

## AGENCY AND PARTNERSHIP OUTLINE

*Substance over Form!*

1. **ANALYSIS AND PARTIES TO LITIGATION.**
  - A. **Exam Analysis.** First, determine whether or not there is an agency relationship. Second, figure out the terms of the agreement, if any. Third, determine whether or not there is a breach. Fourth, figure out if there is liability between the agent and principal, and between the agent or principal and third parties.
  - B. **Litigation Positions.** A third party can sue an agent and a principal. The agent and the principal may also sue each other.
2. **DEFINITION, PROOF, AND KINDS OF AGENCY.**
  - A. **Definition of Agency.** Agency is the fiduciary relationship that arises when one person (a “principal”) manifests assent to another person (an “agent”) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents to act.
    - i. **On Behalf Of.** The purported agent must be acting primarily for the benefit of the purported principal, not merely benefiting another by the purported agent’s actions.
    - ii. **Control.** The purported principal must have the right to control the conduct of the purported agent with respect to matters entrusted to him. Control means prescribing what another will or will not do before and/or during certain acts.
    - iii. **Consent.** Consent can exist even where the parties fail to recognize that they have created an agency relationship. It can be express or implied.
  - B. **Proof of Agency.** Since a person is presumed to act for himself, the burden of proof is on the one asserting the existence of the agency relationship, but proof can be implied from facts, words, acts, circumstances, and prior conduct of the parties.
    - i. **Common Examples.** Agency will generally not be found in the following circumstances without more: offering help, suggestions, or favors; bailor/bailee; trustee/beneficiary; franchisor/franchisee; spouses; landlord/tenant; and family members.
    - ii. **Agency to Sell.** A person selling the goods of another will not be an agent unless the parties agree that the seller is to act primarily for the benefit of the other, determined by: (1) title of the property; (2) power to fix price and terms, recall the goods, and to demand proceeds; and (3) the existence of a commission.
    - iii. **Debtor/Creditor.** A creditor who assumes de facto control of his debtor’s business for the mutual benefit of himself and his debtor may establish an agency relationship.
    - iv. **Employer/Insurance Carrier.** An employer’s administration of a group insurance plan will not create an agency relationship, except to the extent the employer, with the consent of the insurer, performs the functions of the insurer, or has certain functions delegated to it.
    - v. **Middleman.** A person may be a middleman instead of an agent, allowing him to work for both adverse parties without disclosure, so long as he has nothing to do with negotiations or the drafting of the agreement.
  - C. **Coagent.** A coagent is one of two or more agents of a principal. Coagents can be in a hierarchical relationship, but coagents do not have an agency relationship between each other.
  - D. **Subagent.** A subagent is one appointed by an agent to perform functions on behalf of the agent’s principal. The appointing agent and subagent have an agency relationship, and the principal will be liable for the acts of a subagent, so long as the principal knew or had reason to know that the agent would appoint a subagent, and impliedly or expressly consented.
  - E. **Notice.** Notice to an agent or subagent in the course of a transaction within the scope of agency is notice to the principal.
3. **RIGHTS AND DUTIES BETWEEN PRINCIPAL AND AGENT.** Some duties are default rules which can be contracted around, and some are mandatory rules that cannot be contracted around.
  - A. **Agent’s Duty of Care/Performance.** The agent must act only as the principal authorizes, use reasonable effort to provide material facts to the principal, and act with the competence, care, and diligence normally

exercised by agents in similar circumstances.

- i. **Reasonable Effort and Factors.** The agent must make reasonable efforts to accomplish result, based on (1) the nature of the task, (2) the level of expertise required, (3) the level of expertise of the agent, (4) the specificity of the command and the level of control over the task, (5) the general expectations and intent of the parties, and (6) the scope of the authority conferred.
  - ii. **Standard of Skill.** When the agent has, or procures his appointment by asserting that he has, skill beyond that of the ordinary prudent person, he will be judged by the level of skill he has or claims to have, whichever is higher.
  - iii. **Duty to Disclose.** An agent has a strict duty to disclose all material information relevant to the subject matter of the agency relationship in order to protect the principal's ability to control and decide.
    - a. **Materiality.** Information is material if a reasonable person would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question, or if the agent should reasonably know would affect the principal's judgment.
- B. Agent's Duty of Loyalty.** The agent has an obligation to act loyally and solely for the principal's benefit in matters connected with the agency relationship, and cannot place his own or another's interest above that of the principal.
- i. **Adverse Party/Self Interest.** Unless otherwise agreed, an agent may not deal with his principal as or on behalf of an adverse party, or in the agent's own self interest, in a transaction connected with his agency even if the transaction is beneficial to the principal.
  - ii. **Confidential Information.** Unless otherwise agreed, an agent must not use or communicate information confidentially given him by the principal, acquired by him during the course of or on account of his agency, or in violation of his duties as agent, in competition with or to the injury of the principal either on his own account or on behalf of another, although such information does not relate to the transaction for which he was employed, unless the information is a matter of general knowledge.
    - a. **Protected Information.** This rule applies to information which is stated to be confidential, and to information which the agent should know his principal would not care to have revealed to others or used in competition with him.
  - iii. **Competition.** Unless otherwise agreed, after the termination of agency, the agent: (a) has no duty not to compete with the principal; (b) has a duty to the principal not to use or to disclose to third persons on his own account or on account of others, in competition with the principal or to his injury, trade secrets, written lists of names, or other similar confidential matters given to him only for the principal's use or acquired by the agent in violation of duty. The agent is entitled to use general information concerning the method of business of the principal and the names of the customers retained in his memory, if not acquired in violation of his duty as agent; (c) has a duty to account for his profits made by the sale or use of trade secrets and other confidential information, whether or not in competition with the principal; and (d) has a duty to the principal not to take advantage of a still subsisting confidential relation created during the prior agency relation.
    - a. **Protected Information.** This rule applies to information which is stated to be confidential, and to information which the agent should know his principal would not care to have revealed to others or used in competition with him.
  - iv. **Consent.** A principal may consent to conduct by the agent that would otherwise breach a duty of loyalty, but in obtaining the principal's consent, the agent must act in good faith and must fully disclose material information to the principal.
    - a. **Dual Principals.** An agent may act for two principals in a transaction between them when (1) both principals know about the arrangement, (2) the agent acts with fairness to each, (3) and the agent discloses all facts material to consent by the principals to the arrangement. If any of those 3 are missing, the transaction is voidable.
- C. Other Duties of the Agent.**
- i. **Good Conduct.** Unless otherwise agreed, an agent may not conduct himself with such impropriety that he brings disrepute upon the principal, or act in such a way as to make continued friendly relations with the principal impossible.

