CASE 4.1 GENERAL PARTNERSHIP

*Vohland v. Sweet,* 435 N.E. 2d 860 **(Ind.** Ct App. 1982).

Facts

Norman E. Sweet began working for Charles Vohland as an hourly employee at a garden nursery owned by Vohland in 1956, when he was a youngster. Upon completion of military service (from 1958 to 1960), Sweet resumed his former employment. In 1963, Charles Vohland retired, and his son Paul Vohland (Vohland) commenced what became known as Vohland’s Nursery, the business of which was landscape gardening. Vohland purchased the interests of his brothers and sisters in the nursery. At that time, Sweet’s status changed: He was to receive a 20 percent share of the net profit of the business after all expenses were paid, including labor, supplies, plants, and other expenses. Sweet contributed no capital to the enterprise. The compensation was paid on an irregular basis—every several weeks, Vohland and Sweet would sit down, compute the income received and expenses paid, and Sweet would be issued a check for 20 percent of the balance. No Social Security or income taxes were withheld from Sweet’s checks.

It is when merchants dispute about their own rules that they invoke the law.

Judge Brett

*Robinson v. Mollett (1875)*

Vohland and Sweet did not enter into a written agreement. No partnership income tax returns were filed by the business. Sweet’s tax returns declared that he was a self-employed salesman. He paid self-employment Social Security taxes. Vohland handled all the finances and books of the nursery and borrowed money from the bank solely in his own name for business purposes. Vohland made most of the sales for the business. Sweet managed the physical aspects of the nursery, supervised the care of the nursery stock, and oversaw the performance of the contracts for customers. Sweet testified that in the early 1970s, Vohland told him:

* *He was going to take me in and that I wouldn’t have to punch a time clock anymore, that I would be on a commission basis and that I would be*—*have more of an interest in the business if I had an interest in the business.* He *referred to it as a “piece of the action.”*

Vohland denied making this statement. Sweet brought this action for dissolution of the alleged partnership and for an accounting. He sought payment for 20 percent of the business’s inventory. The trial court held in favor of Sweet and awarded him $58,733. Vohland appealed.

Issue

Did Vohland and Sweet enter into a partnership?

Court’s Reasoning

Receipt by a person of a share of the profits is prima facie evidence that he or she is a partner in a business. Here, Sweet shared in the profits of the nursery. Although the parties called Sweet’s sharing in the profits a “commission,” the court stated that the term “when used by landscape gardeners and not lawyers, should not be restricted to its technical definition.” The court found that the absence of a capital contribution by Sweet was not controlling and that his contribution of labor and skill would suffice.

Decision

The court of appeals held that partnership had been created between Vohland and Sweet. The court of appeals affirmed the decision of the trial court in favor of Sweet.

**Case Questions**

* **1.** **Critical Legal Thinking** Do you think a partnership was formed in this case? Should all partnership agreements be required to be in writing?
* **2.** **Business Ethics** Do you think either party acted unethically in this case?
* **3.** **Contemporary Business** What are the economic consequences of founding a partnership?

Taxation of Partnerships

Partnerships do not pay federal income taxes. Instead, the income and losses of partnership flow onto and have to be reported on the individual partners’ personal income tax returns. This is called “flow-through” taxation. However, a partnership has to file an information return with the government, telling the government how much income was earned or losses were incurred by the partnership. This way, the government tax authorities can trace whether partners are correctly reporting their income or losses. Form 1065 (see [Exhibit 4.2](https://jigsaw.vitalsource.com/books/9781323127933/epub/OPS/loc_009.xhtml#eid5132)) is an information return used to report the income, gains, losses, deductions, credits, etc., from the operation of a partnership. A partnership does not pay tax on its income but “passes through” any profits or losses to its partners. Partners must include partnership items on their tax returns.

Every domestic partnership must file Form 1065, unless it neither receives income nor incurs any expenditures treated as deductions or credits for federal income tax purposes. Each members pro rata share on the Schedule K-1 (see [Exhibit 4.3](https://jigsaw.vitalsource.com/books/9781323127933/epub/OPS/loc_009.xhtml#eid5150)).

RIGHTS OF GENERAL PARTNERS

The partners of a general partnership have certain rights. The rights of general partners are discussed in the following paragraphs.

