

# STUDY UNIT ONE

## PROPRIETORSHIPS AND GENERAL PARTNERSHIPS

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The most basic and common form of business organization is the **sole proprietorship**. It consists of one individual who may be engaged in any kind of business. A sole proprietorship is ordinarily a small enterprise. Because it is not distinct from its owner, it is not a separate legal entity.

A **partnership** is an association of two or more persons carrying on a business as co-owners for profit. Unlike a sole proprietorship, a partnership is often treated as an entity distinct from its owners. For example, the UCC and bankruptcy law adopt the separate entity view. However, a partnership was traditionally regarded as a form of agency involving the individual partners. This study unit addresses the form of partnership that may be created without statutory formalities: the **general partnership**.

### 1.1 SOLE PROPRIETORSHIPS

1. **Formation.** Of all business organizations, the sole proprietorship is the easiest and cheapest to create. Most filing, registration, and attorneys' fees are avoided.
  - a. It is formed at the will of the proprietor.
  - b. Formation is subject to only a few legal requirements, for example, local zoning and licensing laws. States rarely require licensing.
    - 1) However, a proprietor doing business under a fictitious name is usually required to make a d/b/a or "**doing business as**" filing under state law. This kind of statute also applies to partnerships.
2. **Capitalization.** A major weakness of a sole proprietorship is that it cannot raise equity capital other than the personal resources of the proprietor.
  - a. Consequently, **debt financing** may be necessary to obtain working capital or to expand the enterprise.
    - 1) Sources of loans are banks and the federal government's **Small Business Administration (SBA)**.
    - 2) If **equity financing** is desired, e.g., by bringing in a partner or issuing ownership interests, the form of the business organization will change.
3. **Profits and losses.** The proprietor has the advantage of receiving all profits. (S)he has the disadvantage of **unlimited personal liability** for all losses and debts.
  - a. The personal assets of the proprietor are therefore at risk.
4. **Taxation.** The proprietor and the proprietorship are not distinct entities, so the income/loss of the business is reported by the proprietor.
  - a. The proprietor receives the tax benefits of all business deductions and losses.
  - b. Other tax advantages are the need to file only one return and the avoidance of the double taxation that corporate earnings are subject to.
  - c. A self-employed person may make contributions to a retirement plan [such as a SEP IRA, SIMPLE 401(k), or self-employed 401(k)]. Plan earnings are exempt from tax until withdrawn.

5. **Operation.** The sole proprietorship is the most flexible of all business organizations. The proprietor has authority to make all management decisions without answering to other executives, directors, or owners.
  - a. Thus, control and accountability are completely centralized.
  - b. A disadvantage is that a sole proprietorship may lack the expertise and the checks and balances relative to the decision-making process that are found in more complex organizations.
  - c. An advantage is that a sole proprietorship ordinarily can do business in any state without having to file, register, or otherwise qualify to do business in that state.
    - 1) The **Internet** allows a sole proprietorship to conduct business nationally or even internationally.
6. **Termination.** The duration of the sole proprietorship is at the proprietor's discretion.
  - a. The interest of the proprietor may be transferred during his/her life, but the sole proprietorship is then dissolved.
    - 1) An advantage of a sole proprietorship is that a change in control of the enterprise can occur only with the proprietor's consent.
    - 2) A transfer of interest often is accompanied by the proprietor's signing of a **noncompetition agreement**.
  - b. The sole proprietorship is automatically terminated upon the proprietor's death.
  - c. Accordingly, lack of **continuity of existence** is a disadvantage of this form of organization.

