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Shawn Bayern
Florida State University College of Law

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THREE PROBLEMS (AND TWO SOLUTIONS) IN THE LAW OF PARTNERSHIP FORMATION

Shawn Bayern*

This Article considers several foundational questions concerning the formation of general partnerships, a topic that has received little modern attention and that is governed largely by classical axioms rather than adaptive modern considerations. Its three main topics concern (1) the timing of partnership formation, (2) the aggregation of multiple distinct questions under the single heading of "partnership formation," and (3) the rarely challenged proposition that general partners ought to be liable for partnership obligations, a doctrine that is surprisingly at odds with the rest of modern business-entity law.

Partnership formation is likely the most frequently litigated question in all of business law,[1] but it has received little modern theoretical attention.[2] As a result, the routine analysis of partnership-formation problems is ruled by relatively unexamined conceptualistic assumptions. This Article raises three problems in

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* Larry & Joyce Beltz Professor, Florida State University College of Law. Thanks to Mark Gergen, Jay Kesten, and Don Weidner for helpful discussions.

1. As of February 2015, Westlaw lists several times as many cases citing the section of Revised Uniform Partnership Act (RUPA) covering partnership formation than each of the sections concerning dissolution, wrongful dissociation, partnership property, and even partner liability. *See also* Elizabeth S. Miller, *Case Law Update: A Survey of Recent Texas Partnership and LLC Cases*, http://www.baylor.edu/law/faculty/doc.php/117962.pdf (devoting about a third of the length of a survey of general-partnership case law to questions involving "Existence of Partnership").

2. Partnership formation was last the subject of significant academic debate about a century ago. *See* William Draper Lewis, *The Uniform Partnership Act*, 24 YALE L. J. 617 (1915) (providing background to the adoption of the UPA). Recent scholarship does not address partnership formation specifically; attention has focused primarily on the vicarious business liability that this Article discusses in Part III, and the modern critique has ordinarily been of alternative business forms that limit vicarious liability rather than of the general partnership that allows it. *See, e.g.*, William W. Bratton & Joseph A. McCahery, *An Inquiry into the Efficiency of the Limited Liability Company: Of Theory of the Firm and Regulatory Competition*, 54 WASH. & LEE L. REV. 629 (1997) (analyzing the efficiency of limited liability in LLCs on economic grounds); Allan Walker Vestal, *". . . Drawing Near the Fastness?"—The Failed United States Experiment in Unincorporated Business Entity Reform*, 26 J. CORP. L. 1019 (2001) (critiquing the limited vicarious liability provided by alternative entities); Megan Causey, Comment, *Limited Liability for General Partnerships: Another Louisiana Anomaly*, 66 LA. L. REV. 527 (2006) (suggesting a reform for Louisiana law to adopt the rules of other United States jurisdictions—that is, of RUPA and the UPA—on vicarious business liability for partners in general partnerships). Even so, the bulk of academic commentary on limited liability concerns the role of the doctrine, and related notions like "piercing the corporate veil," in the law of corporations. For a summary of the lively debate of approximately twenty years ago on corporate limited liability and its exceptions, see generally Joseph A. Grundfest, *The Limited Future of Unlimited Liability*, 102 YALE L.J. 388, 424 (1992) (critiquing the notion of "proportionate liability" for corporate shareholders and arguing that "limited liability may . . . be a necessary evil").

the law of partnership formation and aims to consider their solutions in view of functional goals, such as the expectations of business parties, the instrumental utility and moral basis for vicarious liability, and the administrative costs associated with alternative rules.

The three problems are easy to state. Ordered from easiest to most difficult, and (not coincidentally) from narrowest to most general, they are as follows.

First, in assuming that the law must identify a fixed moment of partnership formation, courts and commentators favor rules that do not necessarily comport with parties' expectations. The solution to this problem is relatively straightforward: Courts should recognize that business formation is often more fluid than they have assumed it is, and they should adopt more flexible remedies in the case of partnerships that are formed and then disbanded.

Second, the law of partnership formation combines several distinct questions; the conventional understanding of the law wrongly assumes that they must have identical answers in all cases.[3] For example, courts formally adopt the same doctrinal analysis regardless of whether the question of partnership formation arises in a case concerning the tort liability of partners to third parties (on one hand) or the contractual or fiduciary duties among partners (on the other).[4] But there is no moral, economic, or administrative principle that requires the proper scope of contractual or fiduciary duties among partners to coextend with questions of vicarious tort liability to third parties. The solution here, too, is relatively straightforward: The question of partnership formation should be refactored into several distinct questions that suit the purposes for which the questions are asked. Matters of vicarious liability, and liability for joint business action, are probably best analyzed through a simple, general extension of tort law, whereas contractual and fiduciary questions depend on a distinct analysis.

As of February 2015, Westlaw lists only four articles, none of which is of general scope and only two of which are published in law reviews, in its annotation to Unif. P'ship Act § 202 (1997) (providing the main statutory rule concerning partnership formation under modern law).

3. For example, the statutory rule concerning partnership formation makes no reference to the context in which the question is asked. *See* Unif. P'ship Act § 202 (1997) ("[T]he 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."); *see also infra* note 4 and accompanying text.

4. This fault is demonstrated by the classically leading case, which is largely decided in conceptual, and not functional terms. Martin v. Peyton, 158 N.E. 77, 78 (N.Y. 1927) ("[T]hose who are partners between themselves may be charged for partnership debts by others.").

Third—both broadest and most difficult—the modern law of vicarious business liability is troubled, inconsistent, and undesirable in several respects. The modern liability of investors and business partners is best summarized as follows: Participants in business activities face unlimited contractual and tort liability for the debts of the business unless the business chooses, in advance, to opt out of such liability.[5] The result is a problematic trap for the unwary; vicarious business liability attaches only to those who lack either the knowledge or the resources to plan to avoid it. Given how easy it is to avoid this liability by means of entirely formal planning,[6] it is unclear why the law should preserve it at all.

Moreover, conceived in relation to tort law, vicarious business liability (what is commonly called "unlimited liability" for the debts of a business) is difficult to justify in the first place; it is, for example, probably strictly less desirable than respondeat superior under all theories that attempt to justify respondeat superior, and most such theories at are best incomplete themselves. Eliminating vicarious business liability entirely, however, likely goes too far in restricting the rights available to victims. There is no clear solution to this fundamental tension in the law, but this Article raises several questions and outlines a few potential reforms, including (1) the substitution of administrative compensation schemes for tort liability, or at least for part of the tort system's interaction with failing businesses, or (2) a moderate expansion of the tort liability associated with joint action, in exchange for the elimination of strict vicarious liability. In considering this problem, however, this Article's main goal is to provoke further discussion rather than to defend a single, definite reform.

This Article focuses on the law of general partnerships under the Revised Uniform Partnership Act,[7] which is the law in the vast

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5. *Compare* UNIF. P'SHIP ACT § 306(a) (1997) (governing general partnership and providing that "all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law") *with id.* § 306(c) (governing limited liability partnerships and providing that "[a]n obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership"). In general, every form but the general partnership lets members, by default, opt out of liability. *See, e.g.*, UNIF. LTD. LIAB. CO. ACT § 304 (2006) [hereinafter "ULLCA"] ("The debts, obligations, or other liabilities of a limited liability company, whether arising in contract, tort, or otherwise . . . are solely the debts, obligations, or other liabilities of the company.").

6. *Cf.* MODEL BUS. CORP. ACT § 2.04 cmt. (2005) ("Incorporation under modern statutes is so simple and inexpensive that a strong argument may be made that nothing short of filing articles of incorporation should create the privilege of limited liability.").

7. UNIF. P'SHIP ACT (1997) [hereinafter RUPA].

majority of United States jurisdictions.[8] The law of other jurisdictions, typically based on the earlier Uniform Partnership Act,[9] raises similar concerns, but for clarity this Article focuses on the modern statutory statement of the law.[10]

To understand the arguments about partnership law that this Article develops, it may be helpful to describe a few principles of the law of general partnerships at the outset. These principles are all uncontroversial; they simply provide background to the Article's discussion.

First, general partnerships can be formed "accidentally" by parties who act as co-owners of a business.[11] The precise contours of this doctrine are subject to intense factual and conceptual dispute in individual cases,[12] but general partnerships clearly can be formed without a formal filing;[13] indeed, they are the only business form involving multiple people that can do so.[14] Second, general partners—that is, the co-owners who have formed a general partnership—are personally liable for the debts of the general partnership.[15] This applies to all liabilities of the general partnership,

8. According to the Uniform Law Commission, which promulgated the Revised Uniform Partnership Act, the act has been adopted in forty U.S. jurisdictions as of early 2015. *See Legislative Fact Sheet—Partnership Act (1997)*, Unif. Law Comm'n, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Partnership%20Act%20%281997%29%20%28Last%20Amended%202013%29 (last visited Jan. 2, 2016).

