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The New PRC Limited Partnership Enterprise Law and the Limited Partnership Law of The United States: A Selective Analytical Comparison

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# THE NEW PRC LIMITED PARTNERSHIP ENTERPRISE LAW AND THE LIMITED PARTNERSHIP LAW OF THE UNITED STATES: A SELECTIVE ANALYTICAL COMPARISON

Yong Wu<sup>1</sup> and Thomas Earl Geu<sup>2</sup>

I.	INTRODUCTION .....	134
A.	Purpose and Recent History .....	134
B.	A Reminder: Civil and Common Law Distinctions .....	135
II.	LIMITED PARTNERSHIP ENTERPRISES: WHAT, WHERE AND WHY .....	137
A.	A Brief and General Overview of Limited Partnerships .....	137
B.	Background: The History, Purpose and Use of Limited Partnerships in the PRC .....	138
C.	Background: The History, Purpose and Use of Limited Partnerships in the USA .....	141
III.	COMPARISON: PROPERTY .....	144
A.	Partnership Property .....	144
B.	The “Partner’s Share”: The Relationship Between Property and Transferable Interests ..	147

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C.	The Partner's Share: Withdrawal and Creditors Rights.....	151
IV.	COMPARISON: LIMITED LIABILITY .....	158
A.	The Basic Liability Scheme .....	158
B.	Contributions, Distributions and Liability.....	161
C.	Limited Liability, Status Changes and New Partners.....	164
D.	Mitigating General Partners Liability .....	165
E.	Extrastatutory Piercing of Limited Liability ...	167
F.	Limited Liability Limited Partnerships: Statutory Protection for All Partners .....	169
V.	CONCLUSION.....	171

## I. INTRODUCTION

### A. PURPOSE AND RECENT HISTORY

The purpose of this article is to better understand the limited partnership law of the People's Republic of China ("PRC" or "China") and the United States of America ("USA" or "United States"). It analyzes and compares selected fundamental aspects of those laws focusing on two broad groups of provisions: (1) property, and (2) limited liability. These groups of related provisions used microcosms to understand the laws in their entirety as well as being independently significant topics. Other characteristics are compared in summary tabular form in the "Comparative Chart: Other Characteristics" which appears as an appendix to this article.

The newest version of the Partnership Enterprise Law of the People's Republic of China was amended and adopted by the National People's Congress ("NPC") on August 27, 2006 and became effective on June 1, 2007.<sup>3</sup> It was promulgated just seventeen months after the amendment, adoption, and promulgation of "The Company Law of the People's Republic of China".<sup>4</sup> Both acts represent a modernization of enterprise law in the PRC and add new concepts and terminology to its law.

One of the new developments in the Partnership Enterprise Law is the addition of the Limited Partnership Enterprise to the menu of enterprise choices available in the PRC. The individual states of the United States of America have a great deal of experience with their versions of the limited partnership law. Thus, a comparison of the limited partnership laws should be helpful to lawyers and businesses in both China and the United States.

3. Hehuo qiye fa [Partnership Enterprise Act] (promulgated by the Standing Comm. Nat'l People's Cong. Feb. 23, 1997, amended Aug. 27, 2006) (P.R.C.).

4. Gongsi fa [Company Law] (promulgated by the Standing Comm. Nat'l People's Cong. Dec. 29, 1993, revised Dec. 25, 1999, revised Oct. 27, 2005) (P.R.C.).

At some basic level it is probably fair to say that the needs and goals of organizations, especially those advancing the goals of society through “profit making” activities, are common across national boundaries. Nonetheless, comparing enterprise law can be misleading because the laws are embedded in different legal systems and in different nations with different histories and cultures which may have different public policy concerns.<sup>5</sup> Stated another way, any comparative analysis of specific laws is necessarily incomplete. The danger to mislead is particularly acute when comparing a new law in one country with a longstanding comparable law in another country.

The USA’s longer experience with limited partnerships, however, may help identify business-based issues that might arise in the use of the PRC’s new limited partnership enterprise. The article will attempt to summarize how these issues have been resolved in the USA but is not necessarily intended as a prescription on how similar issues should be resolved in China. Similarly China’s fresh look at limited partnership law may provide new perspectives and insights unencumbered by long accustomed limited partnership practices and less constrained by legal path dependencies.

This article is divided into parts and will focus on property and liability issues after first providing a very general overview of limited partnerships including reference to their histories, purposes and uses in both countries.

## B. A REMINDER: CIVIL AND COMMON LAW DISTINCTIONS

The PRC generally follows the civil law tradition and the USA follows the common law tradition.<sup>6</sup> The difference be-

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5. See generally, Margaret Fordham, *Comparative Legal Traditions—Introducing the Common Law to Civil Lawyers in Asia*, 1 *ASIAN J. COMP. L.*, art. 11 (2006) [hereinafter *Comparative Legal Traditions*], available at <http://www.bepress.com/asjcl/vol1/iss1/art11>.

6. “[P]robably the most fundamental difference between the two systems lies in the fact that while civil law jurisdictions have comprehensive written codes which are designed to cover every area of the law, common law systems are based on judge-made law, which is developed on a case by case basis.” *Id.* at 1. The common law-civil law distinction, of course, is neither binary nor the only systemic taxonomy. There is, for example, a “socialist law tradition” but that tradition focuses on substance rather than form and it is the form that is the relevant distinction for purposes of this portion of the article. By way of evidence from the late twentieth century:

But, whereas the external forms and the internal divisions of socialist law, as well as its attitude towards the sources of law, the role of the judiciary and judicial procedure are essentially in the civilian mold, the substantive rules of socialist law are heavily laden with the principles of Marxism-Leninism and inspired by the individual countries.

MARY ANN GLENDON, MICHAEL W. GORDON & CHRISTOPHER OSAKWE, *COMPARATIVE LEGAL TRADITIONS IN A NUTSHELL* 261 (1982).

tween the civil law and the common law is well beyond the scope of this article which addresses only limited partnership law. Nonetheless the limited partnership laws are embedded in the legal systems of the two countries which have different systems, history, and approaches. It is necessary, therefore, to briefly acknowledge the broadest distinctions between these traditions as a reminder of the difference in approach to statutory drafting between the systems and the different interpretive approaches to which these laws will be subjected.

Civil codes tend to "offer a sequential view of the law in a given area, moving from first principles to specifics[; to be]. . .written at a high level of abstraction[; to offer] . . .an exhaustive overview of the law"<sup>7</sup> and to be more coherent both internally and within the larger context of the entire code.<sup>8</sup> They tend to be written at a higher level of generality than their common law counterparts because they contain first principles.<sup>9</sup> Probably as a result of the reliance on first principles, civil codes may seem somewhat moralistic when first encountered by a lawyer familiar only with a common law system.<sup>10</sup> Conversely, statutes in common law systems tend to address only select areas of the law but "tend to provide comprehensive rules with respect to specific matters within that area."<sup>11</sup> Thus, legislative acts in common law systems are "exhaustive, but in a difference sense . . . ." <sup>12</sup>

These basic underlying distinctions are mentioned for the purposes of this article because the PRC's new limited partnership act is strikingly similar to the USA's Revised Uniform Limited Partnership Act (1976/1985). Therefore, differences in the language of the statutes (as translated) may be due in part to the distinctions in approach under the common law and civil law systems that do not belie intentional substantive differences. In addition distinctions in approach take on future importance as the law is interpreted and applied on a day-to-day basis. The comparison which follows is limited only to specific statutory language.

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7. Fordham, *supra* note 5, at 2.

8. *Id.* at 6.

9. *Id.* at 2.

10. *See generally id.*

11. *Id.*

12. *Id.*

## II. LIMITED PARTNERSHIP ENTERPRISES: WHAT, WHERE AND WHY

### A. A BRIEF AND GENERAL OVERVIEW OF LIMITED PARTNERSHIPS

In order to establish a framework for specific statutory comparisons, this part of the article first provides a basic and general description of limited partnerships.<sup>13</sup> It is followed by an overview of the history, purpose, and use of limited partnerships in the PRC and the USA.<sup>14</sup> As a practical matter the limited partnership enterprise is a hybrid form of organization which combines attributes of partnerships and corporations. It consists of two types of partners. The first type of partner is the general partner. The general partner has the same rights, obligations, control, authority, and liability as a partner under general partnership law. The limited partnership must have at least one general partner but may have more than one. It must also have at least one limited partner. Limited partners are the other type of partners in a limited partnership. Conceptually, limited partners are passive investors with little or no control of the partnership or no authority to bind the partnership.

In some ways a limited partner is like a shareholder in a corporation. For example, a limited partner is liable for the partnership's liabilities only to the extent of its contribution. In other ways, however, the rights of limited partners are even more limited than those of a shareholder in a corporation and may resemble those of a creditor as much as a corporate shareholder. Nonetheless, under certain circumstances, a limited partner will be treated as a general partner for purposes of liability of the partnership if it exceeds statutory limitations on its management authority.

At the most foundational level, however, limited partnerships are much more like partnerships than they are like corporations or debtor-creditor relationships because the governing structure borrows heavily from general partnership statutes. This is particularly true in such areas as property and the sharing of profits and losses. Indeed, in most jurisdictions the law of limited partnerships simply "supplements" the existing law of partner-

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13. Much of the descriptive information in this section, is expanded, with citation, in Parts II.B. and II.C., *infra*. For "hornbook" descriptions of limited partnership law consistent with this Part of the article see generally, e.g., ROBERT W. HAMILTON, RICHARD A. BOOTH, BUSINESS BASICS FOR LAW STUDENTS at 270-71 (2d ed. 1998); J. DENNIS HYNES, MARK J. LOEWENSTEIN, AGENCY, PARTNERSHIP, AND THE LLC 415-75 (abr. 6th ed. 2003); *Partnership*, 59A AM.JUR. 2d, at 707-833 (2003).

14. See, *infra*, Parts II.B. (PRC) and II.C. (USA).

ships. True to partnership principles, the limited partnership is a more flexible organization wherein the partners (owners) may fashion their relationship contractually within relatively few statutory constraints. The formation of limited partnerships in many common law jurisdictions like the United States is more formalized than is the formation of general partnerships. Unlike in most civil law jurisdictions, the general partnership in a common law jurisdiction does not generally require detailed formal documents to be filed with the government in order to begin or conduct business beyond minimal “certificates” which effect the limited liability of partners.

B. BACKGROUND: THE HISTORY, PURPOSE AND USE OF  
LIMITED PARTNERSHIPS IN THE PEOPLE’S  
REPUBLIC OF CHINA

The limited partnership statute was adopted and promulgated by the National People’s Congress (NPC) of the PRC as a revision to the Partnership Enterprise Law in 2006. It became effective June 1, 2007,<sup>15</sup> and has nationwide applicability.

The history of both the legislation and the limited partnership form of business in China can be divided into stages. The first stage predates the NPC’s adoption of the general partnership enterprise law in 1997.<sup>16</sup> The second stage is the discrete legislative history of the Partnership Enterprise Law (1997); and the third stage is the 2006 revision to the Partnership Enterprise Law adding the limited partnership provisions.

Before 1997 there was no “formal” partnership act of national scope, although the 1986 General Provisions of the Civil Code provided for informal or “dormant” partnerships. These partnerships have no requirements for formal recognition and are usually regarded as a contract rather than as an organization or entity. The dormant partnership is a “union” of individuals, where each partner jointly contributes to the partnership and has joint and several liability for the debts of the partnership, while formal partnerships formed under the 1997 legislation are deemed juridical persons (entities) and have formal requirements for formation.

Most Chinese scholars take the position that the General Provisions of the Civil Code did not prohibit provinces from en-

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15. In China there is only one national legislative body: The National People’s Congress (together with its Standing Committee). Each province’s legislative authority has effect only within its own territory, and its legislation cannot contradict the laws that have been adopted by the NPC and Standing Committee.

16. See *mingfa tongze* [General Principles of Civil Law] (promulgated by the Standing Comm. Nat’l People’s Cong., Apr. 12, 1986, effective Jan. 1, 1987) (P.R.C.), art. 35.

acting limited partnership laws.<sup>17</sup> Indeed, the Shenzhen Special Economic Zone located in Guangdong province, a pioneer in economic reform in China, enacted a municipal partnership act through its local congress on April 20, 1994 which formalized both general and limited partnerships. The limited partnership provisions are found in articles 53 through 69 of Chapter III of its municipal regulations.

