

NOTES

Limited Partnership Control: A Reexamination of Creditor Reliance

Limited partnership is a form of business organization which offers investors unique advantages. One advantage is that investors, as limited partners, can achieve limited liability with respect to the creditors of the partnership business.¹ Naturally, it is of great concern to limited partners to know what actions on their part will cause them to lose their limited liability status and become personally liable as general partners. Uncertainty in this area of the law weakens the confidence investors have that courts will respect their limited liability status, and threatens the usefulness and popularity of the limited partnership as an investment tool.

Unfortunately, the law currently is in a state of uncertainty concerning the vital issue of when a limited partner will be held personally liable to creditors.² While it is clear that a limited partner becomes personally liable when he takes part in the "control" of the business,³ it is far from clear precisely what constitutes control. State statutes which govern limited partnerships do not adequately clarify the control issue. Moreover, courts and

1. The limited partnership differs from the basic partnership organization by including investors who share in the profits of the business as do normal or "general" partners, but who do not share in its liabilities to the same extent as general partners. Unlike general partners, who are individually liable for the obligations of the partnership, "limited" or "special" partners are only liable to the extent of their investment in the partnership. Limited liability is available to an investor in a corporate form of organization, but the limited partnership offers two additional advantages the corporate form does not. First, the limited partnership vests management control in the general partner (or partners) who is individually liable for the partnership's obligations. Thus, those in control of the limited partnership have a greater responsibility to the limited partners than those in control of the corporation have to the shareholders in that they have more to lose in the event of failure. See Shapiro, *The Need for Limited Partnership Reform: A Revised Uniform Act*, 37 MD. L. REV. 544, 545-46 (1978). Second, the limited partnership is taxed as a partnership, which means that investors can employ the "conduit form" of taxation. I.R.C. § 701 (1984). Partnership taxation allows investors to pass business losses through to offset their individual income from other sources, thereby reducing taxable income. Due to the tax advantages they offer, limited partnerships are used as tax shelters in businesses in which the Internal Revenue Service allows large write-offs through accelerated depreciation, I.R.C. § 167, and percentage depletion, I.R.C. § 613. The best examples of this are real estate development projects and oil and gas drilling. Limited partnerships are, however, employed in many other areas, including small-scale manufacturing, motion-picture making, and farming. The limited partnership is predominant in the production of Broadway shows. O'Neal, *Comments on Recent Developments in Limited Partnership Law*, 1978 WASH. U.L.Q. 669, 688. In these contexts, the limited partnership form allows the entrepreneur who lacks capital to build a business and retain control over it. Finally, the limited partnership has been used in more creative applications, such as making it the beneficiary of a land trust in order to obtain tax and liability advantages. Comment, "Control" in the Limited Partnership, 7 J. MAR. J. PRAC. & PROC. 416, 419 n.23 (1974).

2. See *infra* notes 16-60 and accompanying text.

3. See *infra* note 20 and accompanying text.

commentators widely disagree as to the application of the control provisions within such statutes. Faced with this uncertainty, investors may be reluctant to become limited partners. Instead, such investors may well decide to pursue their investment objectives through other business forms, perhaps by becoming corporate shareholders, even though the alternative form is less suited to their investment needs.⁴

A few legislatures, courts and commentators have sought to clarify the liability issue by adopting a creditor reliance test.⁵ Rather than threatening to impose personal liability whenever a limited partner takes any action which might be considered "control," such a test serves to limit creditor recovery to situations where the creditor has been misled by the conduct of the limited partner. After developing the historical background of the limited partnership, and examining statutory and common law approaches to the control provision, this Note attempts to expose the ambiguities inherent in the current approaches to the control provision. Additionally, this Note analyzes the reliance approach to the control provision and demonstrates its advantages by introducing a system for applying the reliance test to factual situations. Such analysis indicates that use of a reliance test clarifies the legal uncertainty surrounding limited partner liability and thereby enhances investor confidence in the limited partnership form of organization.

BACKGROUND

The limited partnership was first recognized in this country by the state of New York in 1822.⁶ Under early limited partnership statutes in the United

4. See *supra* note 1.

5. See *infra* notes 27-45, 49-52 & 63 and accompanying text.

6. Ch. 244, 1822 N.Y. Laws 259. The predecessor of these statutes was the French Commercial Code, which authorized the formation of the "Societe en Commandite." The origins of this statute trace back hundreds of years. The case of *Ames v. Downing*, 1 Bradf. 321, 329-30 (N.Y. Surrogate Ct. 1850), provides an interesting discussion of the origin of the limited partnership:

The system of limited partnerships, which was introduced by statute into this State, and subsequently very generally adopted in many other States of the Union, was borrowed from the French Code. (3 *Kent*, 36; *Code de Commerce*, 19, 23, 24). . . . [I]t has existed in France from the time of the middle ages; mention being made of it in the most authentic commercial records, and in the early mercantile regulations of Marseilles and Montpellier. In the vulgar Latinity of the middle ages it was styled *commenda*, and in Italy *accommoda*. In the statutes of Pisa and Florence, it is recognized so far back as the year 1166; also in the ordinance of Louis-le-Hutin, of 1315; the statutes of Marseilles, 1253; of Genoa, of 1588. In the middle ages it was one of the most frequent combinations of trade, and was the basis of the active and widely-extended commerce of the opulent maritime cities of Italy. It contributed largely to the support of the great and prosperous trade carried on along the shores of the Mediterranean, was known in Languedoc, Provence, and Lombardy, entered into most of the industrial occupations and pursuits of the age, and even traveled under the protection of the arms of the Crusaders to the city of Jerusalem. At a period when capital was in the hands of nobles and clergy, who, from pride of caste, or canonical regulations, could not engage directly in trade, it afforded the means of secretly embarking in commercial enterprises, and reaping the profits of such lucrative pursuits, without personal risk; and thus the vast wealth, which otherwise would have lain dormant in the coffers of the rich, became the foundation, by means of this ingenious idea, of that great commerce which made princes of the mer-

States, limited partners were allowed limited liability status only if they strictly complied with the statutory provisions.⁷ Since limited partnerships are purely statutory, many courts strictly construed their provisions based on what one commentator has called the "unfortunate shibboleth" that statutes in derogation of the common law are to be strictly construed.⁸ The prevailing view of the legislatures and courts at the time these statutes were being adopted and interpreted was that limited liability status was a privilege conditioned upon abstinence from participation in the control of the business.⁹ It was felt that "any interest in a business should make the person holding the interest liable for its obligations."¹⁰

The effect of strict statutory construction was that limited partnerships were not widely utilized.¹¹ Nevertheless, some courts construed the early statutes more liberally, giving recognition to the notion that creditor reliance was a doctrine inherent in the statutory framework governing the limited partner's liability status. For example, in *Lawson v. Wilmer*,¹² the District Court for the City and County of Philadelphia construed the Pennsylvania statute, which deemed a limited partner to be a general partner if he "transact[ed] any business on account of the partnership,"¹³ and refused to render a limited partner liable for participating in the winding up of the partnership's affairs.¹⁴ The court reasoned that the purpose of the statute was to protect those who dealt with the partnership in reliance on the belief that the limited partner would be personally liable for the debts of the partnership.¹⁵

chants, elevated the trading classes, and brought the Commons into position as an influential estate in the Commonwealth.