- ii. Obey. Unless otherwise agreed, an agent must obey all reasonable directions in regard to the manner of performing the services he contracted to perform, even when the terms of the agreement prescribe that such directions shall not be given.
    - a. *Following Orders Defense*. If the principal may not legally commit a certain act, then neither can the agent, and the agent will not be entitled to indemnification for so acting, unless the agent acts in good faith and without knowledge that the act is wrongful.
  - iii. Indemnify. An agent must indemnify his principal for any wrongful act within the scope of the agency that causes loss. Wrongful acts include damage to principal's property, exceeding authority, negligence or fraud that causes liability to a third party, or violation of the duty of loyalty.
  - iv. Account. An agent must keep and render accounts to the principal of money or other things he has received or paid out on behalf of the principal.
  - v. Prior to Agency. If the creation of the agency relationship involves peculiar trust and confidence, and the prospective principal relies on the prospective agent to deal fairly, the prospective agent must deal fairly in arranging the terms of the agency relationship.
    - a. *Required Disclosure*. To deal fairly, a prospective agent must furnish the prospective principal with information that is not otherwise reasonably available to the prospective principal and that is material to the prospective principal's decision whether to engage the agent.
- D. Duties of Principal.** The principal must deal fairly and in good faith with the agent, and in a manner that will not harm the agent's business reputation or self respect.
- i. Provide Information. The principal must provide the information (1) necessary for the agent to carry out his charge, including (2) all information the principal would have to furnish to third parties if he were acting on his own behalf, and (3) any information he knows, has reason to know, or should know about potential physical or pecuniary loss to the agent when dealing on behalf of the principal.
  - ii. Payment. It is inferred that one who requests or permits another to perform services for him as his agent promises to pay for them by implied in fact contract, except where the relationship of the parties, the triviality of the services, or the circumstances indicate that the parties have agreed otherwise.
    - a. *Test*. The test is whether, under all the evidence, the circumstances were such that the agent could reasonably assume that he was to be paid and that the principal should have reasonably expected to pay for such services.
    - b. *Subagents*. A principal is under no duty to pay a subagent, except where, by express promise or otherwise, he becomes a surety under the contract between the agent and subagent.
  - iii. Care in Master/Servant Relationships. A master must provide reasonably safe working conditions, and must use due care (1) in construction, inspection, and maintenance of the premises where the servants work, (2) in the selection of fellow servants, and (3) in the management of the work. The master may not take any action that impedes the servant's duty to perform.
  - iv. Indemnify. A principal must indemnify an agent for liability created as a result of the agent's faithful service within the scope of his duties, but not for losses resulting from the agent's negligence, illegal acts, or other wrongful conduct.
    - a. *Opportunity to Defend*. The agent must notify the principal about a claim against the agent, and give the principal the opportunity to defend the claim.
    - b. *Subagents*. A subagent is entitled to indemnity from either the appointing agent or the principal for appropriate expenses or losses, so long as the subagent was appointed with the principal's knowledge and consent or estoppel to deny consent.
- 4. VICARIOUS TORT LIABILITY.**
- A. Master, Servant, Independent Contractor.** A master is a principal who controls or has the right to control the physical conduct of his agent, who is then called the master's servant. By contrast, an independent contractor is a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking. He may or may not be an agent.
- i. Factors for Determining Master/Servant Relationship. In determining whether a relationship is

master/servant or normal agency, courts will consider the following: (a) the extent of control which, by the agreement, the master may exercise over the details of the work; (b) whether or not the agent is engaged in a distinct occupation or business; (c) the kind of occupation, with reference to whether the work is usually done under the direction of the principal or by a specialist without supervision; (d) the skill required in the particular occupation; (e) who supplies the instrumentalities, tools, and the place of work; (f) the length of time for which the person is employed; (g) the method of payment, whether by the time or by the job; (h) whether or not the work is part of the regular business of the principal; (i) whether or not the parties believe that they are creating a master/servant relationship; and (j) whether the principal is or is not in business.

- B. **Respondeat Superior.** A master is subject to liability for the torts of his servants committed while acting in the scope of their employment.
- i. **Scope of Employment.** Conduct of a servant is within the scope of employment only if: (1) it is of the kind he is employed to perform; (b) it occurs substantially within the authorized time and space limits; (c) it is actuated, at least in part, by a purpose to serve the master; and (d) if force is intentionally used by the servant against another, the use of force is not unexpected by the master.
    - a. **Factors.** Courts will look to the following in determining scope of employment: (a) the time, place, and purpose of the act; (b) its similarity to acts which the servant is authorized to perform; (c) the extent of departure from normal methods; (d) whether the act is commonly performed by servants; and (e) whether the master would reasonably expect such act would be performed.
    - b. **Dual Purpose.** Although an act of a servant is not within the scope of employment if done with no intention to serve his master, an act may be within the scope of employment when the act is partially done for the service of his master and partially for his own or another's purpose.
    - c. **Frolic and Reentry.** A servant who has temporarily departed in space or time from the scope of employment does not reenter it until he is again reasonably near the authorized space and time limits and is acting with the intention of serving his master's business.
  - ii. **Liability for Acts Outside the Scope of Employment.** A master is liable for the torts of his servants acting outside the scope of their employment if: (a) the master intended the conduct or the consequences; (b) the master was negligent or reckless; (c) the conduct violated a non-delegable duty of the master; (d) the servant purported to act or to speak on behalf of the principal and there was reliance upon apparent authority, or (e) he was aided in accomplishing the tort by the existence of the agency relation.
  - iii. **Gratuitously Performed Work.** The fact that work is performed gratuitously does not relieve a principal of liability.
  - iv. **Intentional Torts.** Generally, a master will not be liable for the intentional torts of his servants unless the intentional tort was foreseeable and within the scope of employment.
  - v. **Borrowed Servants.** A temporary master of a servant may be liable for the tortious acts of the servant.
    - a. **Full Control.** For the temporary master to be liable, the servant must be wholly free from control of the general master, and wholly subject to the control of the special master.
    - b. **Control over the Act.** Determining which master is liable for the act of servant is determined by which master had the right to control the act that caused liability.
  - vi. **Imputed Contributory Negligence.** A master is barred from recovery against a third person who negligently caused a loss to the master if the servant also was negligent in the accident giving rise to the loss.
  - vii. **Agent's Liability.** An agent is subject to liability for to a third party for his torts, even when acting as a servant within the scope of employment.
- C. **Apparent Authority.** A principal is subject to vicarious liability for a tort committed by an agent in dealing or communicating with a third party on, or purportedly on, behalf of the principal when actions taken by the agent with apparent authority constitute the tort or enable the agent to conceal its commission.
- D. **Fraudulent Acts of Agents.** A principal is vicariously liable for the fraud of an agent on a third party when the principal puts the agent in a position which enables the agent, while apparently acting within his authority and in a manner that furthers the principal's business, to commit a fraud upon third persons.

- E. **Other Vicarious Liabilities.** A master can be liable for torts by independent contractors for inherently dangerous activities, negligent hiring, and nondelegable duties.

5. **CONTRACTUAL POWERS OF AGENTS.**

- A. **Actual Authority.** Authority is the power of the agent to affect the legal relations of the principal by acts done in accordance with the principal's manifestations of consent to the agent.

i. Ratification. Ratification is the affirmance of a prior act done by another, whereby the act is given effect as if done by an agent acting with actual authority. A person ratifies an act either by manifesting assent that the act shall affect his legal relations, or by conduct that justifies a reasonable assumption that he so consents.

ii. Implied Authority. Implied authority means actual authority either to do what is necessary, usual, and proper to accomplish or perform an agent's express responsibilities, or to act in a manner in which an agent believes the principal wishes the agent to act based on the agent's reasonable interpretation of the principal's manifestation in light of the principal's objectives and other facts known to the agent.

