Fiduciary Duties and Limited Partnership Agreements

Larry E. Ribstein†

Abstract: *This article shows that the ULPA 2001's restrictions on contracting regarding fiduciary duties are seriously misguided because they are based on a fundamental misunderstanding of the special nature and functions of the limited partnership form. Even if restrictions on fiduciary duty waivers are appropriate in some contexts, they clearly are inappropriate in limited partnerships, which are designed for relatively sophisticated firms that frequently would want to limit general partners' fiduciary duties. Even if there are valid concerns about protecting limited partners from general partner misconduct, restrictions on waiver should be designed to balance the costs and benefits of waiver. This article shows that courts have managed to do this under UPA and under the more nuanced approach of Delaware law. By contrast, the heavy-handed approach of RUPA and ULPA 2001 precludes such balancing.*

TABLE OF CONTENTS

Fiduciary duties of general and limited partners in limited partnerships have generated a significant number of recent cases. The most important issue has been the relationship between the partners' default duties and detailed

† Corman Professor, University of Illinois College of Law. Prepared for the Suffolk Conference on Uniform Limited Partnership Act honoring Martin I. Lubaroff, Suffolk University Law School, Boston, Massachusetts, May 30, 2002. Comments by David Rosenberg are gratefully acknowledged.

provisions of the partnership agreement relating to partner duties. The law has developed under the 1916, 1976 and 1985 versions of the Uniform Limited Partnership Act (ULPA), which, in turn, apply the general fiduciary duty provision of the Uniform Partnership Act (UPA).[1] Many recent cases have been decided in Delaware under a statutory provision that explicitly makes the agreement controlling.[2]

The statutory law of limited partnerships has, however, been changing, beginning with the promulgation of the Revised Uniform Partnership Act (RUPA). That Act provides in more detail for general partners' duties[3] and,

---

1. The Uniform Partnership Act (UPA), Partner Accountable as a Fiduciary, provides in relevant part:

> Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

UNIF. P'SHIP ACT § 21(1) (1914).

2. Delaware law relating to limited partnerships provides in relevant part:

> (c) 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.
>
> (d) To the extent that, at law or in equity, a partner has duties (including fiduciary duties) and liabilities relating thereto to a limited partnership or to another partner or to another person that is a party to or is other bound by a partnership agreement, (1) any such partner or other person acting under the partnership agreement shall not be liable to the limited partnership or to any such other partner or to any other such person for the partner's or other person's good faith reliance on the provisions of such partnership agreement, and (2) the partner's duties and liabilities may be expanded or restricted by provisions in a partnership agreement.

DEL. CODE ANN. tit. 6, § 17-1101 (2002). *See generally* Larry E. Ribstein, *Unlimited Contracting in the Delaware Limited Partnership and its Implications for Corporate Law*, 16 J. CORP. L. 299 (1991).

3. The Revised Uniform Partnership Act provides:

> (a) The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (b) and (c).
>
> (b) A partner's duty of loyalty to the partnership and the other partners is limited to the following:
>
> (1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity;
>
> (2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and
>
> (3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.
>
> (c) A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.
>
> (d) A partner shall discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing.
>
> (e) A partner does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the partner's conduct furthers the partner's own interest.
>
> (f) A partner may lend money to and transact other business with the partnership, and as to each loan or transaction the rights and obligations of the partner are the same as those of a person who is not a partner, subject to other applicable law.
>
> (g) This section applies to a person winding up the partnership business as the personal or legal representative of the last surviving partner as if the person were a partner.

UNIF. P'SHIP ACT § 404 (1997).

more importantly restricts contracting over fiduciary duties.[4] RUPA has now been adopted in approximately half the states, virtually all of which include the limitations on contracting just noted.[5] RUPA necessitated revision of ULPA because of the latter's linkage with general partnership law. The result is the Uniform Limited Partnership Act (2001) (ULPA 2001). ULPA 2001 is a self-contained statute that does not rely on cross-references to the general partnership statute. Most importantly for present purposes, ULPA 2001 includes fiduciary duty provisions that are based on RUPA,[6] except that they clarify non-duties of limited partners, an issue that prior law did not address.[7] ULPA 2001 also includes a restriction on contracting similar to that in RUPA.[8]

---

4. The Revised Uniform Partnership Act provides in relevant part that:

[t]he partnership agreement may not. . .

(3) eliminate the duty of loyalty under Section 404(b) or 603(b)(3), but:

(i) the partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; or

(ii) all of the partners or a number or percentage specified in the partnership agreement may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty;

(4) unreasonably reduce the duty of care under Section 404(c) or 603(b)(3);

(5) eliminate the obligation of good faith and fair dealing under Section 404(d), but the partnership agreement may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable. . . .

UNIF. P'SHIP ACT § 103(b)(3)-(5) (1997).

5. The exceptions are Delaware and Virginia, with modifications in New Jersey.

6. The Uniform Limited Partnership Act (2001) establishes the standards for partner's conduct, which in relevant part provides:

(a) The only fiduciary duties that a general partner has to the limited partnership and the other partners are the duties of loyalty and care under subsections (b) and (c).

(b) A general partner's duty of loyalty to the limited partnership and the other partners is limited to the following:

(1) to account to the limited partnership and hold as trustee for it any property, profit, or benefit derived by the general partner in the conduct and winding up of the limited partnership's activities or derived from a use by the general partner of limited partnership property, including the appropriation of a limited partnership opportunity;

(2) to refrain from dealing with the limited partnership in the conduct or winding up of the limited partnership's activities as or on behalf of a party having an interest adverse to the limited partnership; and

(3) to refrain from competing with the limited partnership in the conduct or winding up of the limited partnership's activities.

(c) A general partner's duty of care to the limited partnership and the other partners in the conduct and winding up of the limited partnership's activities is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

(d) A general partner shall discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing.

(e) A general partner does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the general partner's conduct furthers the general partner's own interest.

UNIF. LTD. P'SHIP ACT § 408 (2001).

7. *See infra* note 135 and accompanying text.

8. The Uniform Limited Partnership Act (2001) provides in relevant part that:

(b) A partnership agreement may not: . . .

(5) eliminate the duty of loyalty under Section 408, but the partnership agreement may:

This article shows that the ULPA 2001's restrictions on contracting regarding fiduciary duties are seriously misguided, primarily because they misunderstand the special nature and functions of the limited partnership form. Two aspects of limited partnerships relate particularly to the costs and benefits of restricting waivers of fiduciary duties. First, unlike the general-purpose business forms of general partnership, close corporation, and limited liability company, which must be designed to accommodate relatively unsophisticated business people, the unique dual-level ownership structure of limited partnerships makes it obviously suitable only for specialized purposes.

Second, the special functions of limited partnerships make restricting fiduciary duty waivers particularly costly in this context. The general partners' personal liability and, more importantly, limited partners' passivity, make the limited partnership form unsuited in most cases for active management of ongoing businesses. Thus, limited partnerships are often used as vehicles for holding assets or portfolios of businesses that are managed through other business organization forms. Fiduciary duties based on management of ongoing businesses usually are inappropriate for firms that primarily hold assets, where the managers are expected to maintain multiple portfolios rather than to devote their efforts to a single firm. Fiduciary duties also may undermine the atmosphere of trust that is important in family limited partnerships.

In light of these considerations, waiver of fiduciary duties should be broadly permitted in limited partnerships. Even if there are valid concerns about protecting limited partners from general partner misconduct, restrictions on waiver should be designed to balance the costs and benefits of waiver. This article shows that courts have managed to do this under the permissive approaches of the UPA and Delaware law. By contrast, the heavy-handed approach of RUPA and ULPA 2001 precludes such balancing.

This article proceeds as follows. Part I provides a general theoretical overview of default fiduciary duties and waiver of those duties in limited partnerships. Part II shows how courts have balanced the costs and benefits of waiver under the permissive approaches of the UPA and Delaware law. Part III contrasts the effect of the broad prohibitions of RUPA and ULPA 2001. Part IV discusses broader issues concerning the role of uniform laws in the context

---

(A) identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; and

(B) specify the number or percentage of partners which may authorize or ratify, after full disclosure to all partners of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty;

(6) unreasonably reduce the duty of care under Section 408(c);

(7) eliminate the obligation of good faith and fair dealing under Sections 305(b) and 408(d), but the partnership agreement may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable.

UNIF. LTD. P'SHIP ACT § 110(b), 110(b)(5)-(7) (2001).

of the modern firm. Part V contains concluding remarks.

I. OVERVIEW OF LIMITED PARTNERSHIP FIDUCIARY DUTIES

This Part presents a general theory of fiduciary duties in limited partnerships. It begins in subpart A with general considerations relating to fiduciary duties, including their relationship with other limited partnership terms, the history of the limited partnership, the likely users of limited partnerships, and the general nature of fiduciary duties. Subpart B discusses default duties, while subpart C discusses waiver.

A. General Considerations

An important function of any standard business form is to provide a coherent set of rules that function together as an efficient default contract.[9] In other words, in crafting a particular term of the statute, lawmakers need to view the term in the context of other statutory terms. The nature of a default contract represented by a particular business form, in turn, is shaped by history and by the market for business forms.

1. The Limited Partnership Contract

The distinctive aspects of the limited partnership form traditionally have been its linkage with the general partnership form[10] except for the addition of limited partners, who have limited liability—that is, whose exposure to the firm's debts is generally limited to their investments in the firm. Thus, the limited partnership ownership structure combines actively managing and personally liable general partners with passive limited partners who have no default voting rights. Limited partners' passivity is reinforced by the so-called "control rule," which provides that limited partners are not liable for the limited partnership's obligations unless they "participate[] in the control of the business."[11] Unlike general partners, limited partners have no power to dissolve the firm at will,[12] but traditionally have had the power to cash out of the firm.[13]

---

9. *See generally* Larry E. Ribstein, *Statutory Forms for Closely Held Firms: Theories and Evidence from LLCs*, 73 WASH. U. L.Q. 369 (1995). It follows that it would be misguided to "rationalize" business entities so as to eliminate these distinct sets of rules. *See generally* Larry E. Ribstein, *Making Sense of Entity Rationalization*, 58 BUS. LAW. 1023 (2003).

10. *See* UNIF. LTD. P'SHIP ACT §1005 (1985) (providing that "[i]n any case not provided for in this [Act] the provisions of the Uniform Partnership Act govern"); UNIF. P'SHIP ACT § 6(2) (1914) (providing that "this act shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith"). *See generally* Larry E. Ribstein, *Linking Statutory Forms*, 58 LAW & CONTEMP. PROBS. 187 (Spring 1995).

11. UNIF. LTD. P'SHIP ACT § 303(a) (1985).

12. *Id.* § 801.

13. *Id.* §§ 603-604.

Limited partnerships are distinct not only from general partnerships, but also from the other dominant business forms. While corporations also have passive limited liability owners, corporate default rules do not provide for either ownership by or liability of directors or officers. Moreover, in contrast to the partnership-type default rules that apply to limited partnerships, corporate shareholders generally can freely transfer their interests, have default voting rights, and have no right or power to exit the firm by dissolving or withdrawal.

Limited liability companies (LLCs) resemble limited partnerships. Indeed, the first limited liability company statute, in Wyoming, was closely based on limited partnership law.[14] An important difference is that LLC statutes do not include a control rule, but rather generally provide for default management directly by the owners with an option for management by managers.[15] Also, although LLC statutes continue to borrow heavily from general and limited partnership law, and therefore have similar rules regarding transfer and dissociation, they are not formally linked to partnership law.

2. *History*

Limited partnerships began in the United States as a response to cases such as *Waugh v. Carver*,[16] holding that one who shared profits in a firm could be deemed to be a partner, at least for purposes of liability to third parties. Early nineteenth-century American statutes in New York (which ultimately provided the U.S. model), Connecticut, and Pennsylvania were based on the European "commenda," which dates back to the twelfth century, and was recognized in French statutory law in 1673.[17] In the commenda, a "commendator," the forerunner of the limited partner, invested capital in exchange for a profit share in a relationship that was distinct from credit (and therefore not subject to usury laws or prohibitions on engaging in trade), and without liability for losses.[18]

This brief history shows that the limited partnership from its origins was intended to fill a relatively small slot between outside credit, partner-like ownership, and incorporation. This slot was maintained both here and in Europe primarily by narrowly circumscribing limited partners' participation in the control of the business.