7. See Abrams, *Imposing Liability for "Control" Under Section 7 of the Uniform Limited Partnership Act*, 28 CASE W. RES. L. REV. 785, 789 n.10 (1978). Abrams notes that:

[i]n *Smith v. Argall*, 6 Hill 479 (Sup. Ct. 1844), *aff'd*, 3 Denio 435 (N.Y. 1846), for example, a limited partner was held liable as a general partner because the amount of his contribution was incorrectly shown in one of the two newspaper notices the limited partnership was required to publish on formation. The error was due to a printer's error. The creditor did not have to prove reliance.

8. *Brown, The Limited Partnership in Indiana*, 5 IND. L.J. 421, 422 (1930).

9. UNIF. LIMITED PARTNERSHIP ACT § 1 official comment, 6 U.L.A. 561, 563 (1916) [hereinafter cited as ULPA].

10. *Id.*

11. *Id.* at 563-64.

12. 3 Phila. 122, 15 Leg. Int. 133 (Pa. 1858).

13. Act of March 21, 1856, § 17.

14. *Lawson*, 3 Phila. at 123, 15 Leg. Int. at 133.

15. *Id.* The court stated: "The design, no doubt, was to protect third persons, who were ignorant of the relations between the members of the partnership, and who might be led by the presence and intervention of the special partner, to believe that he was personally liable for the debts of the firm." See also *R.W. Rayne & Co. v. Terrell*, 33 La. Ann. 812 (1881), where the court interpreted a similar provision in the Louisiana Code and refused to hold the limited partner liable absent reasonable reliance by the third party:

It is only where a partner *in commendam* holds himself out as a partner, by actively conducting the business, or introduces his name in the partnership style, or declares his connections as a general partner, or acts in a manner in which a partner *only* could act, and third persons are justified to infer and do infer that he is a general partner and act upon that well-founded inference, that he can be held responsible to them

Id. at 815.

In 1916, the National Conference of Commissioners on Uniform State Laws drafted the Uniform Limited Partnership Act (ULPA),¹⁶ which was subsequently adopted in every state except Louisiana.¹⁷ The ULPA had as its purpose the remediation of the strict construction courts had given to earlier statutes.¹⁸ The ULPA specifically repudiated the maxim that statutes in derogation of the common law are to be strictly construed.¹⁹

Section 7 of the ULPA, entitled "Limited Partner Not Liable to Creditors," provides that "[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."²⁰ While this section seems to retain the idea that control and limited liability are mutually exclusive, the Commissioners made evident in their prefatory comments that creditor reliance is related to the issue of control.²¹

Case law interpreting the control provision of the ULPA is scant, but that which does exist demonstrates that courts have been reluctant to find that creditor reliance is necessary to a finding of unlimited liability under section 7. Several courts presented with the issue have strictly construed the control provision, making no mention of reliance.²² The control exercised

16. ULPA, *supra* note 9.

17. The ULPA was superseded in 1976 by the Revised Uniform Limited Partnership Act, 6 U.L.A. (Supp. 1985) [hereinafter cited as RULPA]. See *infra* notes 53-60 and accompanying text. The original ULPA is still in force in 27 jurisdictions. ALASKA STAT. §§ 32.10.010-.290 (1984); D.C. CODE ANN. §§ 41-201 to -229 (1981); FLA. STAT. ANN. §§ 620.01-.32 (West 1977); GA. CODE ANN. §§ 14-9-1 to -9I (1982); HAWAII REV. STAT. §§ 425-21 to -52 (1976); ILL. ANN. STAT. ch. 106½, §§ 44-73 (Smith-Hurd 1952); IND. CODE ANN. §§ 23-4-2-1 to -30 (Burns 1984); KY. REV. STAT. ANN. §§ 362.410 -.700 (Bobbs-Merrill 1972); ME. REV. STAT. ANN. tit. 31, §§ 151-181 (1978); MISS. CODE ANN. §§ 79-13-1 to -57 (1972); MO. ANN. STAT. §§ 359.010-.290 (Vernon 1968); NEV. REV. STAT. §§ 88.010-.310 (1979); N.H. REV. STAT. ANN. §§ 305:1-.30 (1984); N.M. STAT. ANN. §§ 54-2-1 to -30 (1978); N.Y. PARTNERSHIP LAW §§ 90-119 (McKinney 1948); N.C. GEN. STAT. §§ 59-1 to -30 (1982); N.D. CENT. CODE §§ 45-10-01 to -12-04 (1978); OHIO REV. CODE ANN. §§ 1781.01 -.27 (1982); OR. REV. STAT. §§ 69.150-.530 (1983); PA. STAT. ANN. tit. 59, §§ 501-545 (Purdon Supp. 1985); R.I. GEN. LAWS §§ 7-13-1 to -31 (1969); S.D. CODIFIED LAWS ANN. §§ 48-6-1 to -64 (1983); TENN. CODE ANN. §§ 61-2-101 to -130 (1980); TEX. CIV. STAT. ANN. art. 6132A (Vernon Supp. 1985); UTAH CODE ANN. §§ 48-2-1 to -27 (1981); VT. STAT. ANN. tit. 11, §§ 1391-1419 (1984); VA. CODE §§ 50-44 to -73 (1980).

For a listing of the states that have repealed the ULPA and enacted the RULPA, see *infra* note 60.

18. See ULPA, *supra* note 9, § 1 official comment.

19. *Id.* § 28(1).

20. *Id.* § 7.

21. *Id.* § 1 official comment:

First: No public policy requires a person who contributes to the capital of a business, acquires an interest in the profits, and some degree of control over the conduct of the business, to become bound for the obligations of the business; provided creditors have no reason to believe at the times their credits were extended that such person was so bound.

22. *Holzman v. De Escamilla*, 86 Cal. App. 2d 858, 195 P.2d 833 (1948), involved a limited partnership engaged in farming. The limited partner participated in decisions concerning the kinds of produce which would be farmed, and had some degree of control over the issuance of checks. The California District Court of Appeals strictly applied the control provision and found the limited partner individually liable without indicating whether creditors had been misled by his actions. In *Filesi v. United States*, 352 F.2d 339 (4th Cir. 1965), the court similarly

by the limited partners in these cases, however, appeared to have been significant enough for the courts to determine that the limited partners had acted in violation of the statute and to impose personal liability for the benefit of creditors.²³

The majority of cases falling under section 7 involve situations where the limited partner's activities are less pervasive.²⁴ In these situations, the courts generally find it more difficult to ignore the ULPA's protestation against strict construction.²⁵ Consequently, the courts tend to preserve the limited liability status of the limited partners, determining that whatever the limited partners have done, their acts do not amount to section 7 control.²⁶ The lack of emphasis on reliance in these cases, where courts are unable to find that the control by the limited partner is sufficient to justify liability, makes apparent that section 7 has not achieved its goal of clarifying the law. This case by case approach of the courts to the control issue essentially nullifies the changes intended by the ULPA, and represents a return to earlier interpretations of the pre-ULPA statutes which made any form of limited partner activity hazardous.

found the limited partner liable for "openly and publicly [taking] an active part in the management and control of the business." 352 F.2d at 341. The court did not mention reliance, nor did it indicate what it was that the limited partner had done to result in the loss of his limited liability status. In *Gast v. Petsinger*, 228 Pa. Super. 394, 323 A.2d 371 (1974), the limited partnership employed two limited partners as independent engineering consultants. The Superior Court of Pennsylvania determined that the limited partners, due to their engineering expertise, had influenced the decisions of the general partner, who was without such expertise. Thus the court found that the limited partners had exercised control over the partnership business.