- B. **Scope.** An agent has actual authority to take action designated or implied in the principal's manifestations to the agent and acts necessary or incidental to achieving the principal's objectives, as the agent reasonably understands the principal's manifestations and objectives when the agent determines how to act.

i. Interpretation of Manifestations. An agent's interpretation of the principal's manifestations is reasonable if it reflects any meaning known by the agent to be ascribed by the principal and, in the absence of any meaning known to the agent, as a reasonable person in the agent's position would interpret the manifestations in light of the context, including circumstances of which the agent has notice and the agent's fiduciary duty to the principal.

ii. Interpretation of Objectives. An agent's understanding of the principal's objectives is reasonable if it accords with the principal's manifestations and the inferences that a reasonable person in the agent's position would draw from the circumstances creating the agency.

- C. **Apparent Authority.** Apparent authority is the power held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal, and that belief is traceable to the principal's manifestations.

i. Creation. Apparent authority is created as to a third person by any conduct of the principal which, reasonably interpreted, causes the third person to believe that the principal consents to have the act done on his behalf by the person purporting to act for him.

ii. Reasonable Reliance. In order for a third party's reliance to be reasonable, courts will look to see if the third party actually and subjectively relied on the manifestations, and if such belief is objectively reasonable under the circumstances.

iii. Manifestations. The information received by the third person may come directly from the principal by letter or word of mouth, from authorized statements of the agent, from documents or other indicia of authority given by the principal to the agent, or from third persons who have heard of the agent's authority through authorized or permitted channels of communication.

iv. Common Business Practices. An agent is sometimes placed in a position in an industry or setting in which holders of the position customarily have authority of a specific scope (e.g., treasurer). Absent notice to third parties to the contrary, placing the agent in such a position constitutes a manifestation that the principal assents to be bound by actions by the agent that fall within that scope. A third party who interacts with the person, believing the manifestation to be true, need not establish a communication made directly to the third party by the principal to establish the presence of apparent authority.

v. Writings. If the principal entrusts the agent a writing which manifests that the agent has authority and which is intended to be shown to third persons, and this is retained by the agent and exhibited to third persons, the termination of the agent's authority by causes other than incapacity or impossibility does not prevent him from having apparent authority as to persons to whom he exhibits the document and who have notice of the termination of the authority.

vi. Duty to Inquire. The duty to inquire is a defense for the principal against a third party whose agent acts outside authority. If there is some question as to whether a third party's reliance is reasonable, the

court may look to see if the third party inquired as to the agent's actual authority, and if the third party failed to so inquire, the court will call reliance unreasonable.

a. *The Shady Agent.* In situations in which the agent has employed his power in a manifestly suspicious manner such that there had to arise a reasonable doubt in the mind of a third party as to whether the agent was acting within the scope of his agency, the court will require an inquiry by the third party.

D. **Agency by Estoppel.** A person who has not made a manifestation that an actor has authority as an agent and who is not otherwise liable as a party to a transaction purportedly done by the actor on that person's account is subject to liability to a third party who justifiably is induced to make a detrimental change in position because the transaction is believed to be on the person's account, if (1) the person intentionally or carelessly caused such belief, or (2) having notice of such belief and that it might induce others to change their positions, the person did not take reasonable steps to notify them of the facts.

E. **Inherent Agency Power.** In the second restatement it states that a general agent has the power to bind a principal to unauthorized acts beyond the customary doctrines of apparent authority and estoppel if the acts done usually accompany or are incidental to authorized transactions. In other words, unless otherwise agreed or disallowed, authority to conduct a transaction includes authority to do acts which are incidental to it, usually accompany it, or are reasonably necessary to accomplish it. The third restatement abandons this term.

## 6. THE UNDISCLOSED PRINCIPAL.

A. **Disclosed, Undisclosed, and Partially Disclosed Principals.** (1) If, at the time of a transaction conducted by an agent, the other party thereto has notice that the agent is acting for a principal and of the principal's identity, the principal is a disclosed principal. (2) If the other party has notice that the agent is or may be acting for a principal but has no notice of the principal's identity, the principal for whom the agent is acting is a partially disclosed principal. (3) If the other party has no notice that the agent is acting for a principal, the one for whom he acts is an undisclosed principal.

B. **Acting for a Disclosed Principal.** When an agent acting with actual or apparent authority makes a contract on behalf of a disclosed principal, (1) the principal and the third party are parties to the contract; and (2) the agent is not a party to the contract unless the agent and third party agree otherwise.

i. Liability of Agent. The agent will not generally be liable on a contract if the principal is disclosed, unless the agent has guaranteed performance either expressly or by proof of a custom to that effect. Custom is determinative of the parties' intent where both parties are aware of it, and neither knows or should know that the other party has an intention contrary to it.

ii. Lawyer as Agent. A lawyer who contracts with a third party for goods or services used by lawyers is subject to liability to the third party when the lawyer knows or reasonably should know that the third party relies on the lawyer's credit although the third party knows the identity of the lawyer's client, unless at the time of contracting the lawyer has disclaimed such liability.

iii. The Agent's Warranty of Authority. A person who purports to make a contract, conveyance or representation on behalf of another who has full capacity but whom he has no power to bind, thereby becomes subject to liability, to the other party thereto, not upon the contract, but upon an implied warranty of authority, even if he acts with the utmost good faith, unless he has manifested that he does not make such warranty or the other party knows that the agent is not so authorized.

C. **Acting for a Partially Disclosed Principal.** When an agent acting with actual or apparent authority makes a contract on behalf of unidentified principal, (1) the principal and the third party are parties to the contract; and (2) the agent is a party to the contract unless the agent and third party agree otherwise.

i. Liability of Agent. The agent will generally be liable on a contract if the principal is partially disclosed. To avoid liability, the agent must prove that the agency relationship and the identity of the principal were in fact disclosed.

ii. Notice to Third Party. The third party will be held to have notice of the agency relationship if he knows about it, has reason to know about it, should know about it, or has been given notification of it. In order for an agent to avoid liability, he must disclose not only that he is an agent but also the identity of his principal. There must be such complete information concerning his principal's identity that he can be readily distinguished.

D. **Acting for an Undisclosed Principal.** When an agent acting with actual or apparent authority makes a contract on behalf of an undisclosed principal, (1) unless excluded by the contract, the principal is a party to the contract; (2) the agent and the third party are parties to the contract; and (3) the principal, if a party to the contract, and the third party have the same rights, liabilities, and defenses against each other as if the principal made the contract personally.

i. **Liability of Agent.** The agent will generally be liable on a contract if the principal is undisclosed. The agent will generally be liable on a contract if the principal is partially disclosed. To avoid liability, the agent must prove that the agency relationship and the identity of the principal were in fact disclosed.

ii. **Notice to Third Party.** The third party will be held to have notice of the agency relationship if he knows about it, has reason to know about it, should know about it, or has been given notification of it. In order for an agent to avoid liability, he must disclose not only that he is an agent but also the identity of his principal. There must be such complete information concerning his principal's identity that he can be readily distinguished.

