

U.P.A. Section 18(h): Majority Control, Dissenting Partners, and the Need for Reform

A literal reading of U.P.A. Section 18(h) leaves open the possibility that a majority of partners could change the nature of a partnership against the will of dissenting partners. In contrast, judicial interpretation of Section 18(h), contrary to established rules of statutory construction, has precluded this possibility. This article argues that a literal interpretation of Section 18(h) prejudices the rights of dissenting partners and proposes an amendment to prevent this danger.

The Uniform Partnership Act section 18(h) governs the resolution of internal disputes in a general partnership.¹ Subject to agreement by the partners, section 18(h) provides that a majority of partners may decide differences regarding “ordinary matters” of the partnership business. Section 18(h) also requires the consent of all partners for “acts in contravention” of the partnership agreement.

Section 18(h) is subject to two distinct interpretations. If read literally, section 18(h) imposes no limitation on the extent to which a partnership agreement may modify section 18(h).² For example, a partnership agreement might provide that a mere

¹ The UNIFORM PARTNERSHIP ACT § 18, reprinted in 6 UNIFORM LAWS ANNOTATED 213 (1969) [hereinafter cited as U.P.A.], in relevant part, provides:

The rights and duties of the partners in relation to the partnership shall be determined, *subject to any agreement* between them, by the following rules:

(h) Any differences arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but no act in contravention of any agreement between the partners may be done rightfully without the consent of all partners. (emphasis added).

² The proviso of U.P.A. § 18 reads: “subject to *any agreement*” between the partners (emphasis added). See U.P.A. § 18, set forth in relevant part in note 1 *supra*.

majority vote is sufficient to authorize an "act in contravention" of the other sections of the agreement. In contrast, the Oregon Supreme Court in *McCallum v. Ashbury*³ interpreted section 18(h) to embrace the common law rule that it is never proper for a mere majority to change the "nature" of the partnership business. In *McCallum*, the court ruled that such "fundamental changes" require the consent of all partners.⁴

This comment examines these competing interpretations of the "act in contravention" clause of section 18(h). It explores the policy objective underlying the Oregon Supreme Court's interpretation in *McCallum*. The comment argues that a literal reading of section 18(h) does not adequately protect dissenting partners from prejudicial actions of the majority.⁵ In short, the "act in contravention" clause of the present section 18(h) should not be "subject to any agreement" between the partners. Consequently, the comment concludes with a proposal to amend section 18(h) and add a new section 18.5. The new section would prevent partners from making fundamental changes in the partnership agreement by less than a unanimous vote.

³ 238 Or. 257, 393 P.2d 774 (1964). *McCallum v. Ashbury* is apparently the only case to consider the enforceability of partnership agreements which modify the unanimity requirement of the "act in contravention" clause of section 18(h).

⁴ *Id.* at 260-61, 393 P.2d at 776. In one other case, *Nick v. Craig*, 301 Pa. 50, 151 A. 573 (1930), the court cited section 18(h) and applied a "fundamental change" test. It appears, however, that the court there was construing the "ordinary matters" clause of section 18(h) rather than the "acts in contravention" clause. For a full discussion of *Nick v. Craig*, see note 28 *infra*.

⁵ This comment does not apply to "partnerships at sufferance." In any partnership, each partner is bound by any action authorized by the agreement. U.P.A. § 9(1). In a "partnership at sufferance," dissenting partners who are unhappy with an authorized majority decision may withdraw and dissolve the partnership with impunity. U.P.A. § 31(1)(b).

In contrast, in all other partnerships, dissenting partners who withdraw and dissolve the partnership are subject to unfavorable consequences since such an act constitutes "wrongful dissolution." U.P.A. §§ 31(2), 38(2), 42. Therefore, in partnerships other than a "partnership at sufferance," dissenting partners are effectively trapped; if the majority action is permissible, the dissenting partner must remain with the firm and share any liability arising from the majority action. In these circumstances, majority actions may prejudice the rights of dissenting partners. For a discussion of the ways in which the rights of dissenting partners may be prejudiced by majority actions, see notes 39-41 and accompanying text *infra*.

I. U.P.A. SECTION 18(h): A LITERAL INTERPRETATION

U.P.A. section 18 defines the rights and duties of partners in relation to the partnership.⁶ Section 18(h) specifically governs the resolution of disagreements among partners. In explicit language, section 18 permits modifications of its rules by agreement. On its face, this proviso is unlimited in scope. Thus, if section 18 is read literally, partners may structure the partnership's decision-making procedure in any way they choose.

Courts generally follow rules of statutory construction when interpreting statutes. Under these rules, a literal reading of a statute is preferred.⁷ In applying a literal interpretation, courts look first to the "plain language" of the statute.⁸

Courts depart from a literal interpretation of a statute under certain circumstances. Where the result of a literal interpretation would be either unjust or absurd in light of a statute's purpose, a court may justifiably ignore the literal meaning.⁹ In addi-

⁶ The rules of U.P.A. § 18 encompass several aspects of relations among partners. Partners are entitled to a return on any capital advances to partnership property and must contribute to all partnership losses. U.P.A. § 18(a). The partnership must indemnify any partner who pays partnership debts from personal resources. *Id.* § 18(b). Partners are entitled to interest on any payment or advance made in excess of the amount of capital they agreed to contribute. *Id.* § 18(c). Partners are entitled to receive interest on the capital they contributed only from the date when repayment should be made. *Id.* § 18(d). All partners have equal rights in the management and conduct of the partnership business. *Id.* § 18(e). Partners are not entitled to remuneration for services contributed to the partnership business. However, a surviving partner is entitled to reasonable compensation for services rendered in winding up the partnership affairs. *Id.* § 18(f). No person can become a member of a partnership without the consent of all the partners. *Id.* § 18(g). A majority of partners are entitled to decide ordinary matters of the partnership business, but acts in contravention of the agreement require authorization by a unanimous vote of the partners. *Id.* § 18(h). All rules contained in section 18 are subject to any agreement between the partners. *Id.* § 18.