## 1.2 GENERAL PARTNERSHIPS

1. **Definition.** According to the **Revised Uniform Partnership Act (RUPA)**, a partnership is "an association of two or more persons to carry on as co-owners a business for profit."
  - a. The **general partnership** is the oldest, simplest, and most common form of business organization other than the sole proprietorship.
    - 1) It differs from other partnerships in that **each partner** has **unlimited personal liability** for all losses and debts of the business. This distinction is a major disadvantage of the general partnership.
    - 2) Each partner has consented to being both a principal and an agent of the partnership. A **principal** is a person who permits or directs another to act on his/her behalf. An **agent** is a person who agrees to act on the principal's behalf.
      - a) An agent has **actual or apparent authority** to take actions that obligate the partnership. Thus, the personal liability incurred by one partner **as a principal** may result from conduct of another partner **as an agent**.
        - i) Such liability may arise without the partner's fault, authorization, or knowledge.

- b. An issue with many accounting and auditing implications is whether a partnership is an **entity separate from its owners**.
  - 1) A partnership is **an entity distinct from** the partners (owners).
    - a) The assets of a partnership are treated as those of the business unit.
    - b) Title to real property may be acquired in the partnership name.
    - c) Each partner is considered a fiduciary of the partnership.
    - d) Each partner is considered an agent of the partnership.
    - e) The partnership may sue and be sued in its own name.
      - i) Thus, a judgment against the partnership is not a judgment against a partner.
  - 2) However, in other ways, a partnership is treated as an **aggregate** of the individual partners.
    - a) The duration of a partnership is limited by, for example, the will or the lives of the partners. Thus, it lacks continuity of existence.
    - b) No person can become a partner without consent of all the partners.
      - i) A transferee of a partnership interest, unlike a transferee of shares in a corporation, does not become an owner.
    - c) Debts of a partnership are ultimately the debts of the individual partners.
    - d) A partnership is not subject to regular federal income tax.
- c. The partnership may be **for a term**. The partners may specify the duration of the partnership to be for a specific term or until the completion of a specific project.
  - 1) The partnership may be **at will**. The partners have not agreed to remain partners until the end of a definite term or the completion of a specific undertaking. The partnership can be dissolved at any time by any partner by giving notice of his/her express will to withdraw as a partner.
  - 2) Hence, the **going-concern assumption** may be inappropriate for a partnership.

## 2. Formation.

- a. An advantage of the general partnership is that it can be created without any formalities. No filings are required, and the existence of the partnership may arise from a written or oral agreement.
  - 1) An agreement also may be implied by the conduct of the parties.
  - 2) If the partnership is to exist for a definite period exceeding one year, the **statute of frauds** requires the partnership agreement to be in writing. However, an agreement to transfer real estate, not an agreement to form a partnership to deal in real estate, must be written.
  - 3) **Fictitious name statutes** have been enacted in most states for the protection of creditors. Registration permits creditors to discover the persons liable for the debts of the enterprise. The creation and operation of a partnership is little affected by the requirement because a partnership need not adopt a name, although use of a name may help to distinguish a partnership action from that of a partner. Moreover, the use of a name does not necessarily indicate the existence of a partnership or that a named person is a member of the firm.
- b. Another advantage is that the partners may by **contract** establish the relationships among themselves and between themselves and the partnership.
  - 1) The law recognizes the supremacy of the **partnership agreement** in most situations. The RUPA is therefore largely a series of default rules that govern matters not addressed by the partners in their agreement.

