

CONTRACTING OUT OF A PARTNERSHIP

Douglas K. Moll

This edited panel discussion from the 2020 symposium, *Business Transactions: Connecting the Threads IV*, features University of Houston Law Center professor Douglas K. Moll. The commentators in this discussion include professors Brian Krumm, Joan Heminway, and George Kuney of the University of Tennessee College of Law, as well as second-year student Emily Gould. Third-year student Autumn Bowling moderated the discussion.

Autumn Bowling:

Professor Moll graduated with highest honors from the University of Virginia in 1991 with a Bachelor of Science Degree in Commerce. He attended Harvard Law School where he served as the developments and the law chairperson on the Harvard Law Review. Professor Moll graduated Magna Cum Laude from Harvard Law School in 1994. After a clerkship with Judge Carolyn King on the United States Fifth Circuit Court of Appeals, Professor Moll spent two years practicing commercial litigation with Fulbright and Jaworski in Houston. He came to the University of Houston Law Center in the fall of 1997 as an associate professor of law. Professor Moll teaches in areas of business organizations, business torts, and commercial law.

He is the co-author of a treatise on closely held corporations, three case books on business law, and the Concise Hornbook on Business Organizations, and he has also written numerous law review articles focusing on closely held businesses and related fiduciary duty and oppression doctrines. Professor Moll has been honored with the Professor of the Year Award by the Order of the Barons several times in his career. In 2000 and in 2017, he also received a Teaching Excellence Award from the University of Houston. He is a past chair and current executive committee member of the AALS section on Agency and Unincorporated Business Associations. In April 2015, he was elected to membership in the American Law Institute. Please welcome Professor Douglas Moll.

Douglas Moll:

Well, thank you so much for that introduction, Autumn. I very much appreciate it. What I want to talk to you about today is this notion of contracting out of partnership. And in order to start this discussion in a way that we can all have a common ground to leap off of, let me do a little bit of background on the general partnership and how one is formed. So, you may or may not be aware that the general partnership serves as the default or residual form of co-owned for-profit business organization in this country. That simply means that if two or more persons associate to carry on as co-owners a business for profit, and if they choose not to organize as a corporation or an LLC or some other entity that requires a state filing for its creation, then a general partnership has been formed.

In fact, if we take a look at the actual partnership formation statute, now, by the way, this is from RUPA. RUPA is the Revised Uniform Partnership Act and some version of RUPA has been adopted in this country by approximately 40 states. So, this is the partnership law in a significant number of jurisdictions in this country. If you look at RUPA 202(a), it says exactly what I just mentioned to you, except as otherwise provided in (b), “the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership,” and that’s important language we’ll come back to in just a moment. Then if you’ll notice under (b), “[a]n association formed under a statute other than this [Act] . . . is not a partnership under this [Act].”¹

RUPA explicitly says, if you go off and form what I’m going to call a filing entity, an entity where you have to file something with the state to get it created, then by definition, you are not a general partnership. Okay, so this state of affairs, the general partnership being the default or residual form of business organization, this has existed even since the 1914 Uniform Partnership Act, and even before then, and it’s been carried forward as I mentioned in RUPA—the partnership statute that’s prevalent today. Now, if you’re trying to figure out whether a partnership has been formed, the party’s conduct is of paramount importance. And traditionally the most important factors in determining whether this legal definition of partnership has been met is the sharing of profits and the sharing of

¹ REVISED UNIF. P’SHP ACT § 202(a)–(b) (1997) [hereinafter RUPA]; REVISED UNIF. P’SHP ACT § 202(a)–(b) (2013) [hereinafter RUPA (2013)].

control.² Other factors that courts have found relevant to the partnership determination include sharing losses of the business, contributing money or property to the business, and really any other evidence that is typically associated with ownership.

Now, partnership formation is considered to be a totality of the circumstances inquiry. If a court concludes that sufficient evidence exists of these factual predicates, then the legal definition of partnership is met. Now by contrast, the parties' subjective intent to be characterized or not characterized as partners, that is of little to no relevance. So long as the parties conduct falls within the statutory definition, you've got a general partnership—even if the partners don't realize that they're forming such an enterprise, and even if they specifically disclaim that they are partners.

