

Question 11 – July 2013 – Selected Answer 1

1. ABC partners is a General Partnership

At issue is what type of partnership entity was formed by Abby (A), Bobby (B), and Cathy (C). Under Texas law, a General Partnership is formed by default where there is an agreement by two or more people to operate a business for profit. The facts indicate that the A, B, and C own and operate a for-profit business, thus meeting this standard. Where there is no partnership agreement, Texas law supplements the terms of the partnership with default rules. Here there is a partnership agreement, and where the provisions are not prohibited by the law provided by the Texas Business Organizations Code (TBOC), the terms of the partnership agreement will apply. The facts indicate that the partnership agreement contains provisions limiting personal liability of A, B and C to the partnership, and also appoints Abby as a managing partner. These facts and features indicate that the A, B and C are attempting to operate as a Limited Partnership as opposed to a standard General Partnership.

However a limited partnership requires that a filing be made with the Secretary of State as an application to become a limited partnership. Furthermore, a limited partnership, and all forms of partnership that limit personal liability of the partners for that matter, require that an appropriate suffix be attached to the name of the Limited Partnership (ex. "ABC Partners Ltd."). Since no filing was made as to the partnership's entity status, and since the partnership consists of two or more people (A, B and C) agreeing to operate their business for profit, ABC Partners is a General Partnership.

2. Only provisions "b." and "e." are valid. The rest are invalid.

a. books and records

Under Texas partnership law and the TBOC, a partnership can abrogate fiduciary duties, but cannot eliminate or extinguish them. In partnerships in general, any partner with a financial interest may access the partnership's books and records. A partnership may place reasonable place and time restrictions on this access, but cannot deny a partner the right to access. This provision is invalid.

b. Admitting new partners

Generally, under the TBOC, absent an agreement otherwise, a partnership can only admit a new partner by unanimous vote. However, a partnership agreement can specify the ways in which a partnership may admit new partners so long as it does not outright prohibit the admission of new partners. This provision is valid.

c. Expulsion of partners

A partnership agreement cannot prohibit or abrogate a court's ability from asserting its judiciary rights. This provision is invalid.

d. Personal Liability

In a general partnership under Texas Law, the partners to such are personally liable, jointly and ever ably for the liabilities of the partnership. A General Partnership cannot limit the personal liability of its partners. This provision is invalid.

e. Abrogation of Fiduciary duties

A General Partnership can abrogate but not eliminate fiduciary duties. By agreeing to have the court determine breaches of fiduciary duties, as is the case here, the partnership merely abrogated their fiduciary duties, and did not eliminate them. This provision is valid.

f. Withdrawal

Prohibiting withdrawal of a partner only by death or incapacity unduly burdensome on a partner and constitutes an invalid restraint. This provision is invalid.

g. Governing Law

A partnership operating solely in Texas with its only office in Texas may not agree to be governed by the law of another state. This provision is invalid.

Question 11 – July 2013 – Selected Answer 2

1. ABC is a Texas general partnership. A general partnership is generally defined as an association between two or more people to operate a business for profit, regardless of whether they intended to form a partnership. Factors to consider when determining whether a general partnership has been formed are: profit sharing, contributions to business affairs, sharing of business management, and an existence of a partnership agreement. This is not an exclusive list and none of these factors are controlling in the determination of the existence of a general partnership. The partnership agreement does not have to be filed to form a general partnership. While the inclusion of a provision in Abby, Bobby, and Cathy's partnership agreement providing for limited liability to Bobby and Cathy and vestment of managing rights in Abby as a general partner purports to create a limited partnership, a limited partnership will fail if a proper certificate of formation is not filed with the Texas Secretary of State. This filing must include the name of the limited partnership with an "LP" designation to act as notice to anyone dealing with the partnership of its limited liability status. There is no evidence in the facts of a filed, valid certificate of formation. When a limited partnership fails because of a failure to file, the partnership becomes a general partnership (a general partnership is the default partnership when one partnership business form fails). The hallmark of a general partnership is the partners' joint and several liability. Each partner in a general partnership is liable not only for the contract and tort liabilities of their own, but also for each partner's contract and tort liabilities, in addition to those sustained by the partnership. Though the Texas Business and Organizations Code (TBOC) provides various default rules for the general partnership, such as for profit sharing, withdrawal of partners, and the admission of partners, these default rules may be altered by agreement among the partners. General partners enjoy equal management of the business among the partners unless otherwise agreed. General partners also owe each other duties of care and good faith and fair dealing. The duty of care requires the partner to act as a reasonably prudent person would in carrying out partnership affairs. The duty of good faith and fair dealing requires each partner to work and operate in the best interests of the partnership and to exercise reasonable judgment when conducting partnership affairs. If ABC wishes to alter their business form, they may do so. The business forms are easily converted and merged. As explained above, ABC could become a LP, LLP, or LLLP by filing a certificate of formation with the Texas Secretary of State containing the appropriate information and paying the additional fees. ABC could also become a full-fledged corporation or an LLC with the appropriate filings and payments of fees. But, because of the lack of a valid certificate of formation filing, ABC is currently a Texas general partnership.