9. Unif. P'ship Act. (1914) [hereinafter UPA or the UPA].

10. For ease of exposition, this Article refers to the modern act as the Revised Uniform Partnership Act, or RUPA, and the classical act as the Uniform Partnership Act, or the UPA.

11. RUPA § 202 cmt. (1997) ("[A] partnership is created by the association of persons whose intent is to carry on as co-owners a business for profit, regardless of their subjective intention to be 'partners.'"). For a historical perspective concerning this rule, see Lewis, *supra* note 2, at 622 ("If a partnership act were to declare that a partnership was not formed until the formal requirements of the statute were complied with, it would not be a statute regulating common law partnerships, but one abolishing common law partnership and establishing a new form of statutory association.").

12. Allan Donn, Robert W. Hillman & Donald J. Weidner, The Revised Uniform Partnership Act § 202, at 112 (2014–15 ed.) ("R.U.P.A. does not clarify the troublesome issue under the case law: when is the existence of a partnership a question of fact and when is it a question of law.").

13. *See* RUPA § 202 cmt.

14. Shawn Bayern, Closely Held Organizations 86 (2014) ("[W]ithout any formal organizational filing, something operating as a [for-profit] business is either legally a sole proprietorship . . . or a general partnership . . . ."). Certain not-for-profit organizations also can exist without a formal filing in some common-law systems. *See, e.g.*, Rev. Unif. Unincorporated Nonprofit Ass'n. Act § 2(8) (2008) ("'Unincorporated nonpro?t association' means an unincorporated organization consisting of [two] or more members joined under an agreement that is oral, in a record, or implied from conduct, for one or more common, nonpro?t purposes.").

15. RUPA § 306(a) ("[In the general case], all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law.").

regardless of whether they result from contract, tort, or something else.[16] The process of collecting debts from individual partners varies between classical and modern law, but the end result is the same.[17] Finally, RUPA defines many precise mechanics for the end of the life of a general partnership.[18] When partners leave a partnership, RUPA declares that they have "dissociated."[19] Dissociation leads either to a mandatory buyout of the partner's interest—that is, the partnership must pay the departing partner for his or her ownership stake[20]—or the partnership's being "wound up,"[21] after which the partnership terminates and ceases to exist.[22] The discussion in the rest of the Article implicates these three basic principles in various ways.

I. THE TIMING OF PARTNERSHIP FORMATION

To motivate this Article's concern with the timing of partnership formation, consider the following example:

> *Quick Termination:* Clennam and Doyce agree to form a partnership. Clennam contributes equipment that the partnership agreement values at $18,000; Doyce contributes no property but agrees to work full time on partnership business. Three weeks later, before any further comingling of assets or joint work, the parties agree that it was a bad idea to go into business and that they should disband the partnership. The objective value of the equipment originally owned by Clennam is $15,000. (Or, instead of a misestimation of value in the partnership agreement, suppose the real value of the property fell

16. *Id.* § 306(a) & cmt 1.

17. Unlike the classical act, RUPA provides what is essentially an exhaustion-of-remedies procedure that requires plaintiffs to seek recourse first against the partnership, before recovering against individual partners. *Compare* RUPA § 307 *with* UPA § 15. RUPA also distinguishes a judgment against the partnership from a judgment against the individual partners. *Id.* These requirements are merely procedural.

18. For a general overview of the end-of-life processes of a general partnership, see BAYERN, *supra* note 14, at 131–40.

19. RUPA § 601 (specifying conditions under which a partner "is dissociated from a partnership"). RUPA introduced the notion of dissociation to clarify the end-of-life processes of a general partnership. *See id.* cmt. ("RUPA dramatically changes the law governing partnership breakups and dissolution. An entirely new concept, 'dissociation,' is used in lieu of the UPA term 'dissolution' to denote the change in the relationship caused by a partner's ceasing to be associated in the carrying on of the business.").

20. This process is governed by RUPA §§ 701–05.

21. RUPA § 801(a). This process is governed by *id.* §§ 801–07.

22. *Id.* § 802(a) ("The partnership is terminated when the winding up of its business is completed.").

$3,000 in the three weeks since the parties executed the agreement.)

In this example, by default—that is, without further agreement or prior specific stipulation in the partnership agreement—what will the parties own? What the parties almost certainly expect is that Clennam will receive the property back, and then the parties can simply walk away. The conventional understanding of partnership law would reach a different result, however.

Consider the formal analysis of the Quick Termination case under the conventional understanding of the Revised Uniform Partnership Act (RUPA). First, under section 202, "the association of two or more persons to carry on as co-owners a business for profit forms a partnership";[23] that is, the act of associating has a legal consequence and marks the time of formation. Second, either party's express will to withdraw triggers the "winding up" process under section 801, at least for partnerships at will.[24] (For partnerships other than those at will, the parties' agreement to wind up the partnership's business triggers the same process.)[25] That winding-up process is then governed most significantly by section 807, which requires reconciliation of the partners' capital accounts.[26] In this reconciliation, changes in the value of property since formation will influence the profits and losses of the partnership.[27] A strict reading of section 807(a) and 807(b) requires that Clennam's former property be liquidated and that the proceeds from liquidation determine whether there is a profit or loss from the sale.[28] For example, if the partnership can realize only $15,000 from the sale, it will have suffered a $3,000 loss that the partners must share equally;

23. *Id.* § 202.

24. *See id.* § 101(8) ("'Partnership at will' means a partnership in which the partners have not agreed to remain partners until the expiration of a definite term or the completion of a particular undertaking.").

25. *Id.* § 801. If the partnership is not "at will," one of the parties may, of course, withhold his consent, avoiding the problem discussed in the text. *See id.* § 101 (distinguishing a "partnership at will" from partnerships for a term or a definite undertaking). But that merely leads to a related problem. By hypothesis, the parties wish to avoid a continued association; withholding consent in order to avoid a problematic default distribution of rights and duties simply triggers bargaining in the shadow of those problematic rights and duties.

26. *Id.* § 807(a) ("In winding up a partnership's business, the assets of the partnership, including the contributions of the partners required by this section, must be applied to discharge its obligations to creditors, including, to the extent permitted by law, partners who are creditors. Any surplus must be applied to pay in cash the net amount distributable to partners in accordance with their right to distributions under subsection (b).")

27. *See id.* § 807(b) ("In settling accounts among the partners, profits and losses that result from the liquidation of the partnership assets must be credited and charged to the partners' accounts.").

28. *Id.* § 807(a)–(b).

as a result, Clennam will receive the $15,000 proceeds plus what is effectively a $1,500 transfer from Doyce.[29] Similarly, the partnership might have a gain from the property, in which case Doyce would share equally in the gain.

There are several ways to avoid this result. The easiest, of course, is for the parties to agree otherwise, ex post. If so, there is clearly no need for a liquidation sale or for a counterintuitive assignments of rights and duties among the former partners; the parties may simply choose to settle instead of to litigate their rights and duties. I do not wish to discount this possibility, because incentives other than legal ones do, of course, influence parties' behavior; they may have internalized moral norms, may not wish to be seen as opportunistic or unreasonable for reputational reasons, and so on.[30] Still, it is problematic for the law to assume that parties will, ex post, negotiate reasonably around a rule that gives them counterintuitive rights and duties. For example, problematic rules are likely to give an unreasonable party an opportunity to extract rent from a counterparty.[31]

There are several other ways that the parties might avoid an undesired liquidation of assets and a counterintuitive assignment of rights. First, the parties might have reached an agreement to cover the possibility of "quick termination" ex ante; where parties have reached such an agreement, it will govern them in place of the RUPA defaults.[32] But it is extremely unlikely that parties will foresee minor contingencies like this.[33]

Second, under the UPA, courts over time became hesitant to order what appeared to be a needless liquidation, instead inventing a buyout right that influenced RUPA's drafting.[34] RUPA allows

29. *Id.*

30. *See* ERIC A. POSNER, LAW AND SOCIAL NORMS 150–61 (2000); Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1257–65 (1999) (providing a typology of social norms and the potential reasons for parties' behavior beyond incentives provided by the law, including reputational concerns and the internalization of moral obligations).

31. *See* Robert Cooter et al., *Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior*, 11 J. LEGAL STUD. 225 (1982) (modeling the behavior of parties facing legal incentives).

32. RUPA § 103(a) (providing that, apart from specific exceptions, the parties' agreement trumps the statutory defaults).

33. *See* Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261, 267–73 (1985) (providing a typology of "formulation errors" that prevent parties from explicitly setting their rights in view of all possible contingencies).

