Partnership Law

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Recent Developments

The following discussion is a survey of some selected recent judicial decisions (including bankruptcy court decisions) relating to the law of partnerships, both general and limited. The discussion is divided between decisions dealing with general partnership/joint ventures and those dealing with limited partnerships.

General Partnerships

☐ **Waiver of Right of Partition; Dissolution of Partnership.** In *Brown v. Pasternak*,[1] the heirs of a deceased partner in a joint venture brought an action for partition of the joint venture property. The surviving partner took the position that the heirs were not entitled to partition because of a provision in the joint venture agreement under which each partner specifically waived the right to partition.

The joint venture agreement was executed in 1956. The waiver of partition was specifically limited "for the duration of this Agreement." The agreement further provided that "the death of a partner shall have such effect upon the partnership as is *presently* prescribed by Florida Statutes Annotated" (emphasis added).[2]

The trial court dismissed the action for partition, ruling that the complaint failed to properly state a cause of action. The Florida District Court of Appeals reversed the decision of the circuit court because, while it recognized the validity of the partners to waive partition rights, the waiver was effective as between the partners only during the term of the joint venture. Under both common law and the Uniform Partnership Act (UPA), the death of a partner automatically dissolves the partnership unless the partnership agreement states otherwise.[3] Since the partner's death dissolved the joint venture under Florida law, the waiver of partition was no longer effective because the "duration of this Agreement" had terminated.

While the surviving partner conceded that the death of a partner triggers dissolution of the joint venture, he nevertheless argued that Florida partnership law[4] mandates that the partnership does not terminate upon dissolution, but continues until the partnership winds up its affairs. Hence, the waiver of partition would continue to be enforceable. The court found, however, that the joint venture agreement should be interpreted in accordance with the Florida statute in effect at the time of the agreement. The language of the statute in effect in 1956 stated that "the surviving partner *shall, without delay*, wind up and settle the business and the affairs of the partnership" (emphasis added).[5] Thus, the court held that the partnership was terminated upon the death of the partner; therefore, the waiver was not applicable.

The appellate court noted that the record was silent as to the length of time taken and the effort made by the surviving partner to wind up the partnership matters. While this dicta was not relevant to the case at bar,[6] such language indicates that even under the current, more lax statute, a court might determine that a waiver of the right to partition (and perhaps the waiver of other rights of the partners under the agreement) may not be valid if the surviving partners are not diligent in winding up the affairs of the partnership.

☐ **Contractual Relationship Found to Constitute a Joint Venture.** In *Radaker v. Scott*,[7] a vacant lot owner became convinced that it would be easier to sell his lot with a house built on it. The owner then entered into a contract with a builder that specifically provided for the recovery of the owner's investment in the lot, the construction of the house on the lot within a designated time, and the expectation that both the owner and the builder would realize a profit.

The owner secured building permits, which were taken out in his own name, and opened a bank account entitled "Scott Construction Company." From this account, the owner paid the builder and subcontractors and the costs of materials directly. In addition, the owner obtained workers' compensation coverage in his own name.

Prior to completion of the house, the plaintiff approached the builder and expressed his interest in it. The builder made several oral representations to the buyer regarding the quality of the materials and workmanship. The builder gave the buyer a brochure that further touted the quality of the house.

The plaintiff and the builder signed a Residential Purchase Agreement. The landowner's son, as attorney-in-fact, executed a Seller's Property Disclosure Agree-

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[1] 619 So. 2d 992 (Fla. Dist. Ct. App. 1993).

[2] In Florida, as in most jurisdictions, joint ventures and partnerships are governed by the same rules of law. Kislak v. Kreedian, 95 So. 2d 510 (Fla. 1957).

[3] Fillyau v. Laverty, 3 Fla. 72 (1850); Fla. Stat. § 620.71 (1991). See also Fla. Jur. 2d Business Relationships § 543 (1978).

[4] Fla. Stat. § 620.705 (1991).

[5] Fla. Stat. § 733.37 (1955).

[6] The court relied on the older law to hold that the partnership had been terminated.

[7] 855 P.2d 1037 (Nev. 1993).

ment, authorizing the builder, as "the agent in this transaction," to publish information regarding the house. Furthermore, the disclosure statement designated the owner as the contractor.

Upon taking possession of the home, the plaintiff found material construction defects. The plaintiff sued for damages against both the owner and the builder, alleging that they were either partners or joint venturers in the construction of the house. The complaint further alleged that the builder had knowledge of the existence of several construction defects prior to closing.

