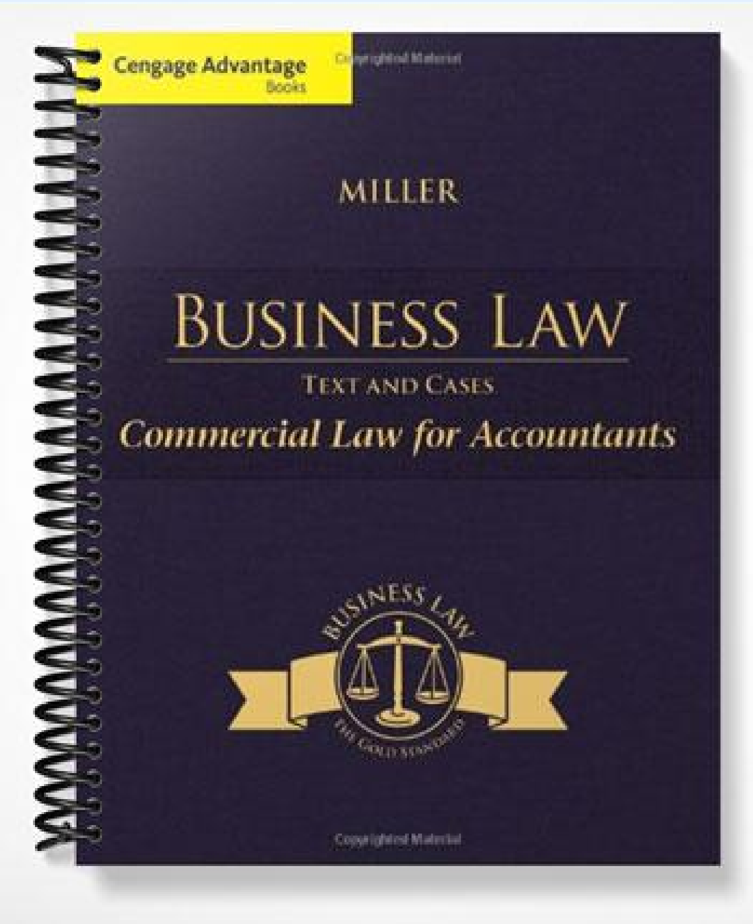
SOLUTIONS MANUAL



CHAPTER 2

PARTNERSHIPS AND LIMITED LIABILITY PARTNERSHIPS

ANSWERS TO QUESTIONS AT THE ENDS OF THE CASES

CASE 2.1—QUESTION (PAGE 22)

WHAT IF THE FACTS WERE DIFFERENT?

Suppose that Salmon had disclosed Gerry's proposal to Meinhard, who had said that he was not interested. Would the result in this case have been different? Explain. Yes, because telling Meinhard about the offer would have met Salmon's fiduciary duty of loyalty to his partner. Without a breach of the duty, there would not have been the same ground on which to award Meinhard "the value of half of the entire lease."

CASE 2.2—QUESTIONS (PAGE 27)

THE ETHICAL DIMENSION

Does the judicial power to dissolve partnerships encourage partners to be more respectful toward each other? Why or why not? Most people do not want courts to dissolve their businesses. If partners honor their enterprise and each other, the partnership is more likely to succeed. And if the partnership succeeds, a court is very unlikely to dissolve it. Thus, the courts' power to judicially dissolve partnerships should encourage partners to be more respectful toward each other.

THE LEGAL ENVIRONMENT DIMENSION

Eddie petitioned for the dissolution of Russell Realty rather than dissociating from the firm because the partnership agreement prohibited the withdrawal of any partner. How might Eddie have divested himself of his interest in the firm without petitioning for its dissolution? There may have been other options set out in the Russell Realty partnership agreement for partners who wanted to quit the firm. Or he could have sold his interest, either to the partnership or to other investors, including other partners. Of course, these options may have required the consent of the other partners, which in this case may have been less than forthcoming, given the circumstances that led to the suit.