I can show you a number of authorities for this proposition, but this one's good enough. If you look at the commentary to the 2013 version of RUPA, let's just look at this passage for a moment. This is right from the official comments:

[RUPA] added “whether or not the persons intend to form a partnership” to the UPA (1914) formulation, thereby codifying a rule uniformly applied by courts: Subjective intent to create the legal relationship of “partnership” is irrelevant. What matters is the intent *vel non* to establish the business relationship that the law labels a “partnership.” Thus, a disclaimer of partnership status is ineffective to the extent the parties intended arrangements meet the criteria stated in this subsection.³

As this and other authorities reveal, the legal definition of partnership cannot be circumvented by the parties' agreement that a partnership has not been formed, or a similar agreement that they're not to be characterized as partners. So long as the parties' actions fall within the statutory definition, again, based on a totality of the circumstances inquiry, a partnership has been formed and the parties are partners, regardless of their subjective desires. Now, that's the way the law was until the *Enterprise*

² RUPA (2013) § 202(a) cmt.; *see, e.g.*, *Westside Wrecker Serv., Inc. v. Skafi*, 361 S.W.3d 153, 166 (Tex. App. 2011) (“Shared rights to profits and to control the business are generally considered the most important factors in establishing the existence of a partnership.”).

³ RUPA (2013) § 202(a) cmt.

decision. In Texas, the Supreme Court of Texas ruled in a case called *Enterprise versus ETP*.⁴

In the interest of time, I'm not going to go into the facts. I don't think they're particularly relevant to us actually, but I do describe them a little bit in the portion of the paper that I submitted, which you all should have. But you'll just have to trust me, the court holds in the *Enterprise* decision that as between the parties themselves, parties can enter into dispositive partnership disclaimers. If they say "we are not partners," that will "override," that's what the court says, the default rule of partnership formation. The court also held that acting as partners will not constitute evidence of waiver of that partnership disclaimer. And lest you think that this is some weird quirk of Texas law, and trust me, there are plenty of those, the rationale of the *Enterprise* court is easily portable. The court largely emphasized freedom of contract, and again, determined that such freedom could "override" the partnership formation inquiry. As authority for incorporating freedom of contract, the court pointed to a Texas statutory provision, which simply stated that the principles of law and equity supplement this chapter.

What's important for you to understand is that RUPA, which again is followed by the vast majority of jurisdictions in this country, has substantially the same partnership definition as the Texas statute. RUPA also has a provision saying that the principles of law and equity supplement this act. So, the real point I want to convey to you is don't view this as just a Texas issue. The holding of the *Enterprise* court could easily be replicated in other jurisdictions. And so, to me, this is a significant issue of national partnership law. I think it is important to consider not only the uneasy doctrinal fit between the *Enterprise* holding and the partnership statutes, but also the substantial normative question: should disclaimers of partnership be dispositive in *inter se* disputes? By *inter se* disputes, I simply mean disputes among the alleged partners themselves as opposed to disputes involving some outside third-party.

Let me just say in case we run out of time, here's my executive summary for you. I think it's a bad idea to permit dispositive disclaimers of partnership. I think that allowing such an outcome would undermine the protections of fiduciary duty, would create uncertainty about the operating rules for the business, and would threaten to deny the rights of

⁴ See *Energy Transfer Partners, L.P. v. Enter. Prods. Partners, L.P.*, 593 S.W.3d 732, 734 (Tex. 2020).

third parties. On the other hand, there's no question that it would promote freedom of contract and would result in a more predictable conclusion on the partnership formation inquiry. I hope to talk about each of these costs and benefits a little bit this morning.

Let's just start by talking about this first cost of permitting dispositive disclaimers of partnership: undermining mandatory fiduciary duties. As you may be aware, it is impossible to start a co-owned business in this country without at least confronting the existence of fiduciary duties.

The structure of every co-owned business organization involves duties that are owed by managers to the organization for sure, and in many cases to the owners of the organization as well. Now, understanding why fiduciary duties are ubiquitous in the business organization setting is really not difficult. Co-owned businesses involve persons who are willing to come together and pool their money and their talent and their services and their property. That pooling is very unlikely to occur unless there is a substantial degree of trust among the participants. In general, this is the province of fiduciary duty—relationships that involve significant trust and confidence between the parties. Fiduciary duties in the business organization setting help constrain those with managerial control from abusing that trust. In other words, from exercising their control in ways that take unfair advantage of the business or the owners. Now compared to other business structures that provide limited liability, the general partnership form, which doesn't provide limited liability, arguably requires even more trust among the participants.

Why is this? Because your fellow partners can go out into the world and they can enter into contracts or commit torts that create partnership obligations, and those obligations have the potential to put your personal assets—the personal assets of your fellow partners—at risk. And so, when limited liability is absent, trust between the owners is even more important because owner conduct and misconduct can affect not only the partnership's assets, but also the personal assets of the partners. So, think of fiduciary duties as really helping to reinforce this trust because they encourage partners, admittedly via the threat of legal action, but they encourage partners to consider the interest of the business and their fellow partners when making decisions. Now, given the importance of trust to the general partnership structure, it is perhaps unsurprising that RUPA provides explicitly for the fiduciary duties of care and loyalty in general partnerships.