34. *See* Creel v. Lilly, 729 A.2d 385 (Md. 1999) (providing an excellent summary of the trend under the UPA).

buyouts, however, only in several statutorily defined cases.[35] And even without liquidation,[36] conventional understanding of partnership law would still require a determination of profit and loss and a reconciliation of the capital accounts before termination,[37] resulting in a potential payment from Doyce to Clennam if the property is now worth less than it was three weeks ago (or is worth less not because its value has changed but because the partnership agreement slightly overvalued it).[38]

Third, in order to apply what they believe to be an equitable rule, courts might determine that the parties formed something other than a "partnership" (for example, a "joint venture") and then find that the parties are not governed by the partnership acts.[39]

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35. *See* McCormick v. Brevig, 96 P.3d 697, 705 (Mont. 2004) (holding that RUPA's switching mechanism between buyout and liquidation as a "statutorily mandated requirement"); RUPA § 801 ("A partnership is dissolved, and its business must be wound up, only upon the occurrence of [a specific list of events].").

36. Without liquidation, a dissociating partner has a right to a buyout from the partnership of his or her share. RUPA § 701(a) ("If a partner is dissociated from a partnership without resulting in a dissolution and winding up of the partnership business under Section 801, the partnership shall cause the dissociated partner's interest in the partnership to be purchased for a buyout price determined pursuant to subsection (b).").

It is worth mentioning that the meaning of "liquidation" is not fully clear in this context. To begin with, even under RUPA's Article 8, the business underlying a general partnership can theoretically survive the winding-up process. Requiring a liquidation sale does not mean that the sale must occur in parts; a business can be sold as a going concern, and the identities of those who continue the business after purchasing it in a liquidation sale (a partner, a third party, or some combination of the two) is arguably irrelevant. The major relevant difference between buyout and winding up under RUPA seems to be that on buyout, payment for a departing partner is based on an estimated market prices, whereas winding up typically involves a market determination of the price (of assets, divisions, the whole business, etc.). *Compare* RUPA § 701 (governing buyout) *with id.* §§ 801, 803 (governing winding up). The major legal distinction, then, appears to be simply whether there is to be a forced, public sale (compared to a court-directed estimation of value following by an implicit grant of ownership of the business to the remaining partners). In that sense, the distinction between buyout and winding up is structurally similar to the distinction between imposing damages and issuing an injunction. *Cf.* Walgreen Co. v. Sara Creek Prop. Co., 966 F. 2d 273 (7th Cir. 1992) (Posner, J.) (highlighting considerations such as the error costs associated with estimating value).

37. Under RUPA, buyout requires what is effectively a hypothetical winding up, with damages determined by the court in lieu of an order requiring an actual winding up. *See* RUPA § 701(b) ("The buyout price of a dissociated partner's interest is the amount that would have been distributable to the dissociating partner under Section 807(b) if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on a sale of the entire business as a going concern without the dissociated partner and the partnership were wound up as of that date.").

38. This follows simply because the value of the partnership, and of the dissociating partner's share, will vary with the price of the underlying assets.

39. On this point, Mel Eisenberg has offered an instructive lesson:

> The line between a joint venture and a partnership is exceedingly thin . . . . As a realistic matter, what seems to be involved is this: Some rules of the [statutes] . . . produce unsatisfactory results in certain kinds of cases. Courts that want to avoid these

Fourth—perhaps the cleanest way to avoid the problem that is still consistent with RUPA's conventional understanding—courts could infer from the parties' conduct an implied term in their partnership agreement that covers the situation of their "quick termination"—that is, that aligns the legal result with the evident expectations of the parties. This possibility, however, highlights a persistent and confusing tension between (1) a statute that offers default rules to fill gaps in the parties' contract and (2) the implication of contractual terms (from the parties' conduct, trade practices, and so on) that contradict these default rules. At least in the context of RUPA, courts have not been eager to detect implied terms that change the statutory default; indeed, as discussed above, they seem more likely overall to sidestep the statute by finding that an activity is not a partnership in the first place.[40]

The easiest and most functional way to avoid the problem raised by the "quick termination" example, however, is to hold that no business venture was ever formed—or that a formed partnership was "unformed," but not through the heavyweight process of "winding up," because there was in fact no business to wind up. A close reading of RUPA's section 202 suggests that nothing in the statute prevents this interpretation. Section 202 declares only that "the association of two or more persons to carry on as co-owners a business for profit forms a partnership," but it does not define "association."[41] Classical understanding is that partnership is contractual and the association occurs at the time of the contract's formation, but as I have pointed out in prior work,[42] the timing of contract formation is more problematic than contract scholars typically assume. It does not comport with the intent of all contracting parties to tie contract formation necessarily to a moment of acceptance, nor does such a rigid view of contractual timing fit the purposes for

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> results will sometimes do so, if they plausibly can, by holding that a 'special rule' applies to joint ventures, and that the enterprise in the case at hand is a joint venture and therefore falls within the special rule. In many or most such cases, the desired result could probably be reached, without applying special rules to joint ventures, by finding that the parties had an implied agreement that overrides the relevant rule of the [statutes].

MELVIN ARON EISENBERG & JAMES D. COX, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 133–34 (10th ed.) (previously quoted in BAYERN, *supra* note 14, at 164).

40. *See generally id.*

41. *See* RUPA § 101 (providing definitions of generally applicable terms but omitting to define "association").

42. Shawn Bayern, *Offer and Acceptance in Modern Contract Law: A Needless Concept*, 103 CALIF. L. REV. 67 (2015) (critiquing the classical rules of "offer and acceptance" in contract law as inappropriately formalistic in view of the goals of modern contract law).

which courts award remedies for breach of contract in the first place.[43]

Accordingly, to address this problem, courts merely need to interpret the word "association" in section 202 broadly enough to accommodate the notion that a relationship that appears to have been formed can be "unformed" by further interactions before it creates a partnership that must be wound up before being terminated.

The only further significant question that this approach raises is—under what circumstances does an association truly become irreversible? There is no reason to tie irreversibility to the execution of a formal document unless it is clear from the circumstances that the parties intend to invoke the full end-of-life machinery, including the formal winding-up process, by adopting a shared written agreement;[44] indeed, there need not ever in fact be a "point" in time that formation becomes irreversible.[45] But there should at least be a principled understanding of when the full statutory process of winding up and termination will be triggered and when it won't be.

In prior work on contract formation,[46] I showed that given the purposes of expectation damages (the normal remedy for breach of contract)—the timing of contract formation can be made to depend on function rather than form (that is, on such factors as the possibility of speculation, reliance, or preparation for performance).[47] A similar proposition is true in the context of partnerships: partnerships need not be treated as formed under section 202 until it is more just or less expensive to do so. In view of functional moral and economic criteria, the timing of partnership formation should depend on (1) parties' understanding of which risks of profits and losses they assume, because agreeing to accept such risks and rewards is a moral justification for requiring parties to accept them; and (2) significant joint activity or comingling of property, because such mixture raises the administrative and error costs associated with "quick termination" rather than the formal winding-up process. Note that these factors are quite consistent with other

43. *Id.* at 98–100.

44. *Cf.* RUPA § 101 (defining the "[p]artnership agreement"] as "the agreement, whether written, oral, or implied, among the partners concerning the partnership, including amendments to the partnership agreement").

45. *See* DONN ET AL., *supra* note 12, at 113 ("It is often difficult to identify the precise moment when a partnership comes into existence."); *cf.* Bayern, *supra* note 42, at 92 (arguing that requiring courts to identify a particular point at which a contract was formed "leads courts to decide potentially unnecessary questions").

46. Bayern, *supra* note 42, at 90–98.

47. *Id.* at 92–98.

language in, and commentary on, section 202 of RUPA because that section requires that the "association of two or more persons" is for the purposes of operating a "business,"[48] and RUPA's official comment notes that "[a] business is a *series* of acts directed toward an end."[49]

So, for example, had Clennam and Doyce intended to bet on the value of Clennam's equipment changing,[50] or had they begun significant work on the partnership, then a formal winding up is probably the right response. In the first case (an explicit or implicit bet), implementing justice requires giving effect to the risks and rewards the parties intended to accept by contract. In the second case (significant work), it likely becomes too expensive to disentangle the parties' formerly individual property. By contrast, if the goal is to fulfill parties' expectations, a mere agreement to enter a business—even accompanied by some property transfers—should not alone trigger the full winding-up process if the parties decide to walk away (precisely because it does not imply, in fact, either a bet or significant entanglement). Parties, particularly those who enter into accidental general partnerships without a formal filing,[51] are not likely to know anything about the detailed operation of the winding-up process under RUPA. Their expectations are informed by sources other than formal partnership statutes. Even formally speaking, it is perhaps truer to RUPA's spirit not to treat an agreement to enter into a partnership as, itself, forming a partnership; embarking on the first step of a business activity is not, itself, necessarily "business" because it is not itself a series of acts.[52]

Moreover, other sections of RUPA strongly suggest that fluidity of formation lies more within the spirit of modern partnership statutes than courts and commentators may typically suppose. For example, section 802(b) gives the partners the ability to "cure" a winding up that none of them want.[53] That is, even though an event

48. RUPA § 202.

49. RUPA § 202 cmt. 1 (emphasis added).

50. Note that there is no general reason to assume that the parties have in fact made this bet just because they have agreed to be in business with each other. The bets that the parties have made is simply a question of contractual interpretation.