The trial court concluded that the contract between the owner and the builder created a joint venture. Moreover, the court determined that (1) the house was not built in a workmanlike manner; (2) there was negligent construction; (3) the quality of the house was, in fact, misrepresented; and (4) breaches of express and implied warranties had occurred. The court, however, found only the builder liable for intentional misrepresentation of the quality of the house.

The appellate court affirmed the lower court's decision that the relationship between the owner and the builder was a joint venture. It stated that the law defines a "joint venture" as follows: "two or more persons conduct[ing] some business enterprise, agreeing to share jointly, or in proportion to capital contributed, in profits and losses."

According to the appellate court, the evidence in the case clearly portrayed a joint venture in that the relationship required the efforts and contributions of both parties to accomplish the common goal of building and selling the house for a profit. Each party had specific abilities that the other party did not have, and made specific contributions to the venture.

Once a determination was made that a joint venture did, in fact, exist, the appellate court concluded that the lower court had erred in apportioning liability between the parties. It held all the members of the joint venture (as in a partnership) jointly and severally liable to third parties for everything chargeable to the venture.[8] In particular, the partnership is bound by torts, including negligence or fraud, inflicted on third parties by a partner acting in the ordinary course of the partnership's business.[9]

☐ **Joint Venture Existed Even Though the Entity Was Never Formally Formed and Did Not Own Property.** In *Metropolitan Research & Development, Inc. v. Tomb et. al.*,[10] the defendant property owners entered into an agreement with the plaintiff consultants to assist in developing or selling certain property. The agreement provided for a fee to the consultants in the event the owners entered into a joint venture arrangement with a developer.

[8] Nevada, like most states, applies the principles of general partnership law to joint ventures. Haertel v. Sunshine Carpet Co., 102 Nev. 614, 616, 730 P.2d 428, 29 (1986); Nev. Stat. ch. 87.

[9] See 87.130 and 87.150 Nev. Stat.

[10] 1993 WL 283216 (Ohio Ct. App.).

While the consultant was continuing to market the property, the owners began negotiating a joint venture arrangement with a developer. When the consultant became aware of these negotiations, it requested information regarding the relationship to determine its fee. The owners responded by agreeing to pay the consultant's fees and expenses to date, but nothing further.

Shortly thereafter, the owners and the developer signed a letter of intent, setting forth the terms and conditions of a joint venture to be formed as well as the duties, obligations, and rights of the parties. The preamble to the specific provisions of the business arrangement stated:

> In consideration of the mutual promises and undertakings herein set forth and other good and valuable consideration, the sufficiency of which is hereby acknowledged, the parties intending to be legally bound hereby agree as follows:

Thereafter, the relationship between the owners and the developer continued for two and one-half years until it was terminated. During that time, no formal joint venture agreement, as required in the letter of intent, was ever executed. Nor was the property ever formally transferred to the name of the joint venture. Nevertheless, the developer paid monies owing to the owners and assumed debts of the owners regarding the property, as it had agreed to do under the letter of intent.

Subsequent to the filing of this suit, but prior to the trial court's decision, the letter of intent was terminated by the owners because they no longer desired to form a business entity with the developer. This termination, however, occurred more than two years after the date of the letter of intent.

The trial court ruled that no joint venture had been formed and, thus, the consultant was entitled to no further payment from the owners. The appellate court recited the basic elements of the existence of a joint venture:

> A joint venture is " . . . an association of persons with intent, by way of contract, express or implied, to engage in and carry out a single business adventure for joint profit, for which purpose they combine their efforts, property, money, skill and knowledge, . . . "[11]

Based on the appellate court's review of the record, it determined that the letter, coupled with the actions taken by the parties, constituted a joint venture.

The owners maintained that the letter did not purport to create a joint venture, but rather, was merely a contract setting forth conditions precedent to the formation of an entity that could be either a joint venture or some other kind of entity, such as a corporation (as specifically enumerated in the letter). Further, a number of conditions precedent to the formal formation of the entity were not met.

The appellate court rejected these arguments by concluding that the letter combined with the actions of the parties "clearly establishes a

[11] Ford v. McCue, 163 Ohio St. 498, 127 N.E.2d 209 (1955); Al Johnson Constr. Co. v. Kosydar, 42 Ohio St. 2d 29, 325 N.E.2d 449 (1975).

present intent to be bound.'' The court relied heavily on the language in the letter's preamble and the time and energies expended by the developer.