Right to Participate in Management

In the absence of an agreement to the contrary, all partners have equal **rights to participate in management** (i.e., equal rights in the conduct and management of the partnership business). In other words, each partner has one vote, regardless of the proportional size of that partner’s capital contribution or share in the partnership’s profits. Under the UPA, a simple majority decides most ordinary partnership matters [UPA Section 18]. If the vote is tied, the action being voted on is considered to be defeated.

right to participate in management

A situation in which, unless otherwise agreed, each partner has a right to participate in the management of a partnership and has an equal vote on partnership matters.

**Exhibit 4.2 Form 1065-U.S. Return of Partnership Income**

**Exhibit 4.3 From 1065 Schedule K−1**

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**Exhibit 4.3 From 1065 Schedule K−1**

Right to Share in Profits

Unless otherwise agreed, the UPA mandates that a partner has the right to an equal share in the partnership’s profits and losses [UPA Section 18(a)]. The right to share in the profits of the partnership is considered to be the right to share in the earnings from the investment of capital.

Right to Compensation and Reimbursement

Unless otherwise agreed, the UPA provides that no partner is entitled to compensation for their performance in the partnership’s business [UPA Section 18(f)]. Under this rule, partners are not entitled to receive a salary for providing services to the partnership unless agreed to by the partners.

Under the UPA, it is implied that partners will devote full time and service to the partnership. Thus, unless otherwise agreed, income earned by partners from providing services elsewhere belongs to the partnership [UPA Section 21]. Partners sometimes incur personal travel, business, and other expenses on behalf of the partnership. A partner is entitled to **indemnification** (i.e., reimbursement) for such expenditures if they are reasonably incurred in the ordinary and proper conduct of the business [UPA Section 18(b)].

**indemnification**

The right of a partner to be reimbursed for expenditures incurred on behalf of the partnership.

Right to Return of Loans and Capital

A partner who makes a loan to the partnership becomes a creditor of the partnership. The partner is entitled to repayment of the loan, but this right is subordinated to the claims of creditors who are not partners [UPA Section 40(b)]. The partner is also entitled to receive interest from the date of the loan.

Upon termination of a partnership, the partners are entitled to have their capital contributions returned to them [UPA Section 18(a)]. However, this right is subordinated to the rights of creditors, who must be paid their claims first [UPA Section 40(b)].

Right to Information

Each partner has the right to demand true and full information from any other partner of all things affecting the partnership [UPA Section 20]. The corollary to this rule is that each partner has a duty to provide such information upon the receipt of a reasonable demand. The partnership books (e.g., financial records, tax records) must be kept at the partnership’s principal place of business [UPA Section 19]. The partners have an absolute right to inspect and copy these records.

DUTIES OF GENERAL PARTNERS

General partners owe certain duties to each other and the partnership. The duties of partners are discussed in the following paragraphs.

Duty of Loyalty

**fiduciary relationship**

A relationship in which one person is under a duty to act for the benefit of another on matters within the scope of the relationship.

**duty of loyalty**

A duty that a partner owes not to act adversely to the interests of the partnership.

Partners are in a **fiduciary relationship** with one another. As such, they owe each other a **duty of loyalty.**This duty is imposed by law and cannot be waived. If there is a conflict between partnership interests and personal interests, the partner must choose the interest of the partnership. Some basic forms of breach of loyalty involve:

* **■** ***Self-dealing.* Self-dealing occurs when a partner deals personally with the partnership, such as buying or selling goods or property to the partnership. Such actions are permitted only if full disclosure is made and consent of the other partners is obtained.self-dealing**If the directors or officers engage in purchasing, selling or leasing of property with the corporation, the contract must be fair to the corporation; otherwise, it is voidable by the corporation. The contract or transaction is enforceable if it has been fully disclosed and approved.**Example:** Dan is a partner in a partnership that is looking for a piece of real property on which to build a new store. Dan owns a desirable piece of property. To sell the property to the partnership, Dan must first disclose his ownership interest and receive his partners’ consent.
* **■** ***Usurping a partnership opportunity.* *A* partner who is offered an opportunity on behalf of the partnership cannot usurp the opportunity for himself or herself. Thus, if a third party offers a business opportunity to a partner in his partnership status, the partner cannot take the opportunity for himself before offering it to the partnership. If the partnership rejects the opportunity, the partner is free to pursue the opportunity.usurping an opportunity**Stealing an opportunity for oneself.
* **■** **Competing** ***with the partnership.* *A* partner may not compete with the partnership without the permission of the other partners.competing with the partnership**A way in which a partner in a partnership can breach his or her duty of loyalty.**Example:** A partner of a general partnership that operates an automobile dealership cannot open a competing automobile dealership without their copartners’ permission.
* **■** ***Secret profits.* Partners may not make secret profits from partnership business.Example:** A partner who takes a kickback from a supplier has made a secret profit. The secret profit belongs to the partnership.
* **■** ***Breach of confidentiality.* Partners owe a duty to keep partnership information confidential by not committing a breach of confidentiality.breach of confidentiality**A breach of fiduciary duty by a partner in a partnership to keep information confidential.**Example:** Trade secrets, customer lists, and other secret information are confidential. A partner who misuses this information—either by himself or by transferring the information to someone else—has **breached confidentiality.**
* **■** ***Misuse of property.* Partners owe a duty not to use partnership property for personal use.**