- 2) Nevertheless, the partnership agreement cannot
  - a) Unreasonably restrict access to books and records,
  - b) Eliminate the duty of loyalty or the obligation of good faith and fair dealing,
  - c) Unreasonably reduce the duty of care,
  - d) Vary the power to dissociate,
  - e) Waive or vary the right to seek court expulsion of another partner,
  - f) Vary the law applying to a limited liability partnership,
  - g) Vary the right to dissolution and winding up, or
  - h) Restrict third-party rights.
- c. **Intent.** If the elements of a partnership are present, it is formed even if the parties do not intend to be partners. But, a partnership is not formed if an element is missing even if the parties intend to be partners.
  - 1) Consequently, parties may disagree about whether their business arrangement is a partnership, especially in the absence of a written agreement.
- d. A partnership is an **association of persons**.
  - 1) Any person who has the **legal capacity** to enter into a contract may enter into a partnership agreement. **Persons** include individuals, partnerships, corporations, estates, trusts, joint ventures, and other associations. Under the RUPA, persons include any legal or commercial entity.
- e. A partnership must carry on a **business**. A business is any trade, occupation, or profession.
- f. Each of the parties must be a **co-owner**. They must share **profits and losses** and **management authority** (unless they agree otherwise).
- g. To form a partnership, the co-owners also must intend that their business make a **profit** even if no profit is earned. Thus, religious, patriotic, and educational organizations that are not for profit are not considered partnerships.
  - 1) **Profit sharing** by itself does not necessarily signify the existence of a partnership. A person who receives a share of the profits of a business is generally **presumed** to be a partner. This presumption is overcome if the receipt is merely as payment of, or for, any of the following:
    - a) Debt or interest on a loan
    - b) Compensation to an employee or independent contractor
    - c) Rent to a landlord
    - d) A health or retirement benefit to the beneficiary or a representative of a deceased or retired partner
    - e) Purchase of goodwill of a business or of other property
  - 2) A **joint interest** in (co-ownership of) property or the **sharing of gross returns** does not by itself establish a partnership.
- h. A **partnership by estoppel** may be recognized when an actual partnership does not exist. The duties and liabilities of a partner sometimes may be imposed on a nonpartner (a **purported partner**). A purported partner has represented him/herself as a partner or has consented to such a representation. Moreover, the purported partner is assumed to be an agent of persons who have consented to the representation.
  - 1) A third party who has reasonably relied on the representation and suffered harm as a result may assert the existence of a partnership. The purported partner then will be prevented (estopped) from denying the existence of a partnership.

- 2) For example, Lawyer A falsely represented to Client that Lawyer A and Lawyer B were partners. Client, in reasonable reliance on this statement, sought legal services from Lawyer B. Because these services were performed without due care, Client suffered harm. Lawyer A (as well as Lawyer B) was liable as a partner despite the absence of an actual partnership.
3. **Capitalization.** A general partnership is advantageous relative to a sole proprietorship because two or more persons may contribute cash, property, or services to the business.
  - a. Combining resources may improve the credit standing of the business.
  - b. However, a general partnership cannot raise equity capital by selling shares.
  - c. The partnership agreement should state the nature and amounts of initial and subsequent **contributions** by partners. It should also address whether
    - 1) Withdrawals are restricted and
    - 2) Individual partner capital, income, and drawing accounts are to be maintained.
  - d. A person may become a partner by contributing cash, property, or services.
4. **Profits, losses, distributions, and the partnership interest.**
  - a. The **right to share in profits**, unless otherwise agreed, allows each partner to have an equal share in partnership profits regardless of differences in the amount of contributions. Also, unless agreed otherwise, each partner must contribute in proportion to his/her share of the profits toward any **losses** of the partnership.
  - b. A partner also has the **right to distributions**. A distribution is a transfer of partnership property from the partnership to a partner. A distribution may take various forms:
    - 1) A share of profits;
    - 2) Compensation for services;
    - 3) Reimbursement for payments made, and indemnification for liabilities incurred, in the ordinary course of business or to preserve the business or its property; and
    - 4) Reimbursement for advances (loans) in excess of agreed capital contributions.
      - a) The payments made and liabilities incurred are **loans** that accrue interest.
  - c. The **right to compensation for services** is in essence the right to receive a share of the profits. A partner is not entitled to be paid for services rendered for the partnership except winding up its business. However, a partnership agreement often does provide for additional compensation.
  - d. A **partner's transferable interest** consists of a partner's share of partnership profits and losses and the right to receive distributions.
    - 1) Partners may sell, pledge, or otherwise **transfer (assign)** their interests to the partnership, another partner, or a third party without loss of the rights, duties, and liabilities of a partner (except the interest transferred). Thus, neither dissociation nor dissolution occurs. Moreover, unless all the other partners agree to accept the assignee as a new partner, the assignee does not become a partner in the firm. Without partner status, an assignee has no liability for partnership obligations.
    - 2) The ability to transfer the financial interest in the firm but not ownership status is a disadvantage of a partnership. For example, a partner cannot, during his/her life or through inheritance, transfer ownership to a family member.