51. *See* RUPA § 202(a) (permitting partnerships to be formed accidentally in this manner).

52. *See* RUPA § 202 cmt. 1.

53. RUPA § 802(b) ("At any time after the dissolution of a partnership and before the winding up of its business is completed, all of the partners, including any dissociating partner other than a wrongfully dissociating partner, may waive the right to have the partnership's business wound up and the partnership terminated.").

has occurred that, under section 801, already has led to a "dissolution and winding up"[54]—and section 801 is explicit that the dissolution occurs "upon" its specific list of events, and that the "business must be wound up" after a dissolution occurs[55]—section 802 gives the parties the power to cause a retroactive change in their legal relationship, so that the dissolution and winding up are deemed never to have occurred. Section 802(b) is indeed explicit about this; when section 802 applies, "the partnership resumes carrying on its business as if dissolution had never occurred."[56] RUPA clearly rejects, in this case, the conceptualistic notion that a change in legal status must be irrevocable; section 802(b) lets the parties rewrite history for functional reasons.[57]

Note that allowing "quick termination" would not preclude one partner from receiving damages from the other for a wrongful repudiation of an executory agreement.[58] Even without the formal winding-up process, damages should be available for breach of contract by a party who wrongfully breaches or repudiates an agreement.[59]

II. THE NATURE AND LEGAL PURPOSE OF PARTNERSHIP FORMATION: AGGREGATION AND DISAGGREGATION

A second significant problem in the law of partnership formation—one that is more theoretical than directly litigable, but which will serve as one basis for this Article's analysis in Part III—is that, at

54. *Id.* § 801.

55. *Id.*

56. *Id.* § 802(b)(1).

57. This kind of retroactive effect is not unfamiliar in the common law, which is typically—at least in modern times—motivated by functional rather than formal concerns. For example, as the RESTATEMENT (THIRD) OF AGENCY describes, a principal's ratification of a contract, the act "retroactively creates the effects of actual authority." RESTATEMENT (THIRD) OF AGENCY § 4.02(1) (AM. LAW INST. 2005). The common-law rule thus permits a convenient rewriting of history that leads to potential conceptual fuzziness but functional utility. Even procedural law permits parties to rewrite history. *See, e.g.*, FED. R. CIV. P. 15(c) (defining "relation back").

58. *Cf.* RUPA § 602(b)–(c) (defining wrongful dissociation and describing some of its legal consequences).

59. Under the law of general partnerships, the remedy for such a breach is always a measure of damages rather than what would effectively be an order for specific performance, because the law will not force partners into an ongoing personal relationship that one of them does not want. *See* RUPA § 602(b) (defining the consequences of wrongful dissociation); *cf.* RESTATEMENT (THIRD) AGENCY § 3.06 (AM. LAW INST. 2005) (providing for the termination of an agency relationship without regard, in the normal case, to an agreement to continue the relationship); RESTATEMENT (SECOND) CONTRACTS § 367(1) (AM. LAW INST. 1981) ("A promise to render personal service will not be specifically enforced.").

least for the purposes of state organizational law,[60] the question of partnership formation is aggregated into a single, abstract inquiry: "Was a partnership formed?" Courts and commentators ask this unified question even though it dictates several distinct legal results, such as (1) duties among the partners, (2) the contractual liability of partners to third parties, and (3) the vicarious tort liability of partners to third parties. Ordinarily, a partnership is formed or not formed based on the criteria and presumptions in RUPA's section 202, and this decision is normally treated as a formal one, not one that serves functional ends.[61] Indeed, it is often difficult to serve purposes rationally when using a singular inquiry to address multiple consequences.[62]

This aggregation, however, reflects a choice, not a consequence of logic. We choose to ask, "Is there a partnership?" rather than, "Should partner *P* be liable to creditor *C*?" Presumably the choice should be made in view of what is desirable according to the law's goals. Instead, the courts' inquiries are largely purposeless. For example, the famous leading case of *Martin v. Peyton*,[63] which addressed the partnership status of a group of creditors who demanded significant control over an enterprise as a condition of credit, engages in essentially no purposive reasoning. Its analysis solely concerns the "proper"[64] or "natural"[65] role of partners versus that of creditors, as if a business partnership were an ontological

60. For federal tax purposes, different results from those that prevail under state organizational law may be reached. *See, e.g.*, 26 C.F.R. § 301.7701-1(a)(1) ("Whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law."). To put it differently, the tax law already implements at least some of the normative conclusions of Part II.

61. For example, RUPA section 202 makes no reference to the purposes for which the question of partnership formation is being asked.

62. *Cf.* Arthur A. Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451 (1974) (critiquing Posner's singular economic methodology to solve legal questions). Leff is worth quoting in full:

> To hold the mind-set constant while the world is played in manageable chunks before its searching single light is a powerful analytic idea, the literary equivalent of dropping a hundred metals successively into the same acid to see what happens. The analytic move, just as a strategy, has its uses, no matter which mind-set is chosen, be it ethics or psychology or economics or even law. In each case, of course, the approach has its limitations . . . .

Id. at 452.

63. 158 N.E. 77 (N.Y. 1927).

64. *Id.* at 79–80.

65. *Id.* at 79.

primitive.[66] It never considers why debtors, for example, are functionally different from partners if the underlying question is whether those providing financing should be liable for the obligations of the business.[67]

My proposal here is simple: There should not be a unified "partnership formation" doctrine. Instead, there should be several distinct questions, each driven by the purpose for which the question is asked. The major split is between questions of partners' duties to third parties and questions of partners' duties to each other. That is, two clearly separate questions should be: (1) Is this an appropriate case for the liability of a partner or purported partner to a third-party plaintiff? and (2) What are the contractual (or statutory default, or fiduciary) duties among partners and purported partners? These questions can perhaps be disaggregated further; for example, in some circumstances the first question could be split depending on whether the third-party plaintiff is an unrelated party with a tort claim or a closely related party with a contractual claim. But the primary split is the most important one.

To change the law here would require minor statutory reform. RUPA's definition of partnership formation is oriented to determine whether a legal entity exists for all purposes.[68] A reform to address the needless aggregation of legal questions in partnership formation would simply remove the implication (codified in section 306) that partners' liability to third parties results from the contractual formation of a partnership[69] and replace this with a purposive inquiry.[70] The overwhelming bulk of RUPA's rules concern the duties and liabilities of partners to one another; that is the main reason for determining whether an entity exists. Those rules can all

66. *Cf.* John F. Sowa, *Glossary*, http://www.jfsowa.com/ontology/gloss.htm (defining an ontological "primitive" as a "category of an ontology that cannot be defined in terms of other categories in the same ontology").

67. *See infra* Part III (considering this question more closely).

68. It is interesting to note that earlier analysis under the UPA, which was not organized to treat partnerships as legal entities but rather simply as processes of association to which legal status attached, much like marriages or certain types of clubs, explicitly exhibited the same aggregation of unrelated questions. *See* UPA § 7(1) ("Except as provided by [s]ection 16 [covering partnership by estoppel] persons who are not partners as to each other are not partners as to third persons."). In other words, the abstraction of questions concerning partnership formation does arise specifically from RUPA's treatment of partnerships as legal entities.

69. RUPA § 306(a) (specifying that in general, "all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law").

70. For reasons I will make clear in Part III, I am not convinced that in modern organizational law there needs to be any accidentally or implicitly created legal entity that results from the operation of a for-profit business. So it may be superior to replace section 202 with a formal "filing requirement" anyway in future partnership acts.

be preserved; what should not be preserved is the assumption that when those rules are triggered, the rules of vicarious liability of partners to third parties (that is, the "unlimited liability" of partners) must also be triggered.[71]

It is hard to see reasons, other than purely conceptualistic ones, for the aggregation of two functionally distinct legal questions.[72] My sense is that such aggregation results from what is essentially oversight, or the limitations of the imaginations, of courts and commentators.[73] It is conceivable that deciding once and for all whether two or more parties are in a partnership is the simplest solution to several problems and that alternative solutions incur administrative costs that outweigh the benefits of disaggregating the question of partnership formation. In practice, however, there is little reason to think that disaggregating the question would incur significant administrative costs. Particularly with regard to the types of questions concerning the timing of formation that I described in Part I, for example, the moment at which fiduciary duties ought to attach may well be different from the moment at which one person ought to be liable for another person's harm to third parties.