⁷ See, e.g., *Hamilton v. Rathbone*, 175 U.S. 414, 419 (1899) (construing Congressional acts regarding "estates of married women," the Court stated and applied the general rule that where an act is "clear on its face . . . that construction must be given to it"). See generally 2A C. SANDS, SUTHERLAND'S STATUTES & STATUTORY CONSTRUCTION, §§ 46.01, 46.04 (4th ed. 1973).

⁸ See, e.g., *Caminetti v. United States*, 242 U.S. 470, 485 (1917) (holding that there was no ambiguity in the White Slave Act, the Court enforced only the act's "plain terms"). See also 2A C. SANDS, *supra* note 7.

⁹ See, e.g., *Organized Migrants in Community Action Inc. v. Brennan*, 520 F.2d 1161 (D.C. Cir. 1975) (Occupational Health and Safety Act held to deny

tion, a court may refuse to interpret a statute literally where such a reading would violate the statute's spirit or legislative intent.¹⁰ The intent of the legislature may be implied from the structure or language of the statute or it may be inferred on grounds of policy, reasonableness or legislative history.¹¹ Consequently, in construing an act, a court looks beyond a single provision to the entire act, its objectives and underlying policies.¹²

When construing rules of the U.P.A., courts rely on the principles of statutory construction discussed above.¹³ Since there is very limited legislative history,¹⁴ courts must imply the legisla-

the Secretary of Labor authority to regulate pesticide hazards since such a result was neither unjust nor absurd in light of legislative intent). *See also* 2A C. SANDS, *supra* note 7, at § 46.07.

¹⁰ The leading authority on this point is *Holy Trinity Church v. United States*, 143 U.S. 457, 459 (1892): "It is a familiar rule that a thing may be within the letter of the statute and yet not within its spirit, nor within the intention of its makers."

¹¹ *See, e.g.*, *Summers v. Dooley*, 94 Idaho 87, 481 P.2d 318 (1971); 2A C. SANDS *supra* note 7, at § 48.03.

¹² For a typical example, *see Philbrook v. Glodgett*, 421 U.S. 707, 713-14 (1975) (construing a provision of the 1935 Social Security Act, the Supreme Court carefully scrutinized the interrelationship of that provision to the act's other pertinent sections and to various relevant congressional reports).

¹³ In *Summers v. Dooley*, 94 Idaho 87, 481 P.2d 318 (1971) the court discusses and then applies each principle of statutory construction discussed above to interpret U.P.A. §§ 18(e) & 18(h). *See also* *In Re Safady Bros.*, 228 F. 538, 539-40 (W.D. Wis. 1915) (principles of statutory construction used to determine the meaning of "attachment" in U.P.A. § 25(2)(c)).

¹⁴ The U.P.A. was developed by the National Conference of Commissioners on Uniform State Laws from 1902 to 1913. Unfortunately, the published records of those meetings are very sketchy. *See* NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK OF PROCEEDINGS 80 (1902-1905); *Id.* at 244-45 (1906-1907); *Id.* at 102 & 112 (1908-1909); *Id.* at 287 (1914) (U.P.A. adopted). Some sections of the U.P.A. were adopted with "Official Comments" accompanying them. Section 18, however, does not include an "Official Comment."

During the development of the U.P.A. and for several years following its adoption, explanatory articles appeared. *See, e.g.*, Lewis, *The Desirability of Expressing the Law of Partnership in Statutory Form*, 60 U. PA. L. REV. 93 (1911); Crane, *The Uniform Partnership Act—A Criticism*, 28 HARV. L. REV. 762 (1914-1915); Wright, *California Partnership Law and the Uniform Partnership Act*, 9 CALIF. L. REV. 206 (1920-1921) (comparing superseded CAL. CIV. CODE partnership provisions to the newly enacted U.P.A.).

Most courts and commentators treat the U.P.A. as a codification of the then existing common law on partnership; where there were conflicting common law positions, the U.P.A. adopted the "better" rule. *See, e.g.*, *In Re Safady Bros.*,

tive intent of each U.P.A. provision from the language and structure of the act itself.¹⁵ Of the U.P.A. provisions governing relations of partners to one another,¹⁶ *only* section 18 includes the express proviso that its rules are “subject to *any* agreement.”¹⁷ Applying the “plain language” standard, this structure clearly indicates which rules affecting partner relations *inter se* are absolute¹⁸ and which rules the partners may modify by agree-

228 F. 538, 540 (W.D. Wis. 1915); A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP 13 (1968). In addition the ENGLISH PARTNERSHIP ACT served as the model for the U.P.A. The primary drafter of the U.P.A., William Draper Lewis, described the influence of the English Act: “As originally drafted, where it was desired to express in a section the same idea as that expressed in the corresponding section of the English Partnership Act, and the English Act was clear, its wording was followed without regard to terseness or simplicity of expression.” Lewis, *The Uniform Partnership Act*, 24 YALE L. J. 43, 43 (1914-1915). See also Mersky, *The Literature of Partnership Law*, 16 VAND. L. REV. 389 (1962-1963).

The English analogue to U.P.A. § 18(h) is nearly identical. Entitled “Rules as to Interests and Duties of Partners Subject to Special Agreement,” section 24(8) reads:

The interests of partners in the partnership property and their rights and duties in relation to the partnership shall be determined, *subject to any agreement between the partners*, by the following rules: —

(8) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of partners, *but no change may be made in the nature of the partnership business* without the consent of all existing partners.

THE PARTNERSHIP ACT, 1890, 53 & 54 Vict., 39, § 24, *reprinted in*, 24 HALSBURY'S STATUTES 495, 513 (3rd Ed. 1970) (emphasis added).

¹⁵ *The general purpose of the [UNIFORM PARTNERSHIP] ACT must be gathered from its language; when this is found, and is plain and unmistakable, particular words may be ignored, if out of harmony with the general purpose, unless they were used by way of proviso or exception, or indicate a positive intent inconsistent with the general spirit.*

In Re Safady Bros., 228 F. 538, 540 (W.D. Wis. 1915) (emphasis added) (citation omitted) (interpreting U.P.A. § 25(2)(c)).

¹⁶ U.P.A., Part IV, “Relations of Partners to One Another” encompasses §§ 18-23.

¹⁷ See note 1 *supra* for language of the proviso.

¹⁸ Partnership agreements may *not* modify the provisions of U.P.A. §§ 20-23.