Although those duties can be substantially modified by a partnership agreement, RUPA prevents the agreement from eliminating the duties entirely. By allowing modifications, but not eliminations, RUPA, and here I'm quoting from the commentary, "ensure[s] a fundamental core of fiduciary responsibility"⁵ and "rejects the notion that a contract can completely transform an inherently fiduciary relationship into a merely arm's length association."⁶ Of course, if parties can use contractual disclaimers to deny partnership status, even while they're fully acting like partners, it completely circumvents this principle, because without forming a filing entity, parties can associate as co-owners in a profit-seeking business without any fiduciary obligations. Any court reaching this result would seem to have directly undermined the policy choice made by the state's legislature when RUPA was adopted. Now that alone in my view should give one pause when considering the wisdom of permitting such disclaimers to be conclusive, but the problem goes further than merely circumventing a legislative choice.

There is great danger to permitting the effective elimination of fiduciary duties via conclusive disclaimers of partnership because many parties are unlikely to understand the full extent of what they're giving up by relinquishing such duties. Circumventing this legislative choice to maintain a fiduciary core, therefore, is not only bad for its own sake, but it leaves partners vulnerable to abuse.

Let me just elaborate on this point for a moment because I think it is important to understand the information-forcing value of modifications. Given the importance of fiduciary duties, I would hope that it goes without saying that we want parties to fully understand what they're giving up when they agree to modify such duties. I would hope that's a somewhat non-objectionable proposition. The ideal rule for modifications would be one that nudges the party desiring a change to convey the most information in the most intelligible manner to the other parties about the need for the modification.

Now, when fiduciary duties are limited as opposed to eliminated, the limitation itself conveys information about the problem or the conflict that the party foresees. Let me give you an easy example. Let's say you have

⁵ RUPA § 103 cmt. 4.

⁶ RUPA (2013) § 105 cmt. (*The Partnership Agreement and the Fiduciary and Other Duties of Those Who Manage*); see also *id.* (stating that "the partnership agreement may not transform the relationship *inter se* partners and the partnership into an entirely arm's length arrangement.").

a real estate partnership and you're trying to attract a prominent developer to join as a partner. Well, that developer may not wish to join if she has to turn over all of her development opportunities to the partnership. An agreement authorizing the developer to retain certain development opportunities for her own account would likely be permitted as a type or category of activity that the parties can agree doesn't violate the duty of loyalty.⁷ More importantly, courts are going to require that limitation to be stated clearly and with particularity in a partnership agreement.⁸ That requirement will help ensure that the other parties are aware of the particular problem that the developer foresees, and they can decide if they're comfortable proceeding with such a limitation.

When fiduciary duties are eliminated, however, no information is provided on the particular problem that the party envisions. A blanket statement in a partnership agreement that partners do not owe the partnership or each other a fiduciary duty of loyalty generally indicates that the proposing party doesn't think the benefits of the fiduciary duty of loyalty exceed its costs, but no detail is provided. The specific problem that the party foresees remains hidden. From an information-forcing standpoint, therefore, there is logic to authorizing limitations while prohibiting eliminations. Limitations convey specific information about foreseeable conflicts that parties without legal backgrounds can arguably understand (e.g., competition is permitted or business opportunities don't have to be turned over), but eliminations convey no information about the problem envisioned by the proposer, and they require the parties to have a legal understanding of what it means to say that there is no fiduciary duty of loyalty. RUPA's choice to allow limitations, but prohibit eliminations, is sensible in my opinion, as it helps to ensure that the parties understand what they're relinquishing when they alter fiduciary duties.

⁷ Cf. RUPA § 103 cmt. 4 (“A provision in a real estate partnership agreement authorizing a partner who is a real estate agent to retain commissions on partnership property bought and sold by that partner would be an example of a ‘type or category’ of activity that is not manifestly unreasonable and thus should be enforceable under the Act.”); *id.* (“Likewise, a provision authorizing that partner to buy or sell real property for his own account without prior disclosure to the other partners or without first offering it to the partnership would be enforceable as a valid category of partnership activity.”).

⁸ See, e.g., RUPA (2013) § 105(d)(3) cmt. (citing cases for the proposition that “displacement of fiduciary duties is effective only to the extent that the displacement is stated clearly and with particularity.”); RUPA § 103 cmt. 4 (“The [exculpatory] agreement may be drafted in terms of types or categories of activities or transactions, but it should be reasonably specific.”).