Consider briefly an analogy to a closely related legal question in the law of agency. In every case where an organization's worker injures a third party, two potentially significant questions arise: (1) Is the worker an "employee," so that the organization will be responsible under principles of respondeat superior?[74] and (2) If so, was the worker within the "scope" of his or her employment?[75] The worker's contractual arrangement with the organization influences the analysis of both of these questions,[76] but courts clearly separate these questions from, for example, those concerning the worker's

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71. *See* RUPA § 306(a).

72. For a historical overview of legal conceptualism, see GARY MINDA, POSTMODERN LEGAL MOVEMENTS: LAW AND JURISPRUDENCE AT CENTURY'S END 14–20 (1996).

73. *Cf.* Bayern, *supra* note 42 (elaborating a similar argument and applying it to the specific context of the development of the doctrines of offer and acceptance in the common law of contracts).

74. *See* RESTATEMENT (THIRD) OF AGENCY § 7.07(3) (AM. LAW INST. 2005) (listing criteria under which an agent will be labeled an "employee" for the purposes of respondeat superior).

75. *See id.* § 7.07(2) ("An employee acts within the scope of employment when performing work assigned by the employer or engaging in a course of conduct subject to the employer's control. An employee's act is not within the scope of employment when it occurs within an independent course of conduct not intended by the employee to serve any purpose of the employer.").

76. *See* RESTATEMENT (SECOND) OF AGENCY § 220 (AM. LAW INST. 1958) (listing factors that influence the separation of employees from independent contractors, including "the extent of control which, by the agreement, the master may exercise over the details of the work" and "whether or not the parties believe they are creating the relation of master and servant").

contractual duties under whatever employment or contractual relationship exists; the answer to one does not dictate the answer to other.[77] Similarly, matters in tax law (such as the worker's liability for self-employment tax,[78] the employer's liability for FICA taxes,[79] and the location of the worker's job-related expenses on Schedule A or Schedule C)[80] depend on a worker's "employment" status,[81] but courts do not let the analysis of tax liability dictate the result in respondeat superior (or vice versa).[82] Perhaps surprisingly, the same is true of worker's-compensation law; both respondeat superior and worker's compensation ask a "scope of employment" question,[83] but courts have decided that those two questions are distinct and may reach different results.[84] It perhaps would have been convenient for courts to muddle the two questions, but separate policies dictated separate analyses.[85]

In general, it is hard to see why questions with separate purposes must be answered in the same way, particularly when that is not the law's practice even in closely related areas. Moreover, the law already disaggregates the question of partnership status into separate questions for one purpose: determining partnerships' tax status.[86]

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77. *See id.* (listing many additional factors distinguishing employees from independent contractors, including "the skill required in the particular occupation," "whether or not the one employed is engaged in a distinct occupation or business," and "whether the principal is or is not in business").

78. *See generally* 26 C.F.R. 1.6017-1 (regulating the filing of self-employment tax returns and specifying when such returns are required).

79. *See* 26 C.F.R. 31.6302-1 (regulating the withholding of FICA taxes by employers).

80. *See* 26 C.F.R. 1.6017-1 (separating self-employment taxes from other taxes).

81. *See id.*

82. For example, neither the Restatement (Second) of Agency §§ 2, 202 (Am. Law Inst. 1958) nor the Restatement (Third) of Agency § 7.07 (Am. Law Inst. 2005) references the Internal Revenue Code or tax regulations.

83. *See, e.g.*, Fla. Stat. 440.09(1) ("The employer must pay compensation or furnish benefits required by this chapter if the employee suffers an accidental compensable injury or death arising out of work performed in the course and the scope of employment."); *see also supra* notes 74–77 (citing sources summarizing the determination of "scope of employment" in the context of respondeat superior).

84. *See e.g.*, Sharrock v. United States, 673 F.3d 1117, 1121 (9th Cir. 2012) ("[W]e decline to base our consideration on the workers' compensation cases in which scope of employment is broadly interpreted in order to carry out the legislative policy of providing medical care and replacement of wages lost due to injuries from industrial accidents."); Dhanraj v. Potomac Elec. Power Co., 305 Md. 623, 630 (1986) ("We see no need to resort, in the circumstances here [*i.e.*, a respondeat superior case], to cases under the Workmen's Compensation."); *cf.* Kerns v. United States, 478 Fed. Appx. 44, 49 n.* (4th Cir. 2012) (leaving open the possibility that "Maryland's scope-of-employment prong of the respondeat superior test is [or is not] coextensive with the [Federal Tort Claims Act] requirement for governmental liability that the tortfeasor acted within the scope of her employment").

85. *See, e.g.*, *Sharrock*, 673 F.3d at 1120–23.

86. *See supra* note 60.

That is, the answer to several federal tax questions concerning partnerships is not dictated by state law.[87] If courts can separate the question of partnership formation for this purpose, it is hard to see why they cannot separate it for other purposes.

III. THE CONUNDRUM OF MODERN VICARIOUS BUSINESS LIABILITY

Part II's concern with the substantive reasons underlying the determination of partnership status in modern partnership law points the way to a more particular and more significant problem in organizational law: Why retain the classical common law's "unlimited" liability for partners in informal general partnerships in the first place? If, as Part II suggested,[88] one of the purposes in asking "Does a partnership exist?" is to determine whether one partner is liable for another partner's actions, it is important to examine the reasons that partners are ever liable for each other's actions in the first place.

On examination in view of (1) the modern purposes of vicarious liability and (2) the nature of modern organizational law, what I will call "vicarious business liability" has begun to seem like an anachronism. Moreover, its justification was never clear; it does not rest on clear functional propositions or even a doctrinal principle of consistent application. That said, removing it entirely would probably be too radical, potentially inconsistent with several moral propositions that underlie modern vicarious liability, and possibly inefficient. Even though the purposes for modern vicarious business liability are unclear, some partially satisfactory rationale may be sufficient to induce, at the very least, some caution in reforming it. Accordingly, this Part does not propose a definite reform to legal rules; instead, it proposes a theoretical reexamination of the purposes of vicarious business liability.

A. *Vicarious Business Liability*

For the purposes of this discussion, I define "vicarious business liability" as the liability of a partner (or owner or member) for the obligations of a business entity. Vicarious business liability may arise in contract or in tort; for example, it includes an individual partner's liability for the malpractice of a partner, for the general

87. *See id.*
88. *See supra* text accompanying notes 61–63.

negligence of a partner, and for a contract signed by a partner on behalf of the organization.

Treating this liability as a distinct concept—a particular species of vicarious liability in the common law—has several expository roles. First, it is helpful to separate individual partners' liability from the partnership's liability as a principal; a legal regime can have one type of liability without the other. For example, it is uncontroversial that a partnership will be liable in respondeat superior when an employee of the partnership drives a car negligently while in the scope of his or her employment.[89] That is not an example of vicarious business liability as I define it here; it is simply an example of liability in respondeat superior for an organizational principal. And, for example, if the partnership is a limited liability partnership (LLP), the liability stops with the organization, and the individual partners are not vicariously liable for the accident.[90] Only under the general partnership, by default, are the individual partners vicariously liable for the partnership's obligations.[91]

Second, emphasizing the *vicariousness* of a partner's liability for partnership obligations clarifies several confusions in the notion of "limited liability" for business entities. It is easy to conceive partnership liability as if limited liability is a special protection against personal liability, bestowed by organizational law as against some background principle of liability. To the contrary, in the usual case, parties are not legally responsible for the actions of others;[92] it requires an exceptional doctrine, like respondeat superior or the various state statutes that hold the owner of a car liable for torts for which the car's driver was responsible,[93] to cause one party to be

89. *See* Restatement (Third) of Agency § 7.07(1) (Am. Law Inst. 2005) ("An employer is subject to vicarious liability for a tort committed by its employee acting within the scope of employment."); *id.* § 7.07 cmt. c. ("Likewise, had *A* contravened an instruction not to exceed the speed limit . . . , *A* [still] would have been acting within the scope of employment.").

90. RUPA § 306(c) ("An obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership.").

91. *Compare* RUPA § 306(a) (liability of partners for obligations of general partnership) *with id.*§ 306(c) (no liability of partners of limited liability partnership for obligations of LLP); ULLCA § 303 (no liability of members and managers of limited liability company for obligations of LLC); Model Bus. Corp. Act. [hereinafter MBCA] § 6.22 (no liability of shareholders for obligations of corporation).

92. *See* Dan B. Dobbs et al., The Law of Torts § 425 (2d ed. 2011) (referring to vicarious liability as "an important exception to the usual rule that each person is accountable for his own legal fault but in the absence of such fault is not responsible for the actions of others").