U.P.A. § 20 (Duty to Render Information). See, e.g., *Berg v. King Cola Inc.*, 227 Cal. App. 2d 338, 38 Cal. Rptr. 655 (2nd Dist. 1964) (owner of all outstand-

ment.¹⁹ Thus, inclusion of the express proviso in section 18 indicates legislative intent to permit partners flexibility in determining certain rights and duties among themselves.

Courts have in fact followed principles of statutory construction when interpreting section 18. They have consistently construed subsections 18(a) through (g) to permit modification by agreement.²⁰ More significantly, courts have upheld agreements

ing stock of a corporation was held liable for not disclosing fact of ownership to his partner who advanced money to the corporation on representations that the stock had not been issued).

U.P.A. § 21 (Partner Accountable as a Fiduciary). See, e.g., *Auld v. Estridge*, 86 Misc. 2d 895, 382 N.Y.S.2d 897 (1976) (partner held liable for disposing of partnership funds to his own advantage).

U.P.A. § 22 (Right to An Account). See, e.g., *Moldovan v. Fischer*, 149 Cal. App. 2d 600, 308 P.2d 844 (1st Dist. 1957) (provision in limited partnership agreement denying the general partner the right to an accounting held unenforceable).

U.P.A. § 23 (Continuation of Partnership Beyond Fixed Term). A partnership agreement may not alter the fact that implied consent of the partners is sufficient to establish a partnership at will when the business continues upon expiration of the original partnership. Although there is no case on point, see generally *Corr v. Hoffman*, 256 N.Y. 254, 176 N.E. 383 (1931).

¹⁹ U.P.A. §§ 18 & 19, in part, may be modified by agreement. For authority upholding modification of section 18, see note 20 *infra*.

U.P.A. § 19 (Partnership Books). Partners may agree to keep books at some location other than the principal place of business. However, an agreement denying some partners their right to inspect partnership books may be invalid. But see *Sanderson v. Cooke*, 256 N.Y. 73, 175 N.E. 518 (1931) (holding right of inspection is subject to special agreement). For a discussion of the scope of a partner's inspection right, see Comment, *A Partner's Right of Inspection under Section 19 of the Uniform Partnership Act: The Case for a Reasonable Restrictions Amendment*, this issue at 886.

²⁰ For a summary of the text of subsections 18 (a)-(g), see note 6 *supra*. Representative cases discussing modifications of U.P.A. § 18 include: *First Mechanic Bank v. Commissioner*, 91 F.2d 275 (3d Cir. 1937) (enforced agreement modifying § 18(a) to provide unequal division of the profits); *Goff v. Bergerman*, 97 Colo. 363, 50 P.2d 59 (1935) (enforced agreement modifying § 18(b) to limit amount of contribution required from each partner); *Fleischer v. Broders*, 178 Neb. 723, 135 N.W.2d 5 (1965) (recognized the validity of an agreement which would modify § 18(c) to forego the requirement that interest be paid on any advance made to the partnership); *Burge v. Michael*, 213 Cal. App. 2d 780, 29 Cal. Rptr. 290 (5th Dist. 1963) (recognized the validity of an agreement which would modify § 18(d) and require payment of interest on contributions prior to an accounting); *Parks v. Riverside Ins. Co. of Am.*, 308 F.2d 175 (10th Cir. 1962) (enforced agreement modifying § 18(e) to vest exclusive control of the management of the business to one partner); *Wind v. Herbert*, 186 Cal. App. 2d 276, 8 Cal. Rptr. 817 (2d Dist. 1960) (defendant failed to

which modify the "ordinary matters" clause of section 18(h).²¹ Therefore, based on the general construction given section 18, including the "ordinary matters" clause of subsection 18(h), the literal interpretation test suggests that the "act in contravention" clause of section 18(h) should also be "subject to any agreement" between the partners.

In summary, a literal reading of the "acts in contravention" clause of section 18(h) to permit modification by agreement is consistent with legislative intent as derived from the language and structure of the act. Indeed, to preclude agreement modifications of only this clause would be highly anomalous.²² Therefore, since both clauses of 18(h) are "subject to any agreement" between the partners, a partnership agreement empowering a majority to carry out acts in contravention of the agreement should be enforceable.

II. JUDICIAL INTERPRETATION OF SECTION 18(h): *McCallum v. Ashbury*

Only the Oregon Supreme Court has considered the validity of a partnership agreement modifying the "acts in contravention" clause of section 18(h).²³ In *McCallum v. Ashbury*,²⁴ the court ignored conventional principles of statutory construction and held that a partnership agreement could not modify the unanimity requirement of the "acts in contravention" clause. Rather

prove an oral agreement to modify § 18(f) and compensate him for services rendered); *but see* Steinberg v. Goodman, 27 N.Y.2d 304, 265 N.E.2d 758, 317 N.Y.S.2d 342 (1970) (partners doing greater than their proportionate share of work can demand commensurate compensation even in absence of agreement modifying § 18(f)); Polikoff v. Levy, 55 Ill. App. 2d 229, 204 N.E.2d 807 (1965), *cert. denied*, 382 U.S. 903 (1965) (enforced agreement modifying § 18(g) to admit unidentified members to a joint venture without the approval of an existing member).

²¹ For example, a partnership may designate a managing partner or an executive committee to supervise and administrate the "ordinary matters" of the partnership business. For further discussion, see note 45 *infra*. When it designates a managing partner or executive committee, a partnership modifies the "ordinary matters" clause of § 18(h) since a majority of partners is no longer making such decisions.

²² See discussion of *McCallum v. Ashbury*, text accompanying notes 25-28 *infra*.

²³ See notes 3 & 4 *supra*. Oregon adopted the U.P.A. in 1939. 1939 Or. Laws, ch. 550, § 18(8) (codified at OR. REV. STAT. § 68.310(8) (1977)).

²⁴ 238 Or. 257, 393 P.2d 774 (1964).

than follow a literal interpretation, the Oregon court apparently applied common law rules of partnership. As a result, the court imposed a significant gloss upon section 18(h).