The 2006 revision to the 1997 PRC's Partnership Enterprise Law generally follows the Shenzhen structure and closely derives many of its limited partnership provisions therefrom. It is not surprising that the PRC's limited partnership law is rooted in the regulations of the Shenzhen Special Economic Zone because the PRC authorized Shenzhen to exercise economic reform policy as an experiment so that successful economic reforms there could be adopted on a nationwide basis by the NPC. This special political and economic phenomenon is captured by the famous Chinese saying: "Cross the river step by step."

Indeed, the second stage of the historical development of Chinese limited partnership was set because, according to the legislative report on the draft, the limited partnership provided another alternative for capital formation, was familiar to international investors, and played a positive role in economic growth in mature western market economies.<sup>18</sup> This stage occurred during drafting and debate of the PRC Partnership Enterprise Law of 1997. The legislative plan of the Eighth Standing Committee authorized the Financial Subcommittee to draft the Partnership Enterprise Law. The Subcommittee organized a working group consisting of officials from relevant ministries and a specialized consultant group to study and draft the law beginning in May 1994. The Subcommittee adopted a draft of the law which included limited partnership provisions after consulting with law professionals and conducting a field investigation.

The draft law was considered by the Standing Committee in its twenty-second session on October 23, 1996. The provisions relating to limited partnerships, however, were deleted. There were two reasons the provisions were deleted. First, the provi-

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17. Tian Tucheng, *Yinming hehuo yu youxian hehuo bijiao yanjiu—jianlun qi tongshi sheli di biyaoxing he helixing* [Analysis of Consistency of the Civil Law Dormant Partnership and the Existence of Limited Partnerships], 35 (6) *Zhengzhou daxue xuebao, zhexue shehui kexue ban* [J. ZHENZHOU UNIV., PHILO & SOC. SCI. ED.] 72 (2002).

18. Huang Yicheng, *Vice Director of NPC Financial Committee, guanyu "Zhonghua Renmin Gongheguo hehuo qiye fa (caoan) di shuoming"* [The Report on the Draft of Partnership Enterprise Law of PRC], 22nd Sess., Standing Comm., 8th NPC, Oct. 23, 1996, *in* *Zhuonghua Renmin Gongheguo hehuo qiye fa shiyi* [Interpretation of PRC Partnership Enterprise Law] (Quanguo renda changweihui fa gong wei bian [NPC Legislative Committee eds.], 2006).



sions appeared within a broader partnership act rather than in a separate specialized act relating only to limited partnerships. Jurisdictions in mature market economies typically have separate laws. Second, limited partnerships had not emerged on a large scale under the Shenzhen special economic zone law. Thus, it did not appear that there was urgent market demand for the form of business.

The third stage of development of limited partnerships in China is the period between the adoption of the Partnership Enterprise Law (1997) and its revision in 2006 which added the limited partnership provisions. In that period the PRC economy accelerated quickly spawning private sources of capital. During the same period the central government accumulated a large foreign exchange reserve. The central government recognized that the capital represented an opportunity to promote long-term core economic competitive competencies through the development of advanced technology. Thus, in 1999, the State Council adopted a policy encouraging scientific innovation. It recognized the risk-return tradeoff required for innovation and that innovative research and development requires capital.<sup>19</sup>

In response to the policy, provincial level legislative bodies introduced limited partnerships as alternative legal entities in order to promote innovation.<sup>20</sup> For example, on February 21, 2001, the Beijing municipal government promulgated a limited partnership act for capital intensive enterprises. It required that total capital contributions of limited partners be a minimum of 10 million yuan (in excess of 1.25 million dollars).<sup>21</sup> Other provinces and municipalities followed the trend.

In February 2004, a working group was established by the NPC Standing Committee and charged with the revision of the Partnership Enterprise Law (1997). There was urgent demand from both business and law experts for the revision to contain limited partnership provisions consistent with the announced policy of encouraging scientific and technological innovation. On April 25, 2006, the Financial and Economic Subcommittee of the NPC reported a first version of the revised Partnership Enterprise Law to the NPC Standing Committee. After two subsequent drafts, the law was adopted on August 27, 2006.

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19. *Cf. infra* notes 123–25 and accompanying text.

20. More than ten municipal governments or provinces have promulgated limited partnership laws including, for example, Szechwan, Shansi, Shandong, Hebei, Fukien, Kwangtung, Beijing, Shensi, Kiansu, Tianjin, and Shanghai.

21. Beijing Shi Renmin Zhengfu guanyu youxian hehuo guanli [Beijing Munic. Gov't Limited Partnership Regulation] (effective Feb. 21, 2001) (P.R.C.), art. 4(3).

Like its USA counterpart, the PRC limited partnership encourages capital investment by offering limited liability to limited partners and a single level tax at the member level.

### C. BACKGROUND: THE HISTORY, PURPOSE AND USE OF LIMITED PARTNERSHIPS IN THE UNITED STATES OF AMERICA

The use of limited partnerships in the USA is directly derived from two of its unique features: (1) the vesting of great authority in the general partner and (2) partnership income tax treatment which taxes income only at the partner level (not the partnership *and* partner levels). This approach to taxation allows losses at the partnership level to offset certain other types of income that a partner reports on his, her or its, federal income tax return. Limited partnerships, therefore, are popular choices in the United States as investment vehicles in the finance and oil and gas industries. They are widely used for real estate development, the entertainment industry (movies and theatrical productions), research and development ventures, and, somewhat paradoxically, family businesses.<sup>22</sup>

Limited partnerships are used for family businesses because they allow parents who own successful businesses to retain control of the business as general partners while at the same time allowing significant economic involvement by children. Moreover, the limited partnership may offer estate tax advantages as well as income tax advantages in the context of family businesses.<sup>23</sup>

The limited partnership is a contractual entity governed by state statutory law in the United States. Most states have adopted, with modifications unique in each state, some version of the Uniform Limited Partnership Act which is drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL).<sup>24</sup> NCCUSL encourages states to adopt its uniform acts as legislation.

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22. ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP, § 11.01(f), at 11:10.1–11 (2005 supp.) [hereinafter BROMBERG & RIBSTEIN].

23. See, e.g., Thomas Earl Geu, *Selected Estate Planning Aspects of the Uniform Limited Partnership Act* (2001), 37 SUFFOLK U. L. REV. 735 (2004).

24. The National Conference of Commissioners on Uniform State Laws is a not-for-profit corporation organized and funded by the state governments of the United States. Its “purpose is to promote uniformity in state law on all subjects where uniformity is practical and advisable.” All commissioners are appointed by their state government, are lawyers, and serve without compensation. Conflict of interest rules are strictly observed. See <http://www.nccusl.org/update> (last visited Nov 9, 2007).

The Uniform Limited Partnership Act is now in its fourth generation.<sup>25</sup> It was originally promulgated by NCCUSL in 1916 and substantial revisions were made in 1976 and 1985. The version that contains both the 1976 and 1985 revisions is generally known as the Revised Uniform Limited Partnership Act (1976/1985) and is referred to as “RULPA (1976/1985).”<sup>26</sup> NCCUSL completely revised RULPA (1976/1985) in 2001, and the act which replaced RULPA is known as ULPA (2001). As of November 9, 2007, approximately fourteen states have adopted ULPA (2001).<sup>27</sup> Thus RULPA (1976/1985) currently remains the basis of most limited partnership law in the USA.

State acts based on RULPA (1976/1985) are “linked” to the state’s general partnership act. “‘Linkage’ is the process by which certain rules governing limited partnerships are borrowed from a general partnership statute.”<sup>28</sup> ULPA (2001), however, is not linked to the general partnership statutes. That is, ULPA (2001) is a fully self-contained organizational statute without relying on partnership law outside the act itself. Its drafters listed the following advantages for a self-contained act: (1) convenience of use by lawyers, business people and the general public; (2) elimination of “confusion as to which issues were solely subject to the limited partnership act and which required reference. . .to the general partnership act;” and (3) rationalization of future decisions in limited partnership controversies by eliminating the aforementioned confusion.<sup>29</sup>

ULPA (2001) varies the law on limited partnerships in several other material respects and provides or recognizes several innovations emanating from state law modification of RULPA (1976/1985). Discussion of those changes is beyond the scope of this article but some of its attributes are compared in the chart

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For an example of how states may modify “uniform” laws *see, e.g.*, Allan W. Vestal & Thomas E. Rutledge, *Modern Partnership Law Comes to Kentucky: Comparing the Kentucky Revised Uniform Partnership Act and the Uniform Act from which it was derived*, 95 Ky. L. J. 715 (2006–2007).

25. Craig B. Smith & Roger D. Anderson, *Limited Partnerships: Legal Aspects of Organization, Operation, and Dissolution*, 24-4th C.P.S. (BNA), at A-1 (2006 supp.).

26. *Id.*

27. <http://www.nccusl.org/Update> (follow “Final Acts and Legislation” hyperlink; then select “Limited Partnership Act”; then follow “Legislative Fact Sheet” hyperlink) (last visited Nov. 9, 2007).

28. ROBERT R. KEATINGE & ANN E. CONAWAY, KEATINGE AND CONAWAY ON CHOICE OF BUSINESS ENTITY, § 2:3, at 26 (2006) [hereinafter KEATINGE & CONAWAY].

29. Daniel S. Kleinberger, *Prefatory Note to UNIF. LTD. P'SHIP ACT* (amended 2001), 6A U.L.A. 3 (2003).

appearing as the appendix to this article.<sup>30</sup> If these changes prove useful in practice in the United States, it is possible that they may influence future legislation in other nations including the PRC.

The original 1916 Uniform Limited Partnership Act was based on earlier acts of the various states. The first states to enact such laws were New York in 1822, Connecticut in 1822, and Pennsylvania in 1836.<sup>31</sup> Interestingly, English law did not recognize the limited partnership until 1907<sup>32</sup> but an organization similar to the limited partnership, the *commenda*, “was sanctioned by the French Ordinance on Commerce in 1673.”<sup>33</sup> Indeed, it appears the limited partnership was “the first instance in which American states derived statutory law from a country other than England.”<sup>34</sup> For purposes of this article it is interesting that USA limited partnerships derived from a civil law jurisdiction, France.

Finally, a relatively new form of entity in the USA called the limited liability company (LLC) has undoubtedly negatively affected the frequency of use of limited partnerships in the United States.<sup>35</sup> The LLC shares many characteristics of the limited

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30. See generally BROMBERG & RIBSTEIN, *supra* note 22; SMITH & ANDERSON, *supra* note 25; Thomas Earl Geu & Barry B. Nekritz, *Expectations for the Twenty-First Century: An Overview of the New Limited Partnership Act*. 16 PROB. & PROP. 47, 47-55 (Jan/Feb 2002).

31. BROMBERG & RIBSTEIN, *supra* note 22, § 11.02(a), at 11:21.

32. *Id.* at 11:22.

33. *Id.* at 11:21.

34. *Id.*

35. For example, a treatise compares the Delaware business formation filing for calendar year s2002 and 2001. It states:

[T]he number of new LLCs [2002]. . . formed [in 2002] increased by 4,292 or 10% (from 43,434 to 47,627), while the number of new corporations decreased by 3,033 or eight percent (from 39,289 to 36,256), and the number of new limited partnerships being formed increased by 93 or two percent (from 5,647 to 5,740).

LARRY E. RIBSTEIN, ROBERT R. KEATINGE, 1 RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES (2d ed.) § 1:2 at p. 1-2 (citation omitted).

See generally, Jeffrey A. Maine, *Evaluating Supchapter S in a “Check-the-Box” World*, 51 TAX. L. 717 at 720-736 (1998) (using IRS statistics to show a precipitous rise in the use of LLCs and providing a history of LLCs); Larry E. Ribstein, *The Deregulation of Limited Liability and the Death of the Partnership*, 70 WASH. U. L.Q. 417 (1992) (predicting that the use of LLCs would decrease the use of partnerships).

