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Partnerships in Bankruptcy**Randall L. Rouse**

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Partnerships in Bankruptcy

Focus of Presentation

1. Reconciliation or Divorce: divorcing your business partners in bankruptcy comes with problems, rights and obligations. There are many open issues involving partnership bankruptcies. Partnership cases often raise a conflict between federal bankruptcy law, state partnership law, and the partnership agreements.

Basic Principles Behind Focus

2. Partnerships are created and governed by the agreement and by state laws. In most states, the Revised Uniform Partnership Act and the Revised Uniform Limited Partnership Act (or their predecessors) are the controlling statutes and each state has a body of common and case law. There are just a few Bankruptcy Code provisions that deal with partnership issues. Although the Bankruptcy Code recognizes that state law governs property interests, it will preempt state law when it is inconsistent with federal law.

3. When partnerships fall on financial hard times, partners can disagree over the course the partnership business should take. These disagreements could include whether the partnership should even file for bankruptcy. If all of the general partners agree to file on behalf of the partnership, that bankruptcy is by definition a voluntary bankruptcy.

4. On the other hand, an involuntary petition may be commenced against a partnership by fewer than all of the general partners. A partner's filing against the partnership under the "generally not paying" must be evaluated for the intent, good or bad, of the filing partners. *See the Involuntary Petition' section herein for a more in depth discussion of involuntary bankruptcy as it pertains to partnerships.*

Characteristics of a Partnership

5. Relationship is governed by state law/agreement.
6. Laws of agency apply: general partner is an agent for the partnership.

In re Sewickley Hospitality, Ltd, 2002 WL 442259, 89 A.F.T.F.2D 2002-1289 (Bankr. S.D. Tex. 2002, Judge Richard Schmidt). (A limited partnership is not liable for payroll taxes incurred by its general partner acting as a management company, where the general partner hired and paid employees in its capacity as a management company, and not as an agent of the partnership).

- Partners may have rights in specific property of the partnership

Partners may have rights in his or her "partnership interest"

Partners may have rights to participate in management of the partnership

A partnership is recognized as an entity separate from partners in bankruptcy proceedings, but not income taxation. *Jennings v. C.I.R.*, 110 F.2d 945, cert. denied, 61 S.Ct. 169, 311 U.S. 704, 85 L.Ed. 457.

7. "A general partner is in a fiduciary relationship with the limited partners. It is important that he have no conflict of interest. Moreover, an agreement among partners is not only a legal relationship, but it is also a personal relation or status, somewhat as marriage is a relation or status." *Skeen v. Harms*, 10 B.R. 817 (Bankr. D. Colo. 1981):

8. "When the only general partner in a limited partnership becomes a debtor-in-possession, there is an inherent conflict of interest... [h]e is a different entity." *Skeen supra*

Issues Raised by the Bankruptcy Filing of Partner or Partnership

9. Partner bankruptcy filings raise some unique legal issues, including:

- Whether the bankruptcy filing leads to the dissolution of the partnership.

Section 723

- Contribution Obligation

What is the automatic stay effect.

What are "estate" interests under Section 541.

- Whether the partner can retain his or her management rights after the bankruptcy filing.
- Impact of Section 365 on partnership agreements.
- Implication of ipso facto provisions

Impact of bankruptcy filing on right of first refusal provisions

- Applicability of buy-out provisions in bankruptcy
- Whether withdrawal provisions conditioned on the bankruptcy filing may be unenforceable because:

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