In the United States, the advent of general corporation laws in the late nineteenth century and widespread availability of the corporate form[19] added

---

14. *See generally* William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. COLO. L. REV. 855 (1995).

15. *See* LARRY E. RIBSTEIN & ROBERT KEATINGE, RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES app. 8-1, at 4-14 (2003) (summarizing statutes).

16. 2 H. Bl. 235, 126 Eng. Rep. 525 (1793).

17. *See* ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON PARTNERSHIP § 11.02(a) (West 2003).

18. *Id.*

19. *See generally* Henry N. Butler, *Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 J. LEGAL STUD. 129 (1985) (discussing move from special chartering by permission

another complication. Since corporate shareholders could have limited liability without restrictions on exercise of control, one would expect a loosening of restrictions on limited partners' control rights. Indeed, one of the two basic assumptions guiding the drafters of the Uniform Limited Partnership Act, promulgated in 1916, was that:

> [n]o public policy requires liability of one who provides capital to a business, acquires an interest in its profits, and has some degree of control if creditors have no reason to believe the person is liable for the debts of the business.[20]

However, the corporate tax was imposed around the same time as the promulgation of ULPA and the rise of general incorporation.[21] For decades, the limited partnership form reflected a tension between loosening restrictions on limited liability and a need to maintain a distinction between limited partnerships and corporations in order to protect the dual-level corporate tax. The tension formally ended in 1996 with the adoption of the "check the box" regulations, which generally permitted unincorporated organizations to choose whether to be taxed as partnerships or corporations.[22]

Some tax constraints remain. First, the Code provides that an "applicable restriction" on liquidation rights can be disregarded in valuing the interest for tax purposes.[23] Such a restriction is defined to exclude "any restriction imposed, or required to be imposed, by any Federal or State law";[24] that is, one that is more restrictive than the limitations that would apply under the State law generally applicable to the entity in absence of the restriction.[25] Thus, only *statutory* restrictions on partner withdrawal, and not those merely provided for in a limited partnership agreement, are effective to discount the value of the interest for estate tax purposes. This is especially significant for a family firm whose owner wants to transfer interests to family members without substantial estate or gift tax. The tax rule provides an incentive for eliminating limited partners' statutory default right to withdraw and receive payment for their interests: even if only a few firms want the discount, the restriction on withdrawal must be in the statute in order for any firms to take advantage of it, while firms whose members want the right to withdraw can draft around the

---

of state legislatures to general incorporation laws).

20. UNIF. LTD. P'SHIP ACT § 1 cmt. (1916), *at* 6 UNIF. LAWS ANN. 563-64 (1969).

21. The corporate tax was adopted in 1909, and upheld in 1911 against a constitutional challenge prior to the constitutional amendment that authorized the individual income tax. *See* Flint v. Stone Tracy Co., 220 U.S. 107, 162 (1911). Indeed, the institution of the corporate tax may be explained partly as a method of controlling the corporate form after it had been freed from state legislative control. *See* RICHARD B. GOODE, THE CORPORATE INCOME TAX 37 (1951) (quoting President Taft's speech introducing corporate tax law). *See generally* Larry E. Ribstein, *The Deregulation of Limited Liability and the Death of Partnership*, 70 WASH. U. L.Q. 417 (1992) (discussing effect of tax and regulatory restrictions on limited liability on partnership law development).

22. Treas. Reg. § 301.7701-1 to -3 (1996).

23. I.R.C. § 2704 (1994).

24. *Id.* § 2704(b)(3)(B).

25. Treas. Reg. § 25.2704-2(b) (1994).

restriction.

Second, the Code subjects to corporate tax treatment a "publicly traded partnership" (that is, whose interests are traded or "readily tradable") that has ninety percent or more "passive-type income," including interest, dividends, rents and income from sale of real property or natural resource production.[26] This eliminates a tax justification for choosing the limited partnership form for a publicly held partnership.

3. The Market for Limited Partnerships

The appropriate design of limited partnership fiduciary duties, like that of other standard form rules, depends on the types of firms that are likely to use the particular bundle of rules that comprise this business form. In other words, there is a two-sided relationship between a business form and the "clientele" of firms that use the form. Firms gravitate to a particular set of rules, and the rules adapt to suit these firms. The relationship is not completely circular, since history determines to some extent both whether firms will want particular rules and the nature of the rules legislatures will have made available. Moreover, as discussed in more detail below, firms may choose a particular business form not just because of its statutory rules, but also because of the case law concerning the form.

There are at least four features of limited partnership-type investments that are important in determining the scope and contractibility of fiduciary duties. First, the limited partnership form is suited for firms that buy, sell, hold, and distribute assets rather than running an ongoing business.[27] These firms notably include firms holding and exploiting natural resources and venture capital partnerships, which hold portfolios of start-up firms.[28] As an indication of this, tax data show that, as of fiscal year 2000, approximately eighty percent of limited partnerships were engaged in the "finance, insurance, real estate, rental and leasing" category, as compared with approximately fifty percent of limited liability companies and general partnerships.[29] This use is consistent with the main distinguishing feature of limited partnerships, the enforced passivity of the limited partners. An ongoing business that seeks to create going concern value must continually make decisions and shift strategies to keep pace with changing markets. This means that owners may benefit from continuously monitoring business decisions and occasionally replacing poorly

26. I.R.C. § 7704 (1994).

27. *See* Sonet v. Timber Co., 722 A.2d 319, 322 (Del. Ch. 1998) (noting limited partnerships "are especially prevalent in enterprises where a general partner (or a corporate subsidiary) is actively engaged in investing the limited partners' passive investments"). The assets may include other firms, as in the case of a venture capital limited partnership, where the ongoing management is at the level of the portfolio firm and the limited partnership is a holding company.

28. *See infra* note 59 and accompanying text (discussing holding companies in limited partnership form).

29. *See* Bill Pratt, *Partnership Returns*, *in* STATISTICS OF INCOME 50, at Table F (Fall 2002).

performing managers. By contrast, firms involved in asset management may be able adequately to constrain managers through covenants that restrict particular types of bad decisions that are known in advance.

Second, it is important to distinguish the limited partnership-type business from one where debt-type interests can be substituted for passive equity. Debt is practicable where the firm's assets are easy to value—as where they are shares of publicly traded firms—or are not likely to significantly fluctuate in value. In this situation, the equity stake need not be significant because the debt can be adequately secured by the value of the property without recourse to the managing owners' personal assets. By contrast, limited partners take more risk than typical creditors, though less than common shareholders.

Third, the combination of default restrictions on transferability of limited partnership interests and the corporate tax treatment of limited partnerships with publicly traded or tradable interests mean that most investments in limited partnerships will be purchased directly from the firm rather than in a secondary trading market. This focuses more investor attention on the specific language of the constitutive documents.

Fourth, limited partners' passivity means that their investments are likely to be "securities" for purposes of the application of federal and state securities laws whether or not they are publicly traded.[30] Even if these securities are subject to exemptions, the exemptions may require at least short-form disclosures, and the anti-fraud provisions of the securities laws will apply. These laws help ensure disclosure of important contract provisions, including fiduciary duty waivers.

An exception to the above aspects of the paradigm limited partnership is the family firm in which the manager or managers are the family elders and the passive owners are succeeding generations. These investors would not be expected to insist on powers of active management irrespective of the type of assets the firm holds.

An implication of the holding company nature of the typical limited partnership is that such a firm is unlikely to have significant debts to outside creditors. The firm will finance the purchase of its property with the limited partners' equity contributions without additional tort or contract liabilities. It follows that any general partners' personal liability probably will not be significant. Alternatively, the costs associated with general partners' personal liability can be viewed as an additional reason why limited partnerships are likely mainly to hold assets rather than to run ongoing businesses.

An implication of the risky nature of limited partnership assets is that the firm not only will find it difficult to finance its initial investments through non-recourse borrowing, but also cannot easily replace equity with debt on an ongoing basis. Thus, such firms would not want to commit to repurchasing

30. *See* BROMBERG & RIBSTEIN, *supra* note 17, § 12.14.

equity holders under circumstances where it might have to make untimely asset sales to fund the repurchases. It arguably follows that such firms should be publicly traded in order to provide both efficient market valuation of their assets and an exit mechanism to replace equity repurchases. However, as noted above, under current tax law, public trading would forfeit the advantage of single-level partnership taxation. This suggests a possible tax explanation for the survival of the limited partnership form in addition to the contractual explanation discussed below.

There is a question whether changes in limited partnership law have changed or will change the market for limited partnerships. Several states let limited partnerships form as limited liability partnerships and thereby limit the liability of general partners.[31] Moreover, general partners have been able to incorporate to obtain effective limited liability.[32] There have also been changes in the limited partnership "control" rule, which provides that limited partners are vicariously liable for the debts of the business if they participate in control.[33] The official version of the rule now imposes such liability only if the third party has detrimentally relied on the exercise of control, and then only if the control is not within a long list of acts that the statute provides do not constitute participating in control.[34] Some states,[35] and ULPA 2001,[36] have eliminated the rule.[37]

Why would the limited partnership continue to matter if parties can obtain similar features along with partnership-type taxation by forming as LLCs? Given the changes in the limited partnership standard form, the main distinct limited partnership feature is limited partners' default passivity. But a firm can obtain the same feature in every state by forming as an LLC and opting for centralized management.

One reason for the persistence of the limited partnership form is that there is now a body of limited partnership case law that explains and interprets the statutory rules providing for active management by general partners and limited partner passivity. For example, some cases define the agency power of general partners in light of the limited partners' passivity so that third parties bear a significant portion of the risk of general partner misappropriation in transactions involving limited partnership assets.[38] Not only is there little such

31. *See generally* ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON LLPS, RUPA AND ULPA ch. 5 (2003).

32. *See* Larry E. Ribstein, *An Applied Theory of Limited Partnership*, 37 EMORY L.J. 837, 868-71 (1988) (discussing incorporated general partners).

33. *See supra* note 11 and accompanying text.

34. *See* UNIF. LTD. P'SHIP ACT § 303 (1985).

35. *See* GA. CODE ANN. § 14-9-303 (West 2003); MO. REV. STAT. § 359.201 (2003).

36. UNIF. LTD. P'SHIP ACT § 303 (2001).

37. The elimination of the control rule is consistent with elimination of mandatory vicarious liability, since both align the interests of limited partnership managers with those of the creditors. *See* Larry E. Ribstein, *Limited Partnerships Revisited*, 67 U. CIN. L. REV. 953, 979 (1999).

38. *See, e.g.*, Anchor Ctr. Partners, Ltd. v. Mercantile Bank, 803 S.W.2d 23 (Mo. 1991); Green River

case law under the relatively new LLC form, but such cases may not apply to limited partnerships because of the more ambiguous power exercised by LLC managers, even in centrally managed firms.

More importantly for present purposes, there is a significant body of case law dealing with the fiduciary duties of general partners in limited partnerships, and specifically with waiver of such duties.[39] Indeed, one Delaware case noted that the waiver rule in Delaware is an important reason for selecting the Delaware limited partnership form.[40] Again, these cases take account of the special role of general partners in limited partnerships, and therefore are not fungible with cases involving LLC managers. Thus, the changes in the limited partnership form make fiduciary case law a main distinct attribute of the limited partnership.

4. The Nature of Fiduciary Duties

Fiduciary duties are a specific type of contractual term, namely a duty of unselfishness, that applies in the particular situation where one who controls and derives the residual benefit from property (i.e., the "principal") delegates open-ended management power to another person (i.e., the "agent").[41] In this situation, the agent has the incentive to use control to enrich herself rather than the principal.[42] One way to protect the principal is to subject the agent to a general "fiduciary" duty of unselfishness.

A broad duty of unselfishness may, however, be costly. In particular, the duty may deter the agent from exercising its discretion, and thereby defeat the principal's main objective in hiring the agent. It follows that fiduciary duties should be reserved for situations where their benefits outweigh their costs, taking into account the availability of lower-cost constraints on agents' conflicts of interest. For example, the agent's task may be sufficiently definite, and possible misconduct sufficiently foreseeable, that the agent can be adequately constrained by specific covenants rather than an open-ended duty of unselfishness.

The strong fiduciary duty of unselfishness contrasts with weaker or narrower

---

Assoc. v. Mark Twain Kan. City Bank, 808 S.W.2d 894 (Mo. App. 1991).

39. *See infra* Part II.

40. *See infra* text accompanying note 109.