If we circumvent this choice by allowing parties to act as partners while conclusively disclaiming partnership (and therefore the fiduciary duties that accompany partnership), that will result in parties making critically important decisions on a less informed basis. In addition, there is reason to doubt that parties can accurately foresee the form and likelihood of future misconduct by their fellow partners. In the paper, I go into some of the literature on bounded rationality and over-optimism, but the whole point is to argue again that the choice made by RUPA and adopting state legislatures to allow fiduciary duty limitations, but not eliminations, is sensible because it recognizes the limits of human foresight and the dangers of permitting general waivers. Allowing parties to act as partners while conclusively disclaiming partnership undermines this choice and leaves parties vulnerable to opportunistic conduct.

Let me switch gears and talk about the second cost of permitting dispositive disclaimers of partnership, and that is creating uncertainty about the operating rules for the business. You're probably aware that modern business organization statutes provide all sorts of rules that govern various aspects of the business. Most of those rules are default rules that the parties can change by agreement. If they don't change them, the statute itself provides the rules of the road, so to speak, for how the business will operate. That helps the parties understand what their rights are in particular situations. More importantly, well, I don't know if it's more importantly, but it's certainly as important, it makes it easier for courts to resolve disputes in the event that the parties can't.

Now the general partnership unquestionably fits this pattern. Almost all of RUPA's provisions are default rules, and if that default rule is unsuitable for your business, of course you can change it. Like other business organization statutes, RUPA provides the baseline rules for how the partnership is going to operate, but as mentioned, almost all of those rules can be displaced by the parties' agreement.⁹

If parties can contract out of general partnership status even while they're fully acting as partners, well, then these baseline rules provided by RUPA are not going to be applicable and the parties' agreement will need to provide the operating rules for the business. Now, while the law of

⁹ See RUPA § 103(a); RUPA (2013) § 105; see also Donald J. Weidner, *RUPA and Fiduciary Duty: The Texture of Relationship*, L. & CONTEMP. PROBS., Spring 1995, at 82, 83 (1995) ("Because almost all of RUPA's rules governing the relations among partners are default rules rather than mandatory rules, partners are free to agree to virtually any relationship they wish.").

agency can provide guidance on certain matters, agency principles are not really designed for co-owner issues. For example, voting rights, access to books and records, sharing of profits and losses—none of that is governed by agency law. Without a comprehensive agreement between the parties, disputes are going to be difficult to resolve because the parties themselves may be uncertain about their rights with respect to a particular issue. Moreover, a court is not going to have any statutory guidance to fall back on.

Are parties likely to disclaim partnership status without providing a comprehensive agreement to cover their affairs? I think this is a hard question to answer but let me make some general statements. To begin with, the Reporter for RUPA has noted that “individuals rarely ‘bargain’ as equals for partnership agreements that completely define their relationship,” and he has opined that “[t]he law should assume that the completely defined partnership relationship is the exception rather than the norm.”¹⁰

Now that said, when parties are sophisticated there's presumably a better chance of a more detailed agreement, particularly because such parties will usually have better access to lawyers and they'll have more resources to devote to drafting a thorough agreement. Even for a sophisticated party, however, preparing a comprehensive and effective agreement can be difficult. With less sophisticated parties, it's reasonable to assume that there is a greater likelihood of incomplete agreements, especially if there are fewer resources available to retain competent counsel.

Under RUPA, we already confront the problem of incomplete agreements. Parties will displace default rules with contractual provisions that don't work—either because they're ambiguous or they're incoherent or otherwise. This problem of displacing a default rule with an inadequate replacement provision is one that courts currently grapple with.

If parties are permitted to contract around partnership status, however, we're going to get an additional type of incomplete agreement—one where the parties completely fail to address some *inter se* issue and we don't have any default rule to fill the gap. Thus, allowing the parties to contract around partnership status is going to increase the likelihood that courts will confront incomplete partnership agreements in one form or another.

¹⁰ Weidner, *supra* note 9, at 82.

Of course, courts are still going to have to resolve disputes. That's what courts do. When we have these incomplete “non-partnership agreements,” maybe the court will use contract interpretation principles, but there would have to be enough content in the parties' agreement to allow for some meaningful interpretation. Maybe the court will invoke equity and attempt to do what it thinks is fair in the circumstances.

My point to you here is not that disputes will go unresolved. To the contrary, they're going to get resolved—that's what courts do—but they're going to get resolved in a less principled and uniform manner than if we had a set of organizational default rules available. The general partnership's traditional role as the residual form of co-owned, for-profit business organization provides this uniform set of gap fillers that result in more consistent outcomes when the parties have not spoken. But a conclusive disclaimer of partnership eliminates those gap fillers. When that's coupled with the inevitable incomplete agreements between the parties, consistent outcomes are going to be less likely.

