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Indiana Law Journal

Volume 5 | Issue 6 Article 1

3-1930

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Recommended Citation

Brown, Robert C. (1930) "The Limited Partnership in Indiana," *Indiana Law Journal*: Vol. 5 : Iss. 6 , Article 1.
Available at: https://www.repository.law.indiana.edu/ilj/vol5/iss6/1

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INDIANA LAW JOURNAL

Vol. V MARCH, 1930 No. 6

THE LIMITED PARTNERSHIP IN INDIANA

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The limited partnership is a business organization of a somewhat hybrid character. Strictly speaking, it is a mere partnership and is, therefore, not a legal entity. On the other hand it resembles a corporation in that the liability of a part of the persons concerned (not all, since there must always be at least one general partner) may be limited.

It is hardly necessary to say that this is a scheme wholly unknown to the common law. It was, however, well developed in the civil law and hence the idea was early taken advantage of in American jurisdictions by statutory provisions. The first of these statutes was adopted in New York in 1822 and since then practically all of the states have followed this example; although, curiously enough, England did not have any provision for limited partnerships until 1908. Perhaps this delay was not an unmixed evil since the English Act has avoided most of the defects which appeared in the early American acts and is, therefore, a very well drawn and workable statute.[1]

The state of Indiana was reasonably prompt in making provision for limited partnerships, the original act having been passed in 1859.[2] In 1903 an amendatory act[3] was passed which to some slight degree liberalized the previous statute. These two acts constitute the existing statutory regulation of the limited partnership in this state.

Despite the comparative antiquity of the authorization of limited partnerships in Indiana, they have been little used. There

* See p. 454 for biographical note.

1 See F. M. Burdick, *Limited Partnership in England and America* (1908), 6 Mich. L. Rev. 523.

2 Burns' Annotated Indiana Statutes, 1926, Secs. 12141-12152.

3 Burns' Annotated Indiana Statutes, 1926, Secs. 12154-12159.

are today comparatively few limited partnerships in the state, and such has apparently always been the case. A rather striking bit of evidence of the unimportance of limited partnerships in the commercial life of Indiana is the fact that not once has the Supreme Court or the Appellate Courts passed upon any litigation respecting limited partnerships. The situation presented here of a fairly elaborate commercial statute constantly in force for seventy years, which has never once been before the courts for construction or for any other purpose, is believed to be almost unique, and it certainly evidences a lack of interest in using this statutory provision. Limited partnerships are not playing the part in the commercial life of Indiana which they might play and which the obvious business advantages of the device make it desirable that they should play.

The reason for this is, however, not difficult to ascertain. As already pointed out, the limited partnership is a device entirely foreign to common law concepts, and even the legislatures that were deliberately making provision for its use did so with great, and in general with rather unfortunate, caution. This is the situation in Indiana where the existing statue, even with the twentieth century modifications, still represents substantially the original form of such statutes devised by legislatures whose primary interest was to change the common law as little as possible, and especially to protect creditors to the limit.

If legislatures were thus unduly hampered by common law concepts it is hardly surprising that courts took the same point of view—and usually much more so. In other words, the courts by a liberal application of such unfortunate shibboleths as "statutes in derogation of the common law are to be strictly construed"[4] have tended to construe out of the statutes such slight efficacy as the legislatures originally put into them. Of course, we cannot definitely ascertain what the attitude of the Indiana courts will be toward this statute, since, as already pointed out, they have never had any occasion to construe it. However, there is an abundance of Indiana authority with respect to ordinary partnerships, and here the courts have been pretty rigid in their construction of rules imposing liability on the partners.[5] Accordingly it seems not unfair to infer that a like view would be

[4] That this doctrine is wholly unsound is convincingly demonstrated by Pound, *Common Law and Legislation* (1908), 21 Harv. L. Rev. 383.

[5] See *Manning v. Gasharie*, 27 Ind. 399 (1866); *Coleman v. Coleman*, 78 Ind. 344 (1881).

taken of the existing limited partnership statute and indeed it seems that business men have already made this inference, as is shown by their disinclination to make any use of the statute. But, however this may be, the statute, as will presently appear, is so rigid in its express language as to make it impossible for the court to obtain results which could be otherwise than severe, even if it desired so to do.

But the situation in Indiana was and is by no means unique. Nearly all of the original limited partnership statutes imposed rather severe liabilities upon persons who attempted to use them —at any rate if these persons made the slightest mistake in their procedure. It is true that in some jurisdictions, at least, a tendency has been apparent in the last few decades toward a more liberal interpretation of the statute and in particular toward a relief from liabilities from merely slight and inconsequential deviations from the prescribed procedure.[6] Yet the situation was quite unsatisfactory, since business men still felt that the protection which the statute was supposed to give to the limited partners was unsatisfactory.