A. *McCallum v. Ashbury*

McCallum involved a partnership of doctors who each had an equal voice in the firm's management. The partnership agreement authorized the amendment of its terms by a mere majority vote of the partners.²⁵ Exercising this power, the majority created an executive committee to manage the general affairs of the partnership.²⁶ The plaintiff, a dissenting partner frequently at odds with the majority, challenged the validity of the committee.

The Oregon court upheld the creation of the committee as a permissible act by the partnership majority. The court sustained the majority's action *only because* the committee, as constituted, did not represent a "fundamental change" in the partnership agreement.²⁷ Any "fundamental change," on the other hand, would have required a unanimous vote of the partners:

Fundamental changes in a partnership agreement may not be made without the consent of all parties. This is true *even though the agreement may provide it can be amended by a majority vote*. The power to amend is limited by the rule that, unless unanimous, no amendment may be in contravention of the agreement.²⁸

²⁵ In pertinent part, the partnership agreement read as follows:

All partners shall have an equal share in the management of the business and *all decisions pertaining to the partnership, not herein specifically provided for, including amendment of the contract, shall be decided by a majority vote of the partners*. Provided that any amendment of this agreement shall not be discriminating against any partner or partners.

Id. at 260, 393 P.2d at 775 (emphasis added).

²⁶ As adopted by the majority, the executive committee's power was not absolute. A majority vote of the partners could alter or cancel any action taken by the committee. Moreover, the agreement required a 10 day delay before any committee action could take effect in order to give the general membership an opportunity to override the decision. Furthermore, a majority of the partners could reconstitute the committee and all partners retained the right to attend committee meetings. *Id.* at 261, 393 P.2d at 776.

²⁷ According to the court, "the limitations upon the committee power kept the delegation well within the scope and intent of the original partnership agreement." *Id.* at 262, 393 P.2d at 776.

²⁸ *Id.* at 261, 393 P.2d at 775 (citing *only* U.P.A. § 18(h)) (emphasis added).

The "ordinary matters" and "acts in contravention" clauses of § 18(h) are significantly interrelated; enlarging the area of decision-making in which una-

The court's analysis here does not follow a literal construction of section 18(h). Section 18 permits modification of its rules by any agreement of the partners and nowhere proscribes agreement provisions which authorize fundamental change by a mere majority vote. The *McCallum* partnership agreement expressly authorized amendment of its provisions by majority vote and did not limit this power to non-fundamental changes. Nevertheless, the Oregon court refused to recognize the right of the *McCallum* partnership to empower a majority to make fundamental changes of its partnership agreement. Thus, the court limited the authority of the partnership majority when neither the partnership agreement nor a literal reading of section 18(h) required such a limitation.

The *McCallum* court's discussion of "fundamental change" is

nimity of partners is required necessarily diminishes the scope of authority permitted to a majority of partners. Thus, while *McCallum* considers the scope of the unanimity requirement of § 18(h), any case considering the permissible scope of majority actions provides important comparisons.

Nick v. Craig, 301 Pa. 50, 151 A. 573 (1930) is the seminal authority for the limits on majority action. Like *McCallum*, this case illustrates judicial disapprobation toward "fundamental changes" in agreements absent the consent of all members.

In *Nick*, a syndicate of 20 persons granted a trustee legal title to particular lands, desiring to contract with a land company to develop the land for the benefit of the syndicate. By resolution, the syndicate created a decision-making structure whereby as few as six members could authorize syndicate conduct. "[A]ll actions and business coming before meetings of the syndicate were to be decided by a majority vote, provided a quorum were present, and that not less than eleven members representing a majority in interest would constitute a quorum." *Id.* at 58, 151 A. at 576.

For the purpose of deciding the propriety of the majority's action, the court assumed the syndicate members were partners, *Id.* at 57, 151 A. at 575 (citing U.P.A. § 18(h)) and ruled that the nature of this arrangement was "administrative" only and did "not create authority to change the *fundamentals* of the contract with the land company." *Id.* at 58, 151 A. at 576. (emphasis added). In these circumstances, the contract with the land company was the business purpose of the syndicate agreement.

The decision-making structure created by resolution in *Nick* ostensibly empowered a majority of a quorum of members (i.e., as few as six of the twenty members) to make fundamental changes in the agreement. The court, however, sustained this structure only for the consideration of administrative matters; as in *McCallum*, a vote of the majority would be inadequate to effect "fundamental" change of the agreement. The *Nick* court thereby limited majority action notwithstanding the unqualified language of the resolution, "[a]ll actions and business . . . were to be decided by a majority vote. . . ." *Id.*

arguably dicta. The court ultimately held no fundamental change was involved because of the checks imposed on the committee and that, therefore, consent of all the partners was not required to create the committee.²⁹ Consequently, the court's language as to "fundamental changes in the partnership agreement" may be gratuitous.

A better reading of the decision is that the "fundamental change" discussion and analysis are holding, not dicta. "Fundamental change" was the standard by which the court judged the validity of the executive committee's creation. Applying the standard, the court found no fundamental change because of the checks on the committee's power. Nevertheless, the standard itself was essential to the court's ultimate determination and should be viewed as part of the court's holding.

The *McCallum* court offers no explanation for refusing to interpret 18(h) literally. There is no indication the court feared that a literal construction would be either absurd or contravene the section's legislative intent. At most, the tone of the opinion suggests that a literal reading in this case would lead to an unjust result.³⁰

The Oregon court's limitations on the power of a majority parallel common law rules regarding changes in partnership agreements.³¹ At common law, a majority "acting fairly and in good faith" could direct the conduct of partnership affairs so long as it kept "within the purposes and scope of the partnership."³² A majority could decide the *manner* of conducting business, but it could not change the essential *nature* of the partnership.³³

²⁹ For a description of the operation of the committee, see note 26 *supra*.

³⁰ The *McCallum* holding avoids unjust results that may follow from a literal interpretation of section 18(h); see notes 39-56 and accompanying text *infra*.

³¹ The common law of partnership is the basis of the U.P.A. See note 14 *supra*.

³² *Clark v. Slate Valley R. Co.*, 136 Pa. 408, 20 A. 562 (1890). See also Note, *The Permissible Conduct of a Partner in Carrying on Firm Business*, 29 COLUM. L. REV. 66, 72 (1929): "Amending the articles of partnership . . . [is a] typical example of acts falling outside the business" (citing *Abbott v. Johnson*, 32 N.H. 9 (1855)).