CASE 2.3—LEGAL REASONING QUESTIONS (PAGE 29)

1A. ***What did the partnership agreement at the center of this case require on the death of a partner and the dissolution of the firm?*** The parties to the partnership agreement at the center of this case were Clyde Webster, James Theis, and Larry Thomas, who formed T&T Agri-Partners Company to own and farm 180 acres in Christian County, Illinois. Under the partnership agreement, the firm was to continue until January 31, 2010 unless it was dissolved, and the death of any partner would dissolve the partnership. Partners owning at least 120 "Partnership units" could, by "written consent," or by vote in the case of a partner's death, continue the partnership. In the event of a partner's death, the vote had to occur within 120 days of the date of the death.

On the dissolution of the firm, the partnership assets were to be "liquidated and distributed."

2A. ***What conduct by which parties triggered this litigation?*** There were a number of events that led to the litigation in this case. Initially, the death of Clyde Webster triggered the provision in the partnership agreement that required the firm's dissolution or a vote by certain remaining partners to continue the partnership.

The failure of the surviving partners James Theis and Larry Thomas to either vote to continue the business of the firm or to dissolve the partnership, as per the partnership agreement, led to the complaint by Webster's estate, seeking the liquidation and distribution of the firm's assets. The continuing failure of the surviving partners to take a vote or to dissolve the firm according to the partnership agreement, and those partners' failure to act on a court's order to dissolve the firm, triggered the trial, which led to a second court order to dissolve the firm and pay the plaintiff's attorney fees.

3A. ***On what did the court base its order regarding attorneys' fees?*** After a trial, the court in the *Webster* case based its order regarding attorney fees on the provision in the partnership agreement that stated "Any Partner who shall violate any of the terms of this Agreement * * * shall indemnify and hold harmless the Partnership, and all other Partners from any and all * * * losses, * * * including but not limited to attorneys' fees."

4A. ***What might the defendants have done to avoid the dispute that arose from the circumstances of this case?*** To avoid the dispute that arose from the circumstances of this case, partners James Theis and Larry Thompson, with the personal representative of Webster's estate, could have voted to continue the partnership after the death of Clyde Webster. A vote taken in accord with the partnership agreement could have averted the dispute and avoided the litigation. Alternatively, the surviving partners could have liquidated the partnership assets and distributed the proceeds. In the facts of the case, of course, the partners did neither, which prompted Webster's estate to file a complaint against the other partners and the firm to liquidate and distribute its assets.

ANSWERS TO QUESTIONS IN THE REVIEWING FEATURE AT THE END OF THE CHAPTER

1A. ***Duration of a partnership***
This is a general partnership, and the facts in the problem indicate that it is a partnership at will. A partnership agreement can limit the duration of a partnership to a certain date or a particular project, in which case it would be considered to be a partnership for a term. If no fixed duration is specified, as in this problem, a partnership is a partnership at will.

2A. ***Authority of a partner***
In a general partnership, all partners have equal rights in managing the partnership. Often, in a large partnership, partners will delegate daily responsibilities to a management committee made up of one or more of the partners. The partnership in this problem is not large, although the management did appear to be split among the partners. In that division of labor, it was Manny's responsibility to handle the livestock. After his injury, the responsibility was apparently still his, and he acted on it. Unanimous consent of all of the partners is required in some circumstances, but none of those circumstances appear to exist here.

3A. ***Liability of an existing partner***
Al's Feed Barn can bring action against Jason or Cowboy Palace. A partner is jointly and severally (separately, or individually) liable for all partnership obligations, including such debts as the one in this question, even if the partner did not participate in, ratify, or know about whatever it was that gave rise to the obligation. Nevertheless, Al's Feed Barn would have to take several steps before succeeding in a suit against Jason individually. Generally, a creditor cannot collect a partnership debt from a partner of a non-bankrupt partnership without first attempting to collect from the partnership, or convincing a court that the attempt would not succeed.

4A. ***Liability of a dissociated partner***
A dissociated partner may be liable for partnership obligations entered into during a two-year period following dissociation. In other words, the partner may be liable to a third party with whom the firm enters into a transaction if the third party reasonably believed that the dissociated partner was still a partner. This same principle applies to the liability of the firm for transactions entered into by dissociated partners within two years after their withdrawal. To avoid this possible liability, a partnership can notify its creditors, customers, and clients of a partner's dissociation. The partnership or former partner can also file a statement of dissociation in the appropriate state office, limiting the dissociated partner's authority to ninety days after the filing.