41. *See* Bond Purchase, L.L.C. v. Patriot Tax Credit Props., L.P., C.A. No. 16643, 1999 WL 596275, at *18 (Del. Ch. July 23, 1999) (stating "a fiduciary is typically one who is entrusted with the power to manage and control the property of another"). *See generally* Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983); Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. Rev. 1045 (1991); Larry E. Ribstein, *The Structure of the Fiduciary Relationship*, U. ILL. LAW & ECON. W.P. No. LE 03-003 (Jan. 4, 2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=397641; J.C. Shepherd, *Towards a Unified Concept of Fiduciary Relationships*, 97 LAW Q. REV. 51 (1981) (receipt of power conditioned on duty to use power in another's best interests).

42. *See generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

duties in other types of relationships, such as that between doctor and patient.[43] In particular, fiduciary duties should be distinguished from the general contractual obligation of "good faith." This obligation is really just one that arises from a generous interpretation of the explicit terms of long-term contracts with a view to their overall structure and intent. One court described this process as follows:

> If in each contract the parties had to expressly describe and prohibit every artifice by which the parties could potentially deprive each other of the fruits of their agreement, then contracts would soon become as long as the tax code, as difficult to interpret, and (like the tax code) still contain innumerable loopholes available to a party that wished to avoid the spirit of its bargain. The better approach . . . is to treat a contract for what it is—an exchange of solemn promises—and enforce the objectively reasonable expectations of the parties. The transaction in question here is an artifice intended to thwart plaintiff's legitimate contractual expectation that it would have a right of first refusal before the partnership interest owned by CRCO could be transferred to someone outside the Cellular family of companies. As such, the Purchase Agreement violates the covenant of good faith and fair dealing that Oregon law implies in every contract. . . . [T]he doctrine of good faith is not a new material term created by the court, but rather a term implied by law in every contract to give effect to the legitimate expectations of the parties that were created by the language of their contract.[44]

Fiduciary and good faith duties, however, may blur at the margins.[45] For example, the parties to a business association agree to a particular arrangement for sharing the firm's property, such as equally in a general partnership.[46] Good faith is a way to interpret these provisions of the parties' contract. Fiduciary duties, on the other hand, impose an additional obligation to act unselfishly even beyond this sharing obligation. But the difference between the two duties diminishes on closer examination. Assuming fiduciary duties can be waived, the contract is obviously relevant to the existence of the duties. Even if courts view fiduciary duties as mandatory, the application of these duties to a particular firm necessarily depends on context, including the other provisions of the agreement.[47]

---

43. For example, the Supreme Court has held that a doctor's duty of care does not make her a fiduciary, noting that a contrary result "entails erroneous corruption of fiduciary obligation." *See* Pegram v. Herdrich, 530 U.S. 211, 233-34 (2000).

44. Or. R.S.A. No. 6, Inc. v. Castle Rock Cellular of Or. L.P., 840 F. Supp. 770, 776-78 (D. Or. 1993).

45. *See generally* Claire Moore Dickerson, *From Behind the Looking Glass: Good Faith, Fiduciary Duty and Permitted Harm*, 22 FLA. ST. U. L. REV. 955 (1995); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993).

46. *See* UNIF. P'SHIP ACT § 18(a) (1914); UNIF. P'SHIP ACT § 401(a) (1997).

47. *See* Lawrence v. Cohn, 197 F. Supp. 2d 16 (S.D.N.Y. 2002) (holding under New York law, including *Meinhard v. Salmon*, fiduciary duties depend on the context of the relationship and that, in the instant case, any duty partner had to offer limited partnership interests to other partners was subject to maintaining the parties' relative control positions in the partnership), *aff'd*, 325 F.3d 141 (2d Cir. 2003) .

B. Default Duties in Limited Partnerships

The fiduciary duties of loyalty and care apply in the specific context of an agent's management of the principal's property. It arguably should follow that *limited* partners, having no default management responsibilities, should have no default fiduciary duties, although they might take on such duties by judicial rule if and to the extent that they become managers of the partnership,[48] or in any other situation by agreement.[49] Perhaps the default rule in limited partnerships should impose such duties along with the undertaking of management responsibilities. The problem with such a rule is that there are gradations in management responsibilities. However, this would force more firms to waive fiduciary duties, which may be a problem if the law restricts waiver. Alternatively, the default rule might impose duties on all limited partners in light of the erosion of the control rule and increasing management role of limited partners, subject to contrary provision in the partnership agreement. The problem is that, if waiver of fiduciary duties is constrained, it may be more difficult to waive than to add duties.[50]

The *general* partners in limited partnerships would seem to have duties similar to those of general partners in limited partnerships. However, the limited partners' passivity requires an important distinction between limited and general partnerships regarding fiduciary duties. In a general partnership, the owners' personal liability encourages them to be active in the business. That is certainly the case in the relatively small firm for which general partnership default rules are designed, featuring co-equal management rights and profit-sharing. By contrast, general partners in a limited partnership manage on behalf of passive limited liability owners, so that fiduciary duties may play a larger role than direct participation in management in constraining conflicts.

It is important to emphasize that the difference between the two types of business entities does *not* lie in the presence or absence of conflicts of interests. In both types of firms there may be significant conflicts of interests between managing and non-managing owners. However, fiduciary duties theoretically are more important in constraining these conflicts in limited than in general partnerships because of reduced owner voting rights in the former context.[51]

The general partners' personal liability arguably affects their duty of care. The risk of personal liability constrains carelessness that might reduce the value

48. *See infra* note 73 and accompanying text.

49. *See infra* note 99 and accompanying text.

50. *See infra* Part I.C.

51. Moreover, the conflicts between owners with limited and with personal liability could make governance contentious and therefore costly if limited liability owners had strong voting rights. This may be one explanation for the control rule. On the other hand, limited partnerships' tendency to own portfolios of assets rather than manage active businesses minimizes the risk of liabilities exceeding assets, and thereby also this potential conflict.

of the firm as a whole and leave the general partners' personal assets vulnerable to creditors' claims. In the absence of such liability, the reduced voting rights of limited partners as compared to corporate shareholders might justify a somewhat stricter duty.

The importance of fiduciary duties in addressing conflicts of interest is increased by the recent trend toward eliminating limited partners' exit rights. Limited partners' inability to respond to self-interested management by cashing out of the firm arguably increases the need to deter self-interested conduct with strong fiduciary duties.

C. Waiver

Default limited partnership fiduciary duties are designed based on the other limited partnership default rules, notably including the passivity of the limited partners. The following discussion will first examine the waiver issue in the context of partnerships generally and then turn to the specific context of limited partnerships.[52]

Some commentators argue for restrictions on waiving fiduciary duties in partnerships.[53] In assessing these arguments, it is important to distinguish considerations that apply to enforcement of waivers from those relevant to designing default fiduciary duties. Although fiduciary duties may be appropriate to protect non-managing from managing partners,[54] it does not necessarily follow that partnerships should be unable to contract around fiduciary duties in this situation.

While default fiduciary duties arise out of the structure of the parties' relationship, rules on waiver look at least in part at the identity and circumstances of the contracting parties. Commentators have argued that partners have difficulty foreseeing the risk of bad fiduciary conduct that waivers might facilitate,[55] that contracting parties may suffer from judgment errors that would cause them to treat the risks of fiduciary duty waivers too lightly,[56] and that parties to long-term contracts may be reluctant to bargain aggressively at the outset of their relationships.[57]

These arguments suffer from two general problems. First, it is not clear why

---

52. *See generally* Larry E. Ribstein, *Fiduciary Duty Contracts In Unincorporated Firms*, 54 WASH. & LEE L. REV. 537 (1997) (discussing arguments supporting wavier in partnerships); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990) (outlining arguments supporting waiver in context of publicly-held corporations).

53. *See* Dickerson, *supra* note 45; Allen Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B.U. L. REV. 523 (1993).

54. *See generally* Dickerson, *supra* note 45; Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983).

55. *See* Dickerson, *supra* note 45; Frankel, *supra* note 54.

56. *See generally* Melvin A. Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211 (1995).

57. *See* WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE (8th ed. 2002).

fiduciary duty waivers in firms should be distinguished from other types of contracts in which the parties may have judgment errors or limited foresight. In other words, why is the general rule on unconscionable contracts not enough to deal with these problems? Second, it is not clear why the problems associated with fiduciary waivers would not apply equally to other partnership terms. Assuming they do, restricting fiduciary duty waivers may be ineffective or counter-productive, since supposedly dominant parties could achieve their purposes by other means, such as by raising the price of their services, contracting for another state's law, or contracting as a non-fiduciary.[58]

The real problem may be foreseeing the effects of fiduciary duty waivers. To be sure, foresight is a problem in writing any part of a long-term contract. But liberal construction in light of the general good faith obligation normally is enough to deal with unexpected issues that arise regarding specific terms. However, this sort of fix is inherently unavailable for fiduciary duties, where general delegation of discretion must replace specific terms. Fiduciary duty waivers therefore involve a special risk of unforeseeable costs that is not raised regarding other types of contract terms.

This is not, however, a complete justification for restricting fiduciary duty waivers. The problem is that the costs of *waivers* are as difficult to foresee as those of *fiduciary duties*. The latter include constraining the fiduciary's exercise of discretion, and the distrust that may arise from giving investors broad power to sue their agents.[59]

Even if restricting fiduciary duty waivers is justified in general partnerships, the arguments are weaker for limited partnerships. Although this might seem to be inconsistent with the above arguments for stronger *default* fiduciary duties in this context, it is important to keep in mind the difference between the issues regarding default duties and those regarding waiver. Permitting waivers also seems not to square with the fact that limited partnership interests often are marketed like corporate stock—without bargaining to passive investors. But it is important to take account of the market for limited partnerships, which indicates that limited partnership investors may be less vulnerable than corporate shareholders.

Three features of the limited partnership form cut in favor of permitting waivers. First, the specialized nature of the limited partnership form is likely to prevent its use by those who most need to be protected from the consequences of their bargains. As discussed above, the mandatory passivity of limited partners and the traditional personal liability of general partners make the limited partnership form suited for only particular uses. Tax considerations suggest that limited partnership interests will not be publicly traded, and therefore will not appear in the guise of the standard corporate investment.[60]

58. *See* Easterbrook & Fischel, *supra* note 45.

59. *See generally* Larry E. Ribstein, *Law v. Trust*, 81 B.U. L. REV. 553 (2001).

60. Publicly traded firms theoretically might use the limited partnership form even without the partnership

Thus, the limited partnership form itself serves as a caution flag that should induce users to get legal advice, and that reduces the justification for protecting those who do not do so.[61] By contrast, close corporations, general partnerships, and LLCs, because of their ready adaptability to a variety of uses, can be viewed as "default" business forms that are likely to be used by small businesses, often with minimal planning and possibly without sophisticated legal advice.[62]

Second, default fiduciary duties may not be cost-effective for many firms that are likely to use the limited partnership form, thereby increasing the benefits of permitting waiver of these duties. As discussed above, many limited partnerships are likely to engage in passive holding of assets rather than active management of ongoing businesses. This type of business lends itself to part-time or short-term management, where syndicators attract investors for multiple portfolios either simultaneously or over time rather than managing a single firm for a long period. In this situation, the managers may need to allocate assets to various portfolios, and therefore would not want to owe duties exclusively to a single entity.[63] Moreover, the benefit of fiduciary duties is reduced by syndicators' need to maintain a reputation for fair dealing in order to raise money from new investors in successive portfolios.[64] Venture capital limited partnerships are a particularly important context for multiple syndicator investments, producing both costs of strong fiduciary duties and reputational incentives mitigating the need for such duties. In family limited partnerships, fiduciary duties may be particularly costly because the threat of litigation can undermine trust among family members.[65] At the same time, these bonds of trust arguably make fiduciary duties less beneficial than they are among strangers in more arms-length business contexts.

---

tax advantage in order to get greater contracting flexibility. The argument for waiver would then have to rest on the costs and benefits of restricting waiver in the public firm context. *See* Ribstein, *supra* note 2.

61. The caution may be reinforced by the application in this context of the federal securities laws, in contrast to general partnerships and manager-managed LLCs in which the owners actively participate in management. *See supra* note 30 and accompanying text. This protection arguably substitutes to some extent for state law restrictions on waiver. To be sure, this does not distinguish limited partnership interests from corporate securities. But the argument for permitting waiver builds on the combination of the caution inherent in the limited partnership form and the federal duty to disclose salient features of the contract, including fiduciary duty waivers.

62. It is not clear that fiduciary duty waivers should be unenforceable even in these firms, since waivers are unlikely to arise in a genuinely "default" situation.