23. See *supra* note 22.

24. In *Grainger v. Antoyan*, 48 Cal. 2d 805, 313 P.2d 848 (1957), a limited partner was employed by an auto dealership limited partnership as its sales manager. The Supreme Court of California found that the limited partner had not exercised control, because he did not have the power to hire or fire employees, or to control pricing. Similarly, in *Plasteel Products Corp. v. Helman*, 271 F.2d 354 (1st Cir. 1959), the limited partners controlled the selection of the sales manager for the business, but again the court found that this did not constitute section 7 control. In *Weil v. Diversified Properties*, 319 F. Supp. 778 (D.D.C. 1970), it was the general partner rather than a creditor who brought the action charging his limited partners with liability. His theory was that they had interfered in his control of the business. The court held that the general partner could not prevail since the limited partners had not breached the partnership agreement. 319 F. Supp. at 783. Thus, the court denied the general partner use of section 7, holding that "[t]he provisions of the Limited Partnership Act are primarily designed to protect creditors." *Id.* Nevertheless, a fair reading of the case indicates that the court felt that the limited partners' efforts to keep the firm afloat during a crisis would not have resulted in section 7 liability had a creditor brought the action. In *Trans-Am Builders, Inc. v. Woods Mill, Ltd.*, 133 Ga. App. 411, 210 S.E.2d 866 (1974), the Georgia Court of Appeals allowed the limited partners in an apartment construction partnership to participate in discussions and raise additional funds where the construction project was encountering difficulties. According to the court, this activity did not constitute control. Another interesting case is *Ina L. Block v. Commissioner*, 49 T.C.M. (P-H) 2351 (1980). This was a Tax Court case in which a woman attempted to have her husband declared a general partner so that she could deduct a greater amount of partnership losses from her income. The court acknowledged that the husband was senior employee of the partnership, but concluded that did not amount to control, thereby causing the husband to retain his limited liability status.

25. See *supra* note 24.

26. See *supra* note 24.

Not all courts have ignored the intent of the ULPA. The Supreme Court of Colorado appeared willing to at least acquiesce in a lower court's intimation that reliance on the part of the creditor is a factor in determining whether to charge the limited partner with unlimited liability.²⁷ Other courts have gone further, specifically mentioning creditor reliance.²⁸ It is evident that these courts believed a creditor must show not only that the limited partner exercised control over the partnership business, but also that, by his actions, he led the creditor to mistakenly believe that he was a general partner.²⁹

A number of recent cases have involved limited partners who became officers and directors of a corporation which served as the general partner. This form of business entity, known as a "corpnership,"³⁰ obviously allows the limited partners greater control over the partnership. Corpnerships have presented the courts with the question of whether such an organizational form costs the limited partners their limited liability status under section 7.³¹

27. *Silvola v. Rowlett*, 129 Colo. 522, 272 P.2d 287 (1954). In this case, the limited partner was the foreman in an auto repair limited partnership and advised the general partner. The creditor was the partnership's accountant, suing to collect his wages. The court found that the limited partner had not exercised section 7 control and, more importantly, noted the trial court's finding that the limited partner's status as such was known to the plaintiff at all times. *Id.* at 526, 272 P.2d at 289.

28. *See Rathke v. Griffith*, 36 Wash. 2d 394, 218 P.2d 757 (1950). The Washington Supreme Court was presented with a situation where a limited partner in a fruit canning partnership executed certain documents, including leases and contracts, in conjunction with the general partners. The court pointed out that the plaintiff creditor was not even aware of the existence of the documents, *id.* at 406, 218 P.2d at 764, and concluded:

We call attention once more to the fact that it is not alleged that respondent ever relied on Mr. Griffith's position as a general partner, or in fact ever understood that Mr. Griffith was anything other than a limited partner. Under these circumstances, we see no reason for holding Mr. Griffith liable to respondent as a general partner.

Id. at 407, 218 P.2d at 764.

See also Vulcan Furniture Mfg. Corp. v. Vaughn, 168 So. 2d 760 (Fla. Dist. Ct. App. 1964), where a creditor sought to collect on merchandise he had sold to a limited partnership, on the ground that the limited partnership had failed to obtain a renewal of its certificate and thus had automatically become a general partnership. The Florida District Court of Appeal found that failure to renew the certificate merely transformed the limited partnership from a "de jure" to a "de facto" status, and there was no reason to deny the limited partners their limited liability status. While this was not a section 7 case, the court stated its view of the purpose of the ULPA, namely, to protect only those creditors who deal with limited partners in the mistaken belief that they are general partners responsible for payment of obligations. 168 So. 2d at 764.

More recently, another Florida District Court of Appeal read reliance into the section 7 determination of control in *Outlet Co. v. Wade*, 377 So. 2d 722 (Fla. Dist. Ct. App. 1979). Without mentioning what activities the limited partner had engaged in, the court held that "there was no evidence that [the creditor] relied or had a right to rely on the individual credit of [the limited partner]." 377 So. 2d at 722.

29. *See supra* notes 27 & 28.

30. *See BLACK'S LAW DICTIONARY* 306 (rev. 5th ed. 1979).

31. The ULPA is silent as to whether a corporation can be a general partner in a limited partnership. The Uniform Partnership Act, 6 U.L.A. 1 (1914), however, does include "corporation" in the term "persons" who may become partners. *Id.* § 2. The Act states that its provisions shall apply to limited partnerships so long as they are not inconsistent therewith. *Id.* § 6(2). The RULPA, *supra* note 17, specifically includes corporations in its definition of "persons" who may become general partners. *Id.* § 101(11).

It is in this area in particular that use of the doctrine of creditor reliance has been a critical issue.³²

The use of a corporation by a limited partnership was first presented to the court in *Bergeson v. Life Insurance Corp. of America*,³³ where a limited partnership was formed to organize a corporation, after which the limited partners took control of the corporation and attempted to issue paid corporation stock back to the partnership. The district court rejected the limited partners' position that they should only be liable to the corporate shareholders to the extent of their limited partnership investment, and stated, "the limited partners participated in the management of the partnership," without elaborating what activities of the limited partners constituted control.³⁴

In *Delaney v. Fidelity Lease, Ltd.*,³⁵ the Texas Court of Civil Appeals was presented with a true corporation, where limited partners organized a corporation for the sole purpose of serving as the general partner. The court respected the limited liability status of the limited partners, reasoning that the creditor did not rely to his detriment on the general liability of the limited partners but rather was fully aware of the corporation arrangement.³⁶ The Texas Supreme Court, however, subsequently reversed the lower court,³⁷ and specifically rejected the idea that creditor reliance had anything to do with section 7 control.³⁸ The court found that the limited partners had used the corporation to circumvent section 7's proscription against participation in control, and held that "strict compliance with the statute is required if a limited partner is to avoid liability as a general partner."³⁹

The same issue was presented, on nearly identical facts, to the Washington Supreme Court in *Frigidaire Sales Corp. v. Union Properties, Inc.*⁴⁰ Affirming the court of appeals,⁴¹ the court stated that minimum capitalization of

32. See *infra* notes 33-45 and accompanying text.

33. 170 F. Supp. 150 (D. Utah 1958), *rev'd on other grounds*, 265 F.2d 227 (10th Cir. 1959).