7. **NOTICE AND IMPUTED KNOWLEDGE.** Generally, notice to the agent is notice to the principal. If the agent fails in this regard, the agent will be liable to the principal. Unless otherwise agreed, the agent has a duty to use reasonable effort to transmit material facts to the principal or to coagents designated by the principal. Because of this, any material facts that the agent is aware of is imputed to the principal in determining the principal's liabilities.

8. **TERMINATION OF THE AGENCY RELATIONSHIP.** An agent's authority is terminated by: (1) the agent's death, cessation of existence, or suspension of powers; (2) the principal's death, cessation of existence, or suspension of powers; (3) the principal's loss of capacity; (4) an agreement between the agent and the principal or the occurrence of circumstances on the basis of which the agent should reasonably conclude that the principal no longer would assent to the agent's taking action on the principal's behalf; (5) a manifestation of revocation by the principal to the agent, or of renunciation by the agent to the principal; or (6) the occurrence of circumstances specified by statute.

There can a natural termination (e.g., a time period), a defined termination (e.g., completion of a task), or termination at will by either party.

A. **Death of Principal.** The death of an individual principal terminates the agent's actual authority. The termination is effective only when the agent or the third party has notice of the principal's death.

9. **ENTITY V. AGGREGATE THEORY.** UPA uses the aggregate theory, which treats a partnership as an aggregate of persons acting with a common purpose. The partnership exists only so long as its exact aggregate of partners exists. If one partner leaves or dies, or a new partner joins, the partnership is dissolved, and if the business is continued, it is continued by a new partnership.

Entity theory is used by RUPA, and treats the partnership as an entity distinct from its partners. The partnership continues to exist even when partners leave or join, subject to the rules discussed below.

10. **DEFAULT AND MANDATORY RULES.** The general rule is that relations among the partners and between the partners and the partnership are governed by the partnership agreement. To the extent that the partners fail to agree upon a contrary rule, UPA or RUPA provides the default rule.

A. **Mandatory Rules.** Under RUPA, the partnership agreement may not: (1) unreasonably restrict the right of access to books and records; (2) eliminate the duty of loyalty; (3) unreasonably reduce the duty of care; (4) eliminate the obligation of good faith and fair dealing, but the partnership agreement may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable; (5) vary the power to dissociate as a partner except to require the notice to be in writing; and (6) restrict the rights of third parties.

The partnership agreement also may not limit actions by the partnership and partners, discussed in detail below.

a. **Restrictions on Duty of Loyalty.** The partnership may (1) identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; or (2) allow for authorization or ratification, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty.

11. **THE CREATION OF A PARTNERSHIP.**

- A. **Definition.** A general partnership is an association of two or more persons to carry on as co-owners of a business for profit.
- B. **Choosing Partners.** Unless otherwise expressly or impliedly agreed, one cannot become a partner without unanimous agreement by all partners.
- C. **Existence of a Partnership.** Courts look to several factors to determine whether the parties have formed a partnership: (1) receipt or right to receive a share of the profits of the business; (2) expression of an intent to be partners in the business; (3) participation or right to participate in the control of the business; (4) sharing or agreeing to share either the losses of the business or liability for claims by third parties against the business; and (5) contribution or agreeing to contribute money or property to the business. No one factor is dispositive and not all factors need be satisfied.
  - i. **Prima Facie Proof.** The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment: (a) as a debt; (b) as wages of an employee or rent to a landlord; (c) as annuity to a widow or representative of a deceased partner; (d) as interest on a loan, though the amount of payment vary with the profits of the business; or (e) as the consideration for the sale of a good-will of a business or other property by installments or otherwise.
- D. **Types of Partnership and General Introduction to Each.**
  - i. **General Partnership.** No documents need to be filed to create a partnership. It exists as soon as two or more people start doing business together without choosing another form of business, and is in that sense a default form of doing business. Partners have equal rights to manage the business, unless they agree otherwise. Partners are personally liable for the debts of the firm. Partners can exit a business whenever they desire, although contractual liability to fellow partners may result under some circumstances. Contractual buyout arrangements with fellow partners are common. In the absence of such agreements, a departing partner has a liquidation right against the partnership. Unless otherwise agreed, partners share income and losses equally and must unanimously agree on new partners. Each partner is a general agent of the partnership.
  - ii. **Limited Liability Partnership (LLP).** LLPs are created by filing a certificate in a designated office of the state. An LLP makes limited liability available for all partners of a general partnership if a property filing is made with the state. An LLP is a general partnership in all other respects.
    - a. **Full Shield v. Partial Shield.** In general, partial shield states provide protection only from vicarious tort liability or limit the availability of the LLP only to certain businesses, or both. Full shield states protect limited partners from both vicarious tort liability and contract liability.
  - iii. **Limited Partnership.** Limited partnerships are created by filing a document with a designated office in the state. The limited partnership has general and limited partners. General partners in a limited partnership are like general partners in a conventional partnership, which includes having personal liability for the debts of the business. Limited partners are not liable for the debts of the business, although care must be exercised in some states about their participation and control. Limited partners do not have management rights, which is in the hands of the general partners. Limited partners are exempt from liability for the debts of the firm, unlike the general partners. Limited partners are entitled to a return of their capital after some period after giving notice of withdrawal, unless the partnership agreement specifies otherwise. In some cases, the limited partnership interests are, by agreement, freely transferable.
  - iv. **Limited Liability Limited Partnership (LLLLP).** A filing with the state is required to create an LLLL. Limited liability is extended to the general partners of a limited partnership in the same manner as it is to partners in an LLP. In all other respects the LLLL is like a regular limited partnership.
- E. **Distinction: Joint Ventures.** A joint venture is different from a partnership because it is used for isolated transactions instead of an ongoing business purpose. Contractual and tort liability of members of a joint venture may be more limited than that of partners due to the narrower scope of the activities.

## 12. TYPES OF PARTNERSHIPS.

- A. **General Partnership.** No documents need to be filed to create a partnership. It exists as soon as two or more people start doing business together without choosing another form of business, and is in that sense a default form of doing business. Partners have equal rights to manage the business, unless they agree

otherwise. Partners are personally liable for the debts of the firm. Partners can exit a business whenever they desire, although contractual liability to fellow partners may result under some circumstances. Contractual buyout arrangements with fellow partners are common. In the absence of such agreements, departing partners have a liquidation right against the partnership. Unless otherwise agreed, partners share income and losses equally and must unanimously agree on new partners. Each partner is a general agent of the partnership.

