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Recommendations of the National Bankruptcy Review Commission: Partnership as Debtor, Partner as Debtor

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In addressing the partnership as debtor and the partner as debtor respectively as subjects for amendment to and supplementation of the Bankruptcy Code (the "Code"), the National Bankruptcy Review Commission (the "Commission") has sought to provide a measure of order and certainty to areas of the law now largely unaddressed in the Code and, therefore, characterized by inconsistent holdings and judicial improvisation. [1] With respect to the partnership as debtor, the Commission has set forth a series of recommendations (the "Recommendations") that skillfully and comprehensively address the legislative omissions that have heretofore given rise to considerable expense and delay in resolving partnership cases involving partner liability to creditors. [2] In the area of the partner as debtor, the Commission has set forth a number of Recommendations that substantially advance the analysis of the "hotly−debated and divisive" [3] issues arising in such cases. However, certain of the Commission's Recommendations for debtor−partner cases will undoubtedly engender still further debate over the treatment proposed to be accorded to nondebtor partners of such debtors and to the creditors of such debtors. [4]

I. The Partnership as Debtor

The Commission has set forth nineteen Recommendations as additions or amendments to the Code dealing with the partnership as debtor. [5] Perhaps most welcome of the Recommendations are those that address the liabilities of general partners to partnership creditors (and the related contribution and indemnity claims) in partnership cases under chapters 11 and 12 as well as under chapter 7. [6] The Commission recommends that the bankruptcy court in a partnership case be granted core jurisdiction to adjudicate the liability of general partners for the debts of the partnership and the rights and liabilities among the general partners with respect thereto. [7] In the case of a deficiency in the property of a partnership estate to pay in full the claims of partnership creditors, the Recommendations provide that the estate in a partnership case under any chapter of the Code is to have a claim enforceable in the bankruptcy court against each partner, to the extent provided under nonbankruptcy law, without reduction for rights of contribution or indemnity among general partners. [8] The Recommendations further provide for the estimation of such claims if determination would unduly delay the administration of the partnership case. [9] As discussed in the Commission Report, bankruptcy court adjudication of partner liability in partnership cases will provide an efficient and more expeditious mechanism for resolving partnership cases, which otherwise would often await the completion of separate litigation involving partner liabilities and claims. [10]

In furtherance of the power of a bankruptcy court to adjudicate the liabilities of partners of debtor partnerships, the Commission proposes that the court be further empowered to require indemnity or other assurance of payment from such partners, and to impose restrictions on the transfer of a partner's assets. [11] This provision would in substance extend the application of existing section 723(b), which presently applies only to chapter 7 cases, [12] to partnership cases under all chapters of the Code. [13]

The Commission further recommends that existing section 723(c) should be amended to provide that estates of debtor partners are to be liable for partnership debts to the same extent as provided under applicable nonbankruptcy law. [14] Section 723(a) of the Code provides that the trustee of a partnership in a chapter 7 case has a claim against each personally liable general partner for a deficiency in estate assets to the extent provided under applicable nonbankruptcy law. [15] Section 723(c) of the Code provides that the trustee of a partnership in a chapter 7 case has a

claim against the estate of each general partner that is a debtor under the Code for the "full amount of all claims of creditors allowed in the case concerning such partnership." [16] Unlike section 723(a), section 723(c) does not refer to applicable nonbankruptcy law when providing for the claims of a trustee against the assets of constituent partners. [17] The Commission's Recommendation would resolve the current discrepancy in language between sections 723(a) and 723(c) and would also extend the provisions thereof to partnership cases under all chapters. [18]

The Commission also suggests that nondebtor general partners and the estates of debtor general partners be liable for the administrative expenses of a partnership case under the Code, with the court empowered to assess such expenses in such proportions as it deems fair and reasonable. [19] Under current law, only the property of the debtor partnership's estate is subject to assessment for administrative claims. [20] The proposed imposition upon general partners of debtor partnerships of personal liability for administrative claims (presumably in the circumstance of a deficiency in partnership assets) is justified by the anticipated benefits to such general partners arising from the administration of the partnership's case under the Code, [21] but could well be a source of contention among partners and estates of debtor partners.