34. *Id.* at 159.

35. 517 S.W.2d 420 (Tex. Civ. App. 1974), *rev'd*, 526 S.W.2d 543 (Tex. 1975).

36. 517 S.W.2d at 426. The court stated:

Admittedly, the decision in the case before us is not free from doubt. The logical reason to hold a limited partner to general liability under the control provision of the [Act] is to prevent third parties from mistakenly assuming that the limited partner is a general partner and to rely on his general liability. However, it is hard to believe that a creditor would be deceived where he knowingly deals with a general partner which is a corporation. That in itself is a creature specifically devised to limit liability. The fact that certain limited partners are stockholders, directors or officers of the corporation is beside the point where the creditor is not deceived. The evidence is that the three limited partners did not control [the limited partnership]. It was controlled by its sole general partner, the corporate entity

37. 526 S.W.2d 543 (Tex. 1975).

38. *Id.* at 545.

39. *Id.* at 546.

40. 88 Wash. 2d 400, 562 P.2d 244 (1977).

41. 14 Wash. App. 634, 544 P.2d 781 (1975).

a corporation is a concern whenever a creditor deals with a corporation, and noted that creditor rights are adequately protected in such a situation through the piercing-the-corporate-veil doctrine of corporate law.⁴² The court held that the creditor was never led to believe that the limited partners were acting within the corporation in any capacity other than as its management, and therefore was not misled as to their limited liability status.⁴³ The Washington Supreme Court struggled to distinguish *Delaney*, rather than reject its reasoning.⁴⁴ Nevertheless, the decision unequivocally incorporates creditor reliance into the determination of section 7 control.⁴⁵

The foregoing cases illustrate the difficulty courts have in determining whether to hold a limited partner personally liable to creditors. The decisions reflect an awareness that a strong policy favoring liability is lacking where

42. *Frigidaire*, 88 Wash. 2d at 405, 562 P.2d at 247.

43. The court held:

When the shareholders of a corporation, who are also the corporation's officers and directors, conscientiously keep the affairs of the corporation separate from their personal affairs, and no fraud or manifest injustice is perpetrated upon third persons who deal with the corporation, the corporation's separate entity should be respected Petitioner knew Union Properties was the sole general partner and did not rely on respondents' control by assuming that they were also general partners. If petitioner had not wished to rely on the solvency of Union Properties as the only general partner, it could have insisted that respondents personally guarantee contractual performance. Because petitioner entered into the contract knowing that Union Properties was the only party with general liability, and because in the eyes of the law it was Union Properties, a separate entity, which controlled the limited partnership, there is no reason for us to find that respondents incurred general liability for their acts done as officers of the corporate general partner.

Id.

44. The court found that in *Delaney*, the sole purpose of the corporation was to operate the single limited partnership whereas in the present case the corporation was not organized for the sole purpose of operating one limited partnership, but several. The court also noted that it was apparently still undecided whether corporations were legal in Texas. *Id.* at 404, 562 P.2d at 246. The latter argument seems rather tenuous in light of the considerations outlined above. *See supra* note 31.

45. A fourth case in this area is *Western Camps, Inc. v. Riverway Ranch Enter.*, 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (1977). Again the facts were similar to those in *Delaney*. The California District Court of Appeals looked at both that case and *Frigidaire*, and concluded that it agreed with the views expressed in *Frigidaire*, thus refusing to hold the limited partners personally liable. *Id.* at 729, 138 Cal. Rptr. at 929. In a final case, again based on a comparison of *Delaney* and *Frigidaire*, *Mursor Builders, Inc. v. Crown Mountain Apt. Ass'n*, 467 F. Supp. 1316 (D.V.I. 1978), the Federal District Court for the Virgin Islands reached the opposite result. The court, however, made clear it was not the fact that a corporation was used as a general partner, but rather its misuse, that caused the liability to attach. The judge reasoned:

I do not hold that merely by acting as officers of a corporate general partner, limited partners become subject to general liability. Rather, I hold that where, as herein, the corporate officers co-mingle partnership funds with personal funds, fail to maintain complete corporate and partnership financial records, utilize corporate and partnership funds for their personal enjoyment, and fail to maintain their corporate officer identify in conducting partnership affairs, said limited partners become generally liable for the debts of the partnership irrespective of third party creditor reliance.

Id. at 1333-34.

a limited partner's exercise of control is not pervasive and where a creditor has not been misled. In the corpnership cases, it is clear that the limited partners were in complete control, and yet there was a recognition that it is unfair to allow the creditor recovery where he has knowingly dealt with the partnership. In light of these considerations, statutory reform was inevitable.

The confusion created by section 7 prompted a number of states to amend their statutes dealing with limited partnership control. New York changed its provisions to list certain activities of the limited partner which would not violate section 7 control.⁴⁶ Five states⁴⁷ amended their acts to provide that limited partners could vote on certain matters without violating section 7 control.⁴⁸ More notable was the adoption by a few states of a control section which specifically incorporated reliance.⁴⁹ Perhaps the most significant step was taken by the Texas legislature. Saying that the control provision "generated one of the cloudiest issues of partnership law,"⁵⁰ the Bar Committee which drafted the amendment expressly overruled the Texas Supreme Court's decision in *Delaney*.⁵¹ The amended act permits certain limited partner activities, and incorporates a reliance test.⁵²

46. N.Y. PARTNERSHIP LAW §§ 96-99 (McKinney Supp. 1978).

47. CAL. CORP. CODE § 15507 (West 1977); DEL. CODE ANN. tit. 6, § 1707 (1975); NEV. REV. STAT. § 88.080 (1973); OR. REV. STAT. § 69.280 (1975); WASH. REV. CODE ANN. § 25.08.020 (Supp. 1977) (repealed 1982).

48. These matters included election or removal of the general partner, termination of the partnership, amendment of the partnership agreement, and sale of all or substantially all of the partnership assets. It should also be noted that many limited partnership interests are considered securities, and as such are regulated by state Blue Sky laws. In recognition of certain abuses by general partners in large tax shelter limited partnerships, securities administrators provided that limited partners must have the rights listed above. See Note, *Partnership: Can Rights to Be Given Limited Partners Under New Tax Shelter Investment Regulations Be Reconciled with Section 7 of the Uniform Limited Partnership Act?*, OKLA. L. REV. 289 (1973). As the title of the Note suggests, the use of such rights by limited partners could easily result in a judicial finding of control and hence, liability. It is clear that investors cannot confidently use limited partnerships where on the one hand they are required by law to possess certain powers, and on the other hand are required by law not to exercise those powers.