- 3) When a partner dies, his/her partnership interest is considered part of the **estate**. The interest is personal property and may be inherited according to the provisions of the deceased partner's will. Heirs of the partnership interest are assignees, not partners.
  - a) The estate does not become a partner.
  - b) Many partnership agreements provide that the surviving partners or the partnership itself will have a right of first refusal to purchase the interest.
    - i) A partnership agreement may incorporate a provision to fund the purchase of the interest using life insurance proceeds.
  - c) The estate is responsible for the partner's allocated share of any partnership liabilities. These liabilities may include post-dissociation contracts entered into with third parties who reasonably believe that the dissociated person is still a partner.
- 4) A creditor who has obtained a judgment against a partner may attach the partner's transferable interest in the partnership only by securing a charging order from a proper court. A **charging order** is a lien on the transferable interest.
  - a) The court may order foreclosure of the interest at any time. After the order, the debtor partner's interest is sold at a judicial sale. Before the sale, the debtor, the other partners, or the partnership itself may redeem the interest by paying the debt. The **purchaser** does not become a partner unless all partners consent.
5. **Taxation.** A principal advantage of a partnership is that it is not a taxable entity. However, it must file an annual informational return on **Form 1065**.
  - a. The partnership's profit/loss is **passed through** to the partners, who report their shares of that profit/loss on their personal income tax returns.
  - b. A partner may make contributions to the partnership's 401(k) plan.
6. **Rights of partners.** The rights, duties, and powers between and among partners are largely defined by the law of **agency**. However, partners may agree to limit rights to which individual partners may otherwise be entitled by law. Nevertheless, neither the partners nor the partnership can modify obligations to third parties imposed by law.
  - a. Each partner has a **right to equal participation in management** of the partnership.
    - 1) The general rule for ordinary matters is majority rule.
    - 2) Issues not ordinarily connected with day-to-day partnership business (such as amending a partnership agreement or admitting a new partner) require a unanimous decision.
    - 3) Different classes of partners may be formed with different management rights.
    - 4) A disadvantage of a partnership is that a decision-making deadlock may develop when partners have equal management rights.
    - 5) Partnership agreements commonly restrict management rights to a few partners or even one partner.
  - b. A partner's **right of access to partnership information** is the right to access, inspect, and copy the partnership books and records, if any. They must be maintained at the partnership's chief executive office.
    - 1) Each partner and the partnership must provide a partner with information "reasonably required for the proper exercise of the partner's rights and duties" under the partnership agreement or the RUPA.
      - a) A reasonable demand for any other information about the partnership also must be honored.