93. *See, e.g.*, Cal. Veh. Code § 17150 (1967) ("Every owner of a motor vehicle is liable and responsible for death or injury to person or property resulting from a negligent or wrongful act or omission in the operation of the motor vehicle, in the business of the owner

liable for another's actions.[94] The only sort of liability that is at issue in discussions of "limited liability" is *vicarious* liability—that is, liability for the actions of others.[95] This liability is as vicarious as respondeat superior liability; it entails the status-based imposition of strict liability for the wrongs of another party.[96] It will be helpful to compare vicarious business liability (the law's demand that equal partners answer valid complaints against each other) with respondeat superior (the law's demand that employers answer valid complaints against their employees), as they are similar types of liability with similar justifications. As the discussion in Section C, *infra,* will show, vicarious business liability is less justified, however, than respondeat superior.

B. Of Anachronism and Inconsistent Exceptions

The clearest and most general problem with the liability of partners in modern general partnerships is simply that it can so easily be avoided.[97] It has long been possible for managers and investors to avoid vicarious liability by means of the corporate form, but historically this choice entailed significant economic and legal tradeoffs; for example, parties organizing a business could choose a partnership to get favorable tax treatment or a corporation for its limited liability, but not both.[98] Organizational law, admittedly, has long been flexible enough to allow creative arrangements under which sophisticated parties could try to get the best of both worlds. For example, a common structure fifty years ago was a limited partnership (a partnership for tax and organizational purposes in which only some of the partners, known as general partners, have

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or otherwise, by any person using or operating the same with the permission, express or implied, of the owner.").

94. *See* DOBBS ET AL., *supra* note 92 (defining vicarious liability).

95. As Mel Eisenberg has suggested, a better term for "limited liability" would perhaps be "no liability." *See* MELVIN ARON EISENBERG & JAMES D. COX, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS, CASES AND MATERIALS 398 (11th ed. 2014); BAYERN, *supra* note 14, at 168–69. As a corollary to the misunderstanding that Professor Eisenberg identifies, many laypeople incorrectly assume that those who form LLCs are immune from the torts they commit as long as the torts relate to a business. *See, e.g.*, *Corporations and Limited Liability*, KHAN ACADEMY, https://www.khanacademy.org/economics-finance-domain/core-finance/taxes-topic/corporate-taxation/v/corporations-and-limited-liability, at 4:12–8:47 (incorrectly explaining that setting up a corporation shields a businessperson from his or her personal torts).

96. *See* DOBBS ET AL., *supra* note 92.

97. *See supra* note 91 and accompanying text.

98. *See* BAYERN, *supra* note 14, at 243–45.

unlimited liability) with only corporations as its general partners.[99] Such a structure received the favorable tax treatment of a partnership but for practical purposes avoided unlimited liability for all the individuals associated with it.[100] Still, in the past there were always complex potential tradeoffs, and parties subjected themselves to the idiosyncratic structures and liabilities associated with different business forms.[101]

Two modern developments have made vicarious business liability in the general partnership seem anachronistic. First, the rise of the limited liability company (LLC)—which is simultaneously (1) the most flexible legal organization available under American law, from a structural perspective; that is, businesspeople can organize an LLC however they wish in terms of control, accounting, authority for the purposes of agency law, and so on;[102] and (2) treated favorably by the tax code, because under the "check-the-box" regulations, organizers can choose whether an LLC is taxed as a corporation or as a partnership[103]—has eliminated most of the significant tradeoffs for organizers.

Second, and perhaps even more clearly, RUPA itself allows the creation of a limited-liability partnership (LLP),[104] which organizationally is identical to a general partnership except for the limited liability of its partners.[105] LLPs were initially available only to professional organizations,[106] but RUPA liberalizes their availability.[107] As a result of the rise of both LLCs and LLPs, anyone who wants to do so can opt out of vicarious business liability when forming an organization. The residual unlimited liability in those who do not

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99. *See* Donald J. Weidner, *The Existence of State and Tax Partnerships: A Primer*, 11 FLA. ST. U. L. REV. 1, 65–69 (1983) (discussing the history of the use of corporate general partners in limited partnerships).

100. *See id.* at 65 ("The short and, to many practitioners, the sweet of it is that, under the present classification regulations, as interpreted by a major Tax Court decision in which the [IRS] has indicated its acquiescence, it appears virtually impossible for any U.L.P.A. limited partnership, including one that has a sole corporate general partner, to be treated as anything other than a partnership for tax purposes.").

101. *See, e.g.*, *id.* at 47–50 (discussing the historical development of competing business forms); Larry E. Ribstein, *The Deregulation of Limited Liability and the Death of Partnership*, 70 WASH. U. L. Q. 417 (1992) (discussing the tradeoffs between taxation and liability).

102. *See* BAYERN, *supra* note 14, at 243–45 (discussing the rise of LLCs).

103. *See* 26 C.F.R. § 301.7701-3(a) ("A business entity that is not classified as a corporation under § 301.7701-2(b) (1), (3), (4), (5), (6), (7), or (8) (an *eligible entity*) can elect its classification for federal tax purposes as provided in this section.").

104. RUPA §§ 1001–03 (defining LLPs); *see also id.* § 306 (specifying the limited liability of LLPs).

105. *Id.* §§ 306, 1001.

106. *See* Elaine A. Welle, *When Are Limited Liability Partnership Interests Securities?*, 27 IOWA J. CORP. L. 63, 84–85 (2001).

107. *See* RUPA §§ 1001–03 (defining LLPs).

explicitly opt out becomes, consequently, nothing more than a trap for the unwary.[108] That is, the status of vicarious business liability under modern law is as follows: it applies to everyone who is in business with other people, except if they opt out of it in advance with trivial effort.[109] The result is a legal regime that is bizarre at best; it is hard to see a plausible way it could be normatively desirable.[110]

To be clear, this Article does not suggest that parties should be unable to opt *into* vicarious business liability—or what is typically called unlimited liability—if they so wish. Wachtell, Lipton, Rosen & Katz, a major business-law firm in New York, is hardly unwary; on the contrary, it is one of a few organizations with a claim to being called the most sophisticated analysts of business law in the world.[111] The organization remains, however, a general partnership.[112] Its reasons for doing so are unclear, but part of the motivation is presumably that the firm wishes to declare to the world that all its partners are liable for each other—for example, when it writes opinion letters for clients.[113] Many lawyers regarded the LLP form, when it arose, as unethical or at least ethically suspect;[114] even if it is not, in the right contexts it could be bad for business to adopt limited liability from the outset. Regardless of all

108. *See* UNIF. LTD. P'SHIP ACT § 303 cmt. (2001) ("In a world with LLPs, LLCs and, most importantly, LLLPs, the control rule [for determining whether limited partners have exercised control over a general partnership sufficient for them to incur vicarious business liability] has become an anachronism. This Act therefore takes the next logical step in the evolution of the limited partner's liability shield and renders the control rule extinct.").

109. *See supra* note 90 and accompanying text.

110. It would be possible to suggest, fancifully, that registration of a business in a form other than a general partnership correlates with the parties' responsibility and is thus a way to separate those who somehow deserve limited liability from those who do not. In view of the ease with which parties can register businesses, *see infra* note 116, this suggestion is extremely unpersuasive.

111. *See* Erin Fuchs, *Here's What It's Like To Work For America's Most Grueling Law Firm*, BUS. INSIDER, Aug. 23, 2013, http://www.businessinsider.com/what-its-like-to-work-for-wachtell-lipton-2013-8 ("For the 10th year in a row, careers website Vault has named New York City law firm Wachtell, Lipton, Rosen & Katz as the most prestigious law firm in America.").

112. DIRK HARLACHER, THE GOVERNANCE OF PROFESSIONAL SERVICE FIRMS 171 (2010); *see also* Wachtell, Lipton, Rosen & Katz, *About the Firm*, http://www.wlrk.com/Firm/ ("Wachtell Lipton was founded on a handshake in 1965.").

113. Also, the risk of litigation is likely low. *See* HARLACHER, *supra* note 112, at 171 (also noting that the firm opts not to use "written fee agreements" with its clients).

114. *See* Grace M. Giesel, *Corporations Practicing Law Through Lawyers: Why the Unauthorized Practice of Law Doctrine Should Not Apply*, 65 MO. L. REV. 151, 187–90 (2000) (discussing the history of the availability of limited liability for law firms); *cf.* Martin C. McWilliams, Jr., *Who Bears the Costs of Lawyers' Mistakes?—Against Limited Liability*, 36 ARIZ. ST. L.J. 885, 946 (2004) ("Rather than encourage law practices to rely upon limited liability structures designed for the purpose of disadvantaging the external stakeholder—which in law firms includes clients—it is more congruent with the central norm of undivided loyalty to design structures directing lawyers toward protecting clients in terms of both financial and fiduciary risk.").

this, however, the default for a general partnership need not be unlimited liability to satisfy legal-ethical concerns or the business priorities of firms like Wachtell. As in corporate law,[115] partnerships under a regime in which limited liability were the default simply could waive such protections in their organizational documents.