49. Alabama, ALA. CODE § 10-9-41 (1977), and Delaware, DEL. CODE ANN. tit. 6, § 1707 (1975) took such a step. The Alabama statute was changed to provide:

A limited partner may from time to time examine into the state and progress of the partnership business, advise as to its management and act as attorney-at-law, but he must not act as agent for the partnership for any purpose; and if he acts contrary to this subsection, he is liable as a general partner to any partnership creditor who extends credit to the partnership in the good faith belief that he was dealing with a general partner.

ALA. CODE § 10-9-41 (1977).

50. TEX. REV. CIV. STAT. ANN. art. 6132a, § 8 comment of bar committee (Vernon 1979).

51. The Bar Committee's statement on the reliance issue is as follows:

(A) Creditor Reliance Test. Other states have read into their equivalent of the original § 8 a creditor reliance test. Its essence is that a limited partner is not automatically liable for partnership obligations by taking part in control, but is liable for such action only to a creditor who was led to believe that the limited partner was a general partner. See *Frigidaire Sales Corp. v. Union Properties, Inc.*, 88 Wash. 2d 400, 562 P.2d 244 (1977); *Western Camps, Inc. v. Riverway Ranch Enterprises*, 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (1977). Delaware

In 1976, the National Conference of Commissioners on Uniform State Laws drafted the Revised Uniform Limited Partnership Act (RULPA),⁵³ which changed section 7 considerably. Section 303 of RULPA is entitled "Liability to Third Parties," and provides, in part:

(a) Except as provided in subsection (d), a limited partner is not liable for the obligations of a limited partnership unless he is also a general partner or, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business. However, if the limited partner's participation in the control of the business is not substantially the same as the exercise of the powers of a general partner, he is liable only to persons who transact business with the limited partnership with actual knowledge of his participation in control.⁵⁴

The new control section goes on to provide a list of activities which do not constitute participation in the control of the business.⁵⁵

has enacted the reliance test in the same form as § 8(a). 6 DEL. CODE ANN. § 1707(a). The Texas Supreme Court, however, rejected a reliance test since it was not explicit in the Texas statute. *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543 (Tex. 1975). That decision created a windfall for careless or indifferent creditors at the expense of limited partners. The amendment to § 8(a) overrules *Delaney* by enacting a reliance test. The amendment puts the burden of proof on the creditor to show that he or she reasonably believed that the limited partner was a general partner, as well as that the limited partner took part in control. The basis for the creditor's belief that a limited partner was a general partner will depend on the circumstances. Normally the creditor will have to show that the limited partner has been involved in the day-to-day management of the partnership. See Op. Atty. Gen. (Tex.) H-1229 (Aug. 16, 1978) and cases cited there. If a limited partner holds himself or herself out as a general partner, he or she may be liable as a partner by estoppel, under *Texas Uniform Partnership Act* § 16, *Vernon's Ann. Civ. Stat.* art. 6132b, § 16.

Id.

52. TEX. REV. CIV. STAT. ANN. art. 6132a, § 8(a) (Vernon 1979) provides:

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, and then only to a person who transacts business with the partnership reasonably believing that the limited partner is a general partner.

53. RULPA, *supra* note 17.

54. *Id.* § 303(a).

55. The remainder of section 303 states:

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

- (1) being a contractor for or an agent or employee of the limited partnership or of a general partner;
- (2) consulting with and advising a general partner with respect to the business of the limited partnership;
- (3) acting as surety for the limited partnership;
- (4) approving or disapproving an amendment to the partnership agreement; or
- (5) voting in one or more of the following matters:
 - (i) the dissolution and winding up of the limited partnership;
 - (ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership other than in the ordinary course of its business;
 - (iii) the incurrence of indebtedness by the limited partnership other

According to the Commissioners' Prefatory Note, the purpose of the new act was to clarify ambiguities in the prior uniform law.⁵⁶ Recognizing that the limited partner liability issue is the "single most difficult issue facing lawyers who use the limited partnership form of organization,"⁵⁷ the Commissioners explain in the Prefatory Note and in their comment to section 303 how the new control provision is to apply.⁵⁸

No state adopted the RULPA until 1979 when the Act finally received a favorable ruling from the Internal Revenue Service that limited partnerships formed under it would continue to receive partnership tax treatment.⁵⁹ Fol-

than in the ordinary course of its business;

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

(v) the removal of a general partner.

(c) The enumeration in subsection (b) does not mean that the possession or exercise of any other powers by a limited partner constitutes participation by him in the business of the limited partnership.

(d) A limited partner who knowingly permits his name to be used in the name of the limited partnership, except under circumstances permitted by Section 102(2)(i), is liable to creditors who extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner.

Id. § 303(b)-(d).

56. RULPA, *supra* 17, Commissioners' Prefatory Note, at 200.

57. *Id.* at 201.

58. The Commissioners state in the Prefatory Note:

Section 303 lists a number of activities in which a limited partner may engage without being held to have so participated in the control of the business that he assumes the liability of a general partner. Moreover, it goes on to confine the liability of a limited partner who merely steps over the line of participation in control to persons who actually know of that participation in control. General liability for partnership debts is imposed only on those limited partners who are, in effect, "silent general partners." With that exception, the provisions of the new act that impose liability on a limited partner who has somehow permitted third parties to be misled to their detriment as to the limited partner's true status confine that liability to those who have actually been misled.

Id. The Commissioners elaborate further on how the new control provision is to be applied in their comment to section 303:

Section 303 makes several important changes in Section 7 of the prior uniform law. The first sentence of Section 303(a) carries over the basic test from former Section 7—whether the limited partner "takes part in the control of the business"—in order to insure that judicial decisions under the prior uniform law remain applicable to the extent not expressly changed. The second sentence of Section 303(a) reflects a wholly new concept. Because of the difficulty of determining when the "control" line has been overstepped, it was thought unfair to impose general partner's liability on a limited partner except to the extent that a third party had knowledge of his participation in control of the business. On the other hand, in order to avoid permitting a limited partner to exercise all of the powers of a general partner while avoiding any direct dealings with third parties, the "is not substantially the same as" test was introduced. Paragraph (b) is intended to provide a "safe harbor" by enumerating certain activities which a limited partner may carry on for the partnership without being deemed to have taken part in control of the business

Id. § 303 Commissioners' comment.

59. Treas. Reg. § 301.7701-2 (1979). The Internal Revenue Service was reluctant to make such a ruling because of a concern that the RULPA would allow limited partnerships which had a limited liability characteristic, and which should be taxed as associations. In other words, the Service was concerned that the RULPA would allow for a corpnership wherein the liability

lowing this ruling, a number of states were quick to adopt the Act, and it is presently in force in twenty-three states.⁶⁰

AMBIGUITIES PRESENTED BY THE CONTROL PROVISIONS

It is clear that a fundamental purpose of the ULPA was to protect creditor reliance.⁶¹ It would seem imperative to incorporate into section 7 of the Act the reliance considerations suggested by the drafters. Yet the foregoing discussion indicates that many courts have been less than eager to embrace reliance concepts.⁶² Commentators have likewise been in disagreement as to the role of reliance in the determination of limited partner liability. A number of commentators have felt that notions of reliance should somehow be tied to the determination of section 7 liability.⁶³ Others have suggested that courts should look to the effect of the limited partner's activity on the third party creditor,⁶⁴ or to the degree to which the limited partner's activity could have prejudiced the third party,⁶⁵ rather than reliance by the third party creditor.

of the general partner is, in fact, no greater than that of the limited partners. *See Anzivino, When Does a Limited Partnership Possess the Corporate Characteristic of Limited Liability?*, 13 IND. L. REV. 503 (1980). The fact that creditors may pierce the corporate veil where the corporate general partner is undercapitalized would seem to mitigate the Service's concern in this area. The Service's uncertainty as to limited partnership taxation, which is of critical importance to limited partners, unfortunately, exacerbates investor apprehension toward the limited partnership form of organization.