Recognizing that this was a situation demanding remedy in most jurisdictions, the matter was considered by the commissioners on Uniform State Laws of the American Bar Association, and a proposed uniform act was drafted and submitted in 1916. Unlike many of the uniform acts, which were intended merely to codify the existing law on the subject, this act was avowedly remedial in character. It was intended to make limited partnerships a useful, and in fact used, method of business organization, by removing the danger of unlimited liability which was cast by the older statutes upon innocent persons believing themselves to be special partners, as a result of the most minute and inconsequential variations from the statutory procedure, not

[6] The most conspicuous examples of this liberalising tendency are *Manhattan Co. v. Lainbeer*, 108 N. Y. 578, 15 N. E. 712 (1888), holding that a special partner is not subjected to the liability of a general partner by reason of the failure of a county clerk, to whom a certificate had been given for recording, to actually record it; and *Chick v. Robinson*, 95 Fed. 619 (1899), holding that under the Michigan statute a payment by check of the amount to be contributed is sufficient, even though the check is not collected at once. Both of these opinions contain language advocating a liberal construction of the limited partnership statutes, in the interest of a reasonably adequate protection of the limited partners. But there are many even recent authorities which are contrary to these cases, both in the precise decisions and in the spirit of construction.

only by themselves but by their partners. The enactment of this uniform statute therefore represents a definite change in policy by those states which have adopted it and it would be a definite change of policy by Indiana—a change which, however, seems distinctly desirable.[7]

A brief analysis of the important provisions of the Indiana statute will now be made, together with some consideration of the changes which would be effected by the enactment of the Uniform Limited Partnership Act.

Limited partnerships are authorized in this state for any business except insurance.[8] The question of what businesses if any are to be forbidden to limited partnerships is one of policy and is indeed left open in the Uniform Act. Accordingly, this prohibition might be continued even if Indiana should adopt the new act. It is submitted, however, that the restriction is unfortunate. Limited partnerships have a certain very narrow usefulness in ordinary commercial business, particularly where an older man desires to retire from active business in favor of his younger partners (frequently sons), but where it is essential to the proper carrying on of the business that he leave a substantial amount of capital in it. However, the utility of limited partnerships in this sort of business is not very extensive; a corporation is the more usual method. The most common use, and it is believed the greatest utility, of limited partnerships (where there is no statute prohibiting) is in financial business—insurance, brokerage and investment banking. Here limited partnerships are often more desirable than corporations because of the unlimited liability of the general partners and the consequent greater financial responsibility of the firm. To restrict limited partnerships from the very sort of business to which they are best adapted, seems, therefore, quite unfortunate.

Next follows provisions[9] with respect to the composition of the firm (at least one general and one special partner) and a statement respecting the contributions to capital, which are always required from each special partner. In Indiana, which in this respect is somewhat more liberal than many states, this

[7] The Uniform Limited Partnership Act has been adopted in fourteen states. For an excellent discussion of the provisions of the Act and the purpose for which it was designed, see W. D. Lewis, *The Uniform Limited Partnership Act* (1917), 65 U. of Pa. L. Rev. 715.

[8] Burns', Sec. 12141.

[9] Burns', Sec. 12142.

contribution may be made in goods as well as in cash. The frequent controversies which have arisen in some states as to what constitutes payment in cash are thus avoided in this state.[10] However, it is required that where the contribution is not in cash the certificate shall so state,[11] and that the property contributed be appraised by an appraiser appointed by the Circuit Court. It would seem clear that such appraisal should be at only the net value of the assets, deducting any incumbrances.[12] This provision for appraisals is not made in the Uniform Act. It seems to be a safeguard not without a certain value, but the protection thus obtained by creditors may perhaps hardly be considered to be worth the expense and delay caused by this requirement.

Next follows the vital provisions with respect to the making, filing and recording of the certificate.[13] This is the most important phase of the law, since the certificate is the only source of information to the creditors of the existence of the limited partnership and the consequent absence of personal liability of the special partners, as well as of the amount contributed by the special partners. Accordingly it is held with practical unanimity that any false statement in the certificate, or any failure to comply, with the utmost exactness, with the requirements of the statutes as to the execution and recording of the certificate, subjects the special partners to the liability of general partners.[14]

[10] The most horrible example of such difficulties is *Haggerty v. Foster*, 103 Mass. 17 (1869), holding that a contribution of government bonds though worth more than their face amount (and actually realizing more) were not cash within the meaning of this requirement. A similar narrow decision is *Durant v. Abendroth*, 69 N. Y. 148 (1877), practically holding that a check is not cash for this purpose. *White v. Eiseman*, 134 N. Y. 101, 31 N. E. 276 (1892), and *Chick v. Robinson, supra*, note 6, take the opposite view as to checks.