The history of the evolution of the USA limited liability company is well documented. See, e.g., Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459 (1998); RIBSTEIN & KEATINGE, *supra*; WILLIAM BAGLEY, PHILIP WHYNOTT, 1 THE LIMITED LIABILITY COMPANY (1994); Thomas Earl Geu, *Understanding the Limited Liability Company: A Basic Comparative Primer (Part One)*, 37 S.D. L.Rev. 44, 44-50 (1992) and sources cited therein (for observations concurrent with the early history of LLCs); Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 Case W. RES. L. REV. 387, 389-91 (same).

partnership. The LLC in the United States is a partnership-based organization and is therefore unlike the PRC organization of the same name which is a category of corporation (company). The typical LLC in both countries typically has a relatively small number of shareholders or members (owners). The United States version of the LLC is eligible for partnership income tax treatment like the limited partnership. One of the features that distinguishes an LLC from a limited partnership is that there is no requirement for a general partner with *unlimited* liability.<sup>36</sup> Nonetheless, limited partnerships remain a popular entity choice in the United States because the entity is familiar to business planners and because, unlike LLCs formed in exclusive reliance on the statutory default rules, limited partnerships allow for strong centralized management.<sup>37</sup>

### III. COMPARISON: PROPERTY

#### A. PARTNERSHIP PROPERTY

The property provisions applicable to limited partners are found in articles 64 and 65 (relating to “contributions” of limited partners); articles 72 through 74 (concerning the voluntary or involuntary transfer of a limited partnership interest by a limited partners); and articles 78 through 80 (concerning the cause and effect of withdrawal/dissociation). The basic property provisions of the limited partnership enterprise and the general partners are found in Chapter II, Section 2, governing general partnership en-

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The history of LLCs is a study of the co-evolution of state organizational law and the federal income tax. The first state to enact LLC legislation was Wyoming in 1977. It was modeled roughly on a type of business found in some civil law countries. Its purpose was to marry limited liability with partnership flow-through income tax treatment for purposes of the federal income tax. Five years later Florida adopted an LLC Act. The uncertainty regarding whether the Internal Revenue Service (IRS) would classify the LLC as a partnership for tax purposes, however, slowed the use of the entity and arrested legislative development. Then, in 1988, the IRS administratively determined that an LLC organized under the Wyoming LLC Act was a partnership for purposes of the federal income tax. REV. RUL. 88-76, 1988-2 C.B. 360. In 1990 two states (Kansas and Colorado) adopted acts; in 1991 four states adopted acts; in 1992, 10 states adopted acts; in 1993, another 10 states adopted acts; and in 1994, 18 states adopted acts. By the end of 1996 every state and the District of Columbia had LLC acts. Maine, *supra*, at 727 n.60. A Uniform Limited Liability Company Act was promulgated by the Uniform Laws Commission in 1996 and significantly revised in 2007.

In late 1996 the IRS issued final regulations which represented a sea-change in its approach to entity classification. TREAS. REGS. § 301.7701. These regulations, known as the “check-the-box regulations,” made it much easier for state law unincorporated entities including the LLC to be classified as partnerships for purposes of the federal income tax.

36. KEATINGE & CONAWAY, *supra* note 28, § 2:3, at 26.

37. See BROMBERG & RIBSTEIN, *supra* note 22, § 11.01(f), at 11:18.1.

terprises and made applicable to limited partnerships by “linkage.”<sup>38</sup>

Understanding these provisions (and the relevant comparisons to USA partnership law) requires analysis along two different dimensions. The first dimension includes the “inside” treatment of property used for partnership purposes and the “outside” treatment of the property rights of the individual partners. The second dimension is time and how the treatment of inside and outside property varies over the life cycle of the partnership; that is, through the stages of “getting in” (formation), operating (conducting the business activities of the enterprise), and “getting out” (including both the termination of the enterprise and a partner ending its partnership relationship with the enterprise).

The interpretation of “inside” treatment of property in the United States is aided by the general partnership law (RUPA) which unequivocally states that a partnership is a juridical person; or in the words of RUPA (1997) an “entity.”<sup>39</sup> The partnership enterprise law in the PRC does not contain such a statement.<sup>40</sup> Like the PRC Act, prior law in the United States (UPA 1916) did not contain such a statement. Its silence reflected a long standing theoretical debate in the United States as to whether a partnership is best categorized as a separate juridical person apart from its partners or as a confederacy of partners that does not rise to the level of a separate “entity.”<sup>41</sup> The answer in the United States, even under RUPA, is probably that it is both an “aggregate” confederation and an entity depending on the specific topic being addressed.<sup>42</sup> One area where the aggregate-entity theory animated the practical conduct of partnership

38. See, *supra* Part II(A).

39. Unif. P’Ship Act (amended 1997), § 201(a) (“A partnership is an entity distinct from its partners.”) [hereinafter RUPA (1997)].

40. *But see* Partnership Enterprise Act, *supra* note 3, arts. 36, 52.

41. See generally STEPHEN M. BAINBRIDGE, AGENCY, PARTNERSHIPS & LLCs 115–16 (2004).

42. The “entity” concept provides the theoretical basis, for example, of the partnership being able to sue or be sued in its own name and being able to transfer property in its own name. See, *supra* note 41 and accompanying text. As stated in a textbook:

RUPA [(1997)] § 201 provides that a partnership is “an entity distinct from its partners.” In contrast, the UPA [(1916)] generally embraces an “aggregate theory”, i.e., it considers a partnership not as a separate legal person but rather as merely the aggregate of its partners. The debate as to whether a partnership is treated as an aggregate or entity is of very limited practical significance. There are provisions in RUPA [(1997)] that are more consistent with the aggregate theory than the entity theory, and there are provisions in UPA [(1916)] that are more consistent with the entity theory than the aggregate theory.

activities concerned how a partnership (including a limited partnership) conveyed, sold, or assigned "its" property.<sup>43</sup> The PRC partnership addresses these practical issues in articles 21, 20 and 17, respectively.

Article 21 succinctly states: "All the capital contribution made by partners, the proceeds and other properties acquired in the name of a partnership shall be properties of the partnership enterprise." The RUPA section that is directly comparable is more detailed but has the same effect.<sup>44</sup> The PRC Partnership Enterprise Law requires non-monetary property contributions to comply with formal transfer required by other law, if any, under article 17, paragraph 2.

Finally, as a matter of ownership of property and the aggregate-entity distinction, article 21 states unless otherwise provided in the Partnership Enterprise Law, "no partner may request dividing the properties of the partnership enterprise."<sup>45</sup> The combined effect of these articles is evidence that the PRC partnership enterprise is an entity for purposes of property ownership.<sup>46</sup>

The statement in article 21 that "[p]rior to liquidation. . . no partner may request for dividing the properties of the partnership enterprise. . ." is relevant to "outside" property rights (those possessed by the partners) as well as to inside property rights (those possessed by the partnership). The PRC's Partnership Enterprise Law uses the phrase "partner's share of properties" to identify what the partner owns.<sup>47</sup> The meaning of this phrase has determinative significance in several other topics including the determination of what may be assigned to a third party and what may be obtained by a creditor of a partner (as contrasted to a creditor of the partnership enterprise).<sup>48</sup>

The significance of the phrase a "partner's share of properties" is emphasized by the fact that RUPA devotes two sections to describing and defining the partner's ownership interest. One

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DAVID G. EPSTEIN, RICHARD D. FREER, MICHAEL J. ROBERTS, GEORGE B. SHEPHERD, *BUSINESS STRUCTURES* 82 (2d ed. 2007).

43. See, e.g., Unif. P'ship Act (1914), § 25(1) ("A partner is a co-owner with his partners of specific partnership property holding as a tenant in partnership.") [hereinafter UPA (1914)].

44. RUPA (1997), § 204.

45. Partnership Enterprise Act, *supra* note 3, art. 21.

46. RUPA provides for a voluntary filing of a "statement of partnership authority" in the state's Secretary of State's office and the land registry for purposes of specifying agents for purposes of representing the partnership. RUPA (1997), § 303.

47. See, e.g., Partnership Enterprise Act, *supra* note 3, arts. 2, 22, 23, 24, 25, 69, 72, 73.

48. See, *infra* notes 46-48 and accompanying text.

RUPA section contains a negative description; and the other, a positive description of the interest.

RUPA Section 501 contains the negative description. It states: "A partner is not a co-owner of partnership property and has no interest in partnership property which can be transferred, either voluntarily or involuntarily."<sup>49</sup> Section 502 is the positive description of the partner's interest in a partnership before liquidation: "The only transferable interest of a partner in the partnership is the partner's share of profits and losses of the partnership and the partner's right to receive distributions."<sup>50</sup> For purposes of USA partnership law, therefore, the interest that may be assigned is limited to financial rights. Unless otherwise agreed in the partnership agreement, however, those rights are "freely transferable."<sup>51</sup>

#### B. THE "PARTNER'S SHARE": THE RELATIONSHIP BETWEEN PROPERTY AND TRANSFERABLE INTERESTS

The formulation of transferable interest in RUPA differs from the approach taken by UPA (1916) which preceded it. RUPA focuses on the interest that is transferable. The prior law focused on the different "rights" possessed by the partner. Its *partner* focus reflects the more aggregate nature of a partnership formed under UPA (1916) when contrasted with the entity-like nature of the RUPA partnership which emphasizes the ownership interest in the entity as a transferable interest. Even so, RUPA retains the concept of rights contemplated by UPA although RUPA distributes the governing provisions concerning those rights throughout its sections and severely restricts a partner's rights to the property owned by the partnership. Thus, UPA's marshalling of those rights in a single section is useful to help understand RUPA and its "transferable interest" provisions. As stated by UPA: "The property rights of a partner are (1) his rights in specific partnership property, (2) his interest in the partnership, and (3) his right to participate in the management."<sup>52</sup>

Just because the transferable interest may be assigned freely absent agreement to the contrary does not mean that such a transfer will not have both practical business and legal ramifications. A simple example illustrates the practical business problem that might be caused by freely transferable interests. Assume Geu, Wu and Lin establish a small construction con-

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49. RUPA (1997), § 501. *See, supra*, note 15.

50. *Id.* § 502. Thus the transferable interest includes both allocations and distributions. *Id.* §§ 401(a) & (b).

51. *Id.* § 503.

52. UPA (1914), § 24.



tracting general partnership. Geu is a mason, Wu is a carpenter, and Lin has experience in business management. All three are necessary for the successful operation of the business in which the partnership is engaged. Now assume Geu transfers his entire transferable interest in the partnership by selling it to a third party, Smith, who lives far away and is not a mason. Geu is still the partner, and is obligated to perform under the partnership agreement but will receive no current financial benefit having sold his right to future distributions. In the commentary on partnership law in the USA this is known as the “vanishing partner problem.”

RUPA addresses the vanishing partner problem by allowing the remaining partners to expel Geu from the partnership. The expulsion is then treated as a withdrawal (a “dissociation” in the nomenclature of RUPA) which may result in dissolution of the partnership.<sup>53</sup> This expulsion provision probably does not apply to general partners in a RULPA (1976/1985) limited partnership through linkage because RULPA has an express provision concerning assignment of all of a partner’s (defined to mean either a limited or general partner) “partnership interest.”<sup>54</sup> Under RULPA the partner automatically ceases to be a partner<sup>55</sup> but the business results can be devastating because the limited partnership must be dissolved and liquidated unless there is at least one other general partner and all the limited partners and remaining partners agree in writing to continue the business.<sup>56</sup>

What is clear for United States limited partnerships governed by RULPA is that the assignment of all of the partnership interest of a limited partner will not usually cause the dissolution of the limited partnership even though the limited partner ceases to be a partner *unless* that limited partner is the only limited partner.<sup>57</sup>

In summary, the transfer or assignment of the “transferable interest” under RUPA or the “partnership interest” under RULPA in the United States can be an operational and life-changing event under the life cycle dimension of analysis even

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53. RUPA (1997), § 601(4)(ii).

54. ULPA (2001), on the other hand, is a free-standing act in part to avoid the necessity of determining if and when general partnership law applies to a limited partnership. *See, e.g.*, Daniel S. Kleinberger, *Prefatory Note* to Unif. Ltd. P’ship Act, 6A U.L.A. 2 (2001) (discussing why ULPA is a free-standing act) [hereinafter ULPA (2001)].

