stock of the corporate general partner. (2) If the corporate general partner has an interest in only one limited partnership and the total capital contribution to the partnership is less than $2,500,000, the net worth of the corporation must always be at least fifteen percent of that capital contribution; if total contributions are over $2,500,000 the net worth of the corporate general partner must at all times be at least ten percent of total contributions. (3) Or-

ganization and operation must be in accordance with the applicable state statutes relating to limited partnerships.

The I.R.S. standards indicate that ownership by the limited partners of over twenty percent of the stock in the corporate general partner will invalidate the limited partnership benefits for income tax purposes. These ownership restrictions are obviously intended to prevent the limited partners from controlling the corporate general partner. The ten and fifteen percent net worth requirements insure the adequate capitalization of the corporation so that creditors who deal with the partnership are protected. Although the I.R.S. guidelines are not binding in state court actions, they may be helpful as a yardstick in determining liability in subsequent limited partnership cases.

One potential problem that is not dealt with by Revenue Procedure 72-13 is the issue of control which is raised when the limited partner serves as a director of the corporation. It may be permissible for the limited partners to have some representation in the corporate management without such participation constituting control. However, the question is not resolved. If the practicing attorney is presented with this situation, he should advise his client that serving as a director may constitute control. Therefore, the risk involved in gaining a voice in management may greatly outweigh the potential benefits.

Sale of Property v. Sale of Securities

For purposes of the federal and state securities laws, it has generally been held that sales of limited partnership interests in real estate ventures involve sales of securities. It is, of course, desirable from the promoter's point of view to organize the entity in such a way that the sales of limited partnership interests will not be construed as investment contracts. If the limited partnership interest is a security, compliance with federal and/or state securities acts may be required. The partnership can save fees and time if securities requirements can be circumvented. Furthermore, a wider geographical area of distribution may be available if the sale does not fall within the securities classification.

The best of both worlds can be attained by (1) giving the limited partner enough control to assure that the sale of the limited partnership interest will not be the sale of a security;

On real estate transactions, including limited partnerships, see 17 C.F.R. 231.4877 (1967).
and (2) assuring that the limited partner does not possess that degree of control which would make him liable as a general partner. Although in certain situations the partnership may obtain registration exemptions, the attorney must keep these two goals in mind when structuring any limited partnership where a public offering is anticipated.

Termination and Winding Up

The U.L.P.A. clearly gives the limited partner the right to demand dissolution of the partnership by decree of court.\(^6\) If the limited partner subsequently takes part in the winding up of the partnership affairs, such action will not be considered control so long as it is in accordance with the court decree.

CONCLUSION

It is submitted that the law on “control” in the limited partnership setting is presently unclear. The minor statutory modifications\(^6\) have provided some guiding light, but they have failed to clear the muddy waters completely. The question of how far a limited partner may go remains unresolved. The decisions have not attempted to state general standards for determining when the limited partners have exercised control. In one case limited partners were entitled to participate in the partnership almost to the exclusion of the general partner without loss of their preferred status,\(^7\) while in other cases lesser action has resulted in liability as general partners.\(^6\) To insure that persons will continue making such investments, it is desirable that the limited partner be allowed to retain a certain degree of control. A clearer delineation of his rights needs to be enunciated by new legislation or by the courts through definitive decisions under section 7 to attain the objectives of the limited partnership organization.

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\(^6\) U.L.P.A. § 10(1) (c).

\(^6\) Adopted by California, Oregon, and Washington, the amendment is set forth at note 25 supra and accompanying text.

\(^6\) Weil v. Diversified Properties, 319 F. Supp. 778 (D.D.C. 1970). It should be noted that this case was an action brought by the general partner rather than a creditor in an attempt to hold the limited partners as general partners.