63. *See* Labovitz v. Dolan, 545 N.E.2d 304, 313 (Ill. App. Ct. 1989).

64. *See* David Rosenberg, *The Two "Cycles" of Venture Capital*, 28 J. CORP. L. 419 (2003). For general discussions of the structure of venture capital limited partnerships, generally see Paul Gompers & Josh Lerner, *The Use of Covevants: An Empirical Analysis of Venture Partnership Agreements*, 29 J.L. & ECON. 463 (1996); David Rosenberg, *Venture Capital Limited Partnerships: A Study in Freedom of Contract*, 2002 COLUM. BUS. L. REV. 363; William Sahlman, *The Structure and Governance of Venture-Capital Organizations*, 27 J. FIN. ECON. 473 (1990). For a discussion of the related problem of constraining fiduciary duties owed by venture capital directors on boards of portfolio companies, see Terence Woolf, *The Venture Capitalist's Corporate Opportunity Problem*, 2001 COLUM. BUS. L. REV. 473.

65. *See* Ribstein, *supra* note 59.

Third, limited partnership investments differ from corporate stock in the important respect that they are unlikely to be publicly traded.[66] As noted above,[67] this helps ensure that limited partners will be directly exposed to, if not actually sign, the partnership agreement, rather than being only constructively aware of it as with secondary market trading. On the other hand, a public market for limited partnership interests can be expected to efficiently discount the effect of a waiver into stock price.

At least some of the above circumstances might support an alternative approach of relatively weak default fiduciary duties, recognizing that the parties can always draft for stricter duties when appropriate. This might cause problems in the relatively few cases where the limited partnership form is used by non-family firms that actively manage businesses, and where the parties do not engage in extensive planning. On the other hand, weak default duties may be appropriate if legal rules restrict waiver. In other words, the costs and benefits of restricting waiver must be determined in light of the implications of such restrictions for the design of default rules.

The above discussion suggests that, particularly in limited partnerships, restricting waiver of fiduciary duties involves uncertain benefits and potentially significant costs. Thus, broadly permitting fiduciary duty waivers, and relying on reputational and other constraints on agents' conduct, may be justified in this context. Even if lawmakers conclude that some constraints on waivers are cost-justified, it is particularly important in the limited partnership context to balance the costs and benefits of restricting waiver of fiduciary duties. As discussed in the next Part, the prevailing approaches to fiduciary duty waivers under the UPA, and more explicitly codified in Delaware, take this middle ground approach. By contrast, RUPA and ULPA 2001 reject the middle ground and are likely to impose costly constraints on limited partnership agreements.

II. LEGAL BACKGROUND

ULPA 2001 is best understood against the background of the statutory law of limited partnerships that underlies most of the cases. Approximately half the states still have the Uniform Partnership Act (1914), the fiduciary provisions of which apply to limited partnerships under all previous versions of the Uniform Limited Partnership Act. Subpart A discusses the UPA and the cases decided under this law. Subpart B discusses Delaware law, which significantly clarifies the enforceability of waivers. This Part shows that both of these approaches facilitate a nuanced approach that balances the costs and benefits of waiving fiduciary duties. The next Part discusses the waiver provisions in ULPA 2001

66. *See supra* text accompanying note 26.
67. *See supra* text accompanying note 30.

and RUPA.[68]

A. UPA

1. Default Duties

Section 21 of the Uniform Partnership Act provides:

> (1) Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

The courts have held that this provision embraces duties of *general* partners to refrain from self-dealing, appropriating partnership assets and opportunities, competing with the partnership, and mismanaging in both general and limited partnerships.[69] Courts have interpreted the mismanagement duty, or duty of care, in the limited partnership context by analogizing general partners to corporate directors and applying the business judgment rule.[70] This arguably makes available the vast range of corporate business judgment rule cases. This analogy is at least roughly appropriate given the shareholder-like passivity of limited partners.

These duties technically apply to *limited* partners, whom RULPA defines as "partners."[71] However, consistent with the policy considerations discussed above, the courts have held that, given their absence of power and control, limited partners do not, as such, have fiduciary duties.[72] On the other hand, a limited partner who takes part in control may be subject to fiduciary duties.[73]

---

68. Unlike the UPA, RUPA has no provision for application to limited partnerships. Thus, any linkage would come by virtue of limited partnership act. *See supra* note 10. Some states that have adopted RUPA may not be clear as to whether the limited partnership statute links with the state's version of UPA or of RUPA. *See* BROMBERG & RIBSTEIN, *supra* note 17, § 1.04(f).

69. *See* BROMBERG & RIBSTEIN, *supra* note 17, §§ 6.07(b)-(f), 16.07(b)-(f).

70. *See generally* Wyler v. Feuer, 85 Cal. App. 3d 392 (1979); Trs. of Gen. Elec. Pension Trust v. Levenson, Civ. A. No. 12,014, 1992 WL 41820 (Del. Ch. Mar. 3, 1992). The Texas Revised Partnership Act applies an ordinary care standard subject to a business judgment rule taken from corporation law. TEX. REV. CIV. STAT. ANN. art. 6132b, § 4.04(c)-(d) (2003).

71. *See* UNIF. LTD. P'SHIP ACT § 101(8) (1985).

72. *See* BROMBERG & RIBSTEIN, *supra* note 17, § 16.07(a)(1); *see also* Bond Purchase, L.L.C. v. Patriot Tax Credit Props., L.P., C.A. No. 16643, 1999 WL 596275 (Del. Ch., July 23, 1999) (minority holders of beneficial interests that were equivalent to limited partnership interests had no fiduciary duty in making mini-tender offer for 4.9 percent of the beneficial interests). *See generally In re* Villa W. Assocs., 146 F.3d 798 (10th Cir. 1998) (holding under Kansas law no fiduciary duty in absence of evidence showing that partners held positions of confidence with, or exercised control over, partnership); Tupper v. Kroc, 494 P.2d 1275 (Nev. 1972) (no duty to justify price paid for interest at public sale pursuant to charging order); Skolny v. Richter, 124 N.Y.S. 152 (App. Div. 1910) (holding that limited partner does not breach fiduciary duty by becoming limited partner in another firm engaged in same business and within same community); Crawford v. Ancira, No. 04-96-00078-CV, 1997 WL 214835 (Tex. App. Apr. 30, 1997) (no fiduciary duty in selling to another limited partner).

73. *See* S. Atl. Ltd. P'ship of Tenn., L.P. v. Riese, 284 F.3d 518 (4th Cir. 2002); RJ Assoc., Inc. v. Health

Also, even without management responsibility, a limited partner has a duty not to use partnership information to compete with the partnership,[74] and may be subject to fiduciary duties under the partnership agreement.[75]

2. *Waiver*

The Uniform Partnership Act does not explicitly restrict waiving fiduciary duties. Rather, it restricts only partner profits from partnership-related transactions "without the consent of the other partners." This appears to contemplate general consent to categories of transactions as well as consent to particular transactions. Thus, courts have held that limited partnership agreements validly can authorize general partner self-dealing.[76]

To be sure, there is some ambiguity concerning the enforceability of fiduciary duty waivers in this context. Much of this ambiguity comes from cases in which the partners had broadly authorized the general partners to take certain actions without explicitly waiving fiduciary duties.[77] The courts sensibly have held that such authorizations, standing alone, do not amount to fiduciary duty waivers.[78] One of these cases deserves special note because it

---

Payors' Org. Ltd. P'ship, Inc., C.A. No. 16873, 1999 WL 550350 (Del. Ch. July 16, 1999); James River-Pennington Inc. v. CRSS Capital, Inc., C.A. No. 13870, 1995 WL 106554 (Del. Ch. Mar. 6, 1995); Goldwasser v. Geller, 684 N.Y.S.2d 210 (App. Div. 1999); *see also* K.E. Prop. Mgmt. v. 275 Madison Mgmt. Corp., Civ. A. No. 12683, 1993 WL 285900 (Del. Ch. July 27, 1993) (holding limited partners who have discretion under partnership agreement may have fiduciary duty, but no such discretion in this case because agreement permitted removal of general partner by limited partners only upon general partner's fraud or willful conduct injurious to the partnership).

74. *See* Tri-Growth Ctr. City, Ltd. v. Silldorf, Burdman, Duignan & Eisenberg, 216 Cal. App. 3d 1139 (1989) (breach of fiduciary duty for limited partner (who was a member of law firm which had represented other partnerships formed by plaintiffs) to bid on property in competition with partnership).

75. *See infra* note 99 and accompanying text.

76. *See* LID Assocs. v. Dolan, 756 N.E.2d 866 (Ill. App. Ct. 2001) (applying provision that authorized general partner's affiliate to reap gains on loans to the partnership); Jerman v. O'Leary, 701 P.2d 1205 (Ariz. Ct. App. 1985) (permitting general partner to acquire property from partnership but holding that he breached fiduciary duty by failing properly to disclose its below-market acquisition cost); Riviera Cong. Assocs. v. Yassky, 223 N.E.2d 876 (N.Y. 1966) (holding that statement of purpose in limited partnership prospectus precluded summary judgment for plaintiff on claim that general partners breached fiduciary duty by leasing the partnership motel to their own companies).

77. *See* Ribstein, *supra* note 52, at 578-81 (discussing this and other interpretation issues in the application of fiduciary duty waivers in partnerships).

78. *See* Time Warner Entm't Co., L.P. v. Six Flags Over Ga., L.L.C., 537 S.E.2d 397 (Ga. Ct. App. 2000) (holding that general partner breached duty by underinvesting in capital improvements for amusement park in order to depress its value, although investments exceeded minimum capital improvements required by the partnership agreement); Labovitz v. Dolan, 545 N.E.2d 304 (Ill. App. Ct. 1989) (holding that although general partner had "sole discretion" under partnership agreement concerning cash distributions to limited partners, he breached fiduciary duty by limiting distributions to force sellout by limited partners who had to pay taxes on partnership's earnings); Palmisano v. Mascaro, 611 So. 2d 632 (La. Ct. App. 1992) (holding that partner had fiduciary duty under agreement providing that general partner shall not be liable for acts within the scope of his authority unless the acts are misfeasance or malfeasance and authorized him to sell partnership property on such terms as he in his sole and uncontrolled discretion shall deem necessary, advisable, or proper, but which also required the partner to act as a fiduciary and prudent administrator); Knopke v. Knopke, 837 S.W.2d 907 (Mo. Ct. App. 1992) (holding that general partners having "unqualified authority" to make all decisions relating

was the sole authority for restricting waivers cited in the Comment to RUPA Section 103, which is discussed in the next section. The Comment to section 103 provides in part:

> There has always been a tension regarding the extent to which a partner's fiduciary duty of loyalty can be varied by agreement, as contrasted with the other partners' consent to a particular and known breach of duty. On the one hand, courts have been loathe to enforce agreements broadly "waiving" in advance a partner's fiduciary duty of loyalty, especially where there is unequal bargaining power, information, or sophistication. For this reason, a very broad provision in a partnership agreement in effect negating any duty of loyalty, such as a provision giving a managing partner complete discretion to manage the business with no liability except for acts and omissions that constitute willful misconduct, will not likely be enforced. *See, e.g.*, Labovitz v. Dolan, 189 Ill. App. 3d 403, 136 Ill. Dec. 780, 545 N.E.2d 304 (1989). On the other hand, it is clear that the remaining partners can "consent" to a particular conflicting interest transaction or other breach of duty, after the fact, provided there is full disclosure.

Although the Comment characterizes *Labovitz* as holding that fiduciary duty waivers would not be enforced, this is an overstatement since the agreement in *Labovitz* contained no such waiver. However, the case does create some uncertainty with its broad dictum:

> It is also clear, however, that despite having such broad discretion, Dolan still owed his limited partners a fiduciary duty, which necessarily encompasses the duty of exercising good faith, honesty, and fairness in his dealings with them and the funds of the partnership. . . . It is no answer to the claim that plaintiffs make in this case that partners have the right to establish among themselves their rights, duties and obligations, as though the exercise of that right releases, waives or delimits somehow, the high fiduciary duty owed to them by the general partner—a gloss we do not find anywhere in our law. On the contrary, the fiduciary duty exists concurrently with the obligations set forth in the partnership agreement whether or not expressed therein. Indeed, at least one of the authorities relied upon by defendants is clear that although "partners are free to vary many aspects of their relationship inter se, . . . they are not free to destroy its fiduciary character.