Let's talk about the third cost of permitting dispositive disclaimers of partnership, and that is denying the rights of third parties. Partnership law provides third parties with a number of rights, including the right to sue partners for partnership obligations and the right to rely upon a partner's statutory apparent authority.¹¹ RUPA explicitly states that a partnership agreement cannot restrict the rights of third parties,¹² which makes sense and it's consistent with a basic principle of contract law—an agreement between parties typically cannot take away the rights of a non-party. If you didn't agree, normally your rights cannot be taken away.

Now to be fair, the *Enterprise* court recognized the problems of allowing a partnership disclaimer to affect third-party rights. In fact, the court attempted to limit its holding to *inter se* disputes and even stated in a footnote that “[s]uch an agreement would not, of course, bind third parties, and we do not consider its effect on them.”¹³

¹¹ See, e.g., RUPA §§ 301, 306(a); RUPA (2013) §§ 301, 306(a). See generally RUPA §§ 301–308 (addressing “relations of partners to persons dealing with partnership”); RUPA (2013) §§ 301–308 (same).

¹² See RUPA § 103(b)(10) (stating that a partnership agreement may not “restrict rights of third parties under this [Act]”); RUPA (2013) § 105(c)(17) (stating that a partnership agreement may not “restrict the rights under this [act] of a person other than a partner”).

¹³ *Energy Transfer Partners, L.P. v. Enter. Prods. Partners, L.P.*, 593 S.W.3d 732, 741 n.34 (Tex. 2020).

The court's intention, it appears, was to hold that a disclaimer of partnership is binding on the alleged partners themselves but has no effect on third parties. Notice that the consequence of that rationale is that the partnership formation test can now differ depending on who our plaintiff is. If our plaintiff is some outside third-party alleging that a partnership has been formed, the inquiry is going to be governed solely by whether the alleged partners' conduct met the legal definition of partnership that we looked at a moment ago. In an *inter se* dispute alleging partnership formation, however, that inquiry into conduct will be irrelevant if the parties agreed to disclaim partnership status.

The problem with the court's effort to impose a conduct-based formation test for third-party disputes and an agreement-based formation test for at least some *inter se* disputes is that RUPA seems to forbid such an approach. RUPA § 308(e), a provision with a Texas analog that neither the court nor the parties cited or mentioned in any way, states that with the exception of a partnership-by-estoppel claim, "persons who are not partners as to each other are not liable as partners to other persons."¹⁴

Now think about that for a minute. The implication is clearly that if parties can use a disclaimer to conclusively avoid a finding of partnership as to each other, that same disclaimer will also prevent a partnership finding as to a third-party.

While the *Enterprise* court does not appear to have intended this result, its holding and its failure to comment on the application of § 308(e) leaves room for future litigants to push for this extension to the third-party setting. In Texas, it's already happening. Such an extension, in my view, would compound the problems associated with the holding because now a partnership disclaimer would allow parties to fully act as partners while sidestepping the statutory obligations that they owe to third parties who deal with partners.

In the paper, I spend a decent amount of time going through the history of § 308(e), and I ultimately conclude that it was designed to make sure that there is one uniform test for determining the existence of a partnership. That, of course, is a problem for decisions like *Enterprise*. To ensure that a disclaimer of partnership doesn't affect the rights of non-parties, it's clear that courts are going to have to narrowly construe this section or ignore it completely.

¹⁴ RUPA § 308(e); *accord* RUPA (2013) § 308(e); *see* TEX. BUS. ORGS. CODE § 152.053(b).

Maybe that won't be hard. Perhaps this section should be understood as simply applying to conduct-based analyses when the parties haven't disclaimed partnership status by agreement. If you understand it in that manner, there is a uniform test to determine the existence of a partnership, and it's based on conduct—but only when that test is applicable by default due to the absence of a partnership disclaimer.

The only reason I'm suggesting this is that courts are going to have to come up with a narrow interpretation of § 308(e) if they want to ensure that a partnership disclaimer between two alleged partners isn't going to deny the rights of third parties. It is by no means certain, of course, that a court would accept such an interpretation, which creates the risk that an *Enterprise*-like holding will also affect the rights of non-parties to the disclaimer.

Let me spend a little bit of time talking about the benefits of allowing dispositive disclaimers of partnership—allowing parties, in other words, to contract around partnership. Unquestionably, one benefit is promoting freedom of contract. Modern society has long valued freedom of contract. As a general matter, letting parties structure their affairs as they see fit, without any governmental interference, is viewed as a social good. Courts routinely cite freedom of contract as an important public policy,¹⁵ and even statutes in the business organizations area often tout the importance of enforcing the parties' agreement.¹⁶

Providing parties with the discretion to contract out of partnership, even while fully acting as partners, would certainly promote freedom of contract. A non-partnership agreement would control over the statutory definition of partnership and would allow the parties to fully act as partners while avoiding *inter se* (and perhaps even third-party) partnership consequences. You could reach that result without the necessity of forming a filing entity and the venture wouldn't be subject to any business organization statute at all.