A partner who breaches the duty of loyalty must disgorge any profits made from the breach to the partnership. In addition, the partner is liable for any damages caused by the breach.

Duty of Care

A partner must use reasonable care and skill in transacting partnership business. The **duty of care** calls for the partners to use the same level of care and skill that a reasonable business manager in the same position would use in the same circumstances. Breach of the duty of care is negligence. A partner is liable to the partnership for any damages caused by his or her own negligence. The partners are not liable for honest errors in judgment.

**duty of care**

The obligation partners owe to use the same level of care and skill that a reasonable person in the same position would use in the same circumstances. A breach of the duty of care is *negligence.*

**Examples:** Tina, Eric, and Brian form a partnership to sell automobiles. Tina, who is responsible for ordering inventory, orders large, expensive sport-utility vehicles (SUVs) that use a lot of gasoline. A war breaks out in the Middle East that interrupts the supply of oil to the United States. The demand for large SUVs drops substantially, and the partnership cannot sell its inventory. Tina is not liable because the duty of care was not breached.

Duty to Inform

Partners owe a **duty to inform** their co-partners of all information they possess that is relevant to the affairs of the partnership [UPA Section 20]. Even if a partner fails to communicate information to other partners, the other partners have **imputed knowledge** of all notices concerning any matters relating to partnership affairs. Knowledge is also imputed regarding information acquired in the role of partner that affects the partnership and should have been communicated to the other partners [UPA Section 12].

**duty to inform**

A duty a partner owes to inform his or her co-partners of all information he or she possesses that is relevant to the affairs of the partnership.

**imputed knowledge**

Knowledge attributed to a given person, especially because of the person’s legal responsibility for another’s conduct.

**Example:** Ted and Diane are partners. Ted knows that a piece of property owned by the partnership contains dangerous toxic wastes but fails to inform Diane of this fact. Even though Diane does not have actual knowledge of this fact, it is imputed to her.

Duty of Obedience

The **duty of obedience** requires partners to adhere to the provisions of the partnership agreement and the decisions of the partnership. A partner who breaches this duty is liable to the partnership for any damages caused by the breach.

**duty of obedience**

A duty that requires partners to adhere to the provisions of the partnership agreement and the decisions of the partnership.

**Example:** Emma, Grace, and Jack form a partnership to develop real property. Their partnership agreement specifies that acts of the partners are limited to those necessary to accomplish the partnership’s purpose. Suppose Jack, acting alone, loses $100,000 of partnership funds in commodities trading. Jack is personally liable to the partnership for the lost funds because he breached the partnership agreement.

CONTEMPORARY Environment: RIGHT TO AN ACCOUNTING

Partners are not permitted to sue the partnership or other partners at law. Instead, they are given the right to bring an **action for an accounting** against other partners. An action for an accounting is a formal judicial proceeding in which the court is authorized to (1) review the partnership and the partners’ transactions, and (2) award each partner his or her share of the partnership assets [UPA Section 24]. An action results in a money judgment for or against partners, according to the balance struck.

**action for an accounting**

A formal judicial proceeding in which the court is authorized to (1) review the partnership and the partners’ transactions and (2) award each partner his or her share of the partnership assets.