55. Revised Unif. Ltd. P’ship Act (1976, amended 1985), § 702 [hereinafter RULPA (1976/1985)].

56. *Id.* § 801, at 462.

57. The Partnership Enterprise Law converts the limited partnership to a general partnership, “[w]here merely general partners are left.” Partnership Enterprise Act, *supra* note 3, art. 75.

though it occurs as a personal property transaction “outside” the limited partnership “entity.” Once dissolution occurs the result is liquidation unless the partners can negotiate a different result. Events causing a dissociation or a withdrawal which are triggering events for dissolution may be dealt with and managed in the partnership agreement, and careful planners will do so.<sup>58</sup>

Moreover, withdrawing limited partners have a right to receive payment within a reasonable time of fair value for the interest based on an income capitalization valuation as of the date of withdrawal unless otherwise agreed in the partnership agreement.<sup>59</sup> This can have disastrous financial consequences for the limited partnership because it might be forced to sell business assets necessary for its continuing conduct of activities in order to generate enough cash to pay the withdrawing limited partner. Finally, the assignees may gain problematic rights under limited partnership law in the United States.<sup>60</sup>

A limited partnership enterprise established under PRC law faces similar issues. Chapter III (limited partnership enterprises) does not address the transfer or assignment of a general partner’s “share of properties in the partnership enterprise.” Rather, similar to USA law, the assignment of the general partner’s share is dealt with in Chapter II (general partnership enterprises) and made applicable to limited partnerships by linkage.<sup>61</sup> The provisions governing the assignment of general partnership shares are articles 22, 23 and 24. Again, as compared to similar provisions in the USA, they are more succinct and direct, in the civil law tradition. They are not, however, as comprehensive or detailed.

Article 22 requires a general partner to obtain the “unanimous consent of all other partners” before assigning all or part of its share of properties of the partnership enterprise and if the assignment is to a non-partner, “the other partners” have a right, termed a “preemptive right” in article 23, to first purchase the share under the same terms as the sale to the non-partner. This kind of right is often called a “first right of refusal” by USA commentators. Thus, the provisions under the PRC law are more protective of the partnership than those in the USA because there the “transferable interest” (financial rights) are freely transferable. Moreover, as used in article 22, the term “partners” may reasonably be interpreted to mean both general and limited partners. There is also a technical distinction between Article 23 and the withdrawal provisions in the USA which may be trig-

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58. See, e.g., *Adams v. Jarvis*, 127 N.W.2d 400 (Wis. 1964).

59. RULPA (1976/1985) § 604; see also *id.* § 603.

60. See RUPA (1997), § 503(b).

61. Partnership Enterprise Act (2006), *supra* note 3, art. 21.

gered by assignment. Article 23 gives the preemptive purchase right to the *partners* rather than placing the burden of financing the payment to a withdrawing partner on the *partnership* as does the USA law.

Importantly, as under RULPA, the Partnership Enterprise Law allows these statutory terms to be varied by the partnership agreement.<sup>62</sup> Perhaps because the transfer of the share is subject to unanimous consent under article 22, article 24 may be interpreted to mean that the transferee, of either all or a portion of the share, becomes a general partner as a matter of law. Article 24 states:

Where a non-partner accepts a partner's share of properties of a partnership enterprise in accordance with the law, it (he) becomes a partner of the partnership enterprise as soon as the partnership agreement is revised and shall enjoy the rights and perform the obligations in accordance with this Law and the post-revision partnership agreement.

The doubt, if any, as to the admission of the transferee, is because of the language, "as soon as the partnership agreement is revised." The purpose of the quoted language is probably simply a mechanism that reflects the PRC's greater filing requirements when compared to the USA's filing requirements. Of course, as discussed in the next subpart of this article, "obligations" under article 24 includes the liabilities of the partnership.

Chapter III of the Partnership Enterprise Law of the People's Republic of China addresses the assignment of the limited partner's assignment of its share of properties of the partnership enterprise. Subject to the partnership agreement, article 73 states that a limited partner may assign its share to a non-partner. Unlike in the case of a general partner's assignment, this article does not require the assigning limited partner to receive consent of the other partners. Neither does it give the other partners a first right of refusal to purchase the share under equivalent terms and conditions. As discussed later in this article, however, article 74 states that other partners have the right to purchase the share when the partner's creditors request a court to enforce the repayment of the debt with the share of the partner's property in the partnership enterprise.

The statutory limited partnership law of both the PRC and the USA provide very few rights to limited partners in the conduct of the limited partnership business.<sup>63</sup> Nonetheless, the assignment of the limited partnership share again places a great deal of interpretive weight on the meaning of the phrase "share

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62. *Id.* arts. 22-4.

63. *See supra* Part II.

of properties of the partnership enterprise” in the PRC because it is possible that the partnership agreement does give the limited partners rights in addition to the statutory rights. Under those circumstances the interpretation of the phrase will determine whether the assignee/transferee accedes to those rights.

Recall in the context of a general partnership, a transfer of a general partner’s share requires unanimous consent of the partners and then appears to transfer the general partners’ authority along with the general partners’ share. In the case of a limited partner, the law is silent. Of course, given the restricted authority given limited partners by law and the flexibility afforded the partnership agreement, the careful planner will include provisions governing these exigencies when providing greater participation to limited partners. Further, even though Chapter III does not contain the express language used in the context of the assignment of shares of general partners, it does reference and link to Chapter II which contains the general rule that, “[t]he admission of a new partner shall, unless otherwise stipulated in the partnership agreement, be subject to a unanimous consent of all partners. . . .”<sup>64</sup>

### C. THE PARTNER’S SHARE: WITHDRAWAL AND CREDITORS RIGHTS

Finally, another provision seems to relate to the discussion of the assignment of the limited partnership share. The provision also has independent significance. Article 50 states that when a limited partner dies, or in the case an organization is terminated, the heir or successor “may obtain the rights and qualifications of the limited partner in the limited partnership enterprise.” This language rather clearly indicates there is a distinction between “rights and qualifications of a limited partner” and “a limited partner’s share of the properties of the partnership enterprise.”<sup>65</sup> It also places some stress on the interpretation of the statutory word “may.”

Withdrawal of a partner from a limited partnership established under the new law in the PRC has similar consequences as the withdrawal of a partner under RULPA (1976/1985) and, likewise the value of the share may be stipulated in the partnership agreement.<sup>66</sup> Absent contrary agreement the withdrawing partner will receive a return of “the property share” less any liabilities owed the partnership.<sup>67</sup>

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64. Partnership Enterprise Act, *supra* note 3, art. 43.

65. *See id.* art. 50.

66. *Id.* art. 52.

67. *Id.* art. 51.

As a general matter, the events or conditions causing or permitting withdrawal are subject to the partnership agreement.<sup>68</sup> Article 48 lists five circumstances which a general partner will be deemed to have "naturally" (the term probably corresponds to "rightfully" under USA law) withdrawn from the partnership.<sup>69</sup> Only a subset of this list is included for purposes of withdrawal of a limited partner: death, administrative termination or bankruptcy of an organization, and, most importantly for purposes of this part of the article, when the "partner's entire property share in the partnership business has been executed by the People's Court."<sup>70</sup> The most reasonable interpretation of the statute is that under the PRC partnership law, the execution against the entire property share of a partner works a withdrawal, and the value of that share will be determined and paid by the other partners.<sup>71</sup>

The law provides, however, for interim steps before forcing a withdrawal of a limited partner. Article 74 states that the limited partner's separate property apart from his partnership share must be insufficient to pay its individual debts. If its other property is insufficient to pay the debt, the court may then use the distributions ("proceeds" under the statute) to pay its individual creditor. If the debt cannot be satisfied using those assets, the creditor may plead to enforce its debt against the limited partner's property share in the partnership.<sup>72</sup> Even then, the other

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68. *Id.* art. 18(7).

69. Partnership Enterprise Act, article 48 states:

Where any partner is under any of the following circumstances, the said partner shall be deemed to have withdrawn naturally from the partnership:

- (1) A natural person partner is deceased or declared deceased according to law;
- (2) It (he) is insolvent;
- (3) A partner as a legal person or any other organization whose business license is revoked, or who is ordered to close up for revocation, or who is declared bankrupt;
- (4) A partner loses the relevant qualifications as required by law or as stipulated in the partnership agreement; or
- (5) A partner's entire property share in the partnership business has been executed by the people's court.

For a partner who is determined as a person without civil capacity or with limited civil capacity according to law, he may be changed to a limited partner upon unanimous consent of the other parties and the general partnership enterprise shall be changed into a limited partnership enterprise in pursuance of law. For failure of unanimous consent of the other partners, this partner without civil capacity or with limited civil capacity shall withdraw from the partnership.

The withdrawal from the partnership shall take effect on the date it is actually made.

70. *Id.* art. 48.

71. *Id.* arts. 48, 51.

72. *Id.* art. 74.

partners have a preemptive right in the share under the same terms and conditions.<sup>73</sup>

Nonetheless, even if articles 74 and 81 are subject to being interpreted together, standing alone they may also be interpreted inconsistently. Article 74 read standing alone, as soon explained, seems to contemplate a result similar to the one of RUPA, which is no withdrawal, (“dissociation”) thus avoiding any partnership crises caused by payment by either the partners or the partnership because of withdrawal.

Article 78 read alone, however, states the limited partner “shall be deemed to have withdrawn naturally from the partnership” under article 48(5) if the “partner’s entire property share in the partnership enterprise has been executed by the People’s Court.” Article 81 then explains the effect of withdrawal expressly recognizing that the limited partner will likely receive a return of property and further, that the limited partner “shall to the extent of the properties it takes back from the limited partnership enterprise at the time of withdrawal, bear the liabilities for the debts incurred to the limited partnership enterprise prior to its withdrawal.”

Under the focused interpretation of articles 78 and 81, therefore, it appears the individual partner’s creditor would receive the properties “taken back from the limited partnership enterprise” and, ultimately, the creditors of the partnership at the time of the withdrawal would be able to seek repayment from the limited partner to the extent of the value of the returned property. Of course, other law would probably determine the steps necessary for the partnership creditor to realize any satisfaction from the value of the returned property and it seems likely, as a practical matter, the withdrawing partner would have no assets to pay such liability no matter the procedural steps involved.

The provisions concerning creditors’ rights against general partners are straightforward in part because they do not contain any equivalent to article 74. Rather articles 48 and 51 operate to require withdrawal and either settlement or return of property. It further appears that the partnership has some flexibility in determining the timing of the payment to the withdrawing limited or general partner.<sup>74</sup> Moreover, and this point cannot be over-emphasized, no interpretation of these provisions allows the creditor of an individual partner to exercise management or governance rights or authority inside the partnership enterprise, an interpretation made explicit in article 41.<sup>75</sup>

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73. *Id.*

74. *Id.* art. 51.

75. Partnership Enterprise Act, article 41 states:

If an interpretive conundrum exists for determining the rights of creditors for limited partners under the PRC Partnership Enterprise Law it might not be alone among partnership laws because few provisions of partnership law in the United States have received more attention recently than the rights of creditors upon the execution of a judgment against partnership interests. Perhaps, however, the controversy surrounding these provisions in the USA is more perceived than founded on statutory language. Even so, a brief description of the controversy is necessary for comparative purposes and probably helpful to understand this substantive area in both the USA and PRC laws.

Before turning to the comparison, an illustration of the historical reasons for this provision provide a necessary background for the provision. The provision is frequently called the "charging order provision" in the USA. The charging order first appeared in the English Partnership Act of 1890 which codified English common law regarding the rights of the creditor of an individual partner to partnership property. The issues it addresses include the rights of "innocent partners" and the possible destruction of an economically productive firm because of the behavior of an individual partner in its personal (not partnership) relationship to its own creditors.