- c. The **right to use or possess partnership property** may only be exercised on behalf of the partnership. The RUPA states, "Property acquired by a partnership is property of the partnership and not of the partners individually."
    - 1) Property is partnership property when it is acquired **in the name of the partnership**. It is also deemed to be partnership property when it is acquired **in the name of a partner**, provided that the instrument of transfer indicates the existence of a partnership.
    - 2) Furthermore, property purchased with **partnership assets** is presumed to be partnership property.
    - 3) Partners do not own any specific partnership property directly or individually. It is owned by the partnership as a legal entity.
      - a) Likewise, the creditors and heirs of an individual partner have no right to specific partnership property. A partner's interest in specific partnership property is a joint right of possession for partnership purposes only. The partner's interest in a specific item of such property is not transferable and cannot be attached by personal creditors or passed through a deceased partner's estate.
      - b) Whether property belongs to the partnership or a partner also determines who has the power to transfer it, who receives the proceeds (or bears the loss) from its disposal, and how it will be disposed of upon termination of the firm.
  - d. The **right to choose associates** means that no partner may be forced to accept any person as a partner. The RUPA states, "A person may become a partner only with the consent of all of the partners."
    - 1) When a partner transfers his/her interest to another, the purchaser or other transferee is entitled only to receive the share of profits and losses and the right to distributions allocated to the interest (s)he has acquired.
  - e. The RUPA provides a broad **right to maintain an action against the partnership or other partners**, with or without an **accounting** as to partnership business, for any form of relief available from a court.
    - 1) Suit may be brought to enforce rights under the partnership agreement or the RUPA or to protect interests arising independently of the partnership.
    - 2) The RUPA also allows the partnership to sue a partner for breaching the partnership agreement or violating a duty to the partnership.
  - f. Each partner is assumed to have an **account** that is credited with his/her contributions made and share of profits, and debited for distributions received and share of losses.
7. **Duties of partners.** A partner has the actual or apparent authority under the principles of agency law to take actions that impose personal liability on the other partners without their knowledge and consent. Hence, a partner is in a **fiduciary position**, i.e., a position involving trust and confidence. (S)he has a duty to act primarily for the benefit of the other partners in partnership affairs.
- a. Duties imposed upon partners include the **fiduciary duties** of loyalty and care. The **duty of loyalty** is limited to
    - 1) Not competing with the partnership;
    - 2) Not dealing with the partnership in the conduct or winding up of the partnership business as (or for) a party with an adverse interest; and

- 3) Accounting to the partnership and holding for it in trust any benefit resulting from
    - a) The conduct or winding up of the partnership business or
    - b) The use of partnership property.
      - i) Accordingly, a partner cannot for personal gain exploit a partnership opportunity or secretly use partnership assets.
  - b. The **duty of care** in the conduct or winding up of the partnership business is not to engage in knowing violations of the law, intentional wrongdoing, gross negligence, or reckless behavior.
  - c. A partner also has an obligation of **good faith and fair dealing**.
    - 1) A partner therefore must be honest in fact and meet reasonable (objective) standards of fair dealing.
  - d. However, no duty is violated solely because a partner acts in his/her own interest.
  - e. A partner may lend money to, or otherwise do business with, the partnership on the same basis as a nonpartner.
8. **Powers of partners.** The powers granted to each partner are governed by law and by the specific terms contained in the partnership agreement.
- a. A partner's status grants him/her **apparent authority** to act as an **agent** of the partnership in any legal transaction that is apparently for "carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership" (business that is normal for the partnership or for a similar partnership).
    - 1) Apparent authority is derived from words or actions of the principal (the partnership) that reasonably induce a third party to rely on the agent's (partner's) authority. The partnership is bound even if the partner had no actual authority in the matter unless the third party knew or had received notification of the lack of actual authority.
    - 2) However, if a partner acts **without actual or apparent authority**, neither the partnership nor the other partners are bound by the act unless the other partners **ratify** the transaction.
    - 3) The RUPA provides for filing a **statement of partnership authority** that may give notice of limitations on the authority of a partner.
      - a) A **statement of denial** also may be filed by a person named in a statement of authority. It states the fact denied, e.g., partner authority or status.
      - b) The extent of authority described in the statement of authority may be relied upon by a person dealing with a partner if that person gives value in a transaction without knowledge to the contrary (assuming no other filing cancels the authority).
      - c) A stronger safeguard against unauthorized transfers is provided for real property. If the filing limits a partner's authority to transfer the partnership's **real property**, and filing is in the public **real property records**, any person is assumed to know of the limitation.
        - i) Except for real property filings and filed statements of dissociation or dissolution, a nonpartner is not assumed to know of a limitation on authority solely because of a filing.
  - b. **Transfer of Partnership Property**
    - 1) Subject to a filed statement of authority, property **in the name of the partnership** may be transferred by any partner in the partnership name.
    - 2) Property **in the name of a partner(s) or in the name of another person(s)** may be transferred by the named person(s).