The Commission's proposed definition of a general partner is any entity (other than a debt guarantor) that is liable for the debts of a partnership. [22] Under this definition, a member of a limited liability company would not be a general partner, and therefore would not be personally liable for the administrative expenses of a case under the Code concerning the limited liability company. [23] Accordingly, the suggested extension of general partner liability to administrative expenses will, if enacted, provide greater impetus to the use of limited liability companies and other limited liability entities as a form of business and property ownership solution. [24]

The Commission has also recommended the abrogation of the "jingle rule." [25] Although, under section 723(c) of the Code, the claim of a debtor partnership's trustee is given equal status with any other general claimant in a chapter 7 case of a partner of the partnership, [26] this provision is applicable only in chapter 7 cases and only when both a partnership and one of its general partners is a chapter 7 debtor. [27] The Commission's proposal would provide equal priority to claims of partnership creditors against a debtor general partner *vis−à−vis* nonpartnership creditors of such partner, both when the partnership is and is not a Bankruptcy Code debtor, and would apply to cases under all chapters of the Code. [28]

This Recommendation, if adopted, would enhance recoveries in partnership cases under the Code by providing to such partnerships and their creditors a claim equal in priority to those of the competing claims against a debtor general partner. [29] The Recommendation is fundamentally consistent with the existing provisions of chapter 7 of the Code. [30] However, if adopted, the proposal will necessitate careful counseling for those who are extending credit to a person or entity that is also a personally liable general partner of one or more partnerships, inasmuch as the actual and contingent liabilities of such a person or entity arising from its status as a general partner will no longer be subordinated to nonpartnership claims whether or not the partnership itself becomes a debtor under the Code. [31]

The Commission recommends that a trustee in a partnership case be empowered to file an involuntary case under the Code against a general partner without regard to the requirements of section 303 of the Code as to the number of creditors filing such a petition and the amount and nature of the claims involved. [32] This proposal further implements the Commission's proposed expansion of the array of powers available to expedite and enhance recoveries in partnership cases under the Code. [33] The proposal would place partnership trustees in a position held by no other creditor under the Code, and accord to the trustee considerable bargaining leverage with respect to nondebtor general partners. [34] Although this proposal may have substantial merit in the context of a professional partnership or similar entity having numerous general partners, careful consideration should be given to its application to the case of a real estate limited partnership or similar entity with respect to which the nondebtor general partner is itself engaged in discussions with its own creditors. In this later circumstance, conferring upon a trustee of a partnership, in which such nondebtor person or entity is a general partner, the power to file an involuntary petition against such nondebtor may unduly upset the balance of power between the nonpartnership creditors of such general partner and the creditors of the debtor partnership. [35] It may be argued, on the other hand, that such an involuntary petition would be subject to the provisions of section 303(h) of the Code requiring a showing of nonpayment of the nondebtor partner's debts or the appointment of a custodian or other fiduciary for substantially all of such partner's property, [36] and therefore could not be filed arbitrarily. However, workout negotiations between a financially distressed general partner and its

nonpartnership and partnership creditors will most often occur in the context of nonpayment of some or all of the debts of such person or entity, thereby making feasible the filing of an involuntary petition against such person or entity. [37] This Recommendation gives rise to a number of competing considerations of substantial merit, and further consideration and discussion.

The Commission recommends that the courts be empowered to issue for cause and upon motion of a party in interest, after notice and a hearing, a temporary injunction against the acts of creditors or general partners of a debtor partnership against nondebtor partners and their property, on account of partnership obligations. [38] The proposed injunctive power would cover claims against the debtor partnership consensually guaranteed by a protected nondebtor partner as well as statutory liabilities imposed on the nondebtor partner by reason of its status as a general partner of the debtor. [39] The Recommendation specifies that the injunction is not to be issued unless the protected general partner: (l) consents to the jurisdiction of the bankruptcy court, (2) makes or agrees to make the financial disclosures required by a separate Recommendation, and (3) is precluded from incurring obligations or transferring property except as specified in the order of injunction. [40] The Recommendation provides further that the injunction may be terminated, annulled, modified or conditioned for cause. [41] The proposed injunction does not extend to claims against general partners arising from nonpartnership obligations, and thereby does not adversely affect nonpartnership creditors of a nondebtor general partner that may be engaged in its own workout negotiations. [42] Indeed, a general partner that receives the benefits of the proposed temporary injunction is subjected to a number of material disabilities relating to the incurrence of obligations and the disposition of its assets, thereby protecting the interests of nonpartnership creditors of such partners while also providing an incentive to the partner to engage in workout negotiations with its nonpartnership creditors. [43]