In any event, under modern law, parties can, for a nominal fee,[116] choose an LLC or an LLP, and doing so has essentially no legal consequences other than a difference in liability. Aside from the fee and various minor naming and registration requirements,[117] parties have as much (if not more) flexibility in formal business forms as they do in the general partnership.[118] It is hard to see what justifies retaining vicarious business liability for the general partnership when it is so easy to avoid; the result is only that unsophisticated parties or those without legal advice will suffer from this liability while others may easily avoid it. That state of affairs alone should suggest that modern American law currently lacks a principled system for vicarious business liability.[119]

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115. *See, e.g.*, MBCA § 6.22(b) (permitting the articles of incorporation to waive the default limited liability for a corporation's shareholders). Perhaps surprisingly to some, corporations in the public exchanges may have waived their limited-liability status in a similar way; of course, this is unlikely to matter in practice, much as it is unlikely to matter in Wachtell's case. For example, until 1965, American Express waived its limited liability for shareholders; removing this provision from its charter had no significant effect on the valuation of its shares. *See* Mark I. Weinstein, *Don't Buy Shares without It: Limited Liability Comes to American Express*, 37 J. Legal Stud. 189 (2008) (studying the effects of the removal of American Express's waiver).

116. *See, e.g.*, Limited Liability Company Fees, Fla. Dep't of State Div. of Corps., http://www.sunbiz.org/feellc.html (last visited Jan. 2, 2016) (listing $100 as the filing fee and $138.75 as the ongoing annual-report fee for a limited liability company in Florida).

117. *E.g.*, RUPA § 1002 ("The name of a limited liability partnership must end with 'Registered Limited Liability Partnership', 'Limited Liability Partnership', 'R.L.L.P.', 'L.L.P.', 'RLLP,' or 'LLP'.").

118. *See* Bayern, *supra* note 14, at 243–45 (discussing the organizational flexibility of LLCs).

119. Moreover, even in the main other sort of organization that can arise accidentally under law—unregistered not-for-profit organizations—the modern trend is toward the elimination of vicarious organizational liability:

> A debt, obligation, or other liability of an unincorporated nonprofit association, whether arising in contract, tort, or otherwise:
>
> (1) is solely the debt, obligation, or other liability of the association; and
>
> (2) does not become a debt, obligation, or other liability of a member or manager solely because the member acts as a member or the manager acts as a manager.

Rev. Unif. Unincorporated Nonprofit Assoc. Act § 8(a) (2008).

C. Candidate Underlying Bases for Vicarious Business Liability

Section B described vicarious business liability as an inconsistent anachronism in modern business-entity law. The inconsistency itself, however, need not point to a fault with the presence of vicarious business liability in general partnerships. Indeed, as many commentators have argued, it can suggest that the problem is the "limited liability"—that is, the elimination of vicarious business liability—that the other business forms provide.[120] This Section surveys the theoretical and practical bases for vicarious business liability and finds them lacking, or at least unclear.

Consider first the case of tort liability. In our tort system, with extremely minor exceptions, liability ordinarily depends on personal fault.[121] Vicarious business liability is "strict" liability—that is, liability without fault. It is most similar in doctrine to respondeat superior (the liability of an employer for the negligent acts of its employees).[122] Respondeat superior is itself difficult to justify; for example, Gary Schwartz, the reporter for the *Restatement (Third) of Torts: Liability for Physical Harm (Basic Principles)*, concluded in 1996 as follows:

> When our own judges and scholars have on occasion focused on vicarious liability, the justifications they have offered have been uneven. At least so far, the rationales set forth by corrective justice theorists have not been persuasive. Economic analysts have developed arguments that are promising, yet incomplete.[123]

Point for point, it turns out that the vicarious liability of partners is harder to justify than respondeat superior on nearly any justificatory theory. For example, respondeat superior is commonly framed

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120. *See* Causey, *supra* note 2, at 540 ("The Louisiana Legislature should address the unexplained limited liability of general partners and amend . . . [the statutes] to conform with every other jurisdiction in the world by changing the limited liability of partners to joint and several liability for the partnership obligations."); Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991) (arguing that corporate law should impose vicarious business liability on shareholders in some situations); David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1569 (1991) ("The case for limited liability of investors for the tort liabilities of corporations has been seriously overestimated.").

121. See DOBBS ET AL., *supra* note 92.

122. *See* RESTATEMENT (THIRD) OF AGENCY § 7.07(1) (AM. LAW INST. 2005) ("An employer is subject to vicarious liability for a tort committed by its employee acting within the scope of employment.").

123. Gary T. Schwartz, *The Hidden and Fundamental Issue of Employer Vicarious Liability*, 69 S. CAL. L. REV. 1739, 1767 (1996).

as a useful kind of enterprise liability, offering benefits like loss spreading.[124] But the typical defendant to which vicarious business liability applies under partnership law is an individual partner, not an enterprise.[125] Indeed, vicarious business liability in partnerships is probably the only significant case of strict liability for *individuals* that exists under American tort law.[126]

A separate justification for respondeat superior is often stated in terms of benefit and control: employers benefit from, and exercise potential control over, employees. That they receive a benefit from good employees makes it fair for them to pay for the harms that bad ones cause; that they exercise control makes it possible to improve public safety by giving employers an incentive to adopt safer hiring, training, and management policies.[127] Regardless of the persuasiveness of this justification, however, in partnerships the benefit is shared and the control is attenuated at best.[128] Unlike "masters" and "servants," partners—particularly by default in unplanned general partnerships—are equals.[129]

Moreover, as appealing as the "benefit and control" principle is, it is not a general principle in our law, or else parents would be liable for the torts of their children,[130] certain creditors would be

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124. *E.g.*, Linda Mabus Jorgenson et al., *Transference of Liability: Employer Liability for Sexual Misconduct by Therapists*, 60 BROOK. L. REV. 1421, 1439–43 (1995) (citing Doe v. Samaritan Counseling Ctr., 791 P.2d 344, 349 (Alaska 1990)).

125. This follows from the recognition that vicarious liability in general partnership results predominantly from the lack of sophistication or planning of the partners. *See supra* notes 110–116 and accompanying text. Note that liability for the partnership (e.g., in respondeat superior), rather than vicarious liability for the constituent partners, is sufficient to achieve the goal of enterprise liability.

126. The only other common case of strict tort liability for individuals—and it is a relatively minor case given its small effects on individuals—is the relatively widespread statutory liability for owners of cars that are driven by negligent drivers other than the owner. *See, e.g.*, CAL. VEHICLE CODE § 17150 ("Every owner of a motor vehicle is liable and responsible for death or injury to person or property resulting from a negligent or wrongful act or omission in the operation of the motor vehicle, in the business of the owner or otherwise, by any person using or operating the same with the permission, express or implied, of the owner."). This statutory liability serves simply to extend required liability insurance for automobile owners to all who drive a car; it rarely serves to impose uninsured liability on individuals.

127. *Cf.* Schwartz, *supra* note 123, at 1749–55 (discussing related rationales for respondeat superior based in "fairness"); Richard W. Wright, *Right, Justice, and Tort Law*, in PHILOSOPHICAL FOUNDATIONS OF TORT LAW 158, 177–80 (David Owen ed. 1995); STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW 170–73 (1987) (presenting an economic analogue to this argument).

128. *See* RUPA § 401(j) ("A difference arising as to a matter in the ordinary course of business of a partnership may be decided by a majority of the partners. An act outside the ordinary course of business of a partnership and an amendment to the partnership agreement may be undertaken only with the consent of all of the partners.").

129. *See id.*

130. Despite some popular misconceptions and the occasional minor exception, they are not. *See* DOBBS ET AL., *supra* note 92, § 435 (referring "to the usual rule that parents are not

liable for their debtors' actions,[131] supervisors in an organization would be liable in an individual capacity for the torts of their organizational subordinates,[132] and so on. Note that respondeat superior explicitly does not make individual supervisors within an organization liable for the torts of organizational subordinates;[133] it makes only the ultimate employer, of whom a supervisory "boss" and lower-level employees are typically coagents, liable.[134]

A more general justification for respondeat superior is pragmatic: it may simply be necessary for our tort system to function, given the pervasiveness of (1) employment and (2) judgment-proof employees.[135] Neither of these characteristics applies to vicarious business liability, so this justification, too, falls flat if it is applied to general partnerships.