LIABILITY OF GENERAL PARTNERS

Partners must deal with third parties in conducting partnership business. This often includes entering into contracts with third parties on behalf of the partnership. Partners, employees, and agents of the partnership sometimes injure third parties while conducting partnership business. Partners of a general partnership have personal liability for the contracts and torts of the partnership. Contract and tort liability of partnerships and their partners is discussed in the following paragraphs.

Tort Liability

While acting on partnership business, a partner or an employee of the partnership may commit a tort that causes injury to a third person. This tort could be caused by a negligent act, a breach of trust (such as embezzlement from a customer’s account), breach of fiduciary duty, defamation, fraud, or another intentional tort. The partnership is liable if the act is committed while the person is acting within the ordinary course of partnership business or with the authority of their co-partners.

Under the UPA, partners are **jointly and severally liable** for torts and breaches of trust [UPA Section 15(a)]. This is so even if a partner did not participate in the commission of the act. This type of liability permits a third party to sue one or more of the partners separately. Judgment can be collected only against the partners who are sued. The partnership and partners who are made to pay **tort liability** may seek indemnification from the partner who committed the wrongful act. A release of one partner does not discharge the liability of other partners.

**joint and several liability**

Tort liability of partners together and individually. A plaintiff can sue one or more partners separately. If successful, the plaintiff can recover the entire amount of the judgment from any or all of the defendant-partners who have been found liable.

**Example:** Amanda, Barb, and Denise form a partnership. Denise, while on partnership business, causes an automobile accident that injures Catherine, a pedestrian. Catherine suffers $100,000 in injuries. Catherine, at her option, can sue Amanda, Barb, and Denise separately, or any two of them, or all of them.

The court applied the doctrine of joint and several liability in the following case.

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Is this enough information?

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This is the right one:

CASE 4.2 TORT LIABILITY OF GENERAL PARTNERS

***Zuckerman v. Antenucci,* 478 N.Y.S.2d 578 (N.Y. App. Div. 1984).**

**“A *partnership is liable for the tortious act of a partner, and a partner is jointly and severally liable for tortious acts chargeable to the partnership.”***

**—Judge Leviss**

**Facts**

**Jose Pena and Joseph Antenucci were both medical doctors who were partners in a medical practice. Both doctors treated Elaine Zuckerman during her pregnancy. Her son, Daniel Zuckerman, was born with severe physical problems. Elaine, as Daniel’s mother and natural guardian, brought a medical malpractice suit against both doctors. The jury found that Pena was guilty of medical malpractice but that Antenucci was not. The amount of the verdict totaled $4 million. The trial court entered judgment against Pena but not against Antenucci. The plaintiffs made a posttrial motion for judgment against both defendants.**

**Issue**

**Is Antenucci jointly and severally liable for the medical malpractice of his partner, Pena?**

**Language of the Court**

* **A *partnership is liable for the tortious act of a partner, and a partner is jointly and severally liable for tortious acts chargeable to the partnership. When a tort is committed by the partnership, the wrong is imputable to all of the partners jointly and severally, and an action may be brought against all or any of them in their individual capacities or against the partnership as an entity. Therefore, even though the jury found that defendant Antenucci was not guilty of any malpractice in his treatment of the patient, but that defendant Pena, his partner, was guilty of malpractice in his treatment of the patient, they were then both jointly and severally liable for the malpractice committed by defendant Pena by operation of law.***

**Decision**

**The court held that both partners were jointly and severally liable for the judgment. The supreme court reversed the decision of the trial court and held that Antenucci was liable for the tort of his partner, Pena.**

**Case Questions**

* **1. Critical Legal Thinking What is joint and several liability? How does it differ from joint liability?**
* **2. Business Ethics Is it ethical for a partner to deny liability for torts of other partners?**
* **3. Contemporary Business What types of insurance should a partnership purchase? Why?**

**joint liability**

**Liability of partners for contracts and debts of the partnership. A plaintiff must name the partnership and all of the partners as defendants in a lawsuit.**

Contract Liability

As a legal entity, a partnership must act through its agents—that is, its partners. Contracts entered into with suppliers, customers, lenders, or others on the partnership’s behalf are binding on the partnership. The Uniform Partnership Act permits a partnership to file a statement of partnership authority that identifies the partners authorized to perform certain acts. (See [Exhibit 4.4](https://jigsaw.vitalsource.com/books/9781323127933/epub/OPS/loc_009.xhtml#eid5426).)