The appellate court in this case may have become lost in the trees and failed to see the forest. The owner and the developer clearly intended to be bound by the letter as in any contractual arrangement. The letter is, at most, a contract to form a business entity, not a joint venture in and of itself. The developer was acting similarly to any contract vendee in performing feasibility studies and redevelopment activities. But there were significant conditions precedent to the forming of the entity that were never satisfied, and the entity was never actually formed. No assets or capital were ever contributed. Additional land required for the development was never acquired.

The most glaring deficiency in the court's reasoning is the fact that the business purpose of the proposed venture (i.e., the development of the property) never clearly began and, most certainly, the arrangement was terminated prior to the actual development of the property. The fact that the arrangement was terminated unilaterally by one party is significant evidence that the letter was a contract whose conditions precedent had not been met. Therefore, how can the arrangement between the owners and the developer be construed as a joint venture when the purpose of the proposed venture was never accomplished? At best, the letter should be characterized as an ''agreement to agree.''

There are many cases similar to this one in which courts have refused to recast the relationship of contracting parties as partnerships where the contracts are explicitly contingent on the occurrence of a future event, such as contribution of capital.[12] A contract to form a partnership is a contract—not a partnership—enforceable primarily through an action for damages.

☐ **Applicability of *D'Oench Duhme* Doctrine as to Priority in Bankruptcy Between Partners and Creditors.** In *Resolution Trust Corp. v. Ocotillo West Joint Venture*,[13] the Resolution Trust Corporation (RTC) stepped into the shoes of a failed bank and became a general partner of a venture that was developing a parcel of real property. The venture was the obligor on an unsecured purchase money note in favor of the defendant of which the RTC had full knowledge. When the venture filed for protection under Chapter 11 of the U.S. Bankruptcy Code, the RTC filed an action for declaratory judgment against the defendant, who was an unsecured creditor, seeking priority of its notes ahead of the RTC on the ground that the RTC was a general partner of the debtor, and hence, the RTC's interest was subordinate to that of the general creditors. The RTC claimed that the *D'Oench Duhme* doctrine[14] barred an unsecured creditor from attempting to have its claim paid ahead of the RTC.

In holding against the RTC, the trial court held that the *D'Oench Duhme* doctrine was inapplicable. The purpose of the doctrine is to allow the RTC to block the enforcement of an agreement with an institution it takes over. An agreement is not valid against the RTC unless such agreement (1) is in writing; (2) is executed by the bank and the adverse party; (3) has been approved by the bank's board; and (4) has been an official record of the bank.

In this case, all four requirements were met. More importantly, the creditor was merely using the agreement to evidence its priority as a bankruptcy creditor, not to enforce the debt itself against the RTC.

Once this analysis was completed, the court reasoned that *D'Oench Duhme* did not invalidate general partnership law[15] that liabilities to outside creditors have priority to those owed to partners. Under this scenario, it does not matter whether the RTC's claims were construed to be debt or capital; they were still subordinate to the claims of the outside creditors.

[12] See Bromberg and Ribstein on Partnership, § 205(b) (1992).

[13] 840 F. Supp. 1463 (D.N.M. 1993).

[14] D'Oench Duhme & Co. v. F.D.I.C., 315 U.S. 447 (1942).

[15] § 29-231E Ariz. Stat. The language of the Arizona statute is substantially the same as that found in § 40 of the Uniform Partnership Act (1916), which has been adopted in most jurisdictions.

Limited Partnerships

☐ **Right to Seek Enforcement of Contract Executed Prior to Formation.** In *Woodlawn Park Limited Partnership v. Doster Construction Co.*,[16] a limited partnership that owned a shopping center brought suit against contractors and engineers to recover damages for construction defects.

Three individuals who were in the business of developing shopping centers signed an option to purchase land on which to construct a shopping center on behalf of a named partnership to be formed. After feasibility studies were performed, the individuals exercised the option to purchase the land.

During that time, the defendant engineers made a proposal to provide engineering services, which was accepted by a corporation owned by the individuals. The corporation was used by the individuals from time to time for performing feasibility studies and other work preliminary to development of the property. Two months later, the individuals formally formed the plaintiff limited partnership. Three months later, the limited partnership purchased the property. Two years later, the partners first noticed the construction defects allegedly attributable to the defendants' failure and thereafter filed suit.

The engineers objected to the complaint on the ground that they did not contract with the partnership. They argued that they could not be bound to the partnership in

[16] 623 So. 2d 645 (La. Sup. Ct. 1993).

the absence of knowledge of its existence when their contract was executed. The plaintiff/limited partnership responded by contending that the corporation had acted as agent for the individuals as well as the partnership then contemplated and eventually formed.