³³ For example, in *Abbott v. Johnson*, 32 N.H. 9 (1855), a partnership formed to carry on retail trade in domestic and foreign goods. The partnership agreement expressly stipulated that there would be no dealing in "ardent spirits." The court held that the majority decision to traffic in liquors was a "material and substantial" change in business activities and that the dissenting

By requiring unanimity for "fundamental changes,"³⁴ the Oregon court neatly forces the *McCallum* agreement to comport with these common law rules. The court's construction enables a majority to make only those changes which remain within the original scope of the partnership business. In common law language, the court barred the *McCallum* majority from making changes in the *nature* of the partnership, though the agreement itself did not make a manner/nature distinction.³⁵

Although the *McCallum* court cited only U.P.A. section 18(h), commentary on the English Partnership Act section 24(8) adopts similar reasoning and provides support for the *McCallum* analysis.³⁶ According to Halsbury, the drafters of the English

partners were not bound by the altered articles of partnership. *Id.* at 19-20.

The manner/nature distinction is best stated in F. MECHEM, *ELEMENTS OF THE LAW OF PARTNERSHIP* 250 (2d ed. 1920):

[N]o majority, however large can, against the dissent of the minority, change the *essential nature* or extent of the partnership business as originally agreed upon, as, for example, to *alter or amend the articles*, reduce or increase the capital, embark upon a new business, change its agreed location, alter the share of a partner, admit a new member, and the like. If they attempt to do so, the dissenting partners will not be bound (citing *Natusch v. Irving*, see note 55 *infra*). Neither can any majority deprive the minority of any rights given by the partnership agreement, or inherent in the nature of the partnership. (emphasis added.)

But as to matters pertaining merely to the *manner* of conducting the business, and all questions concerning what are sometimes called the internal affairs of the partnership, it is equally clear that, if the articles do not determine them, the partners themselves must decide, and here in accordance with a well-settled principle applicable to such cases to which, by implication, all have agreed, the majority will prevail. (emphasis in original.)

³⁴ The Oregon court does not define "fundamental changes" except to equate it with "acts in contravention" of the partnership agreement because both actions require a unanimous vote of the partners. See language from the *McCallum* opinion quoted in text accompanying note 28 *supra*.

³⁵ The agreement did stipulate, however, that no amendment shall discriminate against any partner or partners. See the language of the agreement quoted in note 25 *supra*. Curiously, the court did not mention this caveat, perhaps sensing that the term was too vague to provide much protection.

³⁶ When confronted with interpretations of first impression (as in *McCallum*), American courts may look to the ENGLISH PARTNERSHIP ACT for guidance since it "largely influenced" the drafting of the U.P.A. and "clearly expressed the principles to be applied." *Froess v. Froess*, 284 Pa. 369, 131 A. 276 (1925) (determining the rights of deceased partners by reference to the English Act).

The English analogue to U.P.A. § 18(h) is nearly identical. See note 14

Partnership Act section 24(8) intended to deny a majority of partners the authority to change the *nature* of the partnership.³⁷ Even though the proviso of section 24, "subject to agreement," precedes both clauses of subsection (8), Halsbury treats the proviso as if it applied only to the clause permitting a majority to decide differences arising as to ordinary matters. As authority for this interpretation, Halsbury cites the leading English common law case of *Natusch v. Irving*.³⁸ Thus, Halsbury's commentary on the English Act suffers from the same defect as the *McCallum* court's analysis. In attempting to keep the English Act consonant with prior English common law, Halsbury ignores the explicit proviso of section 24. Like the *McCallum* court, Halsbury refuses to read the statutory language literally—choosing instead to embrace pre-statutory common law rules.

B. *The Policy Objective Underlying the McCallum Approach*

The *McCallum* holding rests on an important policy objective: to prevent a majority of partners from prejudicing the rights of a minority. If a mere majority of partners may make "fundamental changes" in the partnership agreement, dissenting partners may become unwillingly bound by partnership activities they had never anticipated.³⁹ Entering the partnership for one pur-

supra. The English courts, however, have not considered the validity of a partnership agreement which permits a *majority* of partners to change the nature of the partnership. Halsbury's annotations of English laws, however, does discuss the issue. See 28 HALSBURY'S LAWS OF ENGLAND 481, 527 (3d ed. 1959).

³⁷ Subject to any agreement express or implied between the partners, every partner may take part in the management of the partnership business, and, subject to any such agreement, any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but the majority must act in good faith and every partner must have the opportunity of being heard.

A majority of partners, however, cannot change the nature of the partnership business; for this purpose the consent of all the existing parties is required; . . .

28 HALSBURY'S LAWS OF ENGLAND 481, 527 (3d ed. 1959).

³⁸ 47 Eng. Rep. 1196 (Ex. 1824). For a full discussion of *Natusch* see note 55 *infra*.

³⁹ On the other hand, it can be argued that by signing a partnership agreement containing an amendment by majority clause, each partner assented to all future modifications supported by a majority vote. Nonetheless, a partnership agreement is subject to the ordinary rules for construing written contracts,

pose, dissenting partners may watch helplessly as their investment of capital and labor is committed to an entirely different venture.⁴⁰ Moreover, fundamental changes in the partnership

Las Vegas Mach. & Eng'r Works v. Roemisch, 67 Nev. 1, 213 P.2d 319 (1950), and under general contract law, the enforceability of an amendment-by-majority clause, such as the *McCallum* agreement, is questionable.

An amendment-by-majority clause is analogous to the general contract problem where, by agreement, a material term is left open for negotiation at a subsequent time. This is commonly called an "agreement to agree" and is unenforceable on the ground no present contract has been formed. *See, e.g., Transamerica Equip. Leasing Corp. v. Union Bank*, 426 F.2d 273, 274 (9th Cir. 1970) (action by a prospective borrower against bank for breach of contract to make a loan: "[W]here an essential element is reserved for future agreement of both parties, a legal obligation cannot result"); and *Western Airlines, Inc. v. Lathrop Co.*, 499 P.2d 1013, 1019 (Alas. 1972) (citing 1 A. CORBIN, CORBIN ON CONTRACTS § 29 (1960); 1 S. WILLISTON, WILLISTON ON CONTRACTS § 45 (Jaeger ed. 1957)). To be enforceable, the content of any agreement must be definite as to its material terms so that the promise and performances to be rendered by each party are reasonably certain. *St. Paul & Tacoma Lumber v. Fox*, 26 Wash. 2d 109, 173 P.2d 194 (1946) (specific performance on a contract to sell corporate stock denied for lack of definite price).