Keep in mind, however, that the law restricts freedom of contract in a number of contexts, particularly when private parties seek to alter legal definitions. As one example in the business organization setting, if the legal definition of agency is established, contractual denials of an agency

¹⁵ See, e.g., *Bombardier Aerospace Corp. v. SPEP Aircraft Holdings, LLC*, 572 S.W.3d 213, 230 (Tex. 2019).

¹⁶ See, e.g., DEL. CODE tit. 6, § 15-103(d) (2009) (“It is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.”).

relationship do not change that result.¹⁷ That is true even when the dispute is between the agent and the principal who agreed to the denial,¹⁸ and even though agency (like partnership) imposes fiduciary duties and other obligations on the parties.¹⁹ This and other examples that I discuss in the paper underscore that freedom of contract, even between the parties to the contract itself, is not absolute.

What about providing certainty on the partnership formation question? As mentioned, partnership formation is considered to be a totality of the circumstances inquiry. The problem with any totality of the circumstances inquiry is that a court's conclusion as to whether a partnership exists can be difficult to predict, especially when the evidence is mixed.

Some assert that it's problematic for parties to not know whether they are partners, and whether they're subject to the duties and obligations of partners, until a court or a jury tells them as much. In fact, some have argued that this uncertainty makes parties reluctant to collaborate on business ventures. If collaboration occurs, this uncertainty may produce substantial litigation costs if a party contends that it has partnership-related rights.

If disclaimers of partnership are dispositive, of course, parties would have the ability to conclusively block a general partnership finding. They wouldn't owe the duties and obligations of partners and they would avoid the possibility of an expensive dispute over whether a partnership was formed.

Keep in mind, however, that unless we extend the dispositive nature of the disclaimer to the third-party context, these benefits of greater certainty would be limited to *inter se* disputes. Even in that context, certainty on the formation question would be offset by any uncertainty about the operating rules for the business, which may produce its own substantial litigation costs.

¹⁷ See, e.g., RESTATEMENT (THIRD) OF AGENCY § 1.02 cmts. a–c (2006); RESTATEMENT (SECOND) OF AGENCY § 1 cmt. b.

¹⁸ See, e.g., RESTATEMENT (THIRD) OF AGENCY § 1.02 cmt. (2006) (Reporter's Notes) (citing cases for the proposition that “[a]s between the parties to an agreement, an assertion or negation of agency is not determinative”).

¹⁹ See, e.g., RESTATEMENT (THIRD) OF AGENCY §§ 8.01–8.15 (2006) (addressing the agent's duties to the principal, including the “fiduciary duty to act loyally for the principal's benefit,” and the principal's duties to the agent).

In my paper, I try to weigh these costs and benefits of permitting parties to contract around partnership. In so doing, it's important to focus on what the parties are actually seeking. I argue that, for most parties, entering into a disclaimer of partnership is primarily (if not exclusively) an effort to avoid the fiduciary duties that would otherwise be owed if a partnership were formed. In other words, we should really think about the benefit of freedom of contract here as the ability to eliminate fiduciary duties by agreement. Similarly, the desire for certainty on the partnership formation question derives largely from the desire to confirm the absence of fiduciary duties.

Now let's get back into this discussion that we had before, which is fiduciary duties in the partnership cannot be eliminated but they can be substantially limited. This point becomes very important because even if we don't recognize dispositive disclaimers of partnership, parties retain substantial control over their fiduciary duty exposure. Let's take a look at how RUPA talks about this.

With respect to the duty of loyalty, RUPA prohibits elimination of the duty, but it permits the partnership agreement to “identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable.”²⁰ In addition, RUPA allows “all of the partners or a number or percentage specified in the partnership agreement [to] authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty.”²¹

This language provides partners with significant flexibility to authorize foreseeable conduct that would otherwise raise duty of loyalty issues. Courts have upheld a variety of provisions in partnership agreements that modify the duty of loyalty, including provisions permitting competition,²² authorizing self-dealing,²³ and allowing for partnership opportunities to be taken.²⁴

²⁰ RUPA § 103(b)(3)(i); *see* RUPA (2013) § 105(d)(3).

²¹ RUPA § 103(b)(3)(ii); *see* RUPA (2013) § 105(d)(1)(A).

²² *See, e.g.,* Whalen v. Connelly, 545 N.W.2d 284, 291–92 (Iowa 1996); Singer v. Singer, 634 P.2d 766, 768, 772 (Okla. Civ. App. 1981).

²³ *See, e.g.,* Carella v. Scholet, 773 N.Y.S.2d 763, 765 (App. Div. 2004); Marmac Inv. Co. v. Wolpe, 759 A.2d 620, 624–27 (D.C. 2000).