ANSWER TO DEBATE THIS QUESTION IN THE REVIEWING FEATURE AT THE END OF THE CHAPTER

A partnership should automatically end when one partner disassociates from the firm. Prior to a change in the UPA, when a partner left the partnership, it had to be dissolved. That makes sense, given that any partnership is an association of named partners. A new partnership can be created without the partner who left. After all, one of the major distinctions between a corporation and a partnership used to be that the corporation was not dependent on people who owe shares in it. Now, it seems as if a partnership can live forever, too, even if partners come and go.

It was an inefficient legal requirement before when the departure of a partner required the dissolution of the partnership. If we returned to the former law, we would again see partners wasting partnership assets, including the remaining partners' time, to dissolve the partnership and create a new one every time a partner left the firm. In any event, partnerships now survive for decades after one or more partners leave the firm, which shows that they are viable with a different set of partners.

ANSWERS TO ISSUE SPOTTERS IN THE EXAMPREP FEATURE AT THE END OF THE CHAPTER

1A. ***Darnell and Eliana are partners in D&E Designs, an architectural firm. When Darnell dies, his widow claims that as Darnell's heir, she is entitled to take his place as Eliana's partner or to receive a share of the firm's assets. Is she right? Why or why not?*** No. A widow (or widower) has no right to take a dead partner's place. A partner's death causes dissociation after which the partnership must purchase the dissociated partner's partnership interest. Therefore, the surviving partners must pay the decedent's estate (for his widow) the value of the deceased partner's interest in the partnership.

2A. ***Finian and Gloria are partners in F&G Delivery Service. When business is slow, without Gloria's knowledge, Finian leases the delivery vehicles as moving vans. Because the vehicles would otherwise be sitting idle in a parking lot, can Finian keep the income resulting from the leasing of the delivery vehicles? Explain your answer.*** No. Under the partners' fiduciary duty, a partner must account to the partnership for any personal profits or benefits derived without the consent of all the partners in connection with the use of any partnership property. Here, the leasing partner may not keep the money.

ANSWERS TO BUSINESS SCENARIOS AND BUSINESS CASE PROBLEMS AT THE END OF THE CHAPTER

2-1A. ***Partnership formation***
(Chapter 2—Page 18)
Classen cannot hold Daniel liable as a partner, because a true partnership never existed; nor is Daniel liable under a theory of partnership by estoppel. A partnership is defined as an association of two or more persons to conduct, as co-owners, a business for profit [UPA 101(6)]. To determine that a partnership was created, the court must look for a sharing of profits *and* a joint ownership of the business, with each party having an *equal* right to manage the business. When specific evidence that this situation existed is lacking, some guidelines are applied. First, the sharing of profits from a business is *prima facie* evidence of the existence of a partnership, unless such sharing is by means of one party receiving wages as an employee [UPA 202(c)(3)]. Rubya is not a co-owner of the business and his share of profits is partially the means of paying his salary. Therefore, a partnership is not created, and Daniel is not liable as a partner.

To be liable as a partner by estoppel, Daniel must either have represented himself to Classen as Rubya's partner or have impliedly (or expressly) consented to Rubya's representing himself as a partner. Because Daniel did not even know of Rubya's assertions and did nothing to lead Classen to believe he was Rubya's partner, Classen can look only to Rubya for payment of the debt. No partnership by estoppel was created.

2-2A. ***Dissolution of a limited partnership***
(Chapter 2—Page 32)

(a) A limited partner's interest is assignable. In fact, assignment allows the assignee to become a substituted limited partner with the consent of the remaining partners. The assignment, however, does not dissolve the limited partnership.

(b) Bankruptcy of the limited partnership itself causes dissolution, but bankruptcy of one of the limited partners does not dissolve the partnership unless it causes the bankruptcy of the firm.

(c) The retirement, death, or insanity of a general partner dissolves the partnership unless the business can be continued by the remaining general partners. Because Dorinda was the only general partner, her death dissolves the limited partnership.