[11] Compare, *Holiday v. Union Bag and Paper Co.*, 3 Colo. 342 (1877).

[12] *First National Bank v. Creveling*, 177 Pa. 270, 35 Atl. 595 (1896).

[13] Burns', Secs. 12143-12145.

[14] See the cases cited in notes 10 to 12; also *Richardson v. Hogg*, 38 Pa. 153 (1861); *Van Ingen v. Whitman*, 62 N. Y. 513 (1875); *Lineweaver v. Slagle*, 64 Md. 465, 2 Atl. 693 (1886); *Strang v. Thomas*, 114 Wis. 599, 91 N. W. 237 (1902). It has been held, however, that in some circumstances a creditor who has participated in the formation of a limited partnership or has dealt with it as such may be estopped to set up any such dereliction so as to hold special partners to general liability. *Tracy v. Tuffly*, 134 U. S. 206, 10 Sup. Ct. 527 (1889); *Allegheny National Bank v. Bailey*, 147 Pa. 111, 23 Atl. 439 (1892). And, of course, it is no defense to a person sued by an alleged limited partnership that the special partner or partners in the plaintiff firm may have acted in such a manner as to subject them-

Such is indeed the express provisions of the Indiana statute; and it may be assumed that the courts would impose this liability with extreme strictness.

The Uniform Partnership Act is in this respect actually more considerate of the interests of the creditors than the older statutes of which that of Indiana is a type. The provisions of the certificate prescribed by the Uniform Act are much more elaborate and therefore more instructive to the creditors than those of the Indiana Act. In the matter of publicity, the Uniform Act has deleted the Indiana requirement of publication, though retaining the public recording. The requirement of publication is in these days of very little benefit to the creditors since the probability of the publication coming to their notice is not very great. The Indiana act requires filing in each county where the partnership has an office[15] while the Uniform Act requires but one filing. Here the Indiana rule seems to be somewhat desirable and might perhaps be retained if the Uniform Act were adopted in this state.

The provision of the Indiana statute in regard to renewal or continuation of a limited partnership[16] is also quite troublesome. The statute requires the making, recording and publishing of a certificate in exactly the same manner as when the partnership was originally formed, under penalty of general liability of special partners in case of a failure. The special partner is in difficulties from this, not only because of the stringent requirements as to the mechanics of preparation of this certificate, but also because in case of any impairment of capital he is likely to be held as a general partner in that he has failed to contribute the amount specified in the new certificate, and this notwithstanding his ignorance of such impairment.[17] The Uniform Act obviates

selves to the liability of general partners. *Clement v. British American Assurance Company*, 141 Mass. 298, 5 N. E. 847 (1886).

[15] If this is not done, the special partner is liable as a general partner as to all business carried on by the office in the county where the certificate is not recorded but that liability may not extend to business carried on by the office in the county where it is recorded. See *O'Connor v. Graff*, 186 App. Div. 163, 173 N. Y. Supp. 730 (1919).

[16] Burns', Sec. 12146.

[17] This result was reached in *Haddock v. Grinnell*, 109 Pa. 372, 1 Atl. 174 (1885), and *Durgin v. Colburn*, 176 Mass. 710, 57 N. E. 213 (1900). However, in *Fifth Ave. Bank v. Colgate*, 120 N. Y. 381, 24 N. E. 799 (1890), the court reached the opposite result, on the theory that the New York statute does not require any statement as to the condition of the capital in a renewal certificate, and so any statement actually made could be ignored

this difficulty by providing for continuation by mere amendment of the certificate. Under such circumstances the partnership simply continues in existence and possible impairment of capital is not serious.

The next section of the Indiana statute[18] with a section of the 1903 Act supplementing it[19] is concerned mainly with the powers of the special partner. In general, he is forbidden to carry on any partnership business or to attempt to bind the general partners;[20] but he is given the right to examine the books and to give his advice to the general partners, advice which, however, they are under only a moral obligation, if that much, to follow.[21] This is, of course, a fundamental theory of limited partnerships; there can be no possible reason for exempting a partner, who actually participates in the business, from full liability. Such is, therefore, the provision of the Uniform Limited Partnership Act. However, it is expressly provided in that act that such partners may lend money to the partnership and may rank with the general creditors therefor; a power which they probably do not possess without express statutory authorization.[22] The imposition of the liability of a general partner upon a special partner of course carries with it the rights of a general partner, also;[23] but this is generally cold comfort for the supposed special partner, especially as the liability generally becomes important only after the firm has become insolvent.