But *Labovitz*' holding is much more narrowly limited to the freezeout situation involved in the case:

> Our courts are not bound to endow it as doctrine that where the general partner obtains an agreement from his limited partner investors that he is to be the sole arbiter with respect to the flow that the cash of the enterprise takes, and thereby

---

to the financial affairs of the partnership were subject to fiduciary obligation to deal prudently and honestly with the partnership and other partners in investing partnership fund); Fate v. Owens, 27 P.3d 990 (N.M. Ct. App. 2001) (interpreting partnership agreement vesting exclusive management in the general partners and not addressing issues of self-dealing or conflict of interest as subject to general fiduciary duties not specifically addressed by agreement).

> creates conditions favorable to his decision that the business is too good for them and contrives to appropriate it to himself, the articles of partnership constitute an impervious armor against any attack on the transaction short of actual fraud. That is not and cannot be the law. . . . And that is precisely the gravamen of plaintiffs' complaint: that the general partner refused unreasonably to distribute cash and thereby forced plaintiffs to continually dip into their own resources in order to pay heavy taxes on large earnings in a calculated effort to force them to sell their interests to an entity which Dolan owned and controlled at a price well below at least the book value of those interests. Such a claim plainly presents an issue for the finder of fact, namely, whether or not Dolan was serving his own interests or those of the partnership. Although defendants state in their brief that Dolan allocated the partnership's funds to meet its needs and to serve its purposes, and although in oral argument defendants represented that the partnership was continually short of cash, the record at this stage is totally devoid of any such evidence. To be sure, all of the allegations made by plaintiffs in their complaint and noted above stand, according to the record made in this case, as unrebutted, undenied, unexplained and uncontroverted.

Labovitz' limitation to the squeezeout scenario was explicitly noted in *Adler v. William Blair & Co.*[79]

The enforceability of fiduciary duty waivers was confirmed in the later Illinois case of *LID Associates v. Dolan*.[80] In that case, which involved the same general partner as in *Labovitz*, the agreement went beyond merely giving the general partner broad authority to manage the partnership business to include the following provisions:

> [T]he General Partners, on behalf of the Partnership and in their sole discretion, may deal in any manner directly or indirectly with any General Partner or any Limited Partner or any affiliate or firm in which any partner is directly or indirectly interested and may pay any such person fees or compensation *without limitation for any efforts or commitments in connection* with the development, financing, supervision and management of the Partnership or Partnership property or the acquisition thereof, *and neither the Partnership nor any other partner shall have any rights in or to any such fees or compensation* to any such person.
>
> Anything contained in this Agreement to the contrary notwithstanding, any dealings or contracts with, and any payments, fees or compensation paid directly or indirectly, to any partner or affiliate of a partner shall be on terms no less favorable to the Partnership than would be available from unaffiliated third parties for comparable services, property or materials.

The court held that the trial court committed reversible error requiring a new trial when it admitted expert testimony to the effect that the general partner was

79. 607 N.E.2d 194 (Ill. 1992), *reconsidered on other grounds*, 613 N.E.2d 1264 (Ill. 1993).
80. 756 N.E.2d 866 (Ill. App. Ct. 2001).

required to have his affiliates loan money to the partnership their cost of borrowing despite the above provisions. The court noted that these opinions:

> differed from the circuit court's instructions to the jury, which stated that, under Illinois law, "partners are free to vary many aspects of their relationship" as long as they do not "destroy its fiduciary character" and "where a partnership agreement exists and the agreement specifically sets forth what the fiduciary is required to do or not to do with respect to a matter, the terms of the partnership agreement should be considered" in determining whether the fiduciary breached his duty. Weitzman and Strobeck advocated a standard of fiduciary conduct that disregarded the Partnership Agreement by requiring that a general partner loan money to the partnership at his own or his affiliates' cost of bank borrowing, regardless of what the Partnership Agreement states. No Illinois authority is cited or found which supports such an obligation.
>
> . . .
>
> Under Illinois law, a general partner will not be deemed in breach of his fiduciary duties where he has complied with an express authorization in the partnership agreement. Alder v. William Blair & Co., 271 Ill. App. 3d 117, 131-32, 648 N.E.2d 226 (1995) . . . . Plaintiff's assertion, without citation to authority, that Dolan and his affiliates should have extended to them the use of below-market-rate funds that were otherwise unavailable to the Partnership without charge, is without basis in the law.

Even clear fiduciary duty waivers do not necessarily cover all potential fiduciary breaches. Courts understandably hold that conduct outside the waiver is covered by default fiduciary duties. Thus, *Tri-Growth Centre City, Ltd. v. Silldorf, Burdman, Duignan & Eisenberg*[81] held that a contract authorizing the partners to compete with the partnership did not permit a partner-attorney to misuse the partnership's confidential information to cheaply obtain the partnership's property. Along the same lines, a court interpreted a contractual provision clearly recognizing the partners' fiduciary duties as not overriding a waiver of fiduciary duties in the same clause as to conduct that was within the waiver.[82]

---

81. 265 Cal. Rptr. 330 (Ct. App. 1989).

82. *See* Fulcrum Fin. Partners v. Meridian Leasing Corp., 230 F.3d 1004, 1013-14 (7th Cir. 2000) (applying Georgia law). The agreement provided that:

> no Partner shall be liable or accountable to the Partnership or any other Partner for failure to disclose or make available to the Partnership any business opportunity that such Partner becomes aware of in such Partner's capacity as a Partner or otherwise. Notwithstanding the foregoing, nothing contained herein shall in any way relieve any Partner of liability for any breach of its fiduciary duties to the Partnership.

The court reasoned that:

> [o]n the one hand, it allows the parties to compete among themselves, but on the other hand, to the extent that fiduciary duties unrelated to business opportunities might be triggered, those duties remain enforceable. This is just a way of allowing the specific language of the paragraph to limit the general reservation of rights at the end, which is the approach we believe a Georgia court would take.

In the most difficult category of cases, courts have held that even clear fiduciary waivers do not extend to particular conduct, sometimes adding dictum that the agreement cannot eliminate fiduciary duties. In all of these cases, the agreement contained a provision authorizing part-time managers to engage in other businesses even if this business competed with the partnership. As discussed above, this sort of provision would be expected in the typical limited partnership, which manages a portfolio of assets rather than running an ongoing business. However, in each case, a partner seized on the provision not merely to engage in a different business, but to undercut the other partners and take over the business of the firm the partnership was supposed to be managing. This is similar to the freezeout condemned in *Labovitz*, except that even clear waivers of the duty not to compete did not authorize the conduct. The courts correctly held that the agreements contemplated only engaging in outside business, not using such a business as a vehicle for taking over the partnership.

A significant case in this category, *BT-I v. Equitable Life Assurance Society of the United States*,[83] relying in part on *Labovitz*, held that a general partner in a limited partnership could not buy and foreclose on a loan on the partnership's sole asset, an office building, even after giving the partnership an opportunity to participate in the purchase, although the agreement authorized the general partner "to compete, directly or indirectly, with the business of the Partnership."[84] The court noted:

> We do not believe the partnership agreement can be read as permitting Equitable to purchase the loans for its own account and foreclose. Certainly, it does not expressly allow such conduct. Even if the language were broad enough to justify such an interpretation, we hold a partnership agreement cannot relieve a general partner of its fiduciary duties to a limited partner and the partnership where the purchase and foreclosure of partnership debt is involved.[85]

The court also noted that, while the defendant did not have to pay the loan to avoid disclosure, it could not "step out of the role of partner and into that of an aggressive (and apparently greedy) lender in the marketplace."[86] The court recognized that California RULPA allowed the parties to eliminate the limited partners' right to vote on transactions in which the general partner had a conflicting interest, but said:

> [T]he fact that the act allows the parties to structure many aspects of their relationship is not a license to freely engage in self-dealing—it remains our responsibility to delimit the outer boundaries of permissible conduct by a fiduciary. In view of the rule against waiving fundamental fiduciary duties, we

83. 89 Cal. Rptr. 2d 811 (Ct. App. 1999).

84. The court applied the UPA, although California had adopted RUPA, because the partnership had been entered into prior to the effective date of RUPA. *Id.* at 815 n.4.

85. *Id.* at 817.

86. *Id.*

> cannot stretch these general provisions to include giving Equitable a free hand to act for its own self-interest. Equitable was still a fiduciary, and its conduct must be measured by fiduciary standards.[87]

Nor was the conduct authorized by a statutory provision permitting partners to transact business with the partnership with the same rights as non-partners, since that provision merely changed the rule under prior law prohibiting limited partners from making secured loans to the partnership.[88]

In *Wartski v. Bedford*,[89] which also relied on *BT-I*, an inventor formed a general partnership with a venture capitalist to exploit the former's invention. The agreement permitted the venture capitalist to engage in other profit-making activities "whether or not competitive with the business of the partnership." When the business met financial problems, the venture capitalist got control of the invention by buying the interests in a related company for $10. The court held that this conduct breached the partner's fiduciary duty despite the apparent waiver in the agreement. The court said:

> [E]ven if the partnership agreement can be interpreted as [defendant Bedford] claims, it cannot nullify the fiduciary duty owed by Bedford to the partnership. The fiduciary duty of partners is an integral part of the partnership agreement whether or not expressly set forth therein. It cannot be negated by the words of the partnership agreement.[90]

Lyall v. Grayco Builders, Inc.[91] held that a general partnership agreement authorizing the partners to work independently on other projects did not give the defendant the right to undercut the partnership's business, thereby effectively depriving the other partner of his interest.

Finally, *Triple Five of Minnesota, Inc. v. Simon*[92] held that liability for taking a partnership opportunity was not precluded by a provision in the partnership agreement that partners shall not be liable except for fraud or gross negligence. The court stated:

> Defendants contend that, unless the Court finds fraud or gross negligence, Defendants are not liable to Triple Five even if the Court otherwise finds a breach of fiduciary duty. The Court agrees with Defendants that the conduct alleged in this case does not rise to the level of fraud or gross negligence. However, even if the MOAA partnership agreement prohibits contractual liability, the existence of that clause in the agreement does not affect the analysis of Triple Five's breach of fiduciary duty claim. "While 'partners are free to vary many aspects of their relationship . . . they are not free to destroy its fiduciary character.'" Appletree Square I Ltd. Partnership v. Investmark,

87. *BT-I*, 89 Cal. Rptr. 2d at 817-18.
88. *Id.* at 818.
89. 926 F.2d 11 (1st Cir. 1991).
90. *Id.* at 20.
91. 584 N.Y.S.2d 465 (App. Div. 1992).
92. 280 F. Supp. 2d 895 (D. Minn. 2003).

Inc., 494 N.W.2d 889, 893 (Minn. App. 1993) (quoting Saballus v. Timke, 460 N.E.2d 755, 760 (1983)).

Although the above cases can be rationalized as correct interpretations of the partnership agreements, it is necessary also to deal with dicta in *Labovitz*, *BT-I*, *Wartski*, and *Triple Five* to the effect that the parties *cannot* "nullify" their fiduciary duties or waive "fundamental" duties. These dicta indicate that the agreements would not have been enforceable even had they explicitly authorized the particular conduct involved in the cases. However, these dicta are best understood as involving interpretation rather than negation of fiduciary duty waivers. Where the parties enter into a co-ownership relationship such as a partnership, they must be understood as undertaking some commitment to the firm, as distinguished from a relationship such as debtor-creditor in which the party stands outside the firm. Accordingly, it is logical to interpret the parties' agreement as preserving some material aspect of the commitment. This is consistent with the interpretation of the contract consistent with the partners' general obligation of good faith.[93] While it is difficult to define that area of commitment hypothetically, it must include the sort of conduct involved in the above cases—that is, taking over the firm and squeezing out the other owners.

The main question these cases raise is whether it is possible to enter into an agreement that is sufficiently explicit to authorize the sort of conduct involved in the cases. The parties can, of course, provide for what amounts to a call option in which one party buys out the other at a pre-agreed price on the occurrence of a triggering event. But the courts understandably are unwilling to sanction what amounts to an option to take over the going concern value of the firm at a price to the co-owners of zero, at least under a waiver that does not explicitly embrace this conduct. No case has had to confront a waiver that explicitly allowed an agent to completely forsake its fiduciary role. It may be that a court in such a case would not allow the apparently authorized conduct.