60. ALA. CODE §§ 10-9-A-1 to -203 (Supp. 1984); ARIZ. REV. STAT. ANN. §§ 29-301 to -363 (Supp. 1983); ARK. STAT. ANN. §§ 65-501 to -566 (1980); CAL. CORP. CODE §§ 15611-723 (West Supp. 1983); COLO. REV. STAT. §§ 7-62-101 to -1201 (Supp. 1982); CONN. GEN. STAT. ANN. §§ 34-9 to -38n (West 1981); DEL. CODE ANN. tit. 6, §§ 17-101 to -1107 (Supp. 1982); IDAHO CODE §§ 53-201 to -267 (Supp. 1983); IOWA CODE ANN. §§ 545.101 to -.1106 (West 1983); KAN. STAT. ANN. §§ 56-1201 to -12607 (1983); MD. CORPS. & ASS'NS. CODE ANN. §§ 10-101 to -1104 (Supp. 1983); MASS. GEN. LAWS ANN. ch. 109, §§ 1-62, (West 1982); MICH. COMP. LAWS ANN. §§ 449.1101-.2108 (West Supp. 1983); MINN. STAT. ANN. §§ 322A.01-.87 (West 1981); MONT. CODE ANN. §§ 35-12-501 to -1404 (1983); NEV. REV. STAT. §§ 67-233 to -297 (1981); N.J. STAT. ANN. §§ 42:2A-27 (West Supp. 1984); OKLA. STAT. ANN. tit. 54, §§ 301-64 (Supp. 1984); S.C. CODE ANN. §§ 33-42-10 to -2020 (Law. Co-op. Supp. 1984); WASH. REV. CODE ANN. §§ 25.10.010 to -.690 (Supp. 1983); W. VA. CODE §§ 47-9-1 to -63 (Supp. 1983); WIS. STAT. ANN. §§ 179.01-.94 (West Supp. 1984); WYO. STAT. §§ 17-14-102 to -1104 (Supp. 1983). Kansas, Oklahoma, and South Carolina are the three states which have most recently enacted the RULPA. Telephone conversation with the office of the Commissioners on Uniform State Laws. Additionally, the Ohio state legislature has approved the adoption of the Act, and it awaits the governor's signature. The new Delaware control provision, DEL. CODE ANN. tit. 6, § 17-303 (Supp. 1982), retains its reliance provision. *See supra* note 49. Additionally, Alabama has revised its control provision to bring it more into line with section 303, but still retains the reliance requirement. ALA. CODE 10-9A-42 (Supp. 1983). *See also supra* note 49.

61. The drafters of the Act stated as much in their Official Comments. *See supra* notes 16-21 and accompanying text. William Draper Lewis, one of the drafters, later confirmed this proposition. Lewis, *The Uniform Limited Partnership Act*, 65 U. PA. L. REV. 715, 723 (1917).

62. *See supra* notes 22-26 and accompanying text.

63. *See generally* Feld, *The "Control Test" for Limited Partnerships*, 82 HARV. L. REV. 1471 (1969); Feldman, *The Limited Partner's Participation in the Control of the Partnership Business*, 50 CONN. B.J. 168 (1976); Note, *Activities Making a Limited Partner Liable as a General Partner*, 56 MICH. L. REV. 285 (1957).

64. *See generally* Abrams, *supra* note 7.

65. *See generally* Flannigan, *The Control Test of Investor Liability in Limited Partnerships*, 21 ALTA. L. REV. 303 (1983).

Recently, a few commentators have suggested that equitable doctrines of estoppel and fraud may be sufficient to protect creditors, so as to eliminate the need for a control provision.⁶⁶

The diversity of opinion surrounding the control provision is due in large part to the surprising wealth of ambiguity that can be drawn out of the various control statutes. For example, a common argument against incorporating reliance into section 7 determinations is that sections 5 and 6 of the Act specifically mention reliance, thereby causing one to question why mention of it was omitted in section 7 if it were intended to play such a critical role.⁶⁷ On the other hand, the language of the statute does not encourage the interpretation that the limited partner can engage in some degree of control, and yet that is the clear intent of the drafters.⁶⁸ Another problem with section 7 is that absent the use of a reliance test, it is incapable of clarification. There is no way to fashion a predictable boundary between permissible and impermissible control.

Unfortunately, the Revised Act's provision for control, section 303, is nearly as ambiguous as section 7.⁶⁹ The obvious implication of the second sentence in section 303(a)⁷⁰ is that a limited partner whose participation in control is substantially the same as a general partner will be liable to creditors irrespective of whether they have been misled. Thus, it is uncertain whether a corpnership arrangement is prohibited under the Act. The Revised Act does not indicate how corpnerships should be treated. It is also curious to note that the Commissioners' Prefatory Remarks indicate that general liability under the second sentence "is imposed only on those limited partners who are, in effect, 'silent general partners.'"⁷¹ Use of the word "silent" leads one to believe the Commissioners only meant to impose liability where the creditor was unaware of the limited partner's activities. Yet this inference is clearly not allowed by the language of the Act.⁷²

The Commissioners' statement in the Prefatory Note that liability is confined "to those who have actually been misled,"⁷³ is very ambiguous. The language of section 303(a) allows liability only where the creditor has actual knowledge of the limited partner's participation in control.⁷⁴ There is no

66. See Kessler, *The New Uniform Limited Partnership Act: A Critique*, 48 *FORDHAM L. REV.* 159, 167 (1979); Comment, *An Analysis of the Revised Uniform Limited Partnership Act*, 18 *AM. BUS. L.J.* 399, 409 (1980) [hereinafter cited as Comment, *An Analysis*]; Comment, *Limited Partner Control and Liability under the Revised Uniform Limited Partnership Act*, 32 *SW. L.J.* 1301, 1326 (1979) [hereinafter cited as Comment, *Limited Partner Control*].

67. See Abrams, *supra* note 7, at 801; Note, *supra* note 63, at 287.

68. See *supra* note 21.

69. Commentators have been quick to point this out. See generally Abrams, *supra* note 7; Kessler, *supra* note 66; Comment, *Limited Partner Control*, *supra* note 66; Comment, *An Analysis*, *supra* note 66.

