Limited Partnerships—Limited Partners Who Control Corporate General Partner Are Subject to Personal Liability as General Partners. *Delaney v. Fidelity Lease Ltd.*, 526 S.W.2d 543 (Tex. 1975).

Fidelity Lease Limited was a limited partnership organized under the Texas Uniform Limited Partnership Act (TULPA).[1] The partnership was composed of 22 individual limited partners and a single corporate general partner, Interlease Corporation, whose only shareholders, directors, and officers were three of the limited partners.[2] The corporate general partner, acting for the partnership, entered into a contract under which the partnership agreed to lease a fast-food restaurant to be built by plaintiffs. When the restaurant was completed, Fidelity Lease failed to take possession or pay rent; accordingly plaintiffs brought suit against the limited partnership, the corporate general partner, and each of the limited partners.[3] The action against the limited partners was severed on plaintiffs' motion and the trial court granted a take nothing summary judgment in favor of the limited partners.[4] Plaintiffs appealed from this judgment insofar as it related to the three limited partners who controlled the corporation.[5] The court of civil appeals affirmed the trial court's judgment.[6] On appeal to the Supreme Court of Texas, the judgment was affirmed in part and reversed in part and the cause was remanded.[7] The court held that limited partners who take part in the control of the business of the partnership in their capacities as the only shareholders, directors, and officers of the sole corporate general partner are personally liable for the obligations of the partnership.[8]

In *Delaney v. Fidelity Lease Ltd.* plaintiffs contended that the defendant limited partners were personally liable for the obligations of the limited partnership under section 8 of the TULPA because

1. Delaney v. Fidelity Lease Ltd., 526 S.W.2d 543 (Tex. 1975). The Texas Uniform Limited Partnership Act is found in TEX. REV. CIV. STAT. ANN. art. 6132a (1970).

2. 526 S.W.2d at 544.

3. *Id.*

4. *Id.*

5. *Id.*

6. Delaney v. Fidelity Lease Ltd., 517 S.W.2d 420 (Tex. Cit. App.—El Paso 1974), *aff'd in part and rev'd and remanded in part*, 526 S.W.2d 543 (Tex. 1975).

7. 526 S.W.2d at 546.

8. *Id.* at 545. The court also stated that it did not decide whether Interlease Corporation was a legal general partner or whether a corporation could be a sole general partner in a Texas limited partnership. *Id.* at 546.

they took part in the "control of the business" through the corporate general partner.[9] Defendants argued that their only control over the limited partnership was through Interlease Corporation, the general partner, and that they therefore did not "control" the business as contemplated by section 8.[10] Before rejecting defendants' contention, the court set forth the provisions of sections 8 and 13 of the TULPA, which provide that a limited partner who takes part in the control of the business of a limited partnership becomes liable as a general partner, and that a person may be both a limited partner and a general partner in the same partnership at the same time.[11] The court then adopted the view of the dissenting judge below that the acts of defendants had been done for the partnership rather than the corporation and that indirectly, if not directly, defendants had taken part in the control of the partnership.[12] The court then stated its holding to be that "the personal liability, which attaches to a limited partner when 'he takes part in the control and management of the business,' cannot be evaded merely by acting through a corporation."[13]

Defendants also contended that the "control" test of section 8 of the TULPA should be coupled with a requirement that plaintiffs rely on the personal liability of the limited partners.[14] Defendants argued that because plaintiffs had not relied on the personal liability of the limited partners, no personal liability should be imposed on the limited partners even if they had in fact participated in the control of the limited partnership.[15] The court disagreed. It found that section 8 "simply provides that a limited partner who takes part in the control of the business subjects himself to personal liability as a general partner."[16]

Defendants' final contention was that they were insulated by the corporation from liability arising from their activities as corporate officers and the activities of the corporation.[17] Although the court recognized as a general principle of corporate law that officers

9. *Id.* at 545.