As to the next section of the statute,[24] forbidding any reduction of the capital stock of the partnership through withdrawals,

as surplusage. Obviously this New York rule is not applicable under the Indiana statutes.

[18] Burns', Sec. 12147.

[19] Burns', Sec. 12154.

[20] It follows that a special partner has no power to bind the firm. *Columbia Land and Cattle Co. v. Daly*, 46 Kans. 504, 26 Pac. 1042 (1891).

[21] Where a special partner appointed his son as his clerk and provides in his agreement with the general partners that no expenditures could be made without the son's approval, it was held that the special partner had such control of the partnership business as to make him a general partner. *Richardson v. Hogg, supra*, note 14.

[22] Dunning's Appeal, 44 Pa. 150 (1863); *Jaffe v. Krum*, 88 Mo. 669 (1886). But in *Clapp v. Lacey*, 35 Conn. 436 (1868), the opposite result was reached, under a somewhat different statute.

[23] *Hutchins v. Page*, 204 Mass. 284, 90 N. E. 565 (1910). But cf. *Tilge v. Brooks*, 124 Pa. 178, 16 Atl. 746 (1889).

[24] Burns', Sec. 12148. Sec. 12156, a part of the 1903 act, relates to the same subject.

much the same may be said. The liability which the Indiana act imposes for a violation of this provision is not very severe—it is only that the special partner must pay back such withdrawals. Probably the customary but more severe penalty of general liabilities would be imposed in case of a mere colorable compliance with the statute as, for instance, the return to the special partner of all or part of his contribution under the guise of payment for property, etc.[25] But this provision certainly cannot be seriously objected to.

The Indiana statute contains provisions with respect to assignment by a limited partnership to pay its debts.[26] This is not a matter of consequence and is not specifically provided for in the Uniform Act. It is probable that such an assignment if otherwise complying with the statute can be made by a limited as well as by a special partner.[27]

The Indiana act further provides that in case of suit by or against a limited partnership only the general partners shall be made parties except where the special partners have through some dereliction subjected themselves to the liabilities of general partners.[28] This would seem to indicate that a person who becomes liable as a general partner is in fact a general partner—contrary to certain decisions in other jurisdictions.[29] The rule would, however, appear to be clearly correct.

As already seen, formation and renewal of limited partnerships are very technical and highly dangerous in Indiana. Dissolution appears to be nearly as bad. The provision is that there shall be no dissolution, except by operation of law, unless by making, recording and publishing a certificate of dissolution in the same manner and with the same formalities as the earlier certificate.[30] Here again is a troublesome and technical procedure which is not necessary under the Uniform Act. However, the danger to the special partner is perhaps not so great as in

[25] *Lineweaver v. Slagle, supra,* note 14; *Metropolitan Bank v. Sirret,* 97 N. Y. 320 (1884), is difficult to reconcile with this doctrine, and seems of doubtful soundness. See also, *Madison County Bank v. Gould,* 5 Hill (N. Y.) 309 (1843).

[26] Burns', Secs. 12149-12150.

[27] *Tracy v. Tuffly, supra,* note 14; *Continental National Bank v. Strauss,* 137 N. Y. 148, 32 N. E. 1066 (1893).

[28] Burns', Sec. 12151.

[29] *McKnight v. Ratcliff,* 44 Pa. 156 (1863); *Tilge v. Brooks, supra,* note 23.

[30] Burns', Sec. 12152.

the other cases, since in the event of failure to dissolve properly, the partnership continues, and the special partners remain special partners. Since the special partner has nothing to do with carrying on the business, there would seem to be no necessity that he should give notice to the creditors of the firm, whether present or future.