- B. **Limited Liability Partnership (LLP).** LLPs are created by filing a certificate in a designated office of the state. An LLP makes limited liability available for all partners of a general partnership if a property filing is made with the state. An LLP is a general partnership in all other respects.
  - a. *Full Shield v. Partial Shield.* In general, partial shield states provide protection only from vicarious tort liability or limit the availability of the LLP only to certain businesses, or both. Full shield states protect limited partners from both vicarious tort liability and contract liability.
- C. **Limited Partnership.** Limited partnerships are created by filing a document with a designated office in the state. The limited partnership has general and limited partners. General partners in a limited partnership are like general partners in a conventional partnership, which includes having personal liability for the debts of the business. Limited partners are not liable for the debts of the business, although care must be exercised in some states about their participation and control. Limited partners do not have management rights, which is in the hands of the general partners. Limited partners are exempt from liability for the debts of the firm, unlike the general partners. Limited partners are entitled to a return of their capital after some period after giving notice of withdrawal, unless the partnership agreement specifies otherwise. In some cases, the limited partnership interests are, by agreement, freely transferable.
- D. **Limited Liability Limited Partnership (LLLLP).** A filing with the state is required to create an LLLL. Limited liability is extended to the general partners of a limited partnership in the same manner as it is to partners in an LLP. In all other respects the LLLL is like a regular limited partnership.

### 13. PARTNERSHIP PROPERTY.

- A. **UPA.** The partnership owns property as an entity, separate and distinct from the partners. All property originally brought into the partnership stock or subsequently acquired by purchase or otherwise, on account of the partnership, is partnership property.
  - i. Acquisition. Unless a contrary intention appears, property acquired with partnership funds is partnership property.
  - ii. Real Property. Any estate in real property may be acquired in the partnership name. Title so acquired can be conveyed only in the partnership name.
  - iii. Property Rights of a Partner. The property rights of a partner are (1) his specific rights in specific partnership property, (2) his interest in the partnership, and (3) his right to participate in the management.
    - a. *Nature of Interest.* A partner's interest is his share of the profits and surplus, and the same is personal property.
    - b. *Assignment.* A conveyance by a partner of his *interest in the partnership* entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled. In case of dissolution, the assignee is entitled to receive his assignor's interest. Such assignment does not of itself dissolve the partnership, nor entitle the assignee to interfere in the management or administration of the partnership business or affairs, or to require any information or account of partnership transactions, or to inspect the partnership books; it merely entitles the assignee to receive the profits to which the assigning partner would otherwise be entitled.
    - c. *Charging Order.* A judgment creditor may charge the interest of the debtor partner with payment of the unsatisfied amount of such judgment debt with the partnership interest, which may be redeemed at any time before foreclosure with separate property, by any one or more of the partners, or with partnership property with the consent of all partners.
  - iv. Tenant in Partnership. A partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.
    - a. *Possession.* A partner, subject to any agreement, has an equal right with his partners to possess

specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners.

- b. *Assignment.* A partner's right in *specific partnership property* is not assignable except in connection with the assignment of rights of all the partners in the same property.
  - c. *Attachment or Execution.* A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership.
- B. **RUPA.** Partnership is property of the partnership and not of the partners individually. RUPA abolishes the UPA concept of tenants in partnership. Partnership property is owned by the entity and not by the individual partners. Thus, the only transferable interest of a partner in the partnership is the partner's interest in distributions.
- i. Acquisition. Property is partnership property if acquired in the name of: (1) the partnership; or (2) one or more partners with an indication in the instrument transferring title to the property of the person's capacity as a partner or the existence of a partnership but without an indication of the name of the partnership.
    - a. *Acquired by Transfer.* Property is acquired in the name of the partnership by a transfer to (1) the partnership in its name; or (2) one or more partners in their capacity as partners in the partnership, if the name of the partnership is indicated in the instrument transferring title to the property.
    - b. *Presumptions.* Property is presumed to be partnership property if purchased with partnership assets. Property acquired in the name of one or more partners, without an indication of the partner's capacity as a partner or of the existence of a partnership, is presumed to be separate property, even if used for partnership property.
  - ii. Transfer of Partnership Property. Unless otherwise agreed, partnership property held in the name of the partnership may be transferred by a partner in the partnership name. Partnership property held in the name of one or more partners may be transferred by such partners.
    - a. *Transfer to Creditors.* A partner is not a co-owner of partnership property and has no interest in the partnership property which can be transferred, either voluntarily or involuntarily. The only transferable interest of a partner in the partnership is the partner's share of profits and losses of the partnership and the partner's rights to receive distributions. The interest is personal property.
    - b. *Transfer of Interest.* A transfer of a partner's transferable interest does not by itself cause the partner's dissociation or a dissolution, and does not entitle the transferee to participate in the management or conduct of the partnership business, to require access to information concerning partnership transactions, or to inspect or copy the partnership books or records. The transferee has a right to receive distributions to which the transferor would otherwise be entitled, to receive the partner's share in a dissolution and wind up, and to seek judicial wind up and accounting.
    - c. *Charging Order.* A judgment creditor may charge the transferable interest of the judgment debtor to satisfy the judgment. The court may order foreclosure of the interest, and the purchaser has the rights of a transferee. At any time before the foreclosure, the interest may be redeemed by the judgment debtor, with property other than partnership property by one or more of the other partners, or with partnership property by one or more of the other partners with the consent of all partners.

#### 14. PARTNER AND PARTNERSHIP LIABILITY.

##### A. Contractual Operation of a Partnership.

- i. Partners as Agents. Every partner is an agent of the partnership for the purpose of its business, and the act of every partner for apparently carrying on the business of the partnership binds the partnership, unless the partner has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of this fact.
  - a. *Business not in the Usual Way.* An act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.
  - b. *Authority for Less than All Partners.* Under UPA, unless authorized by the other partners or unless they have abandoned the business, one or more but less than all the partners have no

authority to: (a) assign the partnership property in trust for creditors or on the assignee's promise to pay the debts of the partnership; (b) dispose of the good-will of the business; (c) do any other act which would make it impossible to carry on the ordinary business of a partnership; (d) confess a judgment; or (e) submit a partnership claim or liability to arbitration.

- ii. Notice. Notice to a partner, or a partner's knowledge, of any matter relating to partnership affairs operates as notice to, or knowledge of, the partnership.

**B. Partnership Liability for Partner's Actionable Conduct.** A partnership is liable for loss or injury caused to a person as a result of a wrongful act or omission, or other actionable conduct, of a partner acting in the ordinary course of business of the partnership or with authority of the partnership, including a partner's misapplication of money or property from a non-partner.

- i. Actions by and against Partnership and Partners. Under RUPA, a partnership may sue and be sued in the name of the partnership. An action may be brought against the partnership and any or all of the partners in the same action. A judgment against a partnership is not by itself a judgment against a partner, and may not be satisfied from a partner's assets unless there is also a judgment against the partner, unless the partner is found liable individually, the partner agrees otherwise, or upon court order.

Under UPA, a partnership, not being a legal entity, could not sue or be sued in the firm name, so it is generally necessary to join all the partners in action against the partnership. However, most states have statutes authorizing partnership to sue or be sued in the partnership name. Unlike in RUPA, which requires partnership creditors to exhaust partnership assets before levying judgment on a partner, creditors under UPA may attack partner assets, leaving the partner to seek indemnification from the partnership and other partners.