²⁴ *See, e.g.,* Dremco, Inc. v. South Chapel Hill Gardens, Inc., 654 N.E.2d 501, 539–40 (Ill. App. Ct. 1995); Fronk v. Fowler, 883 N.E.2d 972, 976–77 (Mass. App. Ct. 2008); Cowin v. Ross, 406 N.Y.S.2d 841, 841–42 (App. Div. 1978).

My point is that within the general partnership form, parties have the ability to use a partnership agreement to significantly control the reach of fiduciary duties. Freedom of contract, although not absolute, is respected under modern partnership law. Further, to the extent that the question of certainty on partnership formation is desired because it resolves the issue of fiduciary duties, a careful delineation of what will be considered permissible conduct is going to be enforced—even on summary judgment in many cases.²⁵

On balance, I conclude that the costs of allowing parties to contract out of partnership outweigh the benefits. Unquestionably, permitting parties to contract out of partnership does promote freedom of contract and provide increased certainty on the partnership formation question, but these benefits are largely tied to the parties' desire to control their fiduciary duty exposure, and that's a desire that existing partnership law can accommodate. Moreover, any increased certainty brought about by dispositive disclaimers are going to once again be offset, at least to some extent, by increased uncertainty generated by parties who are going to draft incomplete agreements to govern their relationship.

What about beyond the general partnership? I'm sure many of you have been thinking that, if you're seeking freedom of contract and certainty on the partnership formation question, why not go off and form an LLC in a jurisdiction such as Delaware that explicitly permits the elimination of fiduciary duties? Remember that RUPA makes very clear that if you go off and form a filing entity you are not a partnership. By forming, for example, a Delaware LLC at the inception of a business relationship, the parties can negotiate terms between themselves and commence business without having to worry about the possibility of forming a general partnership.

²⁵ See, e.g., *Dremco, Inc. v. South Chapel Hill Gardens, Inc.*, 654 N.E.2d 501, 536, 539–40, 543 (Ill. App. Ct. 1995) (affirming a summary judgment on a partnership opportunity claim based in large part on an “agreement [that] memorialized . . . the partners’ right to independently pursue other opportunities”); *Cowin v. Ross*, 406 N.Y.S.2d 841, 841–42 (App. Div. 1978) (granting summary judgment on a partnership opportunity claim based on the language of the limited partnership agreement that permitted some of the partners to pursue a new development); see also *Kahn v. Icahn*, No. Civ. A. 15916, 1998 WL 832629, at *3 (Del. Ch. Nov. 12, 1998) (granting a motion to dismiss on plaintiffs’ breach of fiduciary duty claim based on a provision in the partnership agreement that permitted the general partner to “compete, directly or indirectly with the business of the Partnership”).

Forming an LLC does require a state filing, and there's a fee associated with that filing. The fee, however, is relatively minor. An LLC will typically have a detailed operating agreement, and one would expect attorney's fees involved with the drafting of that agreement. But remember that a dispositive disclaimer of partnership is also going to give rise to the need for a detailed agreement. Any formation fee differential, therefore, is unlikely to be meaningful. If it is meaningful, however, one can always forego the LLC and work with the tools provided in the general partnership setting that we just finished talking about, which would include significant freedom of contract and the ability to limit fiduciary duties.

The fact that parties can use an LLC to obtain the benefits of promoting freedom of contract and achieving certainty on the partnership formation question is significant. It reveals that purported business needs can be accommodated without altering the general partnership's status as the residual form of co-owned, for-profit business organization. The general partnership can continue to serve in that residual role while protecting partners from difficult-to-foresee exploitation and providing default operating rules for courts to resolve disputes.

In addition, we don't have to strain to ignore statutory language that indicates that the parties' subjective intent is of little relevance, and that links the formation inquiries in the *inter se* and third-party settings. While one might question the merits of a business organization statute (such as the Delaware LLC statute) that provides relatively few default rules and the ability to eliminate fiduciary duties, my point here is that there is no reason to extend this state of affairs to the general partnership setting, as parties have a viable choice.

Autumn Bowling:

Thank you, Professor Moll. We're going to go ahead and turn it over to the faculty discussing for this panel. I'd like to please welcome UT Law professor, Brian Krumm.

[Professor Krumm's and Emily Gould's comments to this presentation are published following this transcription.]

Douglas Moll:

First, let me just say thank you both. And Professor Krumm, in many ways I agree with everything you said. One might read *Enterprise* more narrowly as a case where there wasn't any evidence of a partnership. I'm fine if that was how the court had written the opinion. But that's not the way the court wrote the opinion. The court didn't say that the evidence that you would typically need to find a partnership was not present; instead, the court wrote a much broader opinion suggesting that partnership disclaimers are conclusive, even when the parties are acting like partners. It's the breadth of the opinion that makes me very nervous.