Thus, "[t]he charging order was created as a tool of 'entity asset protection' . . ."<sup>76</sup> The problem is illustrated by the following quotation from an English case in 1895:

When a creditor obtained a judgment against one partner and he wanted to obtain the benefit of that judgment against the share of that partner in the firm, the first thing was to issue a [writ of execution], and the sheriff [local law enforcement] went down to the partnership business, seized everything, stopped the business, drove the solvent partners wild, and caused the execution [judgment] creditor to bring an action in Chancery [court] in order to get an injunction to take into account and pay over that which was due by the execution debtor. A more clumsy method of proceeding could hardly have grown up.

*Brown, Janson & Co. v. A. Hutchinson & Co.*, 1895 Q.B. 737 (Eng. C.A.) (Lindley, J.).

The same chaos existed under the law of the USA at the time, and the drafters of the original Uniform Partnership Act

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Where a partner incurs any debt irrelevant to the partnership enterprise, the relevant creditor shall not offset its credit against the debt it owes to the partnership enterprise, nor may it exercise the said partner's rights in the partnership enterprise by substituting this partner.

76. Daniel S. Kleinberger, Carter G. Bishop, Thomas Earl Geu, *Charging Orders and the New Uniform Limited Partnership Act: Dispelling Rumors of Disaster*, 18 PROB. & PROP. 30 (July/Aug 2004).

(in 1914) and the original Uniform Limited Partnership Act (in 1916) copied the innovation in order to protect both the “innocent” partners and the economically viable firm that, for example, might have employees making a livable wage. These uniform acts provided that distributions due a partner could be redirected to that partner’s creditor and, under limited circumstances, the right to all future distributions could be sold in a foreclosure proceeding.<sup>77</sup>

The starting point for the comparative analysis is RULPA (1976/1985) section 703. In relevant part, it states:

On application to a court of competent jurisdiction by any judgment creditor of a partner, the court may charge the partnership interest of the partner with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the partnership interest.

Courts in most states in the United States, however, have determined that RUPA’s more detailed provisions also apply to limited partnerships under RULPA (1976/1985).<sup>78</sup> RUPA Section 504 is the relevant section. The first sentence of subsection 504(a) is roughly equivalent to the PRC’s article 74 and to the first sentence of RULPA section 704. It provides a *judgment creditor* may “charge the transferable interest” of the judgment debtor partner liable for its individual debts. That means the creditor may receive any distributions from the partnership to which the partner/debtor is entitled to receive until the judgment is satisfied. The second sentence of the subsection states, again in relevant part: “The court may . . . make all other orders, directions, accounts, and inquiries the judgment debtor might have made or which the circumstances may require.” This has led some legal commentators to fear that it allows the court to permissibly step into the shoes of the partner debtor for all purposes and to, for example, “order” the partner debtor to dissociate leading to dissolution of the partnership (in the worse case analysis).<sup>79</sup>

The reality seems to be that courts generally understand that their authority under the provision is bound by the transferable interest concept which is expressed in the first sentence of the subsection. A careful search of the reported cases in the United States is summarized by a quotation from another article:

77. *Id.*

78. *Id.*

79. See, e.g., Elizabeth M. Schurig, Amy P. Jetel, *A Charging Order Is the Exclusive Remedy Against a Partnership Interest: Fact or Fiction?*, 17 *PROB. & PROP.* 57 (Nov/Dec 2003).



It is, of course, possible for a trial judge to misunderstand the distinction between partnership property and issue an ancillary order that overreaches. In the reported cases . . . , however, it is rare for ancillary orders to interfere with partnership management. Moreover, the interference occurs only when fraud or comparable misconduct is involved.<sup>80</sup>

Sections 504 (b) and (c) deal with execution on the transferable interest and serve the same function as execution under the PRC Partnership Enterprise law. The subsections go further because they prescribe the process for executing on transferable interests. Subsection (b) states that the court may order a foreclosure on the transferable interest and subsection (c) provides for redemption though the list of individuals entitled to redeem are expanded when compared to the PRC Partnership Enterprise Law.

Subsection (e) has been the source of some confusion. It provides that the scheme contemplated by section 504 is "the exclusive remedy by which a judgment creditor of a partner may satisfy a judgment out of the judgment debtor's transferable interest." Part of the confusion arises because not all states in the USA have uniformly adopted the language of either RUPA or ULPA *verbatim* and because the language of RULPA section 703 does not expressly include foreclosure. Thus, while it may be true under some state variations that a judgment creditor's "exclusive remedy" is a charging order that may not be foreclosed, it is not necessarily the case under all state law or under RUPA and RULPA as drafted.

The reason that the confusion has spawned controversy is because RUPA permits a transferee to seek judicial dissolution of the partnership where it is fair to do so *and* (a) the term of a term partnership has expired *or* (b) at any time, if the partnership was an at-will partnership.<sup>81</sup> Therefore, if a foreclosure gives the transferee or assignee a "transferable interest," the holder of the interest may seek judicial dissolution under certain circumstances which are equitable to all parties. The fear is that the creditor will become a transferee; go to court; convince the judge it is fair to dissolve the partnership; and not only destroy an economically viable going concern, but tap the value of the property owned by, and held inside, the partnership.

The "charging order"-like provisions discussed so far in both laws appear to be limited to unsecured creditors. That is certainly correct in the case of USA law. It is worth mentioning here that this class of creditors includes, among others, persons

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80. Kleinberger, et. al., *supra* note 76, at 33.

81. RUPA (1997), § 801(6).

whom have received damage awards based upon tort or similar actions. The statutory limitations do not apply to secured creditors; for example, those who receive a pledge of the “share of the property of the partnership enterprise” or of the “transferable interest” respectively. Those issues are largely addressed under the statutory provision of the Uniform Commercial Code.

The PRC’s provision on the pledge of a limited partnership share simply states that pledging the share is permissible, subject to contrary agreement in the partnership agreement.<sup>82</sup> The law in the USA is consistent with that of the PRC.

In response to these concerns, several states in the United States have amended their “charging order” provisions to affirmatively prohibit foreclosure and to expand the “exclusive remedy” provisions to exclude the availability of remedies to creditors under other laws like the Commercial Code.<sup>83</sup> Moreover, ULPA (2001), a probable successor to RULPA (1976/1985) in many states, no longer gives transferees the right to seek judicial dissolution.<sup>84</sup> A very significant change ULPA (2001) severely restricts the ability of a limited partner to withdraw and, therefore, receive payment.<sup>85</sup>

The effect of these revisions to RULPA’s scheme makes it more difficult for a creditor to throw the limited partnership into a business liquidity crisis and enhances the durability of the enterprise by removing a possible cause of dissolution. In total, the

82. Partnership Enterprise Act (2006), *supra* note 3, art. 72.

83. Alaska was the first state to preclude foreclosing on even the partner’s interest as part of its charging order provision. ALASKA STAT. § 32.11. 340(b) (2006). Among others, Delaware (DEL. CODE ANN. tit. 6, § 17-703 (West 2007)) and Virginia (VA. CODE ANN. § 50-73.46:1 (2007)) followed Alaska’s lead. The Virginia provision is as follows:

- A. On application by a judgment creditor of a partner or of a partner’s assignee, a court having jurisdiction may charge the transferable interest of the judgment debtor to satisfy the judgment. To the extent so charged, the judgment credit has only the right to receive any distribution or distributions to which the judgment debtor would otherwise have been entitled in respect of the interest.
- B. A charging order constitutes a lien on the judgment debtor’s transferable interest in the limited partnership.
- C. This chapter does not deprive a partner or a partner’s assignee of a right under exemption laws with respect to the judgment debtor’s interest in the limited partnership.
- D. The entry of a charging order is the exclusive remedy by which a judgment creditor of a partner or of a partner’s assignee may satisfy a judgment out of the judgment debtor’s transferable interest in the limited partnership.
- E. No credit of a partner or of a partner’s assignee shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited partnership.

VA. CODE ANN. § 50-73.46:1.

84. *See* ULPA (2001), § 802.

85. *Id.* § 603.

trend of these changes is to lock capital in the partnership and make it less available to limited partners absent stipulation in the partnership agreement. In addition, these changes may provide benefits under USA estate taxation and, in a twist on an important theme, limited liability.

This article now turns from property to the related, but identifiably separate, topic of limited liability beginning with a comparison of the statutory limited liability of limited partners, continuing with a discussion of liability and possible liability management strategies for general partners, and ending with a short discussion about the possible importation of the corporate "piercing the corporate veil" concept into "unincorporated" law including limited partnership law.

#### IV. COMPARISON: LIMITED LIABILITY

##### A. THE BASIC LIABILITY SCHEME

Articles 2, 68 and 76 of the Partnership Enterprise Law of the PRC are of primary importance in creating and understanding the liability protection afforded limited partnerships in China. The comparative sections of RULPA (1976/1985) include sections 303, 304. Several other articles and sections relate to the limited liability of limited partners under the two laws and will be discussed in turn. Any technical discussion of the statutes themselves, however, first requires an understanding of the nature and context of limited liability as a *concept*.

The basic concept of limited liability is that the limited partner will not be liable to third parties for the limited partnerships debts, obligations and liabilities, beyond the value of the contributions agreed to be made by the limited partner. In contrast, general partners have unlimited personal liability for the debts, obligations and liabilities of the limited partnership under both PRC and United States law. Limited partners, in effect, have a statutory shield which protects them from partnership liabilities. Nonetheless, the limited partner may lower the shield and expose itself to partnership liability by its own conduct.

The same shield, however, does not protect the limited partnership from debts and liabilities incurred by limited partners in their individual capacities. The issue of if; and, if so under what circumstances, a judgment creditor might claim partnership property involves a different analysis hinging on the "charging order" concept under the law of the United States. Charging orders have been discussed previously.<sup>86</sup> The protections provided by the statutes for the limited partnership from the personal debts

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86. See *supra* notes 76-85 and accompanying text.

of the partner, and the limited partners' protection from the debts and liabilities of the limited partnership are asymmetrical but they are part of the integrated liability theory underpinning organizations formed as limited partnerships.

The two protections may be conceptualized as opposite sides of the same "asset partitioning" coin. Both sides play important roles in the pricing and allocation of financial capital and both sides encourage efficient capital formation and economic activity through the formation of operating business entities. "One side encourages equity investment while the other side undergirds the availability of debt capital to the entity and, to a lesser extent, to the individual owner."<sup>87</sup> With this theoretical background of limited liability, a technical statutory comparison is more understandable.

Article 2, paragraph 2, of the PRC law is the basic operational provision for limited liability, and it appears in the definitions of the Enterprise Act. It states, in part: "The general partners shall bear unlimited joint and several liabilities for the debts of the limited liability partnership enterprise. The limited partners bear the liabilities for its debts to the extent of their capital contributions."

The result is the same under RULPA (1976/1985) but its operative provisions are distributed in several sections. First, section 403 (appearing in Article 4 entitled "General Partners") states that "a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners." The general partnership law (Revised Uniform Partnership Act (1997)), in turn states, in relevant part, "all partners are liable jointly and severally for all obligations of the partnership"; and then adds language that is a restatement of the law outside the partnership act saying, "unless otherwise agreed by the claimant or provided by law."<sup>88</sup> Again, the additional language may reflect the distinction in statutory drafting approaches between common law and civil law jurisdictions.<sup>89</sup>

Second, RULPA (1976/1985) section 303(a) (appearing in Article 3 entitled "Limited Partners") states the general rule that

87. Thomas E. Rutledge, Carter G. Bishop & Thomas Earl Geu, *Foreclosure and Dissolution Rights of a Member's Creditors: No Cause for Alarm*, 21 PROB. & PROP. 35, 41 (May/June 2007).

88. RUPA (1997), § 306(a). The rule stated in UPA (1914), the predecessor to RUPA (1997), was different. It bifurcated its treatment of liability between contract liability and tort liability. General partners under UPA (1914) were jointly and severally liable for the tort liability of the partnership but only jointly liable on partnership contract. UPA (1914), § 15. Many states in the USA have modified this provision even before RUPA (1997) was promulgated.