- 3) **Recovery** of partnership property requires the partnership to prove that
  - a) The transferor partner(s) had no authority (actual or apparent), and
  - b) The transferee for value had notice of these facts.
9. **Liabilities of partners.** The liability of a partner and the partnership is founded on the principles of agency. A partner acts as both a principal and an agent for the partnership. Thus, a general partner is liable as a principal for actions of employees within the course and scope of employment by the partnership.
  - a. (S)he also acts as an agent for the co-partners. When an actual partner appears to a third party to be carrying on the business of a partnership in the usual manner or when a partner is authorized by the other partners to take an unusual action, (s)he has the power to obligate the partnership and the co-partners.
    - 1) Accordingly, a partnership is liable for loss or injury caused by the **actionable conduct** (torts and other wrongful acts or omissions) of any partner while the partner is acting within the ordinary course of the partnership business or with its authority. Examples are malpractice, other negligence, fraud, and misappropriation of customer assets.
  - b. Each general partner normally has **joint and several liability** for any partnership obligation. Thus, partners are individually liable for the full amount of a partnership obligation and also liable as a group. Joint and several liability allows either joint suits or separate actions (and separate judgments) at the plaintiff's option.
    - 1) If a creditor obtains a judgment against a partner based on a claim against the partnership, the partner will **not be liable unless** (a) the partnership is in bankruptcy; (b) attempts to use judicial process to collect from the partnership are unsuccessful; (c) the court rules that partnership assets are clearly insufficient, exhaustion of its assets is unduly burdensome, or equity will be served by permitting suit against the partner; (d) the partner agrees that the creditor need not exhaust partnership assets; or (e) the partner is independently liable.
  - c. A partner may obligate the partnership and partners by **contract** when (1) specifically authorized by the partnership agreement, (2) apparently carrying on partnership business in the usual manner, or (3) acting with the actual or implicit consent of the other partners.
    - 1) When partners agree to limit the authority of a partner to act for the partnership, a third party who has no notice of the limitation is not bound.
  - d. **Admission** into an existing partnership results in liability for partnership obligations. However, a new partner is liable for preadmission obligations of the partnership only **to the extent of his/her investment**. An incoming partner may expressly or implicitly assume personal liability for existing partnership debt, and (s)he has unlimited liability for partnership obligations arising after admission.
  - e. **Criminal liability** is not ordinarily imposed on partners as a result of a co-partner's criminal conduct unless they were involved.
  - f. A **partner's knowledge or receipt of notice** of a fact relating to the partnership is attributed to the partnership.
  - g. A **withdrawing partner** remains liable for debts of the partnership incurred before withdrawal unless the creditors agree otherwise.
    - 1) Termination of the partnership also does not discharge any partner's obligations to third parties.