- ii. Partner's Scope of Authority. Since third persons dealing with a partner in reference to partnership matters, in the absence of power expressly conferred, must recognize that the partner's power to bind the partnership is restricted to actions within the scope of the particular business, courts will look to the usages of firms engaged in the same character of business in the community, as well as the general usage of the firm in the conduct of its business, in order to ascertain the implied power possessed by a partner.
- iii. Co-Principal Doctrine. The partnership is not liable for wrongs committed by one partner against another because the wrongdoer is an agent of the partnership, thereby imputing the wrongful conduct to the partner.
- iv. Partnership Liability to Partner. Under UPA, an action at law ordinarily is not maintainable between a partner and his firm, but a partner who is held personally liable to a third party for a partnership obligation ordinarily has indemnity rights against the partnership. There are, however, certain situations where a partner can get an accounting without dissolving the partnership.

Under RUPA, a partner may maintain an action against a partnership for legal or equitable relief, with or without an accounting as to partnership business, to enforce the partner's rights under the partnership agreement, enforce the partner's rights under RUPA, or to enforce the rights and otherwise protect the interests of the partner, including rights and interests arising independently of the partnership relationship.

- a. Differences from UPA. Under UPA, there are certain circumstances in which an accounting action is available without requiring a partner to dissolve the partnership, including when he is excluded from the business or the possession of partnership property, without any express agreement authorizing such exclusion. RUPA provides that, during the term of the partnership, partners may maintain a variety of legal or equitable actions, including an action for an accounting. This reflects a new policy choice that partners should have access to the courts during the term of the partnership to resolve claims against the partnership, leaving broad judicial discretion to fashion appropriate remedies. An accounting is not a prerequisite to the availability of the other remedies a partner may have against the partnership. Thus, partners may bring a direct suit against the partnership for almost any cause of action arising out of the conduct of the partnership business.
- C. Partner's Liability.** Under UPA, all partners are jointly and severally liable for torts of a partner, but only jointly liable for debts and obligations of the partnership, unless a partner enters into a separate obligation

to perform a partnership contract. Under RUPA, all partners are jointly and severally liable for all obligations of the partnership unless otherwise agreed by the claimant.

- i. Incoming Partner. A person admitted as a partner into an existing partnership is not *personally* liable for any partnership obligation incurred before the person's admission as a partner. As to the incoming partner, any antecedent obligation of the partnership can only be satisfied out of partnership assets.
- ii. Liability of Partners to Each Other. If the negligence of a partner causes damage to another partner, the former may be liable to the latter.
- iii. Partnership against Partner. Under RUPA, a partnership may maintain an action against a partner for a breach of the partnership agreement, or for the violation of a duty to the partnership, causing harm to the partnership. This is new and reflects the entity theory of partnership.

Further, under RUPA, a partner may maintain an action against another partner for legal or equitable relief, with or without an accounting as to partnership business, to enforce the partner's rights under the partnership agreement, enforce the partner's rights under RUPA, or to enforce the rights and otherwise protect the interests of the partner, including rights and interests arising independently of the partnership relationship.

- a. Differences from UPA. Under UPA, there are certain circumstances in which an accounting action is available without requiring a partner to dissolve the partnership, including when he is excluded from the business or the possession of partnership property, without any express agreement authorizing such exclusion. RUPA provides that, during the term of the partnership, partners may maintain a variety of legal or equitable actions, including an action for an accounting. This reflects a new policy choice that partners should have access to the courts during the term of the partnership to resolve claims against other partners, leaving broad judicial discretion to fashion appropriate remedies. An accounting is not a prerequisite to the availability of the other remedies a partner may have against other partners. Thus, partners may bring a direct suit against another partner for almost any cause of action arising out of the conduct of the partnership business.

## 15. PARTNER'S RIGHTS, DUTIES, AND RELATIONS TO ONE ANOTHER.

### A. Partner's Rights and Duties. The following are all default rules.

- i. Profits and Losses. Each partner is entitled to an equal share of the partnership profits and is chargeable with a share of the partnership losses in proportion to the partner's share of the profits.
  - a. Partners who Contribute no Capital. Partners who contribute no capital must still take their share of the partnership losses, unless otherwise agreed. It may seem unfair that the contributor of services, who contributes little or no capital and is not entitled to remuneration for services performed, should be obligated toward the capital loss of the large contributor who contributed no services. However, the partners should foresee that application of the default rule may bring about unusual results and take advantage of their power to vary by agreement the allocation of capital losses.
  - b. Timing of Contributing Towards Losses. A partner is not obligated to contribute to partnership losses before his withdrawal or the liquidation of the partnership, unless otherwise agreed.
  - c. Timing of Distribution of Profits. Absent an agreement to the contrary, a partner does not have a right to receive a current distribution of profits because it is a matter of the ordinary course of business, which is to be decided by majority vote of the partners.
- ii. Reimbursement. A partnership shall reimburse a partner for payments made and indemnify a partner for liabilities incurred by the partner in the ordinary course of the business of the partnership.
  - a. Timing of Reimbursement. Usually the right indemnification is enforced in the settlement of accounts upon dissolution, however the right accrues when the liability is incurred and thus may be enforced during the term of the partnership in an appropriate case (see 14(c)(iii), above).
- iii. Management. Each partner has equal rights in the management and conduct of, and to be informed about, the partnership business.
- iv. Use of Partnership Property. A partner may use or possess partnership property only on behalf of the partnership.

- v. Becoming a Partner. A person may become a partner only with the consent of all of the partners.
  - vi. Resolving Differences. A difference arising as to a matter in the ordinary course of business of a partnership may be decided by a majority of the partners. An act outside the ordinary course of business of a partnership and an amendment to the partnership agreement may be undertaken only with the consent of all of the partners.
- B. General Standards of Partner's Conduct under UPA.** For a comparison with RUPA, see section C, below.
- i. Agency. The law of agency applies under UPA.
  - ii. Indemnity. Unless otherwise agreed, the partnership must indemnify every partner in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business, or for the preservation of its business or property.
  - iii. Management. Unless otherwise agreed, all partners have equal rights in the management and conduct of the partnership business.
  - iv. Services. Unless otherwise agreed, no partner is entitled to remuneration for acting in the partnership business, except during the winding up of partnership affairs.
  - v. Membership. Unless otherwise agreed, no person can become a member of a partnership without the consent of all partners.
  - vi. Disputes. Unless otherwise agreed, any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but no act in contravention of any agreement between the partners may be done rightfully without consent of all partners.
  - vii. Books. Unless otherwise agreed, every partner shall at all times have access to and may inspect and copy and of the partnership books.
  - viii. Rendering Information. Partners shall render on demand true and full information of all things affecting the partnership to any partner.
  - ix. Duty of Loyalty. Every partner must account to the partnership for any benefit or profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.
  - x. Account. A partner shall have the right to a formal account as to partnership affairs if he is wrongfully excluded from the partnership business or possession of its property by his co-partners, if the right exists under the terms of the agreement, or whenever other circumstances render it just and reasonable.
    - a. *Dissolution*. Unlike RUPA, discussed below, a partner ordinarily is not entitled to a formal account, except on dissolution. He has equal access with his partners to the partnership books, and there is no reason why they should constantly render to him accounts in the formal sense. When, however, he is excluded from the business or the possession of partnership property, without any express agreement authorizing such exclusion, he should have the right to demand a formal account from his partners, without necessarily requiring him to dissolve the business.
  - xi. Continuation beyond a Fixed Term. When a partnership for a fixed term or particular undertaking is continued without any express agreement, the rights and duties of the partners remain the same as they were at the termination of the term or undertaking, so far as is consistent with a partnership at will.
    - a. *Prima Facie Evidence*. A continuation of the business by the partners or such of them as habitually acted therein during the term, without any settlement or liquidation of the partnership affairs, is prima facie evidence of a continuation of the partnership.
- C. General Standards of Conduct under RUPA.** What follows is that which is different from section B, above. UPA touches only sparingly on a partner's duty of loyalty and leaves any further development of the fiduciary duties of partners to the common law of agency. This section states that the *only* fiduciary duties a partner owes to the partnership and the other partners are those listed below. Those duties may not be waived or eliminated in the partnership agreement, but the agreement may identify activities and determine standards for measuring performance of the duties, if not *manifestly unreasonable*.
- i. Duty of Loyalty. A partner's duty of loyalty to the partnership and the other partners is limited to the following.