Theoretically, the parties could avoid such a result by entering into an agreement that included many of the terms of a partnership or other co-ownership arrangement but that explicitly negated its partnership or fiduciary character. The potential problem with such an arrangement is that the parties might be considered to be liable as partners to third parties. If they tried to avoid this result by forming a limited liability firm such as an LLC or corporation, they would then face being characterized as fiduciaries. The appropriate legal response to this dilemma is to let the parties determine both the characterization and limited liability nature of their relationship.[94]

In general, the cases decided under the UPA efficiently couple flexibility with adequate protection of the limited partners, consistent with the theoretical

93. *See supra* text accompanying note 44.

94. For a suggestion along these lines, generally see Larry E. Ribstein, *Limited Liability Unlimited*, 24 DEL. J. CORP. L. 407 (1999).

considerations discussed in Part I. *LID* clarified that the agreement could generally authorize the general partner to reap a benefit in self-dealing transactions with the partnership, subject to a limitation of this benefit to the price in an arms-length transaction. The other cases discussed in this subpart effectively require that any waiver of fiduciary duties preserve a reasonable commitment by the fiduciary to the firm's interests inherent in the relationship.

B. Delaware: Explicit Enforcement of the Agreement

Delaware has long applied the UPA/RULPA approach to fiduciary duties.[95] As discussed in subpart A, this approach supports enforcement of fiduciary duty waivers. However, as discussed above, *Labovitz* suggested in dictum the possibility that non-waivable fiduciary duties existed apart from the agreement. In the wake of *Labovitz*, the Delaware legislature clarified limited partnership law by adding the provision noted above explicitly providing for "maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements," and that "the partner's duties and liabilities may be expanded or restricted by provisions in a partnership agreement."[96] Perhaps at least partly because of this provision, and because of Delaware's general reputation for legal sophistication,[97] Delaware has become a major jurisdiction for limited partnership formations and litigation[98] just as it has for corporations.

The Delaware statute clarifies that the parties' agreement can at least *modify* fiduciary duties. This would certainly include *adding* duties, as where limited partners are to have management responsibilities that justify such duties.[99] The main questions concern the extent to which contractual duties can *substitute* for default fiduciary duties, and whether the contract can *eliminate* fiduciary duties.

This subpart shows that the substantial litigation under the Delaware freedom-of-contract provision reaches results, and involves a balancing process, similar to the UPA-based cases, with further clarification of the precise limits of fiduciary duty waivers. Delaware courts have enforced explicit waivers as to conduct clearly covered by the waiver,[100] while insisting on good-

95. *See, e.g.*, Boxer v. Husky Oil Co., 429 A.2d 995 (Del. 1981).

96. *See supra* note 2. For a history of this provision, generally see Martin I. Lubaroff & Paul Altman, *Lubaroff & Altman on Delaware Limited Partnerships* (2001, 2002 Supp).

97. *Cf.* Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985) (discussing reasons for Delaware's dominance in corporate law).

98. *See* Sonet v. Timber Co., L.P., 722 A.2d 319, 323 n.9 (Del. Ch. 1998) (noting that "3984, 4038 and 5800 Delaware limited partnerships were formed in each of the last three years, respectively. And, according to Laura Y. Marvel, Corporations Administrator for the Division of Corporations, the Division estimates that almost 6000 domestic limited partnerships were formed for fiscal year 1998").

99. *See* Cantor Fitzgerald, L.P. v. Cantor, No. 16297, 2000 WL 307370 (Del. Ch. Mar. 13, 2000) (holding that the agreement could impose fiduciary duties on limited partners, and noting the need to instill commitment and discourage competition within a closely held limited partnership in a highly competitive industry).

100. An agreement choosing Delaware law also may be enforced by a non-Delaware court. *See* Nolan v. Va. Inv. Fund Ltd. P'ship, 833 So. 2d 853 (Fla. Dist. Ct. App. 2002) (enforcing waiver of self-dealing liability); Whalen v. Connelly, 545 N.W.2d 284 (Iowa 1996) (holding that general partner did not breach its duty as a

faith compliance with the explicit provisions of the agreement and indicating in dictum that they would not enforce a complete waiver even if it were explicit.

More specifically, the Delaware approach can be summarized in the following way. First, the strongly worded statutory protection of "freedom of contract" focuses the court's attention on the language and structure of the contract in the first instance. This strongly discourages courts from substituting judicial default rules for clearly articulated contractual duties.[101] Second, the courts have reserved a category of fundamental, non-waivable fiduciary duties.[102] This default category effectively encourages the parties to substitute their own customized duties that reasonably meet the needs of the particular firm rather than risking invalidation of the waiver. Third, to the extent that default duties are subject to waiver without displacement, the waiver must be explicit in order to be enforced.

These aspects of the Delaware approach can be illustrated by some of the Delaware cases dealing with limited partnership fiduciary duties under the freedom-of-contract provision. The discussion begins with a pair of cases decided within one month of each other in which Chancellor Chandler decided that the agreement had adequately waived or displaced default fiduciary duties. *Kahn v. Icahn*[103] dismissed a claim that Icahn, who indirectly owned the general partner, breached his duties to the limited partnership by allocating some profits from partnership opportunities to his affiliates. The agreement explicitly permitted partners to engage in "other business activities."[104]

---

matter of law by engaging in activity similar to that of the limited partnership pursuant to partnership agreement provision permitting such conduct).

101. *See* Wilmington Leasing, Inc. v. Parrish Leasing Co., L.P., CIV. A. No. 15202, 1996 WL 752364 (Del Ch. Dec. 23, 1996); LUBAROFF & ALTMAN, *supra* note 96, at 10-12 (noting that Delaware courts do not mistakenly believe that they can rewrite contracts). *Wilmington Leasing* stated that:

> [a]ssuming without deciding that the Limited Partners were subject to a fiduciary duty when they acted to remove the General Partner, that duty was satisfied because it was coextensive with the requirements of Section 3.7.3. Where, as here, a Partnership Agreement specifically addresses the rights and duties of the partners, any fiduciary duty that might be owed by the Limited Partners is satisfied by compliance with the applicable provisions of the partnership agreement.

Wilmington Leasing, 1996 WL 752364, at *14.

102. *See infra* text accompanying note 130 (discussing *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160 (Del. 2002)).

103. No. CIV. A. 15916, 1998 WL 832629 (Del. Ch. Nov. 12, 1998).

104. The agreement provided:

> 6.11 *Other Business Activities of Partners*. Any Partner, Record Holder or Affiliate thereof (including, without limitation, the General Partner and any of its Affiliates) may have other business interests or may engage in other business ventures of any nature or description whatsoever, whether presently existing or hereafter created, including, without limitation, the ownership, leasing, management, operation, franchising, syndication and/or development of real estate *and may compete*, *directly or indirectly*, *with the business of the Partnership*. No Partner, Record Holder or Affiliate thereof shall incur any liability to the Partnership as the result of such Partner's, Record Holder's or Affiliate's pursuit of such other business interests and ventures and competitive activity, and neither the *Partnership nor any of the Partners or Record Holders shall have any right to participate in such other business interests or ventures or to receive or share in any income derived therefrom*.

Chancellor Chandler reasoned that the Delaware statute made traditional fiduciary duties:

> defaults that may be modified by partnership agreements. . . . Plaintiffs ask me to craft a new principle of law by recognizing that partners have separate and immutable duties of loyalty irrespective of clear and unambiguous modifications of fiduciary duties provided in a legally enforceable partnership agreement. Under the facts alleged I cannot so hold, for Defendants' actions are covered by the Agreement and as such are permissible as a matter of law.[105]

Chancellor Chandler's second case, *Sonet v. Timber Co. L.P.*,[106] dismissed a claim based on a general partner's receiving an unfairly large amount of shares of a REIT into which the limited partnership was converted. The limited partnership agreement gave the general partner significant power to manage day-to-day affairs, subject to the requirement that its actions be fair and reasonable to the partnership. With respect to mergers and certain other extraordinary acts or transactions, the general partner had sole discretion without a fair and reasonable qualification, but transactions were subject to approval by a supermajority unitholder vote.

The Chancellor held that the "careful framework established by the Agreement confirms that to the extent that unitholders are unhappy with the proposed terms of the merger (and in this case the resultant conversion) their remedy is the ballot box, not the courthouse."[107] The Chancellor again reasoned that "principles of contract preempt fiduciary principles where the parties to a limited partnership have made their intentions to do so plain." He also noted the special function of limited partnerships,[108] and the role of the Delaware freedom-of-contract provision in attracting firms to adopt this particular form.[109] Given the parties' deliberate choice, courts should hesitate to draw from general principles of fairness in the corporate context. Rather, when faced with a clear opt out, a court should analyze a limited partnership fiduciary duty claim in terms of the operative governing instrument—the partnership agreement—and only when that document is silent or ambiguous, or when principles of equity are implicated, will a court begin to look for guidance from the statutory default rules, traditional notions of fiduciary duties, or other extrinsic evidence.[110]

Later cases explained when the preemption of fiduciary duties should be deemed to be sufficiently plain. In some cases, the agreement clearly did not

---

Id. at *1 n.4 (alteration in original).

105. *Id.* at *2-3 (footnotes deleted). The court also noted that the limited partners' knowledge that the general partner was authorized to compete defeated any expectations on which corporate opportunities liability might be based, and that the partnership did share in the opportunities.

106. 722 A.2d 319 (Del. Ch. 1998).

107. *Id.* at 326.

108. *See supra* note 27.

109. *Sonet*, 722 A.2d at 321.

110. *Id.* at 324 (emphasis in original, footnotes omitted).

reach the misconduct. Thus, *Continental Insurance Co. v. Rutledge & Co.*[111] held that a provision permitting a general partner to "engage in other business activities or possess interests in other business activities of every kind and description, independently or with others" did not permit self-dealing.

Similarly, in *Marriott Hotel Properties II Limited Partnership*,[112] although the general partner had full power to manage the hotel,[113] the agreement provided that:

> [t]he General Partner shall be under a duty to conduct the affairs of the Partnership in good faith and in accordance with the terms of this Agreement. . . . Nothing contained in the Agreement is intended or shall be construed to contract away the fiduciary duty of the General Partner to the limited partners.[114]

Vice Chancellor Lamb upheld a claim based on a squeeze-out of the limited partners by manipulation of distributions. The court distinguished *Sonet* on the ground that the agreement preserved the general partner's default fiduciary duties.[115] However, the general partner did not have an affirmative *Unocal* duty[116] to protect the limited partners in connection with a tender offer by the general partner's parent, given the partnership's structure and purpose. Specifically, Host Marriott had formed the partnership to finance the ownership of several hotels managed by another Marriott entity under long-term management agreements. Host's wholly-owned subsidiary was the general partner and all of its directors were affiliated with Host. The partnership merely collected management fees and made payments on the debt and to the limited partners. Accordingly, "the limited partners neither expected nor had any right to expect, that the General Partner or its directors would seek to act independently of Host in relation to the Offer."[117] Thus, even without a fiduciary duty waiver, the limited partnership's "structure and purpose" restricted the application of default fiduciary duties, just as the "careful framework established by the Agreement" guided Chancellor Chandler's application of the waiver provision in *Sonet*.

A pair of cases decided by Vice Chancellor Strine provides additional insights as to when agreements will be deemed to waive default duties. In both cases (as in *Sonet*), there was no explicit waiver of default duties, so that such duties technically survived the agreement. However, the court resolved both cases on the basis of the duties provided for in the agreement. In other words,

---

111. No. CIV. A. 15539, 2000 WL 268297 (Del. Ch. Feb. 15, 2000).

112. No. Civ. A. 14961, 2000 WL 128875 (Del. Ch. Jan. 24, 2000).

113. Specifically, the general partner had "the exclusive right and power to conduct the business and affairs of the Partnership and to do all things necessary to carry on the business of the Partnership in accordance with the provisions of this Agreement and applicable law." *Id.* at *2.

114. *Id.* at *3.

115. *Id.* at *3 n.11.

116. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

117. *Id.* at 17 n.69.

compliance with contractual duties effectively displaced default fiduciary duties.

R.S.M. Inc. v. Alliance Capital Management Holdings, L.P.[118] involved an alleged breach of fiduciary duty by a general partner who caused the reorganization of a public limited partnership into separate privately and publicly traded entities with approval by a majority of the outside unitholders. The transaction allegedly favored the general partner, who was able to use the tax advantages of the private entity without being concerned about restrictions on transferability. The plaintiff claimed the transaction was effected without adequate disclosure of the advantages of favorable tax treatment of the privately held partnership. This discouraged conversion by the outside unitholders and preserved the public market for the firm's shares, thereby enabling the general partner to convert more of its shares for shares of the private partnership.