The foregoing discussion has covered all the provisions of the original Indiana act of 1859 which are still in force, together with one or two sections of the 1903 act which are merely supplementary to the earlier statute. There are, however, a few provisions of the more recent act which are worthy of separate consideration. One of these, and one of distinctly liberalizing tendency, is a provision that capital of limited partnerships may be increased by taking in new partners or by new subscriptions to capital by existing partners.[31] Thus increase is to be shown by a certificate to be executed and recorded; but it is specifically provided that a failure to carry out this provision shall not dissolve the partnership or subject the special partners to the liability of general partners. This provision shows a distinctly modern trend away from the rigid and severe provisions of the older statute. It is a step in the right direction but a very small one. Other important provisions are that a special partner may with the consent of his partners transfer his interest in the firm without causing a dissolution of the partnership[32] and that the insolvency of a special partner shall likewise not dissolve the firm.[33] These provisions are in accordance with the growing recognition of the fact that while a special partner is a partner yet he is not in the confidential relationship to the general partners which would be the case in any ordinary firm.[34] Thus it has been held in New York that a special partner may engage in a competing business without being guilty of bad faith toward his general partners.[35] Such would seem to be the situation in Indiana.

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[31] Burns', Sec. 12157.

[32] Burns', Sec. 12158.

[33] Burns', Sec. 12159.

[34] The Uniform Partnership Act has similar provisions and also specifically provides that the death of a special partner shall not dissolve the partnership. But in any event, a person to be a special partner must be more than a mere creditor of the firm. *Richardson v. Carlton*, 109 Ia. 515, 80 N. W. 532 (1899). However, a special partner under the Uniform Act is hardly to be considered a partner at all.

[35] *Skolny v. Richter*, 139 App. Div. 534, 124 N. Y. Supp. 152 (1910).

As already stated, the purpose of the Uniform Limited Partnership Act was to get away from the rather savage penalty of liability as a general partner imposed by most of the statutes upon a special partner where there was the slightest defect in the formation or conduct of the partnership—a defect of which the special partner would often know nothing and which he could not always control.[36] Some of the liberalizing provisions of the Uniform Act have already been referred to but thus far some of the most fundamental of these provisions have not been touched on. Of these the most important is unquestionably Section 11, which provides: "A person who has contributed to the capital of a business conducted by a person or partnership, erroneously believing that he has become a limited partner in a limited partnership, is not, by reason of his exercise of the rights of a limited partner, a general partner with the person or in the partnership carrying on the business, or bound by the obligations of such person or partnership; provided, that on ascertaining the mistake he promptly renounces his interest in the profits of the business, or other compensation by way of income."

This obviously means that so long as the special partner acts in good faith and remedies any defects as soon as he learns of them he will not be subjected to the liabilities of a general partner. In fact it has been held in Illinois that under this provision special partners were not subject to the liabilities of a general partner although the limited partnership was formed for purposes forbidden by the laws of the state to be carried on by a limited partnership.[37] The recent tendency has undoubtedly been toward a more liberal construction of the old laws in the interest of the special partner,[38] but obviously this single provision accomplishes more than any court could do through mere construction. By protecting the special partners, it insures the reasonable and proper use of the limited partnership when economically desirable—a result which is not and obviously cannot be obtained under such a rigid statute as still governs in Indiana.

Another important provision of the Uniform Act is one by which the same person may become both a general and a special

[36] Another scheme which the Uniform Partnership Act introduces to correct this situation is to restrict somewhat the powers of the general partners as against the special partners.

[37] *Gilles v. Vette*, 263 U. S. 553, 44 Sup. Ct. 157 (1924). See comment on the decision of the lower court in this case in 36 Harv. L. Rev. 1016.

[38] See page 423, *supra*.

partner in the firm. The result of this is that a person who is a general and at the same time a special partner has all the rights and powers, and is subject to all the liabilities, of a general partner, except that in regard to his contributions he has the right against the other partners if he were not a partner. There is also a provision which should have a very large effect in the encouraging of the formation of limited partnerships, since it enables persons desiring to do so, to be in the dual position of a general partner in so far as creditors are concerned and a special partner in relation to their co-partners.[39]

The situation in this state then seems to be as follows: Indiana has, and long has had, a limited partnership act of the conventional type. However, the act has been made little use of, because the possibility of full liability was so serious as to make it seem useless to attempt to carry on business in this manner. In spite of a rather weak attempt to liberalize the act in the early years of the present century that condition still exists, and it will continue to exist until the menacing possibility of unlimited liability, already referred to, is removed. If Indiana desires, as it seems it should desire, the reasonable use of limited partnerships as business organizations in this state[40] it should adopt the Uniform Limited Partnership Act which will have the effect of protecting all honest persons who desire to become limited partners and will, therefore, make this type of partnership a safe as well as a worth while business organization in this state.

[39] See *Lewis, supra,* note 7, at pp. 725 ff.

[40] Especially in view of the present uncertain position of business trusts in this state. See III Ind. L. J. 318.