10. *Id.* Section 8 of the Texas Uniform Limited Partnership Act, TEX. REV. CIV. STAT. ANN. art. 6132a (1970), is identical to UNIFORM LIMITED PARTNERSHIP ACT § 7.

11. 526 S.W.2d at 544-45.

12. *Id.* at 545.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.* at 546.

of a corporation are not liable for corporate obligations, it noted that the corporate fiction may be disregarded when the corporation is used in an attempt to circumvent a statute. The court found such an attempt was being made in the case before it.[18] Although the court declined to decide whether the corporation was a legal general partner or whether a corporation could be a sole general partner in a Texas limited partnership, the court stated that the defendant limited partners could have taken part in the control of the business in both their individual and corporate capacities.[19] Noting that the statute should be strictly construed, the court concluded that the defendants, in no event, should be allowed to interpose as a shield from personal liability a corporation organized for the exclusive purpose of managing the limited partnership.[20] Any other result, the court reasoned, would allow the circumvention of the "statutory requirement of at least one general partner with general liability in a limited partnership" by "limited partners operating the partnership through a corporation with minimum capitalization and therefore minimum liability."[21] The court remanded the case with instructions that the trial court hold defendants personally liable if it determined that they had taken part in the control of the business, whether or not their control had been only in the capacity of officers of the corporate general partner.[22]

At the foundation of the common law of partnerships is the principle that each partner may act as the agent of all the other partners in conducting the business affairs of the partnership.[23] Under this rule of mutual agency, the act of one partner is considered to be the act of all the partners and, as such, is binding on all.[24] As a result of this rule, each partner is liable for the obligations and torts of every other partner if the obligations or torts were undertaken or committed in furtherance of the purposes of the partnership.[25] At common law and under the relevant Texas statute this

18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.*
23. King v. Matney, 259 S.W.2d 606, 608-09 (Tex. Civ. App.—Amarillo 1953, writ ref'd n.r.e.); Pegues v. Dilworth, 104 S.W.2d 558, 563 (Tex. Civ. App.—El Paso 1937), *aff'd*, 134 Tex. 169, 132 S.W.2d 582 (1939).
24. Brewer v. Big Lake State Bank, 378 S.W.2d 948, 951 (Tex. Civ. App.—El Paso 1964, no writ).
25. Smith v. Waymon, 148 Tex. 318, 331, 224 S.W.2d 211, 219 (1949).

liability is joint and several.[26]

The liability of the shareholders of a corporation for corporate obligations and torts is, in contrast, generally limited to the amount of their investment in the corporation.[27] The reason for this limitation is that a corporation is viewed by the law as an entity unto itself, a legal "person," separate and distinct from its shareholders, directors, and officers.[28] A corporate entity, however, may be disregarded in exceptional situations where failure to do so would promote fraud, allow injustice, or permit the circumvention of a statute.[29] The effect of disregarding the corporate entity, or "piercing the corporate veil," is that the shareholders of a corporation may be held personally liable for the obligations or torts of the corporation.[30] The Supreme Court of the United States explained the concept of "piercing the corporate veil" to prevent circumvention of a statute in *Schenley Distillers Corp. v. United States*[31] when it held that

> while corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose, they will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages and where no violence to the legislative purpose is done by treating the corporate entity as a separate legal person.[32]

Although no Texas court has relied on circumvention of a statute as a ground for disregarding a corporate entity, several have mentioned this rationale in dicta.[33] Texas courts have more often based their decisions on a finding that the corporation was the "alter ego"

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26. TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (1970); *see* Rice v. Travelers Express Co., 407 S.W.2d 534, 537 (Tex. Civ. App.—Houston 1966, no writ); Webb v. Gregory, 108 S.W.2d 478, 479 (Tex. Civ. App. 1908, no writ).

27. *See* Walker v. Lewis & Dilworth, 49 Tex. 123, 124 (1878). *See also* H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 73 (2d ed. 1970).