Indeed, even considering the question from scratch, it is unclear that as between, for example, a passive investor who becomes a financial partner in an enterprise and an innocent victim of the enterprise's negligence, the investor should be strictly liable. I doubt modern society shares a clear moral intuition to support that result, particularly as an exception to a general principle of liability based on negligence.[136]

All that said, the cases of vicarious partnership liability for torts may be relatively minor; the threat of vicarious contract liability for business partners is probably more significant in practice. Here too, though, the modern world likely varies from the assumptions that the classical legal model for partnerships assumed.[137]

Given the variety of business forms available today, those with ordinary contractual relationships with businesses probably do not explicitly assume that individual owners have agreed to guarantee the debts of the business. That is, simply as a matter of casual empiricism, when the supplier of nails to a local hardware store implicitly extends short-term credit by shipping the nails and then

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vicariously liable for the torts of their children in the absence of an employment relationship, joint enterprise or the like").

131. *Contra* Martin v. Peyton, 158 N.E. 77 (N.Y. 1927) (distinguishing debtors from partners).

132. *Contra* RESTATEMENT (THIRD) OF AGENCY § 7.07 cmt. a (AM. LAW INST. 2005) ("In a relationship of coagency, neither agent is the other's agent. Thus, neither is vicariously liable for wrongs committed by the other. Each coagent owes duties to the common principal. Coagency is a common phenomenon within organizations.").

133. *See id.*

134. *See id.*

135. DOBBS ET AL., *supra* note 92, § 435 (discussing the notion that respondeat superior is "merely a way of reaching the deep pockets of target defendants like large corporations").

136. *Cf.* DOBBS ET AL., *supra* note 92, § 425 (observing that tort liability is ordinarily based on fault).

137. For the classical assumptions, see generally Lewis, *supra* note 2.

sending a monthly invoice, the supplier probably has little awareness of the business form of the hardware store; if it has considered the question at all, it has probably already priced in the possibility of a default. Sophisticated lenders such as banks will review organizational documents and insist on sureties, if they are required, in any event. There is insufficient evidence in modern commercial law that contracting parties make specific assumptions about business forms, and the consequent liability, when contracting with businesses; modern business-entity law is too varied and too complex for such inquiries to be worthwhile in the ordinary case, and it is typically easier to make specific inquiries or simply to consider the risk of default in pricing supplies or credit.[138]

It seems, overall, that there is little specific justification for modern vicarious business liability—that is, for the rule that partners in general partnerships are liable for organizational debt. This is little surprise, having considered Section B *supra*, because modern law is at best ambivalent to vicarious business liability—which is evident from how easily modern law permits parties to avoid it simply by choosing an alternative business form.

D. Toward a Resolution of the Conundrum

In light of the incomplete justifications for vicarious business liability, the question becomes what to do about it. Unfortunately, this is at present an intractable problem with no clear solution. It would be theoretically simple to advocate for the removal of vicarious business liability from the modern law of general partnerships; this step would simplify and clarify the law. It would also be practically easy to make a focused modification to the partnership laws. For example, section 306 of the Revised Uniform Partnership Act could easily be amended to indicate that partners are not liable by default for the obligations of a general partnership.[139] Theoretical simplicity, however, is not the goal of the law, and the removal of vicarious liability would weaken the position of innocent tort victims in ways for which there is little modern social consensus.

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138. As an example of how difficult it is to make assumptions about entities under modern organizational law, see REVISED UNIF. LTD. LIAB. CO. ACT § 301 cmt. a (discussing removing "statutory apparent authority" from the act in view of third parties' difficulties in making assumptions about modern LLCs).

139. Recall that RUPA already does this in section 306 for limited liability partnerships. *See* RUPA § 306(c). The putative amendment would simply eliminate section 306(a) and replace it with language tracking that of section 306(c).

It is worth observing that though theoretical simplicity alone is not a proper goal for substantive modifications to the law, eliminating vicarious business liability would yield administrative advantages. For one thing, the formation of partnerships, as noted at the outset of this Article,[140] is one of the most frequently litigated questions in modern business law. Moreover, the notion of accidental partnerships raises a variety of questions for which the law has not provided clear answers. For example, the general case of what might be called "shadow partnerships" is troubling; consider the following pattern:

> *Shadow Partnership:* Clennam and Doyce agree to form an organization with one another to invest in real estate. They seek limited liability, so they set up an LLC. Over the next five years, they buy, sell, and rent a variety of properties. They also begin to fund and advise two friends, Edgar and Francina, in a novel hospitality business; their relationship with these two local entrepreneurs is informal, and it is unclear whether they have provided funding and advice as individuals or through the LLC. Are Clennam and Doyce partners with the other two parties?

Under modern partnership law, activities within another business organization clearly do not lead to the formation of a new partnership.[141] But there is little clear principle that separates one set of activities from another.[142]

Similarly, suppose that two LLPs informally enter into a joint venture; there is potential ambiguity under modern law as to whether one LLP's members have become partners in the other entity (or vice versa), whether the two LLPs are in a general partnership, and so on. These ambiguities, which of course may become significant if only one LLP's members directly cause injury to a third party, would not exist but for the need to recognize accidental partnerships for the purpose of vicarious business liability.[143] I say this not,

140. *See supra* note 1.

141. RUPA § 202(b) ("An association formed under a statute other than this [Act], a predecessor statute, or a comparable statute of another jurisdiction is not a partnership under this [Act].") (alteration in original).

142. *See* DONN ET AL., *supra* note 12 § 202 n.7 (2014–15 ed.) (suggesting that changes in the membership of a general partnership may result in a "new partnership," despite the modern entity theory).

143. For contractual purposes, principles of contract formation and interpretation can govern without special reference to partnership law, at least in theory. *See supra* Part II.

however, to advance the proposition that we should certainly eliminate vicarious business liability, only to provoke further consideration of this broad and potentially challenging topic.

In provoking further consideration, it may be helpful to outline several possible avenues for reform. In particular, it may be worth considering what appropriate protections for victims may replace a confused and potentially unjustified regime of vicarious business liability. Two possibilities are salient.

First, partnership statutes might eliminate vicarious liability but extend tort doctrines that concern joint action. In tort law, those participating in a drag race may be liable even if they are not the ones who individually cause injury; the negligence of their general course of conduct, coupled with a more general understanding of causation of harm, is sufficient for liability.[144] If theories of joint action in tort replace vicarious liability, the inquiry then focuses on (1) the wrongfulness of an individual party's conduct, and (2) the *fact*, rather than the legal-fictional presumption based on partnership status, of a jointly committed tort.

For example, on a properly broad application of principles of joint liability, a partner in a small shipping business who knows that her co-owner is likely to drive drunk could still be liable for assisting or contributing to a tort that results from the drunk driving. Similarly, an investor who knows that her investment will aid an ongoing nuisance could be liable for the nuisance under simple principles of joint activity. In these two examples, a partner is liable because of an appropriately broad conception of joint action, not merely because of status.

A second possible improvement is administrative. In exchange for eliminating vicarious business liability, we might require greater insurance or bonding requirements when companies are registered or, for example, when municipalities issue local business licenses. Requiring appropriate capitalization or insurance could address the problems of business liability beyond just general partnerships, of course. States routinely require licensing and insurance for businesses that raise predictable risks.[145] To summarize, it is not this Article's position that vicarious business liability should be eliminated—at least not without reconsidering other features of the law that affect the rights of those who are injured by wrongful conduct. But modern vicarious liability for general partnerships is, on its

144. *See* Restatement (Second) of Torts § 876 (Am. Law Inst. 1979).

145. *E.g.*, Fla. Stat. § 324.032(1)(a) (requiring insurance with "minimum limits of $125,000/250,000/50,000" for those who own and operate taxi and limousine services).

own, difficult to justify, and it is inconsistent with the rest of modern business-entity law.

CONCLUSION

The goal of this Article has been to examine several features of modern partnership-formation law that have been taken for granted, presumably as a result of inertia. Inertia, or the persistence of classical doctrine without challenge, often leads modern law to operate on axiomatic, non-functional grounds.[146] Occasionally, simply recognizing and challenging needless conceptualism is an important way by which law can improve.[147]

In the case of partnership-formation law, significant inertia has led to non-functional rules. Questions about the timing of formation often go unnoticed; the topic of "partnership formation," one of the most commonly litigated features of partnership law, is addressed too monolithically; and the "unlimited liability" of general partners is rarely explained in functional terms. This Article has reconsidered several of these problems, and it calls for greater discussion of the goals of partnership law under modern legal regimes—particularly the imposition of vicarious liability based on partnership status alone.

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146. *Cf.* Bayern, *supra* note 42, at 90–97 (discussing a similar problem in modern contract-formation law).

147. *See, e.g.*, Melvin Aron Eisenberg, *The Principle of* Hadley v. Baxendale, 80 CAL. L. REV. 563, 563 (1992) (critiquing the requirement that contract damages need to be foreseeable at the time of contract formation in order to be awarded—a classical principle that has been subject to surprisingly little criticism); L. L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages: Part I*, 46 YALE L. J. 52 (1936) (identifying reliance damages as an appropriate basis for recovery in contract law).