2-3A. ***Distribution of partnership assets***
(Chapter 2—Page 27)
On the dissolution and winding up of the partnership, the order of liability payment of the assets is as follows:

(a) Debts owed to partnership creditors, including partners.
(b) Capital contributions of partners and profits as provided in the partnership agreement or, in the absence of an agreement, equally [UPA 40(b)].

In this case, the partnership's creditors and Shawna would be paid $18,000 first, leaving a balance of $32,000 from the $50,000. From this amount, Shawna would receive $10,000 and

David's estate $15,000 as payment for their capital contributions, and $7,000 would be split as profits, with 40 percent going to Shawna ($2,800) and 60 percent to David's estate ($4,200).

2–4A. *Limited partnership*
(Chapter 2—Page 30)

General partners owe their partnership a duty of loyalty and a duty of care, as well as an obligation to discharge their duties in good faith and in a reasonable belief that they are acting in the best interest of the partnership. General partners owe their co-partners, including any limited partners, the highest fiduciary duty, in large measure because the general partners manage and control the partnership. In this problem, Carpenter was the general partner who controlled and managed the StoneLake limited partnership and therefore owed McBeth, the firm's limited partner, the highest fiduciary duty. Carpenter breached this duty by misrepresenting the significance of the dispute with the city over water rights, by paying McBeth's $800,000 to Austin Estates without notifying her, and by joining with other investors without McBeth to buy and sell the property that was the stated purpose of the partnership. The court in the case on which this problem is based determined that Carpenter breached his fiduciary duty to McBeth and awarded her damages plus interest. The U.S. Court of Appeals for the Fifth Circuit affirmed the award.

2–5A. *Partnership dissolution*
(Chapter 2—Page 25)

Yes, the court affirmed the decision. The order requiring the partner's heir (Thompson) to wind up the business and affairs of partnership after death of both partners and distribute partnership's land to partners' heirs (the Lynches) as tenants in common resolved Thompson's challenge concerning partition of the land owned by partnership. This is an equity decision regarding what needed to be done. "Equity regards that as done which in good conscience ought to be done. And what ought to have been done, years ago, was that Thompson should have dissolved the partnership and distributed the land in question to the partners, or their heirs, as tenants in common." Evidence supported the conclusion that Bowen's Mill partnership's plans to develop the property were far from certain. The Lynches were interested in proceeding with development of land; Thompson was not interested, so dissolving the partnership and giving each partner land of equal value is a way to resolve the difference in interests.

2–6A. *Fiduciary duties of partners*
(Chapter 2—Page 21)

Yes, Rüsen and Thomas breached their fiduciary duty to HRT and Horvath. The fiduciary duties that a partner owes to the partnership include the duty of loyalty. The duty of loyalty requires a partner to account to the partnership for any property, profit, or benefit derived by the partner in the conduct of the partnership's business or from the use of its property. The duty of loyalty can be breached by dealing with the firm as an adverse party. Each partner must act in good faith for the benefit of the partnership. Of course, a partner may pursue his or her own interests without automatically violating these duties.

Here, Merkur, which was owned by Rüsen and Thomas, leased HRT's property and sublet it to other companies owned by Rüsen and Thomas at a higher rent than Merkur paid to HRT. The facts do not indicate that the lease agreement prohibited this arrangement. But there is an implication that Rüsen and Thomas made use of Merkur to usurp profits that should have gone to HRT. Under the partner's fiduciary duty of loyalty, Rüsen and Thomas were obligated to account to HRT for any profits derived by them from the use of the partnership property. They profited from allowing Merkur to sublet the property for more than Merkur paid HRT to lease it. That Rüsen and Thomas were partners and knew the terms is not enough—disclosure to one partner does not fulfill the duty to every other partner. Rüsen and Thomas may have violated their fiduciary duty by self-dealing and usurping HRT's business opportunity, but they certainly violated that duty by failing to account to HRT for the profits and to disclose the arrangement to Horvath.

In the actual case on which this problem is based, in Horvath's suit, the court issued a judgment in his favor.