70. See *supra* text accompanying note 54 for the text of section 303(a).

71. Commissioners' Prefatory Note, *supra* note 58.

72. See *supra* text accompanying note 54.

73. Commissioners' Prefatory Note, *supra* note 58.

74. See *supra* text accompanying note 54.

question that a limited partner can mislead a creditor without the creditor having such knowledge. For example, the limited partner could conceal his activities and the creditor could deal with the partnership in the reasonable belief that the general partner, not the limited partner, is responsible for the satisfaction of the firm's debts to the creditor.⁷⁵

A number of ambiguities are inherent in the "safe harbor" provisions of section 303(b).⁷⁶ Under section 303(b)(1), the limited partner may be an employee of the partnership, but this provision has the same flaw as section 7. The section replaces the uncertainty over how much control the limited partner may exercise with the uncertainty over how much of an employee the limited partner may become. It is questionable whether the section was intended to allow the limited partner to become a manager of the partnership. Section 303(b)(2) allows the limited partner to advise the general partner. It is unclear whether this section is intended to overrule *Gast v. Petsinger*.⁷⁷ Here, too, there exists an uncertain boundary where the limited partner's advice becomes influence and control. Section 303(b)(3) is a provision which actually benefits creditors. It is therefore unlikely that a creditor would sue a limited partner for acting as a surety. Sections 303(b)(4) and 303(b)(5) involve the limited partner's right to have a say in extraordinary changes in the partnership. As such, they constitute powers which are rarely used. However, their very function is to restrain the power of the general partner. The ability to remove the general partner amounts to, in effect, the ability to hold a club over his head, and thereby gives the limited partner total control. It is obvious that the "safe harbor" provisions of section 303(b) are rife with dangers to the limited liability of the limited partner.

Yet another ambiguity is presented by the apparent differences in coverage of section 7 and section 303. It is clear from the language and title of section 7 that it governs liability with respect to creditors. Thus, its application is limited to contractual situations. Section 303 does not mention creditors, but rather third parties,⁷⁸ leading one to question whether the revised control provision now applies to nonconsensual situations as well. The Commissioners' comments fail to shed light on this question.

Finally, section 208 of the Revised Act declares that a properly filed limited partnership certificate is notice of the limited liability of the limited partners.⁷⁹ If this is true, it is difficult to perceive how a creditor could ever be misled into believing a limited partner is other than such.

75. Abrams puts forth this proposition well: "Of all the individuals in the world who might assume control of a partnership, a creditor has at least some right to expect that those who specifically represented that they would not assume control can be relied upon not to do so." Abrams, *supra* note 7, at 798.

76. See *supra* note 55 for the text of section 303(b).

77. 228 Pa. Super. 394, 323 A.2d 371 (1974). See *supra* note 22.

78. See *supra* text accompanying note 54.

79. RULPA, *supra* note 17, § 208.

A REEXAMINATION OF THE RELIANCE TEST

Adoption of a reliance test to determine the liability status of a limited partner avoids the many ambiguities presented above. This can best be demonstrated by perceiving how such a test is applied. An understanding of how the notion of creditor reliance can work in conjunction with limited partner control provisions, however, is difficult to develop without an awareness of the variety of relationships between a limited partner and a creditor which can lead to creditor reliance. For example, if a creditor knows that an individual exercises control, he may or may not know that the individual is a limited partner. Conversely, if a creditor knows that an individual is a limited partner, he may or may not know that the individual exercises control. These relationships are made more complex by the fact that where a creditor does not know of a limited partner's status or involvement, he may infer, or be misled into believing, either that the limited partner is a general partner when in fact he is not, or that the limited partner does not exercise control when in fact he does. To clarify these distinctions, assume that *L* is a limited partner and *C* is a creditor. Five possible scenarios can develop when *C* deals with *L*'s firm, and *L* exercises control:

- (1) *C* knows *L* exercises control and knows that *L* is a limited partner.
- (2) *C* knows *L* exercises control, and *L* intentionally misleads *C* into believing that *L* is a general partner.
- (3) *C* knows *L* exercises control and therefore infers that *L* is a general partner.
- (4) *C* knows that *L* is a limited partner, and *L* conceals from *C* his exercise of control so that *C* is intentionally misled into believing that *L* does not exercise control.
- (5) *C* knows that *L* is a limited partner, and is unaware of *L*'s participation in control, and *C* therefore infers *L* does not exercise control.

Only in the first scenario does *C* deal with the partnership from a position of full knowledge. In the second and fourth scenarios, the creditor has been misled. In the third and fifth scenarios, the creditor has made a mistaken inference. Reliance has an application to each scenario except the first one. In (2) the creditor relies on a verbal representation by the limited partner. In (4) the creditor relies on the limited partner's intentional silence, a non-verbal representation. In (3) the creditor relies on the limited partner's actions. In (5) the creditor relies on the limited partner's inaction. Of course, the effect on the creditor is the same whether he is actually misled or makes a mistaken inference. However, an awareness of all five scenarios is necessary to see exactly how sections 7 and 303(a) operate, and why a reliance-based liability test is ideal.

Section 7 of the UPLA states that "[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."⁸⁰ It is obvious that under section 7, the limited partner will be held

80. UPLA, *supra* note 9, § 7.

liable in each scenario above, because in each case the limited partner has exercised control. As discussed above, courts and commentators have objected to section 7 for such a blind, overly broad application.⁸¹ The majority of courts incorporating reliance considerations do so to avoid application of section 7 to fact situations identical to the first scenario.⁸² Where a creditor knows limited partners are exercising control and knows they are only limitedly liable, as in the first scenario, and still deals with the partnership, there is no strong policy argument which can justify judicial interference to absolve the creditor of the risks he incorporated into his dealings with the partnership.

Section 303(a) is somewhat more involved. Its approach is two-tiered, distinguishing between situations where the limited partner exercises control substantially the same as that of a general partner and situations where he exercises a lesser amount of control.⁸³ In the first situation, where the limited partner exercises control substantially the same as that of a general partner, section 303(a) applies in the same way as section 7 to each of the above scenarios. The same criticisms of section 7 apply here. The corpnership arrangement⁸⁴ is an example of a fact situation identical to the first scenario where the limited partner's control is substantially the same as that of a general partner. It follows that section 303(a) would operate to prohibit this arrangement. Thus, this part of section 303(a) sweeps too broadly.

In the second situation, where the limited partner's exercise of control is less than that of a general partner, section 303(a) imposes liability only in favor of those creditors having actual knowledge of such control.⁸⁵ Liability is imposed in the first three scenarios, because these three are the only situations where the creditor has knowledge of the limited partner's exercise of control. Again, the shortcomings of section 303(a) are evident. Liability is imposed in the first scenario, where creditors have dealt with the partnership in full knowledge of the situation. Here the limited liability status of the limited partner should be preserved. Additionally, liability under section 303(a) is not imposed in the fourth and fifth scenarios where favoring the creditor would be much more preferable. In both (4) and (5), the creditor's reliance on the limited partner's status as a limited partner has led the creditor to believe that it is the general partner who is responsible for the security of his credit. It is easy to imagine a situation where a creditor would not extend credit to a partnership if he knew a limited partner was responsible for its return. Thus, this part of section 303(a) is overinclusive with respect to (1) and underinclusive with respect to (4) and (5).