2.a. This provision is not valid. All partners have unfettered access to books and records of the partnership per the TBOC.

b. This provision is valid. The TBOC provides that admission of a new partner requires the unanimous consent of all the partners unless otherwise agreed. Here, the partners agreed to give the power of admitting new partners to their managing partner Abby. Therefore, this provision is valid.

c. This provision is invalid. A general partnership may not seek to limit the court's power in any way regarding the partnership. This is clearly against public policy. Though the TBOC may have other

provisions allowing or prohibiting this type of action, it may not be agreed to by the partners in a written agreement, therefore it is invalid.

d. This provision is invalid because of the reasons stated in number 1. Because the limited partnership attempt failed due to a lack of filing, the partners may not attempt to subvert the statute and limit their liability by agreement. Therefore, this provision is not valid and all the partners are considered general partners.

e. This provision may be valid. The TBOC allows for reasonable alteration of the duties of good faith and the duty of care, but prohibits eliminating the duties altogether. While this provision seems reasonable because it still allows for a partner to be held liable for breach of these duties in certain circumstances, a court could, in its discretion, decide otherwise. Therefore, this provision may be valid.

f. This provision is invalid. A partnership may not limit a partner's ability to withdraw. Per the TBOC, however, a withdrawing partner may be liable to the partnership if he wrongfully withdraws (e.g., if he withdraws before a set date in the partnership agreement or incurs partnership debts after leaving the partnership). A general partner may avoid such liability by giving notice to partnership creditors of the withdrawal. Without such notification, a partner remains liable on debts incurred while associating with the partnership, and retains apparent authority for one year after withdrawing from the partnership, which may result in more partnership debts for which he or she will be liable. This provision is invalid.

g. This provision is invalid because it constitutes forum shopping. All of the general partners are Texas residents. ABC's only office is in Texas and all of its business is in Texas. The partnership may not exercise its own source of law for its internal governance. Therefore, this provision is invalid.

Question 11 – July 2013 – Selected Answer 3

Issue 1: ABC is a general partnership. The issue is what kind of partnership ABC is. When two or more people carry on a business for profit, a general partnership is formed. Note that their intent to form a general partnership is irrelevant. The only intent they need is the intent to carry on a business for profit as owners. A General partnership is the default and is formed if no other entity applies. The Texas Business and Commerce Code allow partners to other types of entities that offer limited liability protection, for instance, LLP's, LP's, LLC's, and Corporations. For each, however, you must formally form the entity with the secretary of state. If you do not, you are a general partnership. As such, each partner is jointly and severally liable for the partnership debts.

Here, Abby, Bobby, and Cathy formed a for-profit business to be owned jointly. They made no filing, therefore they are general partnership. It does not matter if Abby will be managing, they are all co-owners, and therefore partners, and jointly and severally liable for ABC's debts.

Issue 2: which provisions are valid and which are invalid. The Texas Business and Commerce Code and the common law have default terms for the management of a partnership. However, Texas law does allow partners to modify the terms by contract. Texas law, however, does not allow complete freedom of contract. Some modifications are not allowed because they are against public policy or void as to third parties.

2a: The provision that only Abby has the right to access ABC's books and record is invalid. While partnership contracts can vest management in just one partner, a contract cannot restrict a partner's right to access the books. Such a provision is void because it serves no purpose and violates public policy. Furthermore, partners have a duty to provide another partner with an accounting on demand, and this provision effectively eliminates that duty, therefore this provision is invalid.

2b: The provision that only Abby have the right to admit new partners is valid. Generally, partners must choose who they will be partners with. the reasoning being that a partner will be liable for the acts of all its partners, therefore it is reasonable that they be able to choose who they are partners with. However, partnership agreements may vest management in a single partner, and therefore may also vest the right to add new partners to a single partner without violating published policy. Therefore, this provision is valid.

2c: The provision that courts may not expel partners is invalid. While partners are free to agree amongst each other how a partnership is run, this agreement is not binding on the courts. Therefore, a partnership agreement cannot restrict a courts right to remove partners.

2d: The provision that limits Bobby and Cathy's personal liability is invalid: As stated above, partners in a general partnership are jointly and severally liable for all partnership debts. A creditor may hold any partner liable for the entire debt once partnership assets are used up. As such, a partnership agreement cannot terminate this right by itself. Therefore, any provision that attempts to is invalid.

2e: The exculpatory provision is valid. Partners have a duty to conduct themselves with a duty of care of a reasonable prudent person and the duty of loyalty and utmost good faith. It is a fiduciary duty, and cannot be completely eliminated. However, a partnership agreement can narrow the duty, as long as they do not attempt to eliminate the duty to not engage in willful and intentional misconduct. This partnership agreement went as far as the law allows, but no farther, and it is therefore valid.

2g: The withdrawal provision is invalid: As stated before, partners are jointly and severally liable for the partnership; therefore it is manifestly unreasonable to force someone to be in a partnership against their will. A partnership agreement can impose a penalty for early withdrawal in contract, but they cannot prohibit it altogether. Therefore, this provision is invalid.

2h: The California law provision is invalid. As stated before, partnerships cannot restrict a courts right to act. Because this is a Texas partnership with seemingly not contacts to California, it would be an undue burden on the court to apply California law; therefore, this provision is invalid.