Upon motion by the defendant, the trial court dismissed the action as to the limited partnership. The court of appeals affirmed that decision based on a prior ruling[17] that an undisclosed principal has no right of action to bring suit in its own name against the party who contracted with the principal's agent. The court relied on the French law principle of prete-nom, under which a contracting agent makes no representation about acting for another. Under that rule, a third party cannot be bound to an undisclosed principal.

The Supreme Court set aside the lower court rulings, rejecting the principle of prete-nom. The court declared its approval of the use of common law agency notions in commercial transactions by Louisiana courts. The court reasoned that under the common law, an agent has the power to enter into business contracts on behalf of an undisclosed principal. A person who contracts with such agent, who is acting within the scope of his power to bind the principal, is generally liable to the principal.[18]

[17] Teachers' Retirement Sys. of La. v. Louisiana State Employees Retirement Sys., 444 So. 2d 594 (La. 1984).

[18] Restatement (Second) of Agency, § 32 (1958).

The defendant also argued that the limited partnership could not bring an action because it had not been legally formed at the time the defendant's contract was executed. The court rejected this argument because it felt the plaintiff was entitled to present its case at trial on the merits. According to the court, the limited partnership might be able to prove its claim either on an agency theory or as an assignee that subsequently acquired rights under the engineering contract.

Interestingly, the plaintiff never argued the existence of a general partnership or joint venture among the individuals and the pre-development corporation. It would seem easy to support an argument that an oral partnership existed among several individual shopping center developers and their 100 percent-owned feasibility corporation.

☐ **Partner's Fiduciary Duty to Other Partners Regarding Undisclosed Profits.** *Grossman et al. v. Greenberg et al.*[19] involved a limited partnership comprised of six general partners and more than thirty limited partners. In 1979, Mr. Grossman and one other general partner, through a realty firm in which Grossman was an associate realtor, arranged a sale of partnership property to a strawman. The strawman immediately sold the property for a substantial profit over and above the price he paid to the partnership. Unbeknownst to the other partners, Grossman and

[19] 616 So. 2d 406 (Fla. Dist. Ct. App. 1993).

the other partner received a significant portion of the strawman's profit. Further, Grossman did not disclose to the partnership that he also received half of the real estate commission resulting from the transaction. In 1984, Grossman withdrew from the partnership. In 1989, the remaining partners became aware of the improprieties of the transaction and sued Grossman and others for breach of fiduciary duty, fraud, civil theft, and conspiracy.

Grossman contended that the statute of limitations had run, because the sale had occurred ten years prior to the filing of the suit, and that his fiduciary duty to the partners ended in 1984, when he withdrew from the partnership. He also claimed that the partnership had constructive knowledge of the fee and profits, because the one duplicitous partner's knowledge was imputed to the partnership.

The trial court entered a judgment in favor of the plaintiffs. The effect of this judgment was to disgorge Grossman of both the commission and the profit realized on the straw sale. The appellate court affirmed the judgment, but remanded the case to the trial court on issues pertaining to inconsistencies in the amounts awarded by the jury. The court rejected Grossman's procedural argument based on the statute of limitations, because the statute of limitations does not begin to run where fraud is involved until the injured parties discover the improprieties.[20]

More importantly, the appellate court agreed with the lower court's determinations pertaining to partnership law: that is, Grossman had a fiduciary duty to give notice to the other partners of any profit derived by him out of partnership transactions.[21] This tenet of partnership law was held applicable to both the undisclosed commission and the profit Grossman realized on the straw sale.

In addition, the court concluded that Grossman's duty to notify the other partners did not end when he withdrew from the partnership.[22] Moreover, one partner's knowledge of the facts cannot be imputed to the partnership in the case of fraud on the partnership.[23]

[20] Nardone v. Reynolds, 333 So. 2d 25, 34 (Fla. 1976); Franklin Life Ins. v. Tharpe, 131 Fla. 213, 170 So. 406 (1938).

[21] § 620.66 Fla. Stat. (1991); March v. Gentry, 642 S.W. 2d 574 (Ky. 1982); Starr v. International Realty, Ltd., 271 Or. 396, 533 P.2d 165 (1975); Band v. Livonia Assocs., 176 Mich. App. 95, 439 N.W.2d 285 (1989).

[22] Nardone v. Reynolds, 538 F.2d 1131, 1136 (5th Cir. 1976); First Fed. Sav. & Loan Ass'n v. Dade Fed. Sav. & Loan Ass'n, 403 So. 2d 1097, 1100 (Fla. Dist. Ct. App. 1981).

[23] Fla. Stat. § 620.615 (1991).