10. **Termination of partnerships.** The process to end a partnership may be governed by the partnership agreement. If it is not, the RUPA provides a scheme that consists of dissociation, dissolution, winding up (also known as liquidation), and termination.
- a. **Dissociation** is the legal effect of a partner's ceasing to be associated in carrying on the business of the partnership. A partner has the power (if not the right) to dissociate at any time, subject to payment of damages if the dissociation is wrongful.
    - 1) The partner's management rights (except with regard to winding up) terminate.
    - 2) After dissociation, the business either continues after purchase of the dissociated partner's interest, or dissolution begins.
    - 3) The dissociation of a partner terminates the **duty not to compete**. The other aspects of the **duties of loyalty and care** continue only with regard to predissociation matters unless the partner participates in winding up.
    - 4) Dissociation results from
      - a) Notice to the partnership of a partner's express will to withdraw;
      - b) An event stipulated in the agreement;
      - c) **Expulsion** of a partner under the terms of the **partnership agreement**;
      - d) **Expulsion** by a **unanimous vote** of the other partners on the grounds that the partnership business cannot legally be conducted with that partner, the partner is a dissolving corporation or partnership, the partner has transferred substantially all of his/her interest, or the partner's interest is subject to a changing order;
      - e) A **court order** on the grounds of a material breach of the partnership agreement or a duty, misconduct materially affecting the business, or conduct making continuation of the business with the partner impracticable (e.g., a deadlock between partners);
      - f) Incapacity;
      - g) Death;
      - h) Insolvency; and
      - i) Distribution by a trust or estate of its entire transferable interest.
    - 5) The partnership is not necessarily dissolved by dissociation unless it occurs by **express will** of the partner.
    - 6) A **statement of dissociation** may be filed by the partnership or a dissociated partner. It is deemed to provide notice of dissociation 90 days after filing.
      - a) Such notice terminates the partner's apparent authority and his/her liability for the partnership's post-dissociation obligations.
      - b) Without this statement or some other form of notice, the dissociated partner will have apparent authority for 2 years to bind the partnership to contracts with third parties who reasonably believe the person is a partner.
      - c) A dissociated partner remains liable to creditors for **predissociation obligations** even if the other partners agreed to assume the debts.
      - d) A dissociated partner also may be liable on **post-dissociation contracts** for up to 2 years if third parties reasonably believe that (s)he is still a partner. Thus, a dissociated partner has an obvious motive for filing a statement of dissociation.

- 7) If the business is not wound up, the partnership must **purchase the dissociated partner's interest**. The price is determined based on a hypothetical sale of the partnership at the dissociation date.
    - a) The buyout price is the amount of the distribution receivable by the partner if the partnership were sold for the greater of
      - i) Liquidation value or
      - ii) The sales value of the entire going concern without the partner.
    - b) The buyout price is offset by damages for wrongful dissociation and other amounts owed to the partnership.
  - 8) The dissociation provision assures greater **continuity** of partnerships and supports the view that a partnership is to be treated, whenever possible, as an **entity**.
- b. **Dissolution and winding up** is the alternative to dissociation and continuation of the partnership. However, although dissolution changes the working relationships of the partners, it is distinct from winding up.
- 1) In a partnership at will, dissolution results from notice of a partner's **express will to withdraw**. It also results from
    - a) In a partnership for a **definite term or specific undertaking**,
      - i) Expiration of the term or completion of the undertaking
      - ii) Unanimous agreement of the partners
      - iii) Wrongful dissociation or death of a partner, unless a majority in interest of the other partners agree to continue
    - b) An event designated in the partnership agreement as causing winding up
    - c) Illegality of the business
    - d) On application of a partner, a **judicial determination** of
      - i) Frustration of the economic purpose of the partnership
      - ii) Impracticability of doing business with a particular partner
      - iii) Impracticability of doing business under the partnership agreement
    - e) A judicial determination made at the request of a transferee of a transferable interest that **winding up is equitable**
  - 2) A partnership continues until the **winding up** of partnership affairs is complete. All partners are entitled to participate in the winding up (liquidation) process except a partner who has wrongfully dissociated.
    - a) However, before winding up is complete, the partners (excluding a wrongfully dissociated partner) may **unanimously agree to continue the business** as if dissolution had not occurred.
      - i) This provision furnishes another opportunity to compensate for the continuity (going-concern) problems faced by partnerships.
  - 3) The **actual authority** of a partner to act on behalf of the partnership terminates upon dissolution except as necessary to wind up partnership affairs.
  - 4) **Apparent authority** of a partner may continue to exist throughout the winding up process unless notice of the dissolution has been communicated to the other party to the transaction.
  - 5) The **fiduciary duties** of the partners also remain in effect with the exception of the duty not to compete, which ceases to exist after dissolution.
  - 6) A **statement of dissolution** may be filed by any partner who has not wrongfully dissociated. It is deemed to provide notice to nonpartners 90 days after the filing regarding dissolution and the limitation of the partners' authority.