The court held that the agreement's requirement of outside unitholder approval effectively reduced the court's inquiry to the adequacy of disclosure, and that the complaint sufficiently alleged inadequate disclosure. The court balanced *Sonet's* requirement that the provisions displacing fiduciary duties be "plain" against the need for "flexibility" in discerning the parties' intention. This involved applying default fiduciary duties in the absence of a clear *Sonet*-type waiver as long as these duties were not irreconcilable with the operation of the partnership agreement. The Vice Chancellor noted that this irreconcilability "can itself be evidence of the clear intention of the parties to preempt fiduciary principles." In the present case, fiduciary duties and the partnership agreement could be reconciled by focusing on whether the transaction had been "ratified by an informed, uncoerced majority vote of the minority stockholders."[119] The voting provisions of the agreement create "a safe harbor, that if effectively utilized, is outcome determinative. In the event that the safe harbor does not apply, the defendants would face liability under both contractual and fiduciary theories."[120] Finally, the court dismissed a claim based on failure to disclose a provision of a proposed agreement that said, in part: *The provisions of this Agreement, to the extent that they restrict the fiduciary duties and liabilities of an Indemnified Person otherwise existing in law or in equity, are agreed by the Partners to replace such other duties and liabilities of such Indemnified Person*.[121] The court described the provision as "nothing more than an inartful re-articulation of section 17-1101(d) . . . all it does is state the obvious: if the Proposed Agreement's provisions restrict fiduciary duties, that restriction is effective and binding."[122] In short, the

118. 790 A.2d 478 (Del. Ch. 2001).
119. *Id.* at 496-99 (footnotes omitted).
120. *Id.* at 499 n.33.
121. *Id.* at 504 (emphasis in original).
122. *R.S.M. Inc.*, 780 A.2d at 504.

agreement can displace default fiduciary duties even in the absence of an explicit, or "plain" provision to that effect.

Six months after *R.S.M.*, Vice Chancellor Strine decided *Miller v. American Real Estate Partners, L.P.*,[123] which involved the same partnership as in *Kahn v. Icahn*, but allegations relating to other transactions and implicating other provisions in the agreement.[124] This case confronted more directly than in *R.S.M.* the intersection between the agreement and default duties in a situation where the agreement did not explicitly negate such duties. Vice Chancellor Strine said that the court:

> will not tempted by the piteous pleas of limited partners who are seeking to escape the consequences of their own decisions to become investors in a partnership whose general partner has clearly exempted itself from traditional fiduciary duties. The DRULPA puts investors on notice that fiduciary duties may be altered by partnership agreements, and therefore that investors should be careful to read partnership agreements before buying units. In large measure, the DRULPA reflects the doctrine of caveat emptor, as is fitting given that investors in limited partnerships have countless other investment opportunities available to them that involve less risk and/or more legal protection. For example, any investor who wishes to retain the protection of traditional fiduciary duties can always invest in corporate stock.[125]

---

123. No. CIV.A. 16788, 2001 WL 1045643 (Del. Ch. Sept. 6, 2001).

124. The agreement provided:

> 6.01 Management and Control of Partnership. Except as otherwise expressly provided or limited by the provisions of this Agreement (including, without limitation, the provisions of Article VII), the General Partner shall have full, exclusive and complete discretion to manage and control the business and affairs of the Partnership, to make all decisions affecting the business and affairs of the Partnership, and to take all such actions as it deems necessary or appropriate to accomplish the purposes of the Partnership as set forth herein. The General Partner shall use reasonable efforts to carry out the purposes of the Partnership as set forth herein. The General Partner shall use reasonable efforts to carry out the purposes of the Partnership and shall devote to the management of the business and affairs of the Partnership such time as the General Partner, in its sole and absolute discretion, shall deem to be reasonably required for the operation thereof. No Limited Partner, Record Holder, Non-Consenting Investor or Subsequent Transferee shall have any authority, right or power to bind the Partnership, or to manage or control, or to participate in the management or control of, the business and affairs of the Partnership in any manner whatsoever.

Id. at *7.

> [6.13 (d)] Whenever in this Agreement the General Partner is permitted or required to make a decision (i) in its "sole discretion" or "discretion", [sic] with "absolute discretion" or under a grant of similar authority or latitude, the General Partner shall be entitled to consider only such interests and factors as it desires and shall have no duty or obligation to give any consideration to any interest of or factors affecting the Partnership, the Operating Partnership or the Record Holders, or (ii) in its "good faith" or under another express standard, the General Partner shall act under such express standard and shall not be subject to any other or different standards imposed by this Agreement or any other agreement contemplated herein.

Id. at *6 (emphasis removed).

125. *Id.* at *8 (internal footnote by court omitted). In a footnote, the court said:

> [t]hat is, if the investors wish to protect themselves through legal means. Many investors protect themselves by diversifying their portfolios. One suspects that investment funds and other sophisticated investors also protect themselves by refusing to invest their money in entities

Nevertheless, the court rejected the defendants' interpretation of the agreement to the effect that "the General Partner could choose to invest Partnership funds in a failing venture solely to ensure that the General Partner's own investment in that venture is not lost, and turn its back on a less risky and more profitable opportunity for the Partnership."[126] The agreement failed explicitly to preclude the application of default fiduciary duties, and indeed revealed an intention to include such duties by adopting a widely used form but deleting language preempting default duties.[127] Thus, preemption of fiduciary duties was not "plain" enough under *Sonet*.[128] The court reasoned:

> [J]ust as investors must use due care, so must the drafter of a partnership agreement who wishes to supplant the operation of traditional fiduciary duties. In view of the great freedom afforded to such drafters and the reality that most publicly traded limited partnerships are governed by agreements drafted exclusively by the original general partner, it is fair to expect that restrictions on fiduciary duties be set forth clearly and unambiguously. A topic as important as this should not be addressed coyly.[129]

The court also noted references to default fiduciary duties in the registration statement used to sell the partnership interests. Thus, while the agreement sufficiently precluded the application of a procedural fairness test, default substantive fairness and bad faith duties applied. However, the complaint did not sufficiently plead breach of these standards as to termination of dividends, amendment of the agreement to permit non-real-estate investments, and co-investment of partnership assets with other Icahn affiliates.

The Chancery Court cases discussed above state or imply that a sufficiently clear partnership agreement *can* eliminate the partners' fiduciary duties. However, in its first opportunity to opine on this issue, the Delaware Supreme Court disagreed. *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*[130] involved a public offer of so-called "odd lot" units, as a result of which the general partner's parent significantly increased its percentage ownership of the limited partnership. The partnership agreement applied specific standards to self-dealing transactions—namely, requiring that the "terms of any such transaction are substantially equivalent to terms obtainable by the Partnership from a comparable unaffiliated third party" and audit committee review. There

---

> controlled by persons who have burned them in the past, and that reputational factors might therefore play some role in deterring opportunistic behavior.

Id. at *8 n.24.

126. *Id.* at *8.

127. *Miller*, 2001 WL 1045643, at *9 (discussing MARTIN I. LUBAROFF & PAUL ALTMAN, LUBAROFF & ALTMAN ON DELAWARE LIMITED PARTNERSHIPS F-38, F-99 (2000 Supp.)).

128. *Id.* at *8, n.25 (quoting Sonet v. Timber Co., L.P, 722 A.2d 319, 322 (Del. Ch. 1998)).

129. *Id.* at *8 (internal citation omitted). In a footnote, the court quotes from *Sonet*, 722 A.2d at 322, that "principles of contract preempt fiduciary principles where the parties to a limited partnership have made their intentions to do so plain." *Id*. at *8 n.25.

130. 817 A.2d 160 (Del. 2002).

were no such duties for transactions involving an *issuance* of units. The court held that the contractual standards applied because the transaction was a resale rather than an issuance, and that the contractual duties supplanted common law fiduciary duties. The defendants failed to comply with the contract's procedural standards for self-dealing transactions, thus triggering damages for breach. Although contractual standards could supplant default standards, the court clarified in dictum that it would not enforce an agreement that *eliminated* fiduciary duties, contrary to language in *Sonet* and in the Chancery Court's opinion in the case.[131] The court noted:

> [I]n the interest of avoiding the perpetuation of a questionable statutory interpretation that could be relied upon adversely by courts, commentators and practitioners in the future, we are constrained to draw attention to the statutory language and the underlying general principle in our jurisprudence that scrupulous adherence to fiduciary duties is normally expected. . . . There is no mention in § 17-1101(d)(2), or elsewhere in DRULPA at 6 Del. C., ch. 17, that a limited partnership agreement may *eliminate* the fiduciary duties or liabilities of a general partner. . . .
>
> Finally, we note the historic cautionary approach of the courts of Delaware that efforts by a fiduciary to escape a fiduciary duty, whether by a corporate director or officer or other type of trustee, should be scrutinized searchingly. Accordingly, although it is not appropriate for us to express an advisory opinion on a matter not before us, we simply raise a note of concern and caution relating to this dubious dictum in the Vice Chancellor's summary judgment opinion.[132]

The above discussion shows that Delaware law, while not taking contractual freedom to its theoretical limit, permits a significant amount of flexibility. Although the courts enforce only agreements that leave the limited partners reasonably protected against general partner self-dealing and bad faith, this gives limited partnerships the freedom to adopt a wide variety of provisions. For example, *Kahn* enforced an agreement permitting the partner to engage in outside business activities. *Sonet* recognizes that the agreement can eliminate the duty of substantive fairness in transactions between general partners and their partnerships, at least as long as the limited partners have had an

---

131. That might have been the situation in *Gotham* if the transaction had qualified as an issuance rather than a resale.

132. *Gotham*, 817 A.2d at 167-68. The court footnotes this discussion, stating that:

> The Vice Chancellor also noted in his summary judgment opinion that "Any interstitial issues in this case are best dealt with through cautious application of the implied covenant of good faith and fair dealing." *Gotham S.J. Op.* at 29 n.37. We note that the implied covenant of good faith and fair dealing that inheres in every contract is not pertinent to the issues in this case and any discussion in the Vice Chancellor's summary judgment about the contractual duty of good faith and fair dealing is also dictum. The issue of good faith and fair dealing is not before us, and we need not express any opinion on that issue in this case.

Id. at 168 n.17.

opportunity after full disclosure to vote on the transaction. *R.S.M.* and *Marriott* permitted avoidance of default substantive fairness standards in general partner transactions with the partnership. *Miller* permitted supplanting of default procedural standards in such a transaction.[133]

This approach effectively balances the countervailing arguments concerning waiver discussed above in Part II.C. On the one hand, the courts have concluded that limited partners need some protection against open-ended waivers whose effects the partners cannot fully evaluate at the time of the agreement. On the other hand, the courts have recognized the strong practical reasons for enforcing fiduciary duty contracts in limited partnerships and the implications of the parties' having deliberately selected an entity form that notoriously permits freedom of contract.

The balancing process encourages lawyers to design some combination of procedural and substantive protections that meets the needs of the particular firm. As long as the design is reasonable, even if imperfect, the court will permit the agreed structure to supplant default duties. The Delaware approach discourages poorly drafted contracts by suggesting that onerous default duties might apply unless the contract explicitly substitutes reasonable alternative protections. Thus, fiduciary duties can be viewed as a way to force the more sophisticated party, the syndicator or promoter, to draft cost-effective protections for limited partners. This encourages contracts that substitute nuanced and context-specific protection for one-size-fits-all default fiduciary duties. Thus, the Delaware statute and case law delineate a middle ground between freedom of contract and prohibiting waivers.

The Delaware cases leave two main questions concerning the relationship between the agreement and the requisite level of protection required for limited partners. First, it is not clear precisely how far the contract can go toward *displacing* fiduciary duties. For example, can a partner engage in self-dealing with the partnership based on authorization by a special committee without having to meet any substantive fairness standards? If so, does the law dictate the membership of the special committee?

Second, what is the effect of a clear waiver of fiduciary duties that does not displace default with contractual standards? As discussed above, several cases permit displacement even in the absence of any clear waiver. It is not clear whether the courts would have allowed replacement of the fiduciary standard with a significantly weaker contractual standard had the waiver been sufficiently clear.

133. *See also* Brickell Partners v. Wise, Civ.A. No. 18145, 2001 WL 1006642 (Del. Ch. Aug. 20, 2001) (interpreting agreement providing for conclusive committee review of conflict of interest transactions to permit review by directors of corporate general partner).

