ESSAY QUESTION NO. 1

Answer this question in booklet No. 1

Several years ago, No Hang Ups Inc. designed a new style of hang glider and began manufacturing and selling it throughout the United States. The hang gliders are selling very well and the "No Hang Ups" name is popular among adventure athletes and tourists.

Bob and Joe decide to develop and operate a new Alaska tourist attraction featuring the No Hang Ups Inc. hang gliders. In January of 2007, they form an Alaska limited partnership named "No Hang Ups Limited Partnership". Bob and Joe are the general partners and the three limited partners are No Hang Ups Inc., Lily and Lester.

Under the terms of the written and signed limited partnership agreement, Joe contributes $200,000 in cash, and Bob contributes two parcels of property he owns at the base and top of an Alaska mountain. Lily and Lester each contribute $25,000 and promise to contribute an additional $75,000 each over the next three years. No Hang Ups Inc. contributes twenty-five No Hang Ups hang gliders from the prior year's inventory, valued at $75,000, and the right to use its name in the limited partnership name and in business promotions.

Alaska Bank loans the "No Hang Ups Limited Partnership" $300,000 to finance the building of a cable car to carry tourists between the limited partnership's properties at the base and top of the mountain. Alaska Bank's loan is secured by a promissory note and deed of trust to the mountain properties lawfully signed by Bob in his capacity as a general partner of "No Hang Ups Limited Partnership". Alaska Bank accepts Bob's verbal assurances that No Hang Ups Limited Partnership is an Alaska limited partnership in good standing. Alaska Bank assumes that the successful and well known enterprise, No Hang Ups Inc., is one of the general partners, and it does not ask to see a full listing of all of the general and limited partners. Alaska Bank sends a representative to discuss the loan and to observe a partnership meeting prior to extending the loan. The representative observes the active participation by all of the partners. Alaska Bank is satisfied that with the existing and future partner capital contributions together with the partners' high energy and drive, the business will be a success, and on that basis they finalize the loan.

During construction of the cable car, various managers employed by No Hang Ups Inc. visit the site and advise Bob and Joe on optimum placement of the release point at the top of the mountain. They also provide instructions and recommendations on how to store and maintain the hang gliders. The limited partnership pays No Hang Ups Inc. for the managers' time and travel costs. Lily and Lester have no involvement with the business, but they do vigorously

participate during the partnership meetings and they anticipate a healthy return on their investment in a few years.

Operations begin, and after two months, a tourist named Tony is killed when winds flip his glider. Before Tony's estate and family file a lawsuit, No Hang Ups Inc. acknowledges the defective design of its hang glider and settles all claims with Tony's Estate and his family members.

The tourism operation shuts down several months after the accident and the limited partnership fails to make the required semi-annual payment on its loan to Alaska Bank.

Alaska Bank sues No Hang Ups Limited Partnership, Joe, Bob, No Hang Ups Inc., Lily and Lester alleging breach of the promissory note, and seeking repayment of the full amount of the remaining loan.

1. Discuss the legal theory that Alaska Bank will use to establish Lily and Lester's liability for the loan debt and the extent of Lily and Lester's liability exposure.

2. Discuss No Hang Ups Inc.'s liability to Alaska Bank for the loan repayment and how that liability is affected by the presence of No Hang Ups Inc.'s name in the limited partnership name.

3. The limited partners are horrified at Tony's death, and even though the partnership agreement is silent on withdrawal of partners, the limited partners immediately send a letter to the general partners withdrawing from the limited partnership and asking for their rightful distributions from the partnership.

    a. Discuss the limited partners' right to withdraw from the limited partnership.

    b. Other than through sale or assignment of the partnership interest, is there an alternative way the limited partners could exit the limited partnership?

GRADER'S GUIDE

***** QUESTION NO. 1 *****

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." Because the limited partnership in question was formed in January 2007, the Alaska Revised Limited Partnership Act applies as set forth at AS 32.11.

Question (1) Discuss the legal theory that Alaska Bank will use to establish Lily and Lester's liability for the loan repayment and the extent of Lily and Lester's liability exposure. (40 points)

The key differences between limited partnerships 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 partners 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. The "defining characteristic of a limited partnership is that limited partners are not liable for the obligations of the partnership." International Investors v. Business Park Fund, 991 P2d 219, at ____ (Alaska 1999). AS 32.11.120(a).

A qualification on this general rule is that the limited partner does risk the capital invested and committed to be invested in the limited partnership interest if that capital commitment is relied upon by a creditor in loaning funds to the limited partnership. This conclusion was reached by the Alaska Supreme Court in International Investors by reliance upon case law interpreting the earlier and current versions of the Uniform Limited Partnership act. Specifically the court noted that under AS 32.11.210(c) (formerly AS 32.10.160(c)), the creditor has a right to enforce the limited partner's obligation to make contributions to the limited partnership. Therefore, it makes sense that a creditor would have the right to proceed against limited partners to the extent of their unpaid contributions. Id. at _____. The facts state that Alaska Bank based its decision to make the loan in part on the various partner contributions. Under the general rule of limited liability, Lily and Lester would

only be liable to the extent of their past $25,000 contribution if it still resides within the assets of the limited partnership, and their respective future capital contribution obligation of $75,000 each.