- c. **Winding up** is the administrative process of settling partnership affairs, including the use of partnership assets and any required contributions by partners to pay creditors.
- 1) The RUPA states that the person winding up may
    - a) Continue the business as a going concern for a reasonable time,
    - b) Take judicial actions,
    - c) Settle and close the business,
    - d) Dispose of and transfer property,
    - e) Discharge liabilities,
    - f) Distribute assets,
    - g) Settle disputes by mediation or arbitration, and
    - h) Perform other necessary acts.
  - 2) Creditors are paid in full before any distributions are made to partners. However, **partners who are creditors** share equally with nonpartner creditors under the RUPA. In practice, because partners are liable for all partnership debts, partnership creditors are paid first.
  - 3) After payment of creditors, any surplus is paid **in cash** to the partners. A partner has no right to a **distribution in kind**. A partner also need not accept a distribution in kind.
  - 4) To settle **partnership accounts** with credit balances, each partner receives a **distribution** equal to the excess of credits over debits to his/her account. Thus, no distinction is made between distributions of capital and of profits.
    - a) Profits and losses from liquidation of assets are credits and debits, respectively.
    - b) Prior credits to an account include contributions made and the partner's share of profits.
    - c) Prior debits include distributions received and the share of losses.
  - 5) If a partner's account has a debit balance, the partner is liable to **contribute** the amount of the balance.
    - a) If a partner does not make a required contribution, the other partners must pay the difference in the same proportion in which they share losses.
    - b) A partner making an excess contribution may recover the excess from the other partners.
    - c) Moreover, the representative of creditors of the partnership or of a partner (e.g., a trustee in bankruptcy) may enforce the obligation to contribute to the partnership.
    - d) One effect of these rules is that the priority rules for unsecured partnership creditors and individual partners' unsecured creditors are consistent with the federal **Bankruptcy Code**. Thus, unsecured partnership creditors
      - i) Have priority in partnership assets and
      - ii) Share equally with creditors of partners in the partners' separate assets.

### 1.3 JOINT VENTURES

1. **Definition.** A joint venture is an easily formed business structure common in international commerce. It is an association to accomplish a specific business purpose or objective and is often organized for a single transaction.
  - a. A joint venture is not a partnership because it does not **carry on a business**.
  - b. However, most rules governing general partnerships apply to joint ventures, including those relating to formation.
  - c. A disadvantage of the joint venture is that it **lacks continuity of existence**.
    - 1) Moreover, the interests in the enterprise are **not readily transferable**.
  - d. The rights and duties of **joint venturers** are generally governed by the RUPA.
    - 1) A joint venturer, like a partner, has a right of access to information.
    - 2) Joint venturers owe each other the same **fiduciary duties** as partners.
    - 3) The most significant difference between joint venturers and partners is that joint venturers typically have **less implied and apparent authority** to bind their associates due to the limited scope of the joint venture.
      - a) Thus, an advantage is that no joint venture is liable for similar activities of other joint ventures outside the scope of the venture.
    - 4) Each joint venturer is **personally liable** for debts of the venture.
    - 5) Each joint venturer is liable for negligence of another acting within the scope and course of the business of the venture.
    - 6) Joint ventures are treated as partnerships (nontaxable entities) for **federal income tax** purposes. Hence, joint ventures have the advantage of avoiding double taxation.
    - 7) Barring a contrary agreement, joint venturers share **profits and losses** equally.
    - 8) Joint venturers may be sued.
      - a) The joint venture is usually not a legal entity and therefore **cannot be sued**.
    - 9) **Antitrust laws** apply to joint venturers who are competitors.
      - a) However, less stringent rules are applied to international joint ventures.
    - 10) **Not-for-profit entities** cannot be joint ventures. The limited objective of a joint venture necessarily includes earning a **profit**.