Where feasible, however, the courts will substitute a reasonable term for the voidable one in the attempt to salvage the entire contract of which the term forms but one part. Alternatively, if the unsettled point may be left unperformed, the remainder of the contract will be enforced. *Wilson v. Wilson*, 96 Cal. App. 2d 589, 216 P.2d 104 (1st Dist. 1950) (partnership agreement providing that son was to substitute for father as a partner in the event that father retired or died was held enforceable notwithstanding the size of the son's future share of profits was left unsettled); 1 S. WILLISTON, *supra*, § 48. Thus, the *McCallum* amendment-by-majority clause might be unenforceable since it empowered a majority to substitute a completely unknown and potentially unrelated objective for the partnership purpose stated in the original agreement. However, the entire partnership agreement need not fail since the parties are still bound by the business objective specified in the original agreement.

Cf. Goldsmith v. Sachs, 17 F. 726 (1882), where the partnership agreement contained the following provision: "The business of the partnership shall be buying and selling and dealing in dry goods and *such other wares and merchandise as may be convenient and profitable to all parties concerned.*" *Id.* at 729 (emphasis added). The court upheld the clause against a claim that it was void for uncertainty. The court stated that the intent to deal in dry goods had a well-known meaning among merchants and was, therefore, clearly enforceable. The court further ruled that the clause, "and such other wares," similarly did not fail for indefiniteness because the parties had "substantially provided a mode and a means of making it specific." *Id.* Significantly, enforceability of this agreement turned on the implication that the decision to expand the business would require the approval of *all* parties.

⁴⁰ If the decision to commit partnership resources to a new venture is authorized by the partnership agreement dissenting partners are forced to com-

business may put at greater risk the personal resources of each partner.⁴¹ A dissenting partner might be liable for partnership activities which, if included in the original partnership agreement, would have dissuaded that partner from joining the partnership.

Majority rule in a partnership is necessary, however, to promote flexibility in partnership governance. Under the U.P.A., *each* partner presumptively has the right to control the partnership business.⁴² Moreover, U.P.A. section 18(e) explicitly entitles each partner to an equal voice in management affairs.⁴³ Thus, in

ply despite their discontent unless the partnership is a "partnership at sufferance." *See* note 5 *supra*.

A parallel situation in the corporate context presents a useful contrast. When majority shareholders impose fundamental corporate changes, most state statutes protect minority shareholders. For example, shareholders dissenting from a merger of their corporation into another may demand that the corporation purchase their shares at the fair market value. *See, e.g., CAL. CORP. CODE*, §§ 1300-12 (West 1977). "Appraisal rights protect the dissenting minority shareholder against being forced to . . . remain an investor in an enterprise fundamentally different than that in which he invested. . . ." *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 117, 460 P.2d 464, 478, 81 Cal. Rptr. 592, 606 (1969) (majority shareholders violated fiduciary duty to minority shareholders when they formed a holding company to control the original corporation and gave minority shareholders no opportunity to acquire an interest in the holding company—virtually destroying the market for the stock of the corporation).

In the absence of a special agreement giving partners a sell-out option, no similar protection exists for dissenting partners dissatisfied with an authorized act of the majority. A provision in the partnership agreement granting the majority *carte blanche* amendment power relegates the minority partners to a helpless position.

⁴¹ Third party claimants to a partnership debt may seek satisfaction from the personal resources of each partner if the partnership assets are inadequate. U.P.A. § 15(b) ("[a]ll partners are liable jointly for all debts and obligations of the partnership"); *Kincade v. Jeffery-De Witt Insulator Corp.* 242 F.2d 328 (5th Cir. 1957). Thus, in the event of inadequate partnership assets, partners may lose much more than their original contributions to partnership capital. In contrast, shareholders of a corporation are generally exempt from individual liability for the debts or torts of their corporation beyond the amount of their agreed investments. As long as the corporate form is scrupulously maintained, claims against the corporation may be collected only from the corporate assets. H. BALLANTINE, *BALLANTINE ON CORPORATIONS* § 1 (rev. ed. 1946).

⁴² U.P.A. § 6 defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit." "Ownership involves the power of ultimate control." U.P.A. § 6 (official comment).

⁴³ U.P.A. § 18(e) provides, subject to agreement, that "[a]ll partners have equal right in the management and conduct of the partnership business."

the absence of agreement and without majority rule, each partner would possess full veto power over all management decisions. To preclude this possibility, U.P.A. section 18(h) alters the presumption of equal control by providing majority rule when partners disagree over management questions.⁴⁴ The majority rule of section 18(h), therefore, prevents debilitating stalemates and facilitates business continuity.⁴⁵

However, if a majority may be empowered to decide matters other than management affairs, the majority role extends far beyond that necessary for decision-making flexibility and business continuity. A literal construction of section 18(h)⁴⁶ leaves open the possibility of excessive majority influence. As in the *McCallum* agreement, a majority may be empowered to amend the agreement terms. Under the authority of an amendment-by-majority clause, a mere majority of partners could, for example, reduce a partner's share, admit a new member or expand the business to an unrelated field. These matters are not mere management questions since they do not involve the day-to-day concerns of the business; rather, the majority is altering the "nature" of the partnership⁴⁷ and in so doing threatens dissenting

⁴⁴ U.P.A. § 18(h) classifies partnership affairs into two categories: "ordinary matters" and "acts in contravention" of the agreement. As commonly understood, "ordinary matters" are acts "within the scope of the partnership business" or more generally, the day-to-day concerns of a going business. See A. BROMBERG, *supra* note 14, at § 53; 68 C.J.S. *Partnership* § 142 (1950). By its language, U.P.A. § 18(h), subject to agreement, applies the majority rule only to these management decisions.