89. *See supra* Part I(B).

the limited partner, "is not liable for the obligations of a limited partnership." Finally, RULPA (1976/1985) does not contain a single clear statement that the limited partner is liable only to the extent of their contributions as does PRC law. Again, however, the result is the same by referencing the different RULPA sections.<sup>90</sup>

The PRC's limited partnership provisions are similar to those of RULPA (1976/1985); though there is at least one notable difference. Article 76 first states the general rule of RULPA. A limited partner who enters a transaction on behalf of the limited partnership will be liable as a general partner if the third person reasonably believes the limited partner is a general partner. Second, Article 68 contains a safe harbor list of activities in which a limited partner may engage without being deemed to be "executing" partnership business. Article 68 is important because only general partners may execute partnership business.<sup>91</sup> The difference between RULPA and the Partnership Enterprise Act is that the PRC law does not directly and unambiguously correlate "executing" partnership affairs by a limited partner with the limited partner's liability to third parties.

There is a strong argument that the correlation is implicit through the use of the term "execute." That is, if a limited partner "executes" partnership affairs beyond the limited partner's statutory authority, it may be reasonable for a third party "to believe a limited partner" is a general partner and be liable under article 76. Nonetheless, the lack of express correlation is a difference between the laws, even if one of style only.

One final noteworthy difference in the unlimited liability for limited partners exists. RULPA expressly provides a limited partner "who knowingly permits his/her name to be used in the name of the limited partnership . . . is liable to creditors who extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner."<sup>92</sup> There is no similar liability provision under PRC law.

The limited liability shield for limited partners against direct unlimited liability for limited partnership obligations is one of the features that distinguishes the limited partnership from other entities. There are, however, other liability issues for limited partners short of becoming jointly and severally liable for the obligations of the partnership.<sup>93</sup> These issues revolve primarily

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90. See RULPA (1976/1985), §§ 303, 502, 1105; RUPA (1997), §§ 203, 204.

91. Partnership Enterprise Act (2006), *supra* note 3, art. 72.

92. RULPA (1976/1985), § 303(d).

93. This analysis does not include certain procedural matters that affect the operation of limited liability. For example, both RUPA (1997) § 307(d) (applicable to general partners under RULPA) and Partnership Enterprise Act, article 74 require

around “contributions” and “distributions” and the rights of creditors of the limited partnership enterprise.

## B. CONTRIBUTIONS, DISTRIBUTIONS AND LIABILITY

RULPA (1976/1985) directly addresses the primary issue concerning contributions. It relates to the balancing of rights between a limited partner and a creditor of the partnership upon return of all or part of the limited partner’s contribution. RULPA (1976/1985) bifurcates its provision between a distribution returning all or part of a contribution as being in accordance with the partnership agreement (“not in violation of”) or one in violation of the partnership agreement. In the former, the limited partner will be liable to the limited partnership for the amount of the returned contribution for one year but only “to the extent necessary to discharge the limited partnership’s liabilities to creditors who extended credit to the limited partnership during the period the contribution was held by the partnership.”<sup>94</sup> If the distribution returning the contribution was in violation of the partnership agreement, the limited partner is liable to the limited partnership for six years unmitigated by the amount of credit extended in reliance thereon.<sup>95</sup> Substantively, these RULPA provisions clearly provide for *limited* liability rather than *unlimited* liability because the amount for which the limited partner is liable is limited to the portion of the distribution that represents a return of contribution. The Act also defines when a return of a contribution has occurred.<sup>96</sup>

The PRC law does not include any provisions that directly address liability for any return of contributions. However, the general partnership provisions which apply through the PRC’s version of “linkage”<sup>97</sup> do state, “inside” the partnership, that decreases (or increases) of capital contributions may occur only in accordance with stipulations in the partnership agreement or by unanimous consent among the partners under article 34.

Other provisions concerning distributions in both laws may indirectly affect return of contributions or even distributions more broadly. The PRC partnership law, for example, uses the term “distribution” only in relationship with the term “profit”

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partnership property to be exhausted before the partner’s individual property is assessed. However, RUPA (1997) § 307(d) contains procedural requirements not contained in article 74 of Partnership Enterprise Act.

94. RULPA (1976/1985), § 608(a).

95. *Id.* § 608(b).

96. *Id.* § 608(c). Contribution and distribution concepts are loosely similar in function to notions of reserves, par value, and stated value in corporation and company. See *infra* note 99.

97. See Partnership Enterprise Act, *supra* note 3, art. 60, for linkage.

which might be interpreted to disallow the return of contributions. Such an interpretation supports, and is internally consistent with, article 34.<sup>98</sup>

The USA law permits distributions only to the extent that “after giving effect to the distribution” the fair value of the partnership assets still exceeds the value of the partnership liabilities.<sup>99</sup> This provision is similar to one that appears in most state corporate law in the United States as an additional or substitute test for the “stated capital test for distributions.”<sup>100</sup> It is worth noting, however, that USA corporate statutes, unlike the law of the PRC, have moved away from capital accounting tests like stated capital based on a par value.<sup>101</sup> This movement in the USA corporate context is at odds with RULPA (1985/1976) because of RULPA’s emphasis on contributions. Similarly, the absence of creditor specific provisions concerning the return of capital in the PRC is somewhat paradoxical when compared with the PRC’s company law which emphasizes capital accounting tests for dividends.<sup>102</sup>

An example of consistency between the PRC limited partnership law’s contribution articles and its company law is the type of property that may be contributed by limited partners.<sup>103</sup> Article 64 clearly and unambiguously states: “No limited partner may make capital contributions of labor.” This prohibition is consistent, too, with the permissive activities allowed a limited partner under the safe harbor provisions.<sup>104</sup> Conversely, RULPA (1976/1985) expressly allows contributions to be in the form of contribution of services (labor).<sup>105</sup>

The differences concerning the contribution of labor are significant for purposes of limited liability of limited partnerships because of the obligation of a limited partner to fulfill any contribution agreements and the pressure the contribution of labor places on valuation. Regarding contributions, the PRC law states:

A limited partner shall make full payment of the capital contributions within the time limit as stipulated in the partnership agreement. If it fails to do so, it shall be obliged to make

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98. *Id.* art. 33.

99. RULPA (1976/1985), § 607.

100. For a thorough discussion of legal capital statutes in the USA, see BAYLESS MANNING & JAMES J. HANKS, JR., *LEGAL CAPITAL* (3d ed. 1990).

101. *See e.g.*, ARTHUR R. PINTO & DOUGLAS M. BRANSON, *UNDERSTANDING CORPORATE LAW*, § 4.04[B], at 77 (2d ed. 2004).

102. *See, e.g.*, *Company Law*, *supra* note 4, §§ 26, 167.

103. *Partnership Enterprise Act* (2006), *supra* note 3, art. 64.

104. *Id.* art 68.

105. RULPA (1976/1985), § 101(2).

up the payment and shall bear the liabilities for breach of contract to the other partners.<sup>106</sup>

RULPA (1976/1985) simply provides that any obligation to contribute by limited partners must be in writing.<sup>107</sup>

The pressure on valuation of the contribution under both PRC and USA law comes as a result of distributions being measured, unless otherwise provided in the partnership agreement, upon the value of contributions.<sup>108</sup> This relates to the liability of limited partners because it is conceivable that creditors of the limited partnership could question the valuation of the contribution (and whether the obligation has been satisfied) or whether the limited partner still “owes” the partnership additional contribution. The PRC eliminates the difficult problem associated with the valuation of labor or services. Nonetheless, it could be argued that the valuation of services is no more difficult than the valuation of other types of “property” allowed under the PRC law; for example, intellectual property.<sup>109</sup> At base, whether to allow labor as an allowable type of contribution is a policy decision. The policy trade-off for avoiding controversy on the valuation of services, however, should not be underestimated. It gives “owners” of capital greater opportunity under the law than “owners” of labor.

In summary, the distributions and contributions provisions are not about “unlimited liability”, but they do relate to “surprise” liability limited to a determinable, if unspecified, amount. These issues relate to the same theoretical issue as unlimited liability, however, because they are part of the balance between debt of individual partners and the partnership and the ability of partnership creditors to obtain payment by otherwise protected limited partners. This balance is important in understanding the nature of the limited partnership across national borders.

There remain three topics that affect *unlimited* liability of either limited or general partners in a limited partnership. They are (1) the liability of new partners or partners switching between limited and general partnership roles, (2) mitigation of the effect of unlimited liability of general partners through planning and use of other law, and (3) the concept of “piercing” statutory liability protection using techniques outside the limited partnership laws.<sup>110</sup>

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106. Partnership Enterprise Act (2006), *supra* note 3, art. 65.

107. RULPA (1976/1985), § 502.

108. Partnership Enterprise Act (2006), arts. 33, 60; RULPA (1976/1985), § 503.

109. Partnership Enterprise Act (2006), art. 64.

110. *See, e.g., infra* notes 129-30 and accompanying text. An additional topic not included in this article but important for planning purposes is liability upon with-



### C. LIMITED LIABILITY, STATUS CHANGES AND NEW PARTNERS

The first of the three remaining topics is one of pure statutory comparison. The limited partnership law of the PRC expressly provides that a new limited partner is liable for the debts incurred by the limited partnership before its admission but only to the extent of the limited partners' contributed capital.<sup>111</sup> Where a general partner changes status to a limited partner,<sup>112</sup> the partner will be jointly and severally liable "for the debts incurred to the partnership enterprise during the period when it . . . is a general partner."<sup>113</sup> The converse yields a different statutory result. That is, where a limited partner changes status to a general partner,<sup>114</sup> article 83 states that the new general partner "shall bear joint and several unlimited liabilities for the debts incurred to the partnership enterprise during the period *when it . . . is a limited partner*."<sup>115</sup> Consistently, a new general partner will bear joint and several liability "for the debts of the partnership enterprise incurred before it is admitted to a partnership enterprise."<sup>116</sup>

An analysis of these provisions suggests they are concerned with two dimensions: time (before and after) and status (general or limited). When separately analyzed, the operation of the provisions can be summarized by stating that the most meaningful dimension is status. If a partner is currently a general partner, it will be jointly and severally liable for the obligations of the partnership whenever they were incurred. If the partner is currently a limited partner, it will be liable for the obligations of the partnership to the extent of its contribution no matter when those obligations were incurred. In operational effect, the time the obligation was incurred and the status of the partner as newly admitted or changed, are simply not relevant. There is one exception. The exception occurs where a general partner changes to a limited partner. In that circumstance only, the law of the PRC confers unlimited liability only for partnership obligations incurred before changing to a limited partner.<sup>117</sup>

RULPA (1976/1985) is silent concerning the liability of newly admitted general or limited partners or the changing of

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drawal from the partnership. Selected "property" aspects of withdrawal are discussed generally, *supra*, notes 65-75 and accompanying text.

111. Partnership Enterprise Act (2006), *supra* note 3, art. 77.

112. *Id.* art. 82.

113. *Id.* art. 84.

114. *Id.* art. 82.

115. *Id.* art. 83 (emphasis added).

116. *Id.* art. 44, para. 2; art. 60.

117. *Id.* art. 53. For liability on withdrawal, *see id.* art. 51.

roles during the operation of the partnership business. Therefore, the rules of the “linked” general partnership law govern even though they do not differentiate between limited and general partners.<sup>118</sup> The result is the same as under PRC law with two exceptions. The exceptions occur upon the admission of a new general partner and the change in status from a limited partner to a general partner. When a new general partner is admitted under the linked RUPA (1997) the general partner does not have unlimited personal liability for partnership obligations incurred before its admission. Rather, any contributions made by the general partner will be at risk for those prior partnership obligations.<sup>119</sup> By analogy, this same rule should provide a similar result when a limited partner “changes” status to a general partner (is admitted as a new general partner).

The real distinction between the operation of the PRC and USA statutory rules, therefore, is in their treatment of a new general partner. The PRC law provides unlimited liability for all partnership obligations whenever occurred but the USA law dictates unlimited liability only for obligations incurred while the partner is a general partner. There are good policy reasons for both solutions. Under the PRC law it is not necessary to try to determine when an obligation occurred. The USA law, however, encourages (or at least is less discouraging) the addition of new general partners which may aid the capital structure of the limited partnership going forward. Even the PRC law, however, provides partial protection when a general partner changes status to a limited partner and therefore shares the accounting and timing difficulties with the USA law under that circumstance. Further, the provisions governing liability for change in status, contributions and distributions are also clearly interrelated to property issues and withdrawal.<sup>120</sup>

#### D. MITIGATING GENERAL PARTNERS LIABILITY

One way to mitigate the unlimited liability of the general partner in some states in the United States is to form an organization called the limited liability limited partnership (LLLP) which combines the limited partnership under RULPA (1976/1985) with the limited liability partnership.<sup>121</sup> At base, it affords the general partner in a limited partnership under RULPA the

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118. RUPA (1997), § 306; *see supra* notes 28–29 and accompanying text for a discussion of linkage.