Emily, thank you for your comments. I thought they were great. I do think the Texas Supreme Court has been banging the freedom of contract drum in all kinds of contexts. I have never thought of RUPA § 202 as being a default rule. I have always thought of it as a legal definition that cannot be altered by the parties. But what this case has done, as you mentioned, is it did characterize RUPA § 202 as a default rule. So I share your concern. Thank you all again.

Autumn Bowling:

Thank you. It does look like Professor Heminway would actually like to ask the questions. We'll go ahead and let her go first, and we'll get probably about five minutes left for Q&A. So, Professor Hemingway, go ahead with your question.

Joan Heminway:

Thanks. So, I found this case really interesting, Doug. I'm so glad that you pointed it out to us, and I really appreciate Brian's practice thoughts, which I'm sympathetic with as well, but I admit that given that I'm Emily's teacher, first of all, I'm very proud that she was able to derive from the course everything that she said to the extent, I won't take any credit for it, but to the extent that it did come from the course, she's obviously learning extremely well. I have a question that's related to all of this, and some of your observations actually that you made, and it has to do with something you maybe didn't explicitly say, but it's another part of the statute that I worry about in this context. Maybe not as much worry as Emily shared, but some worry, which is the fact that partnership agreements can be written, oral or implied. And so, again, you alluded to this in your

comments, and in talking about the rights of third parties as opposed to really the internal governance rights of partners in a partnership.

It strikes me that the solutions that you were sort of positing and spinning out do depend in part on that, and the court doesn't say much here about what if there was in addition to maybe a writing that might be expressed, disclaiming partnership. Also, some other conduct, also some verbiage that was shared. One of the things that we talked about in the midterm exam that Emily referred to is, wouldn't we want to get more information from clients that are in this situation of maybe they have a partnership, maybe they don't, about what the nature of their course of conduct was, what was actually said during the course of their dealings with each other? So, I wondered if you'd thought about any of that, or could at least comment on it, even if you haven't?

Douglas Moll:

I think it's a great point. There is a part in the paper that I did not discuss this morning where I posit the following scenario, which involves, as Joan said, the proposition that a partnership agreement can be written, oral, or implied. Let's say you and I get together and we want to have a partnership. You and I both believe that we are a general partnership. Five years later, we get into a dispute and you claim that we had an oral agreement that we would not be partners. The fact that you can have an oral agreement adds uncertainty on the partnership formation question because one can now claim that we orally disclaimed partnership, even though we have been acting like partners for years.

Of course, if we orally agree that we are not partners, that is probably not a "partnership agreement." A partnership agreement is an agreement that affects some issue related to the partnership. When we agree that we are not partners, is that a partnership agreement? Even if it is not, unless you have a statute of frauds issue, I assume that contract law would enforce an oral agreement when we say we're not partners. So, I think you're right, Joan, that we also can have uncertainty because the parties might be fighting over oral or implied disclaimers of partnership. I think it's a great point and it adds another wrinkle to the mess that the *Enterprise* court has arguably created.

Autumn Bowling:

I think Professor Kuney had a question as well. And after that, I think we'll move on to the next panel if that's okay.

George Kuney:

So, really quick, I'm concerned about the third-party liability aspects of this, and I'm wondering if you've got non-partners working together to generate a profit, do we try to solve the third-party liability problem by simply making each of them principals and each of them agents of each other? Your thoughts?

Douglas Moll:

Right. In other words, as Professor Kuney is suggesting, partnership law draws heavily from agency. Many of partnership law's historical antecedents are in agency law, and we used to say that partners were agents of one another. We're going to need to something like that. I assume that most people find it problematic that a non-partnership agreement between two parties can bind a third-party. Of course, you could make the argument (as I do in a footnote in the paper) that a third-party who had no idea that there was a partnership should not be able to recover on a partnership theory of liability unless they relied in some way on a representation of partnership. But let's put that to the side. If you think that it's problematic to bind third parties to a non-partnership agreement, then we're going to need to come up with something to limit *Enterprise*-like holdings. Once again, the *Enterprise* Court tried to duck the third-party issue by limiting the decision to the purported partners themselves. As I mentioned, however, because of RUPA § 308(e), I don't think that's such an easy duck.

Perhaps, as Professor Kuney suggests, we can say that non-partners in a contractual business relationship are agents of one another. As each enters into transactions, they bind the other as an agent would bind an undisclosed principal. Something like that, I think, is a good idea and might be a sounder basis than simply ignoring RUPA § 308(e).

Autumn Bowling:

Fantastic. Thank you so much to our first panelists. Thank you, Professor Moll.