⁴⁵ The needs and desires of a partnership change throughout the course of the enterprise; permissive rules allow the partnership to respond appropriately. At the start of the business, equal control is the usual posture. But even then, one partner may wish to be inactive, while another may demand a veto power in exchange for providing the bulk of the financing. Later, as the natural capacities of each partner emerge or membership changes, internal structural changes are often warranted. See A. BROMBERG, *supra* note 14, at § 23B. To promote effective decision-making, a partnership may delegate management authority to a managing partner (see *Elle v. Babbit*, 259 Or. 590, 488 P.2d 440 (1971); and see generally A. BROMBERG, *supra* note 14, at 374 n. 56) or an executive committee (see *Bernstein, Bernstein, Wile & Gordon v. Ross*, 22 Mich. App. 117, 177 N.W.2d 193 (1970); *McCallum v. Ashbury*, 238 Or. 257, 393 P.2d 774 (1964)). For contra authority regarding delegation to a managing partner, see *Wild v. Commissioner*, 62 F.2d 777 (2d Cir. 1933).

⁴⁶ See text accompanying notes 13-22 *supra* for a discussion of a literal construction of section 18(h).

⁴⁷ See note 33 *supra* for a discussion of what constitutes the "nature" of a

partners with contingencies they could not have foreseen.⁴⁸

If the majority is authorized to make changes in the original scope of the partnership business, dissenting partners face new liability risks they were impotent to prevent. Under the U.P.A., general partners are personally liable for the acts of all other partners which bind the partnership.⁴⁹ A partner's authority to bind the partnership is defined by the partnership agreement.⁵⁰ Thus, majority actions which change the partnership agreement could confer new powers of representation upon all partners. As powers of representation change, each partner's potential liability changes concomitantly. That is, if the partnership incurs liability based on an authorized action by the majority, dissenting partners will be compelled to contribute to payment of the partnership debt.⁵¹ Consequently, if a mere majority of partners can amend the partnership agreement, dissenting partners may

partnership.

⁴⁸ The fiduciary duty owed between partners might diffuse the concentration of powers vested in the majority by an amendment-by-majority clause. See U.P.A. § 21 (Partners Accountable as Fiduciaries). From the first negotiations for the formation of the partnership through the final phases of winding up, *Herring v. Offutt*, 266 Md. 593, 295 A.2d 876 (1972) (the fiduciary duty attaches throughout this entire sequence of events), fiduciaries are held to a higher standard of care between themselves than is required between other parties who contract only at arm's length. What might be impermissibly broad powers between parties owing only ordinary care will be tolerated by courts construing a partnership agreement. Under the authority of an amendment-by-majority clause, however, the acts of a majority may not rise to the status of a breach of fiduciary duty and thus, fiduciary status may provide no protection to dissenting partners.

⁴⁹ U.P.A. § 15(b). See also Comment, *Apparent Authority and the Joint Venture: Narrowing the Scope of Agency Between Business Associates*, this issue at 830.

⁵⁰ Each partner is an agent of both the partnership and every other partner. The scope of the partnership business defines a partner's agency. When a partner acts with "real" or "apparent" authority on behalf of the partnership, the partnership is bound. U.P.A. § 9(1); A. BROMBERG, *supra* note 14, at § 49.

⁵¹ U.P.A. §§ 18(a), 18(b). In contrast, if the action was not authorized by the partnership agreement, the majority has no right to indemnification by dissenting partners. Furthermore, partners may agree among themselves to share losses or pay debts in particular proportions, U.P.A. § 18(a); *First Mechanics Bank of Trenton, N.J. v. Commissioner*, 91 F.2d 275 (3rd Cir. 1937), but third parties are not bound by that agreement and may recover in full from any of the partners. See, e.g., *Misco-United Supply, Inc. v. Petroleum Corp.*, 462 F.2d 75 (5th Cir. 1972).

be liable for activities engaged in against their will.⁵²

The *McCallum* holding imposes an important safeguard against overly-broad majority influence. Requiring unanimity for "fundamental changes" preserves some veto power in each partner. Dissenting partners thereby possess a means of self-protection when the majority seeks changes inconsistent with the original partnership agreement.

The common law also recognized the possibility for majority abuse of dissenting partners and sought to preclude such abuse. The standard at common law was the manner/nature distinction⁵³ whereby majority influence was restricted to matters within the original scope of the partnership business. At common law, any delegation of partnership control to a segment of the partnership conferred only authority commensurate with that normally held by a majority.⁵⁴ Furthermore, at common law, a partnership could not expand activities to an unrelated field without the consent of all partners unless the original partnership agreement expressed an intention to enter that specific

⁵² More importantly, because the majority action would have been authorized by the partnership agreement, dissenting partners could not withdraw from the partnership at that time without suffering penalties for wrongful dissolution. See note 5 *supra*.

⁵³ See notes 31-33 and accompanying text *supra* for a description of the manner/nature distinction.

⁵⁴ By delegating control, the partners modify only *who* has the exclusive authority to decide a management question; the subject matters upon which the managing partner may act are identical with those otherwise within the authority of the majority.

In *Arado v. Keitel*, 353 Mo. 223, 182 S.W.2d 176 (1944), contribution liabilities under the Missouri Unemployment Compensation Law required that the court compare the source of control of the successor of the business with that of the person from whom he acquired the business.

The court set out the effect of vesting control in a single partner:

[W]here the terms of the contract of partnership confer the power of control over the business of the partnership upon one of the partners, the stipulation will govern. (citation omitted.)

...
A distinction may be drawn between the active actual control of a partnership business which a partner may exercise as the active agent of the partnership, which control may at any time be legally withdrawn and exercised by the majority of the partners, and the *legally enforceable control* of a partnership business which a partner may exercise by virtue of an exclusive control vested in him by the terms of the partnership agreement.

Id. at 227, 182 S.W.2d at 179 (emphasis in original).

business.⁵⁵ Finally, at common law, a court would even ignore the literal terms of a partnership agreement that divested some partners of decision-making authority they otherwise would have.⁵⁶ The common law manner/nature distinction and the *Mc-*

⁵⁵ The partnership contract defines the particular purpose and scope of the business endeavor. Thus, the partnership may not engage in any activity unless the partnership agreement expressly or impliedly gives that power. *Natusch v. Irving*, 47 Eng. Rep. 1196, 1201 (Ex. 1824).