28. *See* Pittsburg Water Heater Co. v. Sullivan, 115 Tex. 417, 422, 282 S.W. 576, 578 (1926); Gossett v. State, 417 S.W.2d 730, 734 (Tex. Civ. App.—Eastland 1967, writ ref'd n.r.e).

29. Pace Corp. v. Jackson, 155 Tex. 179, 195, 284 S.W.2d 340, 351 (1955); Pacific Am. Gasoline v. Miller, 76 S.W.2d 833, 851 (Tex. Civ. App.—Amarillo 1934, writ ref'd). *See generally* H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS § 146 (2d ed. 1970).

30. Sutter v. Reagan & Gee, 405 S.W.2d 828, 836-37 (Tex. Civ. App.—San Antonio 1966, writ ref'd n.r.e.).

31. 326 U.S. 432, 437 (1946).

32. *Id.* at 437.

33. Pace Corp. v. Jackson, 155 Tex. 179, 195, 284 S.W.2d 340, 351 (1955); Pacific Am. Gasoline v. Miller, 76 S.W.2d 833, 851 (Tex. Civ. App.—Amarillo 1934, writ ref'd).

of its owners, that fraud or injustice would result if the corporation was not disregarded, or that the corporation was inadequately capitalized for the business it was conducting.[34]

The limited partnership has attributes of both the general partnership and the corporation. The general partners of a limited partnership have personal and unlimited liability for the partnership's obligations, just as they have in a general partnership.[35] Limited partners, however, are liable for the partnership's obligations only to the extent of their investment, a limited liability similar to that of the shareholders of a corporation.[36] Aside from the difference in liability, the major distinguishing characteristic of a limited partner, as compared to a general partner, is the participation in the business affairs of the partnership which is permissible for each.[37] A general partner may actively participate in the business, but a limited partner who "takes part in the control of the business" loses his position of limited liability and becomes liable as a general partner.[38] This restriction of the management rights of limited partners has been a standard provision of the statutes that allow creation of limited partnerships, and it is included in the Texas statute.[39]

Under the Texas Uniform Limited Partnership Act, limited partners, as such, are not personally liable for the obligations of the

34. First Nat'l Bank v. Gamble, 134 Tex. 112, 119-20, 132 S.W.2d 100, 103-04 (1939) (alter ego); McDonald & Co. v. Kemper, 386 S.W.2d 215, 217 (Tex. Civ. App.—Forth Worth 1965, no writ) (fraud); Landa v. Whitfield, 131 S.W.2d 310, 312 (Tex. Civ. App.—San Antonio 1939, writ ref'd) (injustice).

35. Section 10(a) of the TULPA, TEX. REV. CIV. STAT. ANN. art. 6132a, § 10(a) (1970), provides:

> A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners. . . .

Section 15 of the Texas Uniform Partnership Act, TEX. REV. CIV. STAT. ANN. art. 6132b, § 15(a) (1970), provides: "All partners are liable jointly and severally for all debts and obligations of the partnership including those under Sections 13 and 14."

See Merrick v. New York Subways Adv. Co., Inc., 178 N.Y.S.2d 814, 818 (Sup. Ct. 1958).

36. TEX. REV. CIV. STAT. ANN. art. 6132a, §§ 2, 8 (1970); *see* UNIFORM LIMITED PARTNERSHIP ACT §§ 1, 7.

37. Toor v. Westover, 94 F. Supp. 860, 863 (S.D. Cal. 1950), *aff'd*, 200 F.2d 713 (9th Cir. 1952), *cert. denied*, 345 U.S. 975 (1953); New York Subways Adv. Co., Inc., 178 N.Y.2d 814, 818 (Sup. Ct. 1958). *See generally* 2 R. ROWLEY & D. SIVE, ROWLEY ON PARTNERSHIP § 53.0, at 549 (2d ed. 1960).