- a. *Account.* A partner must account to the partnership and hold as trustee any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity.
- b. *Adverse Party.* A partner must refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership.
- c. *Competition.* A partner must refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.
- ii. Duty of Care. A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.
- iii. Good Faith and Fair Dealing. A partner shall discharge the duties to the partnership and the other partners under RUPA or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing.
- iv. Partner's Own Interest. A partner does not violate a duty or obligation under RUPA or under the partnership agreement merely because the partner's conduct furthers the partner's own interest.

**16. DISSOCIATION OF A PARTNER AND DISSOLUTION OF A PARTNERSHIP.**

- A. **Dissolution under UPA.** The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on of the business. On dissolution, the partnership is not terminated, but continues until the winding up of partnership affairs is completed.
  - i. Causes of Dissolution. Without violation of the agreement between partners, dissolution is caused by: (a) the termination of the definite term or particular undertaking specified in the agreement; (b) by the express will of any partner when no definite term or particular undertaking is specified; (c) by the express will of all the partners who have not assigned their interests or suffered them to be charged for their separate debts, either before or after the termination of any specified term or particular undertaking; or (d) by the expulsion of any partner from the business bona fide in accordance with such a power conferred by the agreement between the partners.  
 Dissolution can also be caused: in contravention of the agreement between the partners by the express will of any partner at any time; by the death of any partner; or by the bankruptcy of any partner.
  - ii. Dissolution by Decree of Court. On application, the court shall decree dissolution whenever, among other things, a partner has been guilty of such conduct as tends to affect prejudicially the carrying on of the business; a partner willfully or persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business partnership with him; the business of the partnership can only be carried on at a loss; or other circumstances that render a dissolution equitable.
  - iii. Effect of Dissolution. Except so far as may be necessary to wind up partnership affairs or to complete transactions begun but not then finished, dissolution terminates all authority of any partner to act for the partnership when dissolution is not by the act, bankruptcy, or death of a partner.
  - iv. Debts Entered into after Dissolution. Where the dissolution is caused by the act, death, or bankruptcy of a partner, each partner is liable to his co-partners for his share of any liability created by any partner acting for the partnership as if the partnership had not been dissolved.
  - v. Power to Bind after Dissolution. After dissolution a partner can bind the partnership by any act appropriate for winding up partnership affairs or completing transactions unfinished at dissolution, or by any transaction which would bind the partnership if dissolution had not taken place, provided the other party to the transaction had extended credit to the partnership prior to dissolution and had no knowledge or notice of the dissolution, or though he had not so extended credit had nevertheless known of the partnership prior to dissolution, and, having no knowledge or notice of dissolution, the fact of dissolution had not been advertised in a newspaper of general circulation in the places at which the partnership business was regularly carried on.
  - vi. Effect of Dissolution on Partner's Existing Liability. A partner is discharged from any existing

liability upon dissolution of the partnership by an agreement to that effect between himself, the partnership creditor, and the person or partnership continuing the business. Such agreement may be inferred from the course of dealing between the creditor having knowledge of the dissolution and the person or partnership continuing the business.

- v. Application of Partnership Property. When dissolution is caused in any way, except in contravention of the partnership agreement, each partner, as against his co-partners, may have the partnership property applied to discharge its liabilities, and the surplus applied to pay in cash the net amount owing to the respective partners.
    - i. *Expulsion of Partner.* If dissolution is caused by expulsion of a partner, bona fide under the partnership agreement, and if the expelled partner is discharged from all partnership liabilities, he shall receive in cash only the net amount due him from the partnership.
    - ii. *Contravention of the Agreement.* When dissolution is caused in contravention of the partnership agreement, each partner who has not caused dissolution wrongfully shall have the right, as against the partner who has caused dissolution wrongfully, to damages for breach of the agreement. Further, if they all desire to continue the business, they may do so provided they pay to any partner who has caused the dissolution wrongfully the value of his interest in the partnership at the dissolution, less any damages recoverable for the wrongful dissolution, and in like manner indemnify him against all present or future partnership liabilities.
  - vi. Contractual Right to Avoid Dissolution. Partners have the contractual freedom to avoid termination of the business.
  - vii. Distribution in Kind. A partner has no right to receive, and may not be required to accept, distribution in kind, unless the partnership agreement permits in-kind distribution, all partners agree to in-kind distribution, or (1) there are no creditors, (2) ordering a sale would be senseless because only the partners would be interested in the assets of the business, and (3) in-kind distribution is fair to all partners.
- B. **Dissolution under RUPA.** For situations not discussed below, assume they are substantially the same as under UPA, above.
- i. Causes. A partnership is dissolved, and its business must be wound up, only upon the occurrence of any of the following events. First, in a partnership at will, the partnership's having notice from a partner of that partner's express will to withdraw causes dissolution. Second, in a partnership with a definite term or particular undertaking, things causing dissociation will cause dissolution with the express will of all of the partners to wind up the partnership business, or with the expiration of the term or the completion of the undertaking. Finally, dissolution will occur when an event agreed to in the partnership agreement resulting in the winding up of the partnership business occurs.
    - a. *Judicial Determination.* A court may order dissolution if another partner has engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with that partner, or it is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement. Further, dissolution may be ordered on application by a transferee of a partner's transferable interest when it is equitable to wind up the partnership business after the expiration of the term or the completion of the undertaking or at any time if the partnership was at will.
  - ii. Continuance after Dissolution. A partnership continues after dissolution only for the purpose of winding up the business, unless at any time after dissolution and before winding up, all of the partners waive the right to have the partnership's business wound up. If this occurs, the partnership resumes and any liability incurred is determined as if dissolution had never occurred.
  - iii. Distribution in Kind. A partner has no right to receive, and may not be required to accept, distribution in kind, unless the partnership agreement permits in-kind distribution, all partners agree to in-kind distribution, or (1) there are no creditors, (2) ordering a sale would be senseless because only the partners would be interested in the assets of the business, and (3) in-kind distribution is fair to all partners.
- C. **Dissociation under RUPA.** Dissociation is intended to recognize that there are circumstances in which a partner can leave a partnership without causing dissolution of the firm. Most dissociations result in a

buyout of the dissociating partner's interest.