Natusch is the leading authority for the proposition that the partnership is restricted to the purposes defined in the original partnership agreement. In *Natusch*, a majority of the partnership originally formed to sell life and fire assurances wanted to expand the business to the unrelated field of marine insurances, underwriting ships and their cargoes. At the request of a dissenting partner, the court enjoined the company from engaging in this new field when the defendant partners were unable to prove clearly that the dissenting partner knew of their intention to so expand when he first joined the association. The opinion of Lord Eldon forcefully makes the point:

If six persons joined in a partnership of life assurances, it seems clear that neither the majority nor any select part of them, nor five out of the six, could engage that partnership in marine insurances, unless the contract of partnership expressly, or impliedly, gave that power; because if this was otherwise an individual or individuals by engaging in one specified concern might be implicated in any other concern whatever, however different in its nature, against his or their consent. . . . They, who seek to embark a partner in a business not originally part of the partnership concern, must make out clearly that he did expressly, or tacitly, acquiesce.

Id. at 1201-02 (emphasis added).

⁵⁶ In *Cotton Plant Oil Co. v. Buckeye Cotton Oil Co.*, 92 Ark. 271, 122 S.W. 658 (1909) a partnership agreement delegated the entire management to one partner. A majority of the partners, dissatisfied with the managing partner's choice of buyers, contracted to sell the same partnership property to a different merchant. The court held the majority could revoke the managing partner's exclusive power to dispose of partnership property. The majority's action in directing the sale of partnership property was proper because "there was here a diversity of opinion between the partners as to the conduct of their affairs" and a majority of them "acted within the scope of the partnership business." *Id.* at 272, 122 S.W. at 659.

In *Cotton*, the agreement expressly vested the authority to make partnership decisions affecting ordinary matters in the managing partner. Notwithstanding the agreement and without requiring formal modification of it, the court permitted the general partnership to dispose of property by majority vote. The court's result appears to give greater weight to the common law norm that a majority may always decide management questions, even in light of an agreement to the contrary. See also *Groth v. Payment*, 79 Mich. 290, 44 N.W. 611 (1890) for a similar result.

Both *Cotton* and *McCallum* illustrate the courts' tendency to reach a result

Callum holding avoid the onerous results possible under a literal construction of U.P.A. section 18(h).

III. PROPOSED AMENDMENT TO U.P.A. SECTION 18

Subject to agreement by the partners, section 18(h) of the Uniform Partnership Act enables a majority of partners to decide differences regarding "ordinary matters" of the partnership business, but provides that all the partners must consent to "acts in contravention" of the agreement.⁵⁷ The Oregon Supreme Court in *McCallum v. Ashbury* is the only court to consider the validity of an agreement modifying the "act in contravention" clause of section 18(h).⁵⁸ The court there held that even though the partnership authorized a majority of partners to amend the agreement's provisions, "fundamental changes" of the partnership agreement nevertheless required the consent of all partners.⁵⁹ The *McCallum* holding is consistent with pre-U.P.A. common law.⁶⁰ The holding rests on a sound policy objective: protection of dissenting partners from the prejudicial actions of the majority.⁶¹

The *McCallum* holding, however, conflicts with the proper statutory construction of section 18(h).⁶² In the absence of legislative history to the contrary, and given the internal structure of the U.P.A., courts must read the language of section 18 literally.⁶³ If section 18 is read literally, partners may, by agreement, modify the operation of subsection 18(h) in any way they choose. Thus, the *McCallum* result appears to be incorrect in light of the unambiguous language of section 18(h).

Therefore, statutory change is necessary to protect dissenting partners from prejudicial actions of the majority. The legislature should amend section 18 to codify the *McCallum* result without violating basic rules of statutory construction. To achieve this

which allocates control along the lines of the manner/nature distinction. At common law, courts sought to protect the fundamental right of each partner to participate in partnership decisions—even if it meant ignoring express agreements between the partners.

⁵⁷ See note 1 *supra*.

⁵⁸ See note 3 *supra*.

⁵⁹ See text at Section IIA. *supra*.

⁶⁰ See text at Section IIB. *supra*.

⁶¹ See text accompanying notes 36-38 *supra*.

⁶² See text accompanying notes 6-12 *supra*.

⁶³ See text accompanying notes 13-22 *supra*.

objective, the present "act in contravention" clause of section 18(h) should be removed from section 18 so that it is no longer "subject to any agreement" between the partners. Additionally, a new section 18.5 should expressly preclude the possibility that the partners could grant a majority unlimited power to amend the partnership agreement. These changes will achieve a proper balance between protecting dissenting partners and preserving majority influence in management affairs.

Specifically, the statutory language should be modified in two ways. Section 18(h) should be re-written to exclude its second clause, written below in italics:

"Any differences arising as to ordinary matters may be decided by a majority of the partners; *but no act in contravention of any agreement between the partners may be done rightfully without the consent of all partners.*"

In addition, a new section 18.5 should be added to reflect appropriate limitations on fundamental changes in the partnership agreement:

"Notwithstanding any other provision in this part, no change in the nature of the partnership or act in contravention of any agreement between the partners may be done rightfully without the consent of all partners."

These revisions preserve flexibility in partnership management while minimizing the potential for majority abuse of dissenting partners. A partnership agreement containing an amendment-by-majority clause would be governed by section 18(h) and enforceable only as to changes which altered the *manner* of doing business. For example, to the extent that such items were actually specified in the agreement, the majority could modify the size of salaries, select a new managing partner or designate a different bank for the deposit of partnership funds. The majority could not, however, authorize expansion to an unrelated business, alter a partner's share of profits or admit a new member. Since these latter changes involve the *nature* of the partnership business, section 18.5 would govern. As a result, such changes would require unanimous vote of the partners.

The present U.P.A. section 18(h) leaves open the possibility that dissenting partners could find themselves responsible for a partnership fundamentally different from that in which they originally invested. Because partners assume such great risks and liabilities, it is unjust that changes in the nature of the partnership could be made against their will. If the legislature

adopted the changes proposed above, the U.P.A. would better balance the rights of dissenting partners with the need to preserve flexibility in partnership management.

Jody E. Graham