The Commission recommends empowering the bankruptcy courts to issue postconfirmation injunctions to protect against actions by partnership creditors and general partners against nondebtor general partners who contribute to the estates of debtor partnerships. [44] This proposal would settle any issue relating to the reach of the courts' authority to protect nondebtor partners who contribute to a partnership plan confirmation and should assist in providing an incentive to such partners to participate in the plan formulation and funding process. [45] This Recommendation is an appropriate application of the proposed enhancement of bankruptcy court jurisdiction over nondebtor partners. [46] The Recommendation does not, however, contemplate the issuance of a postconfirmation injunction covering actions by nonpartnership creditors of nondebtor general partners. [47]

The other Recommendations of the Commission relating to the partnership as debtor, further serve to provide a workable and cohesive system for the adjudication of partnership cases under the Code. The Commission's work in this area has provided the wherewithal to fill a significant void in the Code and should, in general, constitute the basis for legislation consistent with its Recommendations.

II. The Partner as Debtor

The Bankruptcy Code generally embodies a policy favoring the inclusion in a debtor's estate of contractual rights and ownership interests notwithstanding contractual or nonbankruptcy law provisions that would otherwise terminate or impair the value of such rights or interests upon the filing of a petition under the Code by or against the debtor. [48] The application of this policy to debtors' interests in executory contracts has meant that nondebtor parties to such contracts have been compelled to maintain their contractual relationships with Bankruptcy Code debtors notwithstanding their desires to the contrary. [49] The application of this policy to the interests of debtor general partners in partnerships and of debtor managing members in limited liability companies may be viewed as antithetical to the essential nature of the partnership or limited liability company relationship, which is based on private agreement and consensual association. [50]

The Commission has done a highly creditable job in seeking to resolve or at least temper the conflict between preservation of estate value and the rights of nondebtor parties in dealing with the debtor as partner or managing member. However, as more fully discussed below, certain of its Recommendations warrant further explanation and amplification, while others should be subject to additional consideration and debate.

As a preliminary matter, it is good to see that the Commission has covered in its analysis and Recommendations the respective positions of debtor members of member−managed limited liability companies and debtor managers of manager−managed limited liability companies, and proposes to treat such debtors in a manner that is, in many respects, similar to the treatment it proposes for debtor general partners. [51] This is, of course, a welcome and necessary addition that takes into account the creation and widespread acceptance of limited liability companies as property ownership entities that occurred after the enactment of the Bankruptcy Code. [52] For ease of reference, this article will employ terminology referring only to general partners and to partnerships, while intending to apply the same discussion and analysis to limited liability companies and debtor managing members thereof.

The partnership solution of property ownership gives rise to several different types of relationships and rights. [53] A partnership agreement is, of course, a contract among the parties thereto, specifying the respective rights and obligations of the partners. [54] In addition, a partnership agreement evidences certain "property rights" of the partners, arising from their investment in the partnership's enterprise and their expectations concerning capital appreciation, and income and distributions generated by the operation of the partnership's business. [55] A partnership agreement will provide for management and governance of the partnership. [56] The entry into a partnership agreement gives rise to a fiduciary relationship between the partners vested with the managerial rights of the partnership and the partners that are not vested with such rights. [57] The partnership relationship is also subject to the provisions of applicable state partnership statutes, which may be varied in certain instances by the overriding provisions of a partnership agreement. [58]

Most partnership agreements and the applicable state statutes governing the partnership relationship provide for the modification of the relationship among the partners upon the filing by or against a general partner of a petition under the Code. [59] This modification may take the form of a dissolution of the partnership and liquidation of its assets, [60] the dissolution of the partnership and reconstitution thereof among the remaining nondebtor members, [61] the disenfranchisement of the debtor partner and relegation of its status to that of a limited partner, [62] or the buyout of the debtor partner at a fair market or below fair market price. [63] Modification of the rights and benefits of a debtor partner or disengagement of the debtor partner from a partnership may mean the reduction or loss to the debtor and its estate of the value of the debtor's investment in the partnership including the reduction or loss of the right to income and distributions, the loss of fee income that may have been payable to the debtor partner in the performance of its management functions, the incurrence of income tax liability as the result of the termination of its interest in the partnership, and the winding up of the operations of the debtor if it is in the business of managing the assets of such partnerships.