The foregoing analysis also enables one to understand how reliance considerations interact with other equitable doctrines. For example, section 16

81. See *supra* notes 22-45 & 61-68 and accompanying text.

82. See *supra* 27, 28 & 43 and accompanying text.

83. See *supra* text accompanying note 54.

84. See *supra* notes 30-45 and accompanying text.

85. See *supra* text accompanying note 54.

of the Uniform Partnership Act,⁸⁶ entitled "Partner by Estoppel," provides that a person is liable to a creditor to whom he has represented himself to be a partner, where the creditor has extended credit relying on the faith of such representation.⁸⁷ Assuming that this provision is not inconsistent with the Limited Partnership Act and therefore has application to limited partnerships,⁸⁸ a limited partner would lose his limited liability status in the second scenario, where he has made a misrepresentation. Estoppel might also be applied in the fourth scenario, to the extent that silence is a non-verbal representation. However, it is unlikely that estoppel could be applied to the third and fifth scenarios, because no representation has been made.

Section 208 of the RULPA, mentioned above,⁸⁹ imposes constructive notice upon creditors of the limited liability status of the limited partners. In the second and third scenarios, the creditor believes the limited partner is a general partner, so it would seem that section 208 applies to both of these cases. The Commissioners' Comment to section 208, however, states that the provision "is not intended to change any liability of a limited partner which may be created by his action or inaction under the law of estoppel"⁹⁰ Since estoppel can be applied to the second scenario, section 208 denies a creditor recovery against a limited partner only in the third scenario. The implication of section 208 is that in (3), it is not reasonable for the creditor to infer that the limited partner is a general partner based upon his exercise of control. It is unfair to find the creditor reasonably relied on the limited partner's conduct when all the creditor had to do before extending credit was to take a look at the limited partnership certificate. A creditor should be expected to have some amount of responsibility for his business dealings. Thus, the result obtained here is desirable. It can of course be argued that a shrewd creditor may figure that he can count on the law to impose liability on the limited partner whom he knows is participating in control. One answer to this is that the creditor in such a situation is using the law to achieve a result not intended. A better answer is to recognize that an estoppel theory should apply.⁹¹

Finally, in the fifth scenario, the agency concept of undisclosed principal can apply to hold the limited partner liable. This concept would be limited to situations where a limited partner exercised sufficient control to justify a finding that the general partner with whom the creditor dealt was an agent of the limited partner.

86. UNIF. PARTNERSHIP ACT, 6 U.L.A. 1 (1914).

87. *Id.* § 16(1).

88. *See supra* note 31.

89. *See supra* note 79 and accompanying text.

90. RULPA, *supra* note 17, § 208 Commissioners' comment.

91. Feldman has compared this situation to a similar one in corporate law. A creditor is estopped to deny the existence of the corporate entity following defective incorporation where he has dealt with it as a corporate entity. Feldman, *supra* note 63, at 196-97 n.63.

It can now be seen that the ideal reliance test presumes limited liability for a limited partner in the first and third scenarios, where there has been no reliance or unreasonable reliance. Such a test causes a limited partner to be personally liable in the second, fourth, and fifth scenarios, where he has misled a creditor deliberately or by his conduct has induced reasonable detrimental reliance. The Alabama, Delaware, and Texas statutes, which incorporate creditor reliance on the good faith belief that the limited partner is a general partner, are a step toward this test.⁹² However, these statutes do not cover the type of reliance occurring as a result of the limited partner's control being undisclosed. It may well be that estoppel, constructive notice and agency concepts could serve as a substitute for a reliance-based test, but the latter is a far simpler and more coherent approach.

A number of related situations involving limited partnership control have yet to be examined in light of a reliance test. First, it is conceivable that instead of forming a copnership, the limited partners might appoint and direct the activities of a general partner. The relevant consideration is whether the creditor is aware of the arrangement. Assuming he is, there is no reason for holding the limited partners personally liable. Again, the result of the reliance test is that it avoids distinctions between permissible and impermissible control. The test is instead premised on the proposition that any amount of control is permissible absent reasonable, detrimental creditor reliance.

A second situation is where the general partner wishes to hold the limited partners liable for interfering in the control of the business, as was the case in *Weil v. Diversified Properties*.⁹³ The court in that case correctly held that the control provision is for the protection of creditors. The general partner has no right to complain where the limited partners have not breached their agreement with him, such agreement being the limited partnership certificate. Where the general partner is also a creditor of the business, it is clear that he would have full knowledge in his dealings with the partnership and should not be able to later look to the limited partners to bear the burden of his improvident bargain.

Finally, nonconsensual situations present an issue. It is clear that there are occasions where, for example, partner activity results in tortious harm to third persons. A reliance test has application only to consensual situations involving creditors.⁹⁴ It is arguable that section 303 extends beyond the scope of section 7 to nonconsensual situations.⁹⁵ Such an extension ignores the historical basis of the control section.⁹⁶ Moreover, where a limited partner commits a tort, he can be held accountable regardless of his limited liability

92. See *supra* notes 49 & 52.

93. 319 F. Supp. 778 (D.D.C. 1970). See *supra* note 24.

94. The reliance test looks only to whether a creditor voluntarily deals with a limited partnership and, if so, what knowledge the creditor possesses concerning the limited partner.

95. See *supra* text accompanying note 79.

96. See *supra* text accompanying note 78.

status.⁹⁷ The hardest question arises in a situation where a limited partner, who is not the tortfeasor, has nevertheless exercised control over the partnership resulting in the dissipation of the partnership assets. Since, under section 13 of the ULPA, the partnership is bound by the torts of a partner, the limited partner has effectively reduced the recovery available to the injured party. Had the general partner been responsible for the dissipation of the assets, however, the injured party would be in no better position. To a large extent, the injured party's recovery against the partnership, above and beyond his recovery against the tortfeasor, is an application of respondeat superior and "deep pocket" notions. Thus, his recovery against the partnership, however much dissipated, remains somewhat of a windfall. For these reasons, the control provisions governing limited partner liability should be confined to contractual situations.

CONCLUSION

Very few legislatures have adopted a reliance-based test for limited partner liability. Statutes which do incorporate such a test are imperfect. To date only a few courts have looked to reliance in determining limited partner liability. Nevertheless, the history of the limited partnership, the policies underlying its formation, and the judicial and legislative attempts to regulate its use have all evinced the proposition that creditor reliance plays a fundamental role in the determination of a limited partner's liability.

For these reasons, this Note urges the adoption of a reliance test which should function as follows: the limited partner's limited liability should be preserved where there has been no reliance by the creditor and where there has been unreasonable reliance by the creditor. On the other hand, the creditor should be favored and personal liability should be imposed where the limited partner has deliberately misled the creditor or acted in such a way as to induce reasonable detrimental reliance by the creditor.

Use of a reliance-based test clarifies the control problem and more importantly promotes the policies underlying the use of the limited partnership form of organization. By looking to the nature of the relationship between the limited partner and the creditor, the investor is better able to predict the situations in which he will lose his limited liability status as a limited partner. By being more certain as to his potential liability, the investor can have greater confidence in the limited partnership as an investment tool.

R. KURT WILKE

97. See, e.g., RESTATEMENT (SECOND) OF AGENCY §§ 343-59A (1957) (stating generally that an agent who does an act otherwise a tort is not relieved from liability by the fact that he acted on account of the principal).