119. RUPA (1997), § 306(b).

120. *See supra* notes 110, 117.

121. *See supra* note 76 and accompanying text. *See generally*, J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, *PARTNERSHIP LAW AND PRACTICE*, § 32:5, at 32 (2007).

same protection from liability afforded a general partnership which elects LLP status under RUPA (1997). Arguably any limited partnership could elect such status under the linkage between RULPA and RUPA in reliance on RULPA Section 1105.<sup>122</sup> There is some question, however, about the interpretation of Section 1105's language which limits RUPA's application to limited partnerships to "any case not provided for in [RULPA] . . . ." That is, RULPA (1976/1985) certainly contemplates unlimited liability for general partners. Therefore the interpretive question becomes whether the unlimited liability of general partners is "a case . . . provided for in [RULPA]." If it is "a case . . . provided for," the LLP election in RUPA is not available to limited partnerships. As a result of this interpretive difficulty some states have allowed the formation of LLLPs expressly by statute.<sup>123</sup> The successor to RULPA (1976/1985) expressly recognizes LLLPs.<sup>124</sup>

Even without reference to LLPs and LLLPs, planners using RULPA (1976/1985) use "combination entities" to protect individual persons from unlimited liability as general partners. The easiest example of such a combination entity is using a corporation as a general partner in the limited partnership. As a result, the corporate general partner will be liable to the full extent of its assets (unlimited liability) but the owners (shareholders) of the corporation (company) will be protected by the corporation's liability shield. This is possible under RULPA (1976/1985) because any "person" may be a general or limited partner and "person" is defined to include a broad list of natural persons (individuals) and juridical persons expressly including corporations. Moreover, it is now generally settled under USA case law that a limited partner who is an officer of a corporation does not lose her limited liability by "controlling" the general partner.<sup>125</sup>

The same planning technique of using a corporate general partner to mitigate the full-effect is available under the PRC Partnership Enterprise Law but with significant limitation. The limitation is in Article 3. It expressly *prohibits* wholly state-funded companies, state-owned companies, listed companies, public-welfare-oriented public institutions and social organizations from being *general* partners. While the list significantly restricts the categories of companies that may be general partners, it does not exhaust all companies that may be organized under the PRC Company Law. The most reasonable interpretation of

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122. See RUPA (1997), § 101, Comment (suggesting a new § 1107 for RULPA).

123. KEATINGE & CONAWAY, *supra* note 28, § 1.10, at 14.

124. ULPA (2001), § 404.

125. See, e.g., *Zeiger v. Wilf*, 755 A.2d 608 (N.J. 2000).

Article 3 is that those companies not listed in the statute may be used to provide a backstop on unlimited liability from reaching the owners of those companies.

Notably, no similar restriction against these entities being limited partners is expressed in the statute. Thus, these entities, unless subject to restrictions outside the limited partnership law, may invest and participate as limited partners and the limited partnership may be another organization that can be used by the PRC to encourage economic development through direct investment.<sup>126</sup> Further, by contributing property other than money, these entities (the government) may choose to use limited partnerships as “one step across the river”<sup>127</sup> in privatizing select enterprises or portions of the economy. Such use would allow the government or entities it controls to enjoy limited liability, equity return, and still have some modicum of voice or control as a limited partner under the terms and stipulations contained in the limited partnership agreement.<sup>128</sup>

#### E. EXTRASTATUTORY PIERCING OF LIMITED LIABILITY

The use of corporations (companies) as general partners, however, does not provide fail-safe protection from unlimited liability. A doctrine of “piercing” the liability shield has a long history in the corporate (company) law of the states of the United States. It is referred to as “piercing the corporate veil.” When it is applied, a shareholder (or in some states a board of director member, officer, or other controlling insider) will be held to be liable for the debts and obligations of the corporation. It applies only under extraordinary situations and in the USA is an equitable remedy to avoid injustice.<sup>129</sup> By way of further introduction, one treatise states: “In cases where courts have pierced the corporate veil, the traditional test of “alter ego” (lack of corporate formalities, failure of sufficient capitalization, and commingling of funds) have usually been found.”<sup>130</sup> In the United States the doctrine is almost exclusively a creature of common law (judge made).

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126. Several governments in Asia, including the PRC, play a direct role in what would be termed the “private sector” in the West. Investment and ownership is a significant source of revenue as well as a policy lever in the PRC. Government reserves are also invested internationally. This creates great opportunity but difficult balancing issues at the political level. *See generally, Sovereign Wealth Funds: Keep your T-bonds, we'll take the bank*, THE ECONOMIST, Jul. 28, 2007, at 75–6; *Caught between right and left*, THE ECONOMIST, Mar. 10, 2007, at 23–5.

127. *See supra* notes 17–18 and accompanying text.

128. *See generally supra* Part II(A).

129. *See generally*, KEATINGE & CONAWAY, *supra* note 28, § 7.24, at 142.

130. *Id. See, e.g.*, *Kansas Gas & Elec. Co. v. Ross*, 521 N.W.2d 107 (S.D. 1994).

On October 27, 2005, the PRC's National People's Congress amended The Company Law of the People's Republic of China. The amendments included Article 20 which seems to be a codification of a functional equivalent to piercing the corporate veil though it, like some states in the USA, limits the remedy to apply to only shareholders. Article 20 states in relevant part: "Where any of the shareholders of a company evades the payment of its debts by abusing the independent status of juridical person or the shareholder's limited liabilities, and thus seriously damages the interests of any creditor, it shall bear joint liabilities for the debts of the company."<sup>131</sup>

As a practical matter, the presence of corporate piercing law in the USA and the PRC means that the shareholders of a corporation acting as a general partner in a limited partnership may not be protected completely and under all circumstances by the corporate liability shield. The circumstances where "piercing" will apply, however, are limited to extraordinary situations where the shareholders use the corporate form in an abusive and inequitable manner.

Neither the Partnership Enterprise Law of the PRC nor RULPA (1976/1985) codify the piercing doctrine. Under the PRC's civil law system this would seem to foreclose its application to limited partnerships beyond its use against a corporate general partner. Nonetheless, there is at least some *possibility* it could be applied by PRC courts because there is evidence those courts showed a reticent willingness to use it in the company context before its codification there.<sup>132</sup>

In the USA the doctrine has been used in cases involving LLCs (unincorporated partnership-like entities under USA law).<sup>133</sup> Limited partnerships, however, have different structural mechanisms to assess liability than either companies (corporations) or other USA unincorporated entities which have the limited liability feature. Limited partnerships are based on the premise that limited partners may lose liability protection only if they exert prohibited "control" and, in effect, act as a general partner. As a result, a leading treatise states: "Corporate-type veil-piercing has been held to be inappropriate in limited partnerships because of the statutory liability of general partners and of limited partners who take part in the control of the busi-

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131. See Bradley C. Reed, Note, *Clearing Away the Mist: Suggestions for Developing a Principled Veil Piercing Doctrine in China*, 39 VAND. J. TRANSNAT'L L. 1644-75 (2006).

132. *Id.* at 1661-62 (citations omitted).

133. KEATINGE & CONAWAY, *supra* note 28, § 7:24, at 142-43.

ness.”<sup>134</sup> The same treatise cautions that the evolution of the limited partnership may invite the use of piercing in the USA as it relaxes statutory control restrictions on limited partners and expands statutory liability protection to general partners through the LLLP.<sup>135</sup>

“Piercing” typically asserts liability against an “owner” of an entity *for the debts and obligations of the entity* because the owner is “abusing” the entity form. In unincorporated organizational law the “charging order” attempts to provide *protection of the entity’s property* against liability asserted against an individual owner.<sup>136</sup> In the United States “piercing the veil” has generated a companion doctrine known as “reverse piercing” to hold the entity liable for the debts of an owner under an abuse standard generally similar to the one used in typical piercing cases.<sup>137</sup> Unlike under the typical piercing context, courts have applied reverse piercing to limited partnerships. Obviously, this type of piercing is not the focus of this portion of the article concerning the limited liability of limited partners for partnership liability. However, it illustrates the interrelationships between the statutory provisions governing limited partnership property and the limited liability of the partners under the broader notion of asset partitioning.

#### F. LIMITED LIABILITY LIMITED PARTNERSHIPS: STATUTORY PROTECTION FOR ALL PARTNERS

There is an anomaly in terminology used in article 2 and chapter III of the PRC. As quoted previously, article 2, paragraph 2 uses the term “limited liability partnership enterprise” to denote a partnership comprised of both general and limited partners. Chapter III, on the other hand, is captioned “Limited Partnership Enterprises” and the text of the law in that Chapter uses the captioned term.<sup>138</sup> The Partnership Enterprise Law can only be interpreted to recognize three types of partnerships: general partnerships, special general partnerships,<sup>139</sup> and limited partnerships. Indeed the term “limited liability partnerships” appears only in Article 2 and only within the context of an enterprise

134. BROMBERG AND RIBSTEIN, ON PARTNERSHIP, *supra* note 22, § 15.14(m), at 15-163-164.

135. See *supra* notes 121-24 and accompanying text (introducing LLLPs).

136. See *supra* notes 76-77 and accompanying text (charging orders and asset partitioning).

137. See Larry E. Ribstein, *Reverse Limited Liability and the Design of Business Associations*, 30 DEL. J. CORP. L. 199 (2005).

138. See, e.g., Partnership Enterprise Law (2006), *supra* note 3, arts. 60, 61, 62, 66, 67, 79, 81.

139. See *id.* Ch. II, § 6. Special general partnership enterprises are partnerships of professionals. Partnership Enterprise Law, article 57, paragraph 2 states:

consisting of general and limited partners. This interpretation is so clear that it would not normally even warrant comment. The only reason it is worthy of discussion is because lawyers from the United States may initially and mistakenly believe that the use of "limited liability partnership" in the statute refers to an organization called the same name and identified by the abbreviation "LLP" which is recognized under amendments to RUPA. Stated another way, LLPs and limited partnerships are different and separate kinds of organizations under USA law.

Very generally, LLPs in the United States are general partnerships that file a certificate with their state of formation to be recognized as an LLP. Once recognized as an LLP, the general partners have limited liability similar to the limited liability of corporate shareholders. Some states allow only professionals (like lawyers) to be partners in LLPs and some states only protect the partners from certain categories of partnership liabilities. RUPA, however, contains broad eligibility and liability protection.<sup>140</sup> It is not necessary for any LLP partner to be jointly and severally liable for the debts of the LLP. The latter point is important in the discussion of limited partnerships. Moreover, unlike under limited partnership law, there are no restrictions on the control or management rights of partners of an LLP.

Unlike the LLP law in the USA, limited partnership law in both the PRC and the United States contemplates a passive investor role for limited partners. Under RULPA (1976/1985) there is a direct statutory relationship between "control" of the limited partnership's business and unlimited liability. Under the USA law a limited partner will become liable for the obligations of the limited partnership if it "participates in the control of the business" beyond "the exercise of . . . [its] rights and powers of a limited partner."<sup>141</sup> However, even where the limited partner "participates in control," "it is liable only to persons who transact business reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner."<sup>142</sup> Finally, RULPA (1976/1985) contains a safe harbor; that is, it lists a num-

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All partners shall bear joint and several liabilities for the debts incurred by any partner(s) to the partnership enterprise because of his (their) intentional or serious wrongful act, and for other debts of the partnership enterprise.

The law of the USA has similar notions under the regulatory agencies of the various professions and under RUPA (1997), § 305(b), though the USA law does not provide for a different statutory category of partnership.

140. See ALAN R. BROMBERG, LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON LIMITED LIABILITY PARTNERSHIPS, THE REVISED UNIFORM PARTNERSHIP ACT, AND THE UNIFORM LIMITED PARTNERSHIP ACT (2001), § 1.01, at 2-17; *id.* § 1.02(b), at 17; *id.* § 1.03(a), at 19 (2006).

