

GRADERS' GUIDE

*** QUESTION NO. 2 ***

SUBJECT: BUSINESS LAW

In 1992, Alaska adopted the Uniform Limited Partnership Act. In 1997, the Alaska legislature revised some of the provisions of the uniform law and renamed the body of statutory law governing limited partnerships as the "Alaska Revised Limited Partnership Act." Some points should be given to the examinee who recognizes that this body of law exists and has been adopted in the Alaska.

Question (1): Estoppel to deny Limited Partnership structure among Partners (35 points)

[Background: Limited partnerships are creatures of statute. They only exist when the statutory requirements are fully satisfied for their establishment. In contrast, general partnerships can arise as a matter of law, when two or more individuals decide to pursue a business venture jointly and share in the profits and risks of that venture. The key differences between limited partnership and general partnerships lie in their types of partners and the scope of responsibility and liability of those partners. In a general partnership, all partners are on an equal footing, share control of the business and are personally liable for its debts. In a limited partnership, there are two levels of partners: general and limited. The general partner has responsibility for running the business enterprise and bears personal liability for the partnership's debts. The limited partner(s) have a substantially reduced scope of involvement in running the business enterprise, and in exchange for that limited involvement, their personal liability for the debts of the partnership is limited to the funds which they invest or are obligated to invest in the partnership.]

Lands-R-Us Inc.'s theory is based on the fact that under AS 32.11.010(b) a limited partnership is formed at the time of the filing of the certificate. In this case, that did not occur until July 1, 2002, six months after the partners had signed the limited partnership agreement and the partnership had already incurred the debt under the promissory note. Thus, its argument is that in January 2001 when the promissory note was executed, the partnership was not a limited partnership but instead a general partnership. Lands-R-Us Inc. will argue that therefore, all partners at the time the debt was incurred are general partners and bear joint and several liability for the debt.

Lands-R-Us Inc. will not prevail in its attempt to make the limited partners liable as general partners for the amounts due under the promissory note due to the late filing of the certificate of limited partnership.

This is because Lands-R-Us Inc. is not only a creditor; it is also a partner. If Lands-R-Us Inc. was only a creditor, it would succeed in establishing the joint and several liability of the limited partners for the debt. However, Alaska law is well settled that partners will be bound by the limited partnership agreement in their relations with one another, even though the certificate is not filed. Betz v. Chena Hot Springs Group, 657 P2d 831 (Alaska 1982) (applying former AS 32.10.010). This is true even where the partner also holds the position of a creditor of the partnership. In Neal and Lakeside Mall, Ltd., v. Hill et al. 826 P2d 1137, a group of investors sold a shopping mall subject to a bank's mortgage lien to an Alaska limited partnership. As part of the transaction, the investor group received a limited partnership interest in the purchasing partnership. Later when the purchasing limited partnership defaulted on the mortgage, and the bank went against the original investor group for the loan amount, the investor group sought to impose joint and several liability on the other limited partners on the grounds that the limited partnership had not filed its certificate with the state at the time of the property conveyance and loan assumption, and thus was a general partnership. In Neal, the Alaska Supreme Court held that a partner is "estopped to deny the existence of a limited partnership among the partners inter se for the purpose of imposing general partnership liability on his former co-partners." (Id. at 1138).

The court in Neal indicated that the type of estoppel involved a hybrid between equitable estoppel and quasi-estoppel. Id. at 1142, fn 12. Therefore, as between Lands-R-Us Inc. and the limited partners, Lands-R-Us Inc. is estopped to deny that the other partners have the limited liability protections afforded them under the statutes simply because of defects in the formation of the limited liability partnership.

[Examinees may discuss fact that Lands-R-Us Inc. was the general partner of the Limited Partnership, and thus had the ultimate responsibility for filing the certificate of limited partnership, even though the facts attempt to steer examinees away from this argument by stating that it was the fault of one of the limited partners that caused the delay in filing the certificate. The examinee that goes down this path will argue that Lands-R-Us Inc.'s failure to get the certificate filed, and then subsequent attempt to take advantage of that failure could give rise to the more traditional equitable estoppel argument. A lesser amount of credit can be given for this answer.]

Question (2): Conversion of limited partner John Rich to general partner status (35 points)

Lyon Forest will try to establish John Rich's liability for the debt as a general partner under the theory that John Rich "participated in the control of the business". Under AS 32.11.120, a limited partner who "participates in the

control of the business ... is liable ... to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner." This statute goes on to clarify what "participates in the control of the business" means by listing conduct that does not qualify. From Lyon's perspective, John Rich was his key contact with the partnership, and from all appearances, was the guy in charge.

Unfortunately for Lyon, most of John's conduct falls in the category of conduct that will not constitute participating in the control of the business. The following actions or conduct on John Rich's part fall in that category:

- (a) Remaining a director of Lands-R-Us Inc., the general partner.
- (b) Being an employee of the limited partnership.
- (c) Consulting with and advising the general partner Lands-R-Us Inc. with respect to the business of the limited partnership.
- (d) Requesting and attending a meeting of the partnership

However, John Rich did have a significant amount of personal contact with Lyon Forest. John Rich exerted a substantial amount of control over the Lyon Forest transaction and appeared to be calling the shots with respect to the meeting in which Lyon's contract was approved. Even though the partnership agreement states that the general partner is to make all management decisions, the fact that John Rich briefed Lyon on his personal vision for the course, and insisted on all partners voting on the Lyon contract is evidence of John Rich participating in the control of the business. This would particularly be the case if Lands-R-Us Inc., as general partner, considered the vote binding and not just advisory.

Based on John Rich's substantial involvement in bringing about the Lyon Forest contract, John Rich would most likely lose his limited liability protection under AS 32.11.120. [Examinees may come to different conclusions. Points should be awarded based on breadth of fact analysis, and recognition of "control of business" issue.]

Question (3): Derivative Action on behalf of Limited Partnership. (30 points)

Ann and Scott would have filed a derivative action on behalf of the Limited Partnership as provided for under AS 32.11.490-.520. They would allege that Lands-R-Us Inc. breached its fiduciary duty to the Limited Partnership by imposing an excessive financial burden on the Limited Partnership in order to gain a financial windfall for its own in project in Arizona.

The pleading requirements in this case would be met by Ann and Scott by stating that the general partner would have refused to prosecute the legal

action since it was the general partner who was the entity engaged in the act of self dealing. AS 32.11.510.

Both Ann and Scott are proper plaintiffs since they were partners at the time of filing the derivative action, and partners at the time of the transaction complained of took place. AS 32.11.500.

If Ann and Scott recover a judgment or settle the case, they will be entitled to deduct from the recovery any attorney's fees and costs awarded to them by the court, and the remaining proceeds will be remitted to the limited partnership. AS 32.11.520. The proceeds remitted to the limited partnership would be distributed in the following order: (1) creditors; (2) general and limited partners in satisfaction of liabilities for interim distributions; and (3) general and limited partners first for return of contributions and then for profits.