38. TEX. REV. CIV. STAT. ANN. art. 6132a, § 8 (1970).

39. *Id.*; UNIFORM LIMITED PARTNERSHIP ACT § 7. *But see* A.L. Coupe Constr. Co. v. United States, 139 F. Supp. 61 (Ct. Cl.), *cert. denied*, 352 U.S. 834 (1956); Ky. Acts 1960, ch. 151, § 2 (repealed 1970).

partnership beyond their investment therein. They may, however, become personally liable as general partners under section 8 if they "take part in the control of the business."[40] Because the term "control" is not defined in the TULPA or the Uniform Partnership Act on which the TULPA is based, the question of what actions constitute "control" within the meaning of the statute has arisen in varied factual contexts.[41] It appears that a corporation can exercise that control, however, because the Texas Business Corporation Act apparently authorizes a corporation to be a general partner in a limited partnership.[42] This conclusion is supported by the TULPA[43] and the Texas Uniform Partnership Act,[44] both of which speak only in terms of "persons," and neither of which restricts corporations from becoming partners.[45]

Delaney v. Fidelity Lease Ltd. was a case of first impression under the TULPA. In this case the Supreme Court of Texas was confronted by one of the problems arising from the uncertain meaning of "control" as that term is used in section 8 of the TULPA. The court had to determine whether limited partners could escape personal liability as general partners under section 8 by participating in the control of partnership business through a corporation. In *Delaney* the court concluded that control exercised in the capacity of an officer and director of a corporate general partner of a limited partnership is "control" as that term is used in section 8.[46] Support for this interpretation of *Delaney* is found in the court's stated hold-

40. TEX. REV. CIV. STAT. ANN. art. 6132a, § 8 (1970).

41. Bergeson v. Life Ins. Corp. of Am., 170 F. Supp. 150 (D. Utah 1958), *modified*, 265 F.2d 227 (10th Cir.), *cert. denied*, 360 U.S. 932 (1959) (limited partner was director of corporation owned by limited partnership); Grainger v. Antoyan, 48 Cal. 2d 805, 313 P.2d 848 (1957) (limited partner was sales manager); Holzman v. De Escamilla, 86 Cal. App. 2d 858, 195 P.2d 833 (Dist. Ct. App. 1948) (limited partner chose manager, decided which crops would be planted, and countersigned checks); Silvola v. Rowlett, 129 Colo. 522, 272 P.2d 287 (1954) (limited partner was repair shop foreman); Rathke v. Griffith, 36 Wash. 2d 394, 218 P.2d 757 (1950) (limited partner was elected director but never voted). *See generally* Feld, *The "Control" Test for Limited Partnerships*, 82 HARV. L. REV. 1471 (1969).

42. TEX. BUS. CORP. ACT art. 2.02A(18) (Supp. 1975). This statute provides: "Subject to the provisions of Sections B and C of this Article, each corporation shall have power: . . . To be a . . . partner . . . of any partnership . . . ." *But see* Tomlin v. Ceres Corp., 507 F.2d 642 (5th Cir. 1975).

43. TEX. REV. CIV. STAT. ANN. art. 6132a, § 2 (1970).

44. TEX. REV. CIV. STAT. ANN. art. 6132b, § 6 (1970).

45. The Texas Supreme Court expressly left this question open in *Delaney*. 526 S.W.2d at 546.

46. 526 S.W.2d at 545-46.

ing,[47] its response to the defendants' "reliance test" argument,[48] and its instructions to the trial court in remanding the case.[49] Although the court's decision was based on application of section 8 alone, its opinion contained language which suggested that the case could have been decided on different grounds. This language makes the opinion somewhat confusing.