- i. **Causes.** A partner is dissociated from a partnership when: (1) the partnership has notice of the partner's express will to withdraw; (2) an event agreed to in the partnership agreement as causing the partner's dissociation; (3) the partner's expulsion pursuant to the partnership agreement; (4) the partner's expulsion by the unanimous vote of the other partners if there has been a transfer of all or substantially all of that partner's transferable interest in the partnership, or a court order charging that partner's interest, which has not been foreclosed; (5) on application by the partnership or another partner, the partner's expulsion by judicial determination because the partner engaged in wrongful conduct that adversely and materially affected the partnership business, the partner willfully or persistently committed a material breach of the partnership agreement or of a duty owed, or the partner engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with the partner; or (6) the partner's death or becoming incompetent.
  - ii. **Power to Dissociate, Wrongful Dissociation.** A partner has the power to dissociate at any time, rightfully or wrongfully. A partner's dissociation is wrongful only if: it is in breach of an express provision of the partnership agreement, or in the case of a partnership for a definite term or particular undertaking, before the expiration of the term or the completion of the undertaking, when the partner withdraws by express will, by judicial determination, or by becoming bankrupt.
  - iii. **Effect.** When dissociation does not lead to a wind up, upon a partner's dissociation, the partner's right to participate in the management and conduct of the partnership business terminates and the partner's duty of loyalty terminates.
  - iv. **Buyout.** If a partner is dissociated without wind up, the partnership must buyout the partner's interest at a price determined by an accounting, offset against damages from a wrongful dissociation. The partnership must also indemnify the partner from liability to third parties.
17. **THE LIMITED PARTNERSHIP.** The LP is a form of doing business made available by statute. It is created by filing with the state a certificate for a partnership consisting of at least one general partner and one limited partner. It allows an investor who is a limited partner to participate in profits in an ownership capacity in a partnership without personal liability for the obligations of the partnership.
- A. **Definition.** A limited partnership is a partnership formed by two or more persons and having one or more general partners and one or more limited partners.
  - B. **Limited Liability.** Limited partners are not exposed to personal liability so long as the partnership is properly formed and, depending on the jurisdiction, the limited partners are careful not to exercise control over the business.
  - C. **"Hard-Wired."** The LP has a convenient and well-defined distinction between general and limited partners, making the LP "hard-wired." That feature makes it a favorite, among other things, for estate planning, where a family may want to include children in a partnership without sharing control with them.
  - D. **Limited Liability Limited Partnership.** The LLLP extends limited liability to general partners. Under the LLLP all owners enjoy limited liability.
18. **THE LIMITED LIABILITY COMPANY.** The LLC is designed to offer co-owners of an unincorporated business who make a proper filing with the state freedom from personal liability for the debts of the business, the option to manage the business, and the tax advantage of partnership status, which provides that the income of a business will pass through directly to its owners, without separate taxation at the entity level.
- A. **Limited Liability.** The owners of an LLC enjoy limited liability. This means that owners, while remaining liable for personal wrongdoing, are not vicariously liable for the contract or tort obligations of the business. The LLC is viewed by some investors as an improvement over the limited partnership because it allows for the exercise of managerial powers without the risk of personal liability for the debts of the business. Also, in the LLC all owners enjoy limited liability, contrasted with the limited partnership, where the general partners are liable for all obligations of the partnership. The LLC is viewed as an improvement over the general partnership because there is no personal liability for the debts of the business.
  - B. **Flexibility of Management.** The LLC is a flexible form of doing business. Similar to partners, the owners of an LLC can structure management as they wish. They can be member-managed (and thus very similar

in informality and flexibility to a partnership), or the LLC can be manager-managed, where the owners who are not also managers play a largely passive role, similar to limited partners in a limited partnership. The LLC is an improvement over the corporation in some situations because it can be run more informally and the double taxation of operating in corporate form is avoided.

C.

#### 19. THEORY OF AGENCY: THE ARTICLES.

- A. **Mitnick: Institutional Mitigation of Imperfection.** Mitnick introduced the now common insight that institutions form around agency, and evolve to deal with agency, in response to the essential imperfection of agency relationships. Behavior never occurs as it is performed by the principal because it does not pay to make it perfect. We are then led to focus on the mechanisms, and costs, of specifying what the agent is to do, as well as the costs of observing and policing the agent. The approach becomes vertically relational, as institutions are created to instruct and manage agents, and to deal with the inevitable (and sometimes rationally tolerated) imperfections of control.
- i. Ice Cream Cone Problem. The ice cream cone problem is the agent's problem of selecting what the principal wants without knowing the principal's preferences. Mitnick believed that institutions and social mechanisms exist to guide such behaviors and choices.
- B. **Ross: Basic Economic Theory of Agency.** This article is concerned with incentivizing agent behavior. The fiduciary duties of agents may not lead to maximization unless the agent also has an interest and investment in maximizing the principal's interest. Thus, fee schedules and other incentive structures may induce agent behavior beyond the minimal effort. These incentives produce results. In economic agency, the problem is one of selecting a compensation system that will produce behavior by the agent consistent with the principal's preferences. To the extent you can find the right match between principal and agent to maximize the utility of both (when their interests are aligned), the better and more useful the relationship will be. Thus, the best way to structure it is in such a way so as to convince the agent that it is in his best interest to act on behalf and in favor of the principal's interest. In other words, the principal has incentive to create the agency relationship in a manner that will maximize the interests of both the principal and the agent.
- i. The Problem of Choice and Control. When in the face of uncertainty does the agent have choice, and what choices does he have? The scope of the relationship will define this. Leaving the agent without the freedom to act by his own choice and discretion is not usually a tenable position because the principal might as well be doing the task himself. However, giving the agent choice and discretion risks a situation where the agent maximizes his own self interest at the expense of the principal.
- C. **Jensen: The Theory of the Firm.** If both parties to the relationship are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principal.
- i. Agency Costs. Bonding costs are costs expended by the agent to guarantee he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such actions. There will also be monitoring expenditures by the principal, which include efforts on the part of the principal to control the behavior of the agent through budget restrictions, compensation policies, operating rules, etc., in addition to money spent observing the behavior of the agent. The dollar amount of the reduction in welfare experienced by the principal as a result of the divergence between the agent's decisions and those decisions which would maximize the welfare of the principal is called the residual loss. Thus, agency costs are the sum of these monitoring and bonding expenditures, and the residual loss.
- D. **Demott: Disloyal Agents.** The relatively ferocious consequences that the law ascribes to an instance of disloyalty by an agent to which the principal has not consented reflect the distinctive legal consequences triggered by disloyalty. The approach to remedies for disloyal conduct by an agent that many cases represent is inconsistent with attempting to capture fiduciary duties of loyalty within contract law. These cases represent an entitlement on the part of the principal to loyal service from an agent that operates independently of contract norms. Enforcing this entitlement also reinforces other basic elements of an agency relationship, including the principal's ability to control the agent's conduct.
- i. Attribution in the Subagent Context. The attribution of a subagent's wrongful conduct to the appointing agent creates incentives in the appointing agent to use care in selecting and monitoring the

individual actors who carry out its work, especially when the appointing agent is an organizational entity. Thus, it is essential to effective recognition of the impact of the disloyal conduct on the principal's rights and liabilities as defined by the contract.