2-7A. BUSINESS CASE PROBLEM WITH SAMPLE ANSWER—*Partnership formation*

Garcia and Lucero probably satisfied all three requirements for forming a partnership. They owned the two properties equally, agreed to share both profits and losses, and enjoyed equal management rights. Moreover, it is immaterial that they lacked a written partnership agreement. The Statute of Frauds does not apply to these facts, and a partnership agreement can be oral or implied by the parties' conduct.

2–8A. *Winding up and distribution of assets*

(Chapter 2—Page 27)

Yes, Dan can be held liable for the amount of the debt owed to Flying Cat. Even after a partnership has been dissolved, a partner may still bind the firm by engaging in a transaction that would have bound the partnership if it had not been dissolved, provided the other party to the transaction had known of the partnership before dissolution and had no knowledge or notice of the dissolution.

In this problem, the Coles operated their business as a partnership during their marriage. The partnership was dissolved by the parties' divorce, but Dan could be held liable under the extension of the lease entered into by Lori alone after the divorce. The lease fell within the scope of the former partnership's business. The lease was executed with the authority that would have bound the firm if it had not been dissolved. And the landlord did not have notice that the Coles, who had held themselves out as partners during the previous lease terms, had dissolved their partnership.

In the actual case on which this problem is based, in the landlord's suit to collect on the judgment, the court ruled in Flying Cat's favor. Dan appealed, claiming that he was not liable. A state intermediate appellate court held that he was—although the partnership was dissolved when the couple divorced, the landlord had no notice of the dissolution.

2-9A. A QUESTION OF ETHICS—*Wrongful dissociation*

(a) Willensky's dissociation occurred when he left for Florida and did not return. According to the partnership agreement, he was to supply the labor and oversee the construction and renovation. By effectively abandoning the project and failing to keep his side of the bargain, he breached the partnership agreement. Whenever a partner's dissociation constitutes a breach of the partnership agreement, it is deemed wrongful.

(b) Many of Willensky's actions represented poor management of the project, and some acts were clearly unethical, if not illegal. Willensky failed to pay bills on time; did not keep Moran informed of his expenditures and the status of the partnership accounts; incurred excessive and unnecessary costs (at one point, he allegedly paid $320 for an ironing board); failed to communicate with Moran for long periods of time, even when she requested that she be kept apprised of certain matters; and refused to take suggestions from advisers who were experienced in renovating houses. These actions certainly reflected poor management of the project and a general carelessness with partnership funds—but they did not necessarily breach the partnership agreement. Although the court concluded that his conduct both before and after his departure to Florida constituted a breach of contract, Willensky could probably argue that Moran, by tolerating his delays and the excessive and unnecessary costs, had waived her right to claim that these actions caused a breach of contract. His use of partnership funds to pay for certain personal expenses, however, certainly was not only unethical but also breached the agreement that the funds provided by Moran would only be used to cover expenses relating to the renovation. Also, his departure to Florida and failure to return breached the contract in that he did not fulfill his promise to provide his labor in completing the renovation.

2–10A. LEGAL REASONING GROUP ACTIVITY—*Liability of partners*

(a) Partnership agreements can be oral, written, or implied by contract. The elements of a partnership are (1) a sharing of profits and losses, (2) a joint ownership of the business, and (3) an equal right to be involved in the management of the business. Several months before the Olympics, Fontenot and his friends agreed to sell Cajun food in Atlanta and on May 19 applied for a license as a group. Although the partnership agreement was not signed until July 31, Fontenot and his friends had an oral agreement to form an association and to work together toward a common goal before they purchased the mobile kitchen on June 12. At that point, a partnership existed between Fontenot and his friends. In other words, in signing the notes, Fontenot entered into the act of sale on behalf of the partnership.

(b) The partnership and all of the partners jointly or severally are liable on the notes. In other words, each partner can be held individually and personally liable on the notes, but could obtain reimbursement for the liability from the partnership and the other partners. Of course, the partnership assets must be exhausted before a judgment could be enforced against the personal assets of individual partners. Fontenot and his friends agreed to sell Cajun food in Atlanta and on May 19 applied for a license as a group. Although the partnership agreement was not signed until July 31, Fontenot and his friends had an oral agreement to form an association and to work together toward a common goal before they bought the mobile kitchen on June 12. Thus, in signing the notes, Fontenot entered into the act of sale on behalf of the partnership.