At one point the court stated: "[C]ourts will disregard the corporate fiction . . . where it is used to circumvent a statute [and] [t]hat is precisely the result here . . . ."[50] This language suggests that the court was "piercing the corporate veil" of Interlease Corporation in the sense of refusing to recognize the corporation as a legal entity apart from its shareholders. If the court had done this, the shareholders of Interlease Corporation, the three defendant limited partners, would have been personally liable for the obligations of the corporation and thus personally liable for the obligations of the partnership which would fall upon Interlease as general partner. Regardless of whether liability had been imposed on the defendants as limited partners who took part in the control of the business of the partnership or as shareholders of a corporation which the law did not recognize as a legal entity, the result in *Delaney* would have been the same. In other circumstances, however, because there are important differences between the two theories and their operation, the application of one theory or the other might yield varied results. For example, consider the situation in which a corporate general partner in a limited partnership is composed of several shareholders and officers, some of whom are limited partners and some of whom are not limited partners. If a court "pierced its corporate veil" to prevent the circumvention of a statute, or for any other reason, all the shareholders of the corporation, not just the limited partners, would be held personally liable for the obligations of the corporation which would include the obligations of the partnership. On the other hand, if a court relied only on

47. "[W]e hold that the personal liability, which attaches to a limited partner when 'he takes part in the control and management of the business,' cannot be evaded merely by acting through a corporation." *Id.* at 545.

48. "Section 8 of Article 6132a simply provides that a limited partner who takes part in the control of the business subjects himself to personal liability as a general partner." *Id.*

49. "If, upon trial on the merits it is found from a preponderance of the evidence that either of these three limited partners took part in the control of the business, whether or not in his capacity as an officer of Interlease Corporation, he should be adjudged personally liable as a general partner." *Id.* at 546.

50. *Id.*

section 8, personal liability for the obligations of the partnership would be imposed only upon the limited partners who had taken part in the control of the partnership business. Because the results obtained would vary considerably depending on the theory used, it is important to understand which theory the *Delaney* court relied on.

Although some language used by the court in *Delaney* suggests that the court "pierced the corporate veil" of the corporate general partner in that case, it appears that the court used "disregard[ing] the corporate fiction" in an entirely different sense. It seems that the court, by using the phrase, actually meant that the corporation would not be recognized as a shield from the personal liability which would otherwise be imposed upon limited partners who took part in the control of the partnership business. This interpretation of the court's language is consistent with its application of section 8. When the court spoke of "disregard[ing] the corporate fiction," it seems to have been stating the reasoning underlying its holding that control in a corporate capacity is "control" for the purposes of section 8. The court simply "disregarded" the fact that the control in *Delaney* was exercised in a corporate capacity.

Despite the court's interjection of some confusing language, its interpretation of section 8 "control" to include control exerted in a corporate capacity is correct in light of the legal philosophy which prevailed in 1916, the year in which the Uniform Limited Partnership Act was drafted.[51] At that time, abstention from active participation in the business was viewed as the "price to be paid" for the privilege of limited liability afforded limited partners. While this position may be questioned as a matter of policy, no state has removed the control restrictions from its statute. Indeed, the very fact that this provision appears in section 8 of the TULPA evidences the intent of the Texas legislature that "control of the business" and limited liability shall not coincide in a limited partnership. The

51. Cummings v. Hayes, 100 Ill. App. 347, 353-54 (Ct. App. 1902). *See also* A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP § 26, at 144-45 (1968); 2 S. ROWLEY, THE MODERN LAW OF PARTNERSHIP § 1000, at 1370-71 (2d ed. 1916). Although section 28(a) of the TULPA provides that "[t]he rule that statutes in derogation of the common law are to be strictly construed shall have no application to this Act," the Supreme Court of Texas, in *Delaney* held that "[s]trict compliance with the statute is required if a limited partner is to avoid liability as a general partner." Just how strictly section 8 of the TULPA will be construed remains to be be seen, but *Delaney* indicates that Texas courts may look closely at any activities of limited partners in relation to the partnership business. 526 S.W.2d at 546.

decision of the Supreme Court of Texas in *Delaney v. Fidelity Lease Ltd.*[52] is consistent with this legislative intent.

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52. 526 S.W.2d 543 (Tex. 1975).