141. RULPA (1976/1985), § 303(a).

142. *Id.*

ber of activities which do not constitute participation in control.<sup>143</sup>

In summary, the comparison of selected features of the liability protection afforded limited partners under PRC law is similar enough to seem familiar to common law lawyers having a knowledge of RULPA (1976/1985). In turn, USA cases interpreting RULPA (1976/1985) might be relevant to planners attempting to plan limited partnerships in the PRC to the extent those cases may raise issues not directly addressed statutorily.

## V. CONCLUSION

The purpose of this article was to provide an introduction to the new, and first, limited partnership statute in the PRC with national application. It did so by analyzing selected statutory provisions about property and liability which represent two important substantive areas in the law of limited partnerships.

The analysis compared Chapter III of the Partnership Enterprise Law of the PRC with the provisions of RULPA (1976/1985) which is the most similar version of the law of limited partnerships in the USA and which is currently the most generally recognized limited partnership law in the United States. The use of RULPA (1976/1985) is informative to discover differences and similarities between it and the new PRC law. RULPA may also serve as a helpful practice guide for use of the PRC law because it has been seasoned by experience, court interpretation, and academic commentary in the United States.

This article discusses many distinctions between the two laws and suggests circumstances where the compared provisions lead to different legal results. Nonetheless, the most basic conclusion is that the two laws are more alike than different and that the PRC limited partnership enterprise law has the same “look and feel” as RULPA. The analysis of the PRC law indicates its purpose is to encourage risk capital formation. This is consistent with the purpose of USA limited partnerships and represents one of the two major uses of limited partnerships in the USA. Further, the express language of the PRC law hints at its capacity to be used as an investment and policy vehicle for the central government.

In using this article, it is important to recognize it textually compares only two key aspects of the law and in that regard it is more analytical than introductory. Important features of limited partnerships not analyzed in any significant way include internal decision making processes; the rights and duties between and

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143. RULPA (1976/1985) § 303(b).



among the partners (including “fiduciary” duties); the relationship between the limited partnership and third parties; and the formation of limited partnerships. A brief comparative summary of those features is contained in the Appendix to this article.

Finally, RULPA (1976/1985) is not the newest version of limited partnership law in the United States though, at least as of 2007, it is the limited partnership act most widely adopted by the states. Perhaps paradoxically, the fact that there is a newer limited partnership act circulating in the states of the United States makes the comparisons in this article even more relevant. These comparisons may be used to help establish a baseline from which the PRC may assess whether the features of the newer USA law are successes or failures. At the very least, the comparisons provide for a deeper understanding of those changes. Select features of the newest uniform law of limited partnerships (ULPA (2001)) are also compared in the Appendix.

## APPENDIX

This appendix contains a chart of fifteen selected attributes of limited partnerships. It compares the attributes under the Partnership Enterprise Law of the Peoples Republic of China, the Revised Uniform Limited Partnership Act (1976/1985), and the Uniform Limited Partnership Act (2001). Most of the attributes listed are not analyzed in the text of the article. It is intended to provide introductory comparisons between the PRC law and RULPA as well as to introduce changes made from RULPA to ULPA (2001). It is, in part, closely derived from a chart that appears in the Official Prefatory Note to ULPA (2001) prepared by Dan Klienberger, the Reporter for ULPA (2001), comparing RULPA and ULPA. The chart in this appendix is less comprehensive than the one in the Prefatory Note and is for illustrative purposes only.<sup>144</sup>

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144. For more comprehensive charts comparing a larger number of attributes, including tax attributes, across more types of entities organized under USA law, see Robert R. Keatinge, Ann E. Conaway & Bruce P. Ely, KEATINGE AND CONAWAY ON CHOICE OF BUSINESS ENTITY, at A-1 to A-58 (2006) and Bruce P. Ely & Christopher R. Grissom, CHOICE OF ENTITY: LEGAL CONSIDERATIONS OF ENTITY SELECTION, BNA Corporate Practice Series, #50 (4th ed. 2006).

## COMPARATIVE CHART: OTHER CHARACTERISTICS

Characteristic	Partnership Enterprise Law of the People's Republic of China (2006)	RULPA (1976/1985)	ULPA (2001)
Relationship to general partnership act or provisions.	Limited partnership provisions are Ch. III of Partnership Enterprise Law; Art. 60 links general partnership provisions; that is, general partnership provisions matters not governed by Ch. III.	Linked, §§ 1105, 403	Free standing/not linked but many general partnership provisions included or repeated as part of ULPA
Permitted purposes and/or partners.	Use of term profit may indicate for-profit businesses only. See Art. 69, "No wholly state-funded company, state-owned company, listed company, public-welfare-oriented public institution or social organization may become a general partner." Art. 3.	In most states, "any business that a partnership without limited partners may carry." § 106 typically requires a for-profit business purpose, frequently excludes commercial banking and insurance.	Any lawful purpose. § 104(b). This includes not-for-profit purposes and is subject to other law which makes it difficult, if impossible, to be a public charity or carry on commercial banking, insurance or professional services. Expands definition of partner (through the definition of person in § 102(14)) to include "governmental subdivision" and "government" though restrictions in law outside ULPA may prohibit those entities becoming partners.
Number of limited and general partners.	Must have at least 2 partners, one of whom is a general partner and one of whom is a limited partner. There may be no more than 50 partners unless otherwise provided by law. Art. 61.	Two or more partners, must have at least one general partner and one limited partner. § 101(7).	Two or more partners, must have one or more general partners and one or more limited partners. § 102(11).
Filings required for organization/registration.	The name of each limited partner and the amount of the capital subscription of each. Art. 66. All partnerships must submit identity certificates for general partners and the partnership agreement as well as unspecified other documents. Art. 9.	Similar to ULPA (2001). § 201.	Submission of certificate of limited partnership including name of LP, name of each general partner, designated address, whether the LP is also an LLLP. § 201.

<p>Writing requirements.</p>	<p>The partnership agreement which is required to contain information and items under §§ 18, 63.</p>	<p>Some provisions pertain only to written understandings. For example, admission of additional general partners (otherwise requires unanimous consent). § 401.</p>	<p>No writing requirements but does require the limited partnership to maintain certain information including, for example, information concerning contributions in record form. § 111. Record form means stored in some medium that is retrievable in perceivable form (electronic will satisfy) § 102(17).</p>
<p>Use of limited partnership name in name of limited partnership.</p>	<p>No provision on use of limited partner's name. Must contain the words "limited partnership." Art. 62.</p>	<p>Prohibited, except in unusual circumstances like the use of the name of a corporate general partner whom is also a limited partner. § 102(2). Must contain without abbreviation the words "limited partnership."</p>	<p>Permitted, § 108(a). Must contain the words "limited partnership" or the abbreviation "L.P." or "LP." If it is an LLLP it must contain the words "limited liability partnership" or the abbreviations "L.L.L.P." or "LLL.P." § 108(b)&amp;(c).</p>
<p>Contributions/valuation</p>	<p>No limited partner may make contribution in the form of labor services; otherwise may contribute any type of property. Art. 64. General partner may contribute services. Art. 16. Value to be agreed by partners or "assessed by the statutory assessment institution contrasted by all partners."</p>	<p>Broadly permissive. Expressly includes "services rendered" and "obligation. . .to perform services." § 101(2).</p>	<p>Broadly permissive. Contributions may include "any benefit." § 102(2).</p>
<p>Limited partner liability for partnership debt and obligations, generally.</p>	<p>"Where it is reasonable for a third person to believe a limited partner as a general partner and make a transaction with him. . .this limited partner shall bear the same liabilities. . .as a general partner. . ." Art. 76, para. 1.</p>	<p>None unless limited partner "participates in the control of the business" and the third person reasonably believes the limited partner is a general partner. § 303(a). List of safe harbor activities that do not constitute control. § 303(b).</p>	<p>None, "even if the limited partner participates in the management and control of the limited partnership." § 303 (whether or not the LP is also an LLP).</p>

<p>General partner duties.</p>	<p>Silent, but the same as partners in a general partnership through linkage. <i>See</i> Art. 60. "the principle of willingness, equality, fairness and good faith in the conclusion of a partnership agreement and in the establishment of a partnership enterprise." Art. 5. "[P]artners shall abide by the laws, administrative regulations, social morals, commercial morals and bear social liabilities." Art. 7. A partner may not operate a business in competition with the limited partnership. Art. 60. Liability for competition. Art. 99.</p>	<p>The same general rights, restrictions, and liabilities to the partners in a general partnership. RULPA (1976/1985) § 403. Basic <i>fiduciary</i> duties applied through linkage to RUPA. These include the duties of loyalty and care. RUPA (1997) § 404. General partners must also exercise any authority in good faith. RUPA (1997) § 404.</p>	<p>The same as under RULPA (1976/1985). <i>See</i> ULPA (2001) § 408. Duty not to compete continues during winding-up and liquidation. ULPA (2001) § 408 (b)(3).</p>
<p>Limited partner duties.</p>	<p><i>See</i> general partners duties. Some doubt as to which apply through linkage. A limited partner may compete with the business of the limited partnership unless otherwise provided by the partnership agreement. Art. 71.</p>	<p>Silent, none specified. Some doubt as to how many duties carry over from linkage with general partnership act (RUPA).</p>	<p>No fiduciary duties "solely by reason of being a limited partner. § 305(a). Each limited partner is obligated to act in good faith and in fair dealing. § 305(b).</p>
<p>Persons with ability to bind the limited partnership in the conduct of business by statute.</p>	<p>General partners. Art. 67. Partners may object to the conduct of the affairs by another partner. Though not free from doubt the objection probably does not affect third party rights. Art. 29.</p>	<p>General partners. § 403(a).</p>	<p>General partners. § 402.</p>

<p>Allocations of profits, losses, and distributions.</p>	<p>Ultimate default rule for distribution of profits and allocation of losses is based on actual capital contribution, but agreement cannot provide that all profits will be distributed to some partners or that all losses will be born by some partners; Art. 33, applicable to limited partnership by linkage. But seems to be relaxed in the case of limited partnerships. Art. 69.</p>	<p>Separate provisions for the sharing of profits and losses (§ 503) and distributions (§ 504); allocates each based on contributions made and not paid back.</p>	<p>Same result as under RULPA but eliminates as unnecessary any rules for allocations. Distributions based on contributions paid-in. § 503.</p>
<p>Access to information.</p>	<p>Silent but general partnership provision applies through linkage, Art. 60; it provides, "the partners have the right to consult the account books and other financial materials" but seems to be limited by "in order to know the business operations, and financial status of partnership enterprise." Art. 28, para. 2.</p>	<p>All partners have right of access, silent as to whether partnership agreement may limit access. §§ 105(b), 305(1).</p>	<p>List of information to be maintained expanded from RULPA, § 304, 407(a); but partnership agreement may set reasonable restrictions on access to information and its use, § 110(b)(4); may impose restrictions on use of information, §§ 304(g), 407(f).</p>
<p>Limited partner withdrawal (dissociation) and payout.</p>	<p>Limited partner shall be liable for the debts of partnership at time of withdrawal "to extent of property it takes", Art. 81; by linkage, partnership "shall make settlement and return the property share to . . .[the partner]", Art. 51.</p>	<p>. . ."fair value. . .based upon. . .right to share in distributions", § 604.</p>	<p>No payout; person becomes a "transferee" of own interest meaning continued right to distribution. § 602(3).</p>

<p>Dissolution after withdrawal (dissociation) of general partner.</p>	<p>Upon withdrawal of last or only general partner the limited partnership is dissolved. Art. 75.</p>	<p>Automatically occurs <i>unless</i> all remaining limited and general partners unanimously consent to continue and to appoint a replacement general partner. § 801(4).</p>	<ul style="list-style-type: none"> <li>• if at least one general partner remains, no dissolution occurs unless majority of the rights to receive distribution consent to dissolution within 90 days of the dissociation (withdrawal) § 803(3).</li> <li>• if no general partner remains, dissolution occurs after 90 days unless the same vote above occurs to continue and a new general partner is admitted. § 803(3).</li> </ul>
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