III. CRITIQUE OF ULPA 2001

This Part analyzes the fiduciary duty provisions of RUPA and ULPA. It shows that, in light of the above theory and law on limited partnership fiduciary duties, the Act is seriously flawed in restricting waiver of fiduciary duties. In general, ULPA 2001's most significant contribution is its "de-linkage" from general partnership law. In other words, ULPA 2001 is a stand-alone statute that does not rely on cross-references to general partnership law.[134]

ULPA 2001 helpfully clarifies that a limited partner, acting solely as such, does not have fiduciary duties:

> (a) A limited partner does not have any fiduciary duty to the limited partnership or to any other partner solely by reason of being a limited partner.
>
> (b) A limited partner shall discharge the duties to the partnership and the other partners under this [Act] or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing.
>
> (c) A limited partner does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the limited partner's conduct furthers the limited partner's own interest.[135]

A possible criticism of this approach is that, given ULPA 2001's elimination of the control rule,[136] limited partners can be expected to take over management functions, and therefore the fiduciary duties that accompany these functions. This suggests that ULPA might include a provision, like what the Uniform Limited Liability Company Act (ULLCA) applies to LLCs,[137] which imposes fiduciary duties to the extent that limited partners exercise management powers. However, it is difficult to design a default rule that accommodates the myriad possible variations in the parties' agreements.[138] This problem would be complicated by the difficulty of waiving default duties under ULPA 2001, discussed below.[139]

ULPA 2001's default duties of general partners[140] are based closely on those in RUPA,[141] which probably apply to limited partnerships where RUPA, and not ULPA 2001, is in effect.[142] These duties are probably similar to those

---

134. As to linkage under prior law, see note 10 and accompanying text, above.

135. UNIF. LTD. P'SHIP ACT § 305 (2001).

136. *Id*. § 303.

137. *See* UNIF. LTD. LIAB. CO. ACT § 409 (1995).

138. *See* Ribstein, *supra* note 37, at 983-84.

139. The problems raised by subsections (b) and (c) are discussed below in connection with the analogous general partner provisions. *See infra* text accompanying notes 145-47.

140. UNIF. LTD. P'SHIP ACT § 408 (2001).

141. *See supra* note 3.

142. *See supra* note 68. A potential problem with this mimicking approach is that it defeats the purpose of de-linkage by inviting the same results in general and limited partnerships despite contextual differences. On the other hand, the statute only outlines the basic duty. *Delinkage* invites courts to apply the duties differently in the two contexts.

applied in cases under the more general UPA provision: a duty of loyalty that includes, in addition to the UPA duty not to appropriate benefits without co-partner consent, specific duties to refrain from self-dealing or competition with the partnership;[143] and a duty of care that involves refraining from engaging in "grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law."[144]

RUPA/ULPA 2001's most significant change regarding default duties is its explicit addition of an "obligation of good faith and fair dealing."[145] Although partners, like other contracting parties, clearly have such an obligation,[146] there is a problem inherent in placing the obligation in the fiduciary duty section of the statute and characterizing it as a "standard[] of partner's conduct." Even the RUPA Comments recognize that good faith "is not a fiduciary duty arising out of the partners' special relationship."[147] These comments and provisions make the line between good faith and fiduciary duties even hazier than it otherwise would be.

The main problem with RUPA/ULPA 2001 lies in their restrictions on waiver.[148] As discussed in Part I, restrictions on waiver are particularly ill-advised in limited partnerships given the strong arguments and reasons for permitting waiver in this context. Because of the general structure of the limited partnership form, and the "market" for limited partnerships that has developed based on this structure, precluding potential conflicts of interests is likely to be very costly in limited partnerships. Also, the benefits of restricting waiver are relatively low in limited partnerships since investors are more likely to be able to protect themselves in this context than in less specialized business forms such as the general partnership. This is particularly clear in light of the discussion above of Delaware law, which demonstrates the feasibility of combining significant flexibility with protection of limited partners.

Even if some restrictions on waiver are appropriate, the RUPA/ULPA 2001 approach is misguided because it precludes the sort of balancing of costs and benefits that courts have managed to do under the permissive UPA and Delaware statutes. The parties have only two ways to validly restrict the duty of loyalty—by identifying specific categories of activities that do not violate the duty, and by authorizing or ratifying by partner vote.[149] They cannot, for example, substitute an alternative standard such as an arms' length test.[150] Nor can they identify a general category of acts that do not violate the duty, notably

143. UNIF. P'SHIP ACT § 404(b) (1997).

144. *Id.* § 404(c). For a general analysis of fiduciary duties under RUPA, see Alan R. Bromberg & Larry E. Ribstein, *Bromberg & Ribstein on LLPs, RUPA and ULPA 2001* § 8.404 (2002).

145. UNIF. P'SHIP ACT § 404(d) (1997); UNIF. LTD. P'SHIP ACT § 408 (2001).

146. *See supra* Part I.B.1.

147. UNIF. P'SHIP ACT § 404 cmt. 4 (1997).

148. *See supra* note 4 (quoting RUPA provisions); UNIF. LTD. P'SHIP ACT § 110(b)(5)-(7) (2001).

149. *See* UNIF. P'SHIP ACT § 103(b)(3) (1997); UNIF. LTD. P'SHIP ACT § 110(b)(5) (2001).

150. *Cf.* LID Assocs. v. Dolan 756 N.E.2d 866 (Ill. App. Ct. 2001).

including competition with the partnership, even if in either case the substitute rule would *not* be "manifestly unreasonable."

The inherent problems of restricting waiver are complicated by the potential ways to avoid the restrictions through other provisions of ULPA 2001. First, ULPA 2001 provides that a person who is both a general and a limited partner, and who "acts as a limited partner," "is subject to the obligations, duties and restrictions under this [Act] and the partnership agreement for limited partners." Since, as discussed above, limited partners have no default duties, this suggests that a general partner may avoid duties by acting as a limited partner. But ULPA 2001 does not define what acts would be those of a limited partner in the dual capacity situation. The agreement theoretically could define those acts without explicitly violating the restrictions on waiver.

Second, ULPA 2001 permits the firm to "specify the number or percentage of partners which may authorize or ratify, after full disclosure to all partners of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty."[151] This suggests that the agreement could permit the general partners themselves to authorize such acts, thereby effectively waiving the restriction on contracting out of the duty of loyalty.

These provisions raise significant interpretation problems that would be avoided by straightforwardly permitting waiver. Moreover, they invite complex end-runs that can make fiduciary duty provisions relatively opaque, inconsistent with the function of restrictions on contracting to protect the unsophisticated.

RUPA and ULPA 2001 also complicate the law through their restriction on default duties in RUPA section 404(e) and ULPA 2001 section 408(e). These sections provide that a partner's conduct "does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the general partner's conduct furthers the general partner's own interest."[152] This probably means that, to the extent that the partners do *not* act as fiduciaries, they can look to their own interests rather than those of the firm or the other owners, subject to any limitations provided for in the contract.[153] However, this potentially confuses such actions with partners' actions as fiduciaries.

A possible argument for ULPA 2001's restrictions on waiver is that Delaware-type provisions are appropriate mainly for relatively sophisticated firms, or mainly in a context where sophisticated judges and lawyers make a flexible approach workable. As discussed above, the function of the Delaware approach is to encourage sophisticated lawyers to use their skills to craft

151. UNIF. LTD. P'SHIP ACT § 110(b)(5)(ii) (2001).

152. *See supra* notes 3, 6 (quoting RUPA and ULPA provisions).

153. *See* Chimblo v. Hutter, No. X01CV990162957, 2001 WL 357919, at *15 (Conn. Super. Ct. Mar 29, 2001) (stating that "the partners owe each other a fiduciary duty only to interpret the contract in a manner consistent with achieving the agreed mutual purpose unless such a construction imposes on one party a burden not contemplated by the scope of the partnership agreement").

agreements that provide for flexibility while taking the limited partners' rights into account. ULPA 2001, on the other hand, arguably suits situations where sophisticated legal talent cannot be assumed to be available. In other words, ULPA 2001 provides a kind of "limited partnership law for dummies."

ULPA 2001-type restrictions on contracting, however, probably are inappropriate for *any* limited partnership, given the specialized structure of such firms. Indeed, given the high costs and low benefits of ULPA 2001's restrictions on waiver, legal advice to form under ULPA 2001 usually would be highly questionable, if not malpractice, for the many firms that could afford to organize under the more flexible Delware-type law. To be sure, organization outside the home state may be impractical for smaller firms for which the cost of organizing in one state and doing business in another will be a high percentage of capitalization. Yet ULPA 2001's restrictions on contracting are no more appropriate for smaller than for larger firms. For example, the restrictions would force general partners in family limited partnerships to assume fiduciary duties to junior family members. Accordingly, in the multi-state context, restrictions on contracting simply discriminate against firms based on the level of capitalization rather than protecting the unsophisticated.

Given the theoretical criticisms of restricting waiver in this context, the practical difficulties of crafting clear restrictions, and difficulties arising from the interstate context, states adopting ULPA 2001 clearly should eliminate its restrictions on waiver. The Delaware approach of generally permitting contracts subject to case-by-case judicial interpretation and application is far superior.

IV. A MORE BASIC PROBLEM: UNIFORM LAWS

The problem with RUPA and ULPA lies at a level deeper than these specific misguided provisions. Uniform laws developed in this country at the end of the nineteenth century, before contractual choice of law was well-recognized. In this earlier context, uniformity was the best way to provide reasonable certainty about which laws would be applied. Notably, there has never been a "uniform," as distinguished from "model," corporation law, perhaps at least partly because the state-of-incorporation choice of law rule for corporations has been well accepted during the entire history of uniform laws.

A current argument for uniform partnership laws is that the drafters of the National Conference of Commissioners of Uniform State Laws (NCCUSL) provide drafting expertise for relatively unsophisticated states. This argument makes little sense given the realities of business law drafting at the state and the NCCUSL levels. Even states removed from the commercial centers have many sophisticated commercial lawyers who can provide guidance in drafting business organization statutes. Moreover, state drafters can draw guidance from what other states have done without having to look to NCCUSL.

Alternatively, the ABA Business Law Section or other national group can provide a model law that is intended to provide guidance rather than to promote uniformity.[154]

At the same time, NCCUSL itself has little relevant expertise to offer. Its drafters are generalists who may lack specific knowledge of business association law. They draw their expertise from other NCCUSL statutes, leading to errors such as the ULPA 2001's excessive reliance on general partnership law.

To be sure, a NCCUSL proposal is only that, and can be rejected by state legislators. But NCCUSL proposals carry inherent weight, and come complete with NCCUSL's lobbying muscle to promote enactment.[155] A NCCUSL proposal therefore tends to suck oxygen out of competing model proposals and state law alternatives. Accordingly, it is time to consider abandoning NCCUSL as a drag on efficient development of state laws, or at least keeping it out of business organization law, where there are so many more efficient ways to solve the problems NCCUSL purports to address.

V. CONCLUDING REMARKS

Fiduciary duties in business associations should be regarded as default rules that work together with, and can be displaced by, explicit provisions of the contract. This combination of default and customized rules enables firms to balance protection of non-managing owners with the flexibility necessary to meet business needs. The traditional law of partnership under the Uniform Partnership Act provided an adequate framework for development of judicial rules that provide this efficient balance. The Delaware limited partnership statute provided additional clarification of both the primacy of the parties' contract and the limits of those contracts. But the restrictions on RUPA and ULPA 2001 have no place in the modern law of limited partnerships. In the context of rules permitting firms to choose to be governed by the law of any state, the real effect of these restrictions is simply to discriminate against smaller firms. Indeed, this calls into question the whole project of uniform state laws, at least insofar as these laws relate to firms and other contracts that can effectively choose the applicable state law.

154. Indeed, before the adoption of the Uniform Limited Liability Company Act, an ad hoc subcommittee of Partnership and Unincorporated Businesses Committee of the Business Law Section promulgated the Prototype Limited Liability Company Act, which served as a model for several state laws. *See generally* Larry E. Ribstein & Bruce H. Kobayashi, *Uniform Laws, Model Laws and ULLCA*, 66 COLO. L. REV. 947 (1995) (comparing the model and uniform acts). A project to revise the Prototype in light of the manifest failure of ULLCA is currently underway.

155. Bruce H. Kobayashi & Larry E. Ribstein, *Economic Analysis of Uniform State Laws*, 25 J. LEG. STUD. 131, 146-48 (1996).