Alaska Bank could only make Lily and Lester liable for the entire loan repayment if they were able to establish that Lily and Lester went outside the bounds of permissible behavior by a limited partner and engaged in conduct that constituted control of the partnership business. Pursuant to AS 32.11.120, a limited partner would face personal liability if they had engaged in activities in which they controlled the business and those activities were witnessed and lead the third party to assume that the limited partner were in fact a general partner. The facts state that Lily and Lester do attend and vigorously participate in the partnership meetings. They also state that Alaska Bank observed their conduct at a partnership meeting prior to extending the loan. While Lily and Lester participated in partnership meetings, this conduct would not qualify as "control of the business" as AS 32.11.120(b)(5) specifically lists "requesting or attending a meeting of partners" and "consulting with and advising a general partner with respect to the business of the limited partnership" as activities that do not qualify as engaging in control of the business.

Question (2) Discuss No Hang Ups Inc.'s liability to Alaska Bank for the loan repayment and how that liability is affected by the presence of No Hang Ups Inc.'s name in the limited partnership name. (40 Points)

As a limited partner, No Hang Ups Inc. would be expected to have the same limited liability as Lily and Lester, and thus be exposed to recourse against the value of its future contribution obligation. Because Alaska Bank would likely not want $75,000 in defective hang gliders and No Hang Ups Inc. would likely not want to put additional hang gliders into public circulation knowing of the defects, Alaska Bank would request cash equal to the intended value of that contribution under AS 32.11.201(b).

Alaska Bank might seek to establish No Hang Ups Inc's personal liability for the loan repayment on the basis of conduct to "control of the business" which led Alaska Bank to reasonably assume that No Hang Ups Inc. was a general partner. The facts state that No Hang Ups Inc. sent managers to consult with the general partners in the placement of the facilities and maintenance of the hang gliders and was paid for those services. This level of activity, however, is also expressly excluded from consideration as "control of the business" under AS 32.11.120((1) and (2) where in addition to consulting activities, the statute excludes situations where a limited partner is serving as a contractor to the limited partnership. Thus, regardless of whether such conduct was witnessed by Alaska Bank, it is not considered "control of the business".

No Hang Ups Inc., however, has a liability exposure to Alaska Bank that Lily and Lester do not share. Under AS 32.11.810, the name of a limited partnership cannot contain the name of a limited partner unless that name is shared or held in common with a general partner or was coincidentally the name of the limited partnership before the limited partner joined the limited partnership. The consequence of violating this rule can be severe when it comes to liability to creditors who extend credit to the limited partnership.

Under AS 32.11.120(d), (except where the exceptions of AS 32.11.810 apply), a limited partner who knowingly permits its name to be used in the name of the limited partnership is liable to creditors who extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner. The fact that the certificate of limited partnership is a matter of public record does not relieve the limited partner from this liability, because the statute calls for actual, not constructive knowledge.

Under the facts, Alaska Bank had no actual knowledge that No Hang Ups Inc. was not a general partner. It never received the names of the general and limited partners. The fact that the name was used in the limited partnership name would suggest that it was in fact a general partner. No Hang Ups was aware that its name would be used in the name of the limited partnership. In fact, that was part of the value it contributed as a limited partner. It made no effort to ensure that Alaska Bank was aware that it was not a general partner prior to Alaska Bank extending the credit to the limited partnership.

None of the exceptions set forth in AS 32.11.810(a)(2) to the rule of liability to creditors are applicable. Despite its standing as a limited partner, No Hang Ups Inc. would have personal liability for any loss associated with the extension of the credit, and that liability would not be limited to the value of No Hang Ups Inc.'s past and future capital contributions obligations.

Some examinees may not know the requirements of AS 32.11.810 but discuss the legal principles that underpin the statute. Those could include misrepresentation of a material fact (negligent, fraudulent or intentional) which has the effect of causing reasonable reliance by a creditor on the misrepresented material fact, and apparent agency principles where a party permits a creditor to draw a reasonable inference of its business involvement and legal responsibility for the business dealings of another.

3. Legal Effect of Withdrawal Letter, and Alternatives to End Limited Partnership. (20 points)

Question (3)(a) Discuss the limited partners' right to withdraw from the limited partnership.

Pursuant to AS 32.11.260, a limited partner may not withdraw from a limited partnership except as allowed under the limited partnership agreement. If the partnership agreement does not otherwise allow withdrawal, the limited partner is restricted from withdrawing before dissolution and winding up of the partnership. In fact, absent provisions otherwise in the partnership agreement, the death of a limited partner does not eliminate or end the limited partnership interest and any obligations arising there under to contribute money, property or services. AS 32.11.210(b).

Under the facts, the partnership agreement is silent on withdrawal. Therefore, the limited partners would not have the right to withdraw from the limited partnership. Their attempt to do so has no legal effect.

Question (3)(b) Other than through sale or assignment of the partnership interest, is there an alternative way the limited partners could exit the limited partnership?

Under AS 32.11.380, the limited partners could apply to the superior court for a decree of dissolution on the grounds that it was impossible for the limited partnership to carry on its business in conformity with the partnership agreement. If they prevailed, the court would order the dissolution of the partnership and its affairs would be wound up with a distribution of the limited partnership's assets.

The facts suggest that the idea for the partnership rested on the accident proof hang glider design that was now admitted to be defective. The partnership was in arrears on its major loan. The business was shut down. These facts would support the limited partners in the claim that the business of the partnership was done and that the partnership should be dissolved.

The facts, however, do not state what the limited partnership agreement authorized the general partners to pursue as an authorized scope of business. Therefore, it is possible that the general partners may be able to use broad language of authority within the partnership agreement to demonstrate that they still have the capability to carry on a course of business that would be in conformity with the partnership agreement, notwithstanding that it was different than that initially anticipated by the limited partners.

More facts would need to be known about the partnership agreement to make a determination of the viability of the limited partners' claim for dissolution under AS 32.11.380.