However, the consequences to the nondebtor partners of the financial distress and Bankruptcy Code filing of a general partner may be extremely severe, and may in many circumstances justify disengagement between the partnership and the debtor partner. In the case of a partnership engaged in the development of real property requiring the satisfaction of one or more capital calls, the bankruptcy of a general partner may give rise to a conflict between the interests of the debtor general partner (to preserve its assets and therefore to defer capital calls) and those of the nondebtor partners. [64] In the case of a professional partnership, the bankruptcy of a general partner may have arisen from some improvident act of the partner or, in any event, may serve to divert the attention of the debtor from the work of the partnership, such that the nondebtor partners would be fully justified in requiring disengagement from the debtor. [65]

The Bankruptcy Code of 1978 effected a radical change in the treatment of executory contracts and unexpired leases by generally rendering unenforceable bankruptcy termination and bankruptcy default clauses contained in such agreements. Under the Code, many of these agreements cannot be terminated or modified solely by reason of the filing of a petition under the Code by or against a party, or by reason of the financial condition of such party. [66] The inclusion in the estate of a debtor's rights under otherwise terminable executory contracts and unexpired leases was intended to preserve for the estate and its creditors the value of these contractual and leasehold interests and therefore to foster reorganization or other realization of value. [67] Albeit somewhat cryptically, the Code exempted from the rule of unenforceability contracts in the nature of personal service agreements, as well as other agreements involving fiduciary or other special relationships between the parties with respect to which the nondebtor party is entitled to determine whether it wishes to terminate the relationship as the result of the debtor's Bankruptcy Code filing or financial condition. [68]

Notwithstanding that all partnership agreements give rise to a fiduciary relationship between a general partner and its other partners, a number of courts dealing with the question whether a debtor in possession under the Code could assume a partnership agreement have refused to adopt a blanket rule requiring the automatic termination of all partnership agreements and the dissolution of all partnerships by reason of the occurrence of a Code filing by or against a general partner, and have ruled in favor of the assumability of a partnership agreement by a debtor in possession in the Bankruptcy Code case of a general partner. [69] These courts have determined that there are certain types of partnerships in which the presence of a debtor in possession as a managing general partner does not necessarily result in harm to the nondebtor partners or give rise to an inherent conflict of interest among such partners. [70] Essentially, these decisions have acknowledged that vast differences may exist between entities that are all denominated as partnerships, and that such differences may mandate varying results with respect to the consequences to the nondebtor partners of the bankruptcy of a general partner. Thus, for example, the effect on a small professional partnership of the bankruptcy of its managing general partner may be contrasted with the effect of such a bankruptcy on a real estate partnership owning a fully−tenanted office building that requires no further capital commitments or unique expertise of its managing general partner. In the former case, the bankruptcy of a managing general partner may make it impossible to sustain the business of the partnership unless the debtor managing general partner is either expelled or at least relieved of its management responsibilities. [71] In the latter case, the debtor managing general partner may be fully able to perform its obligations to the nondebtor partners notwithstanding its status as a debtor under the Code. [72]

However, the development of a statutory basis for the holdings denying enforceability of bankruptcy termination provisions of partnership agreements has required complex and sometimes tortuous interpretations of the Bankruptcy Code that reflect the complexity of the issues in this area. [73] The courts have dealt with the following issues, among others, in grappling with the effects of a general partner bankruptcy case under the Code: [74]

(1) Is a partnership agreement an executory contract for the purposes of section 365? [75]

(2) Is a partnership agreement the type of agreement that may be terminated or modified under a bankruptcy termination or modification clause pursuant to section 365(e)(2)(A) of the Code? [76]

(3) If a partnership agreement may not be terminated or modified under a bankruptcy termination or modification provision, is it nevertheless the type of agreement that may not be assumed under section 365(c) of the Code? May it be assumed by a debtor in possession? May the agreement be assumed by a trustee? [77]

(4) What is the significance, if any, of the difference between the language of section 365(c)—prohibiting assumption and assignment of a contract under which applicable law excuses the nondebtor party from accepting performance *from anyone other than the debtor or debtor in possession*—and the language of section 365(e)(2)(A)—authorizing termination or modification of a contract with respect to which applicable law excuses the nondebtor party from accepting performance *from a trustee, or an assignee of such contract or lease*? [78]

(5) If a partnership agreement may not be assumed what treatment is to be accorded to the interest of the debtor in the partnership? If there is disengagement, will the court enforce a below−market buyout provision? What will the court do if there is no buyout provision in the partnership agreement? [79]

(6) If a partnership agreement may be assumed under section 365(b) of the Code, may it also be assigned to a third party under section 365(f) of the Code? May the court require the admission to the partnership of a new partner over the objections of a nondebtor partner? [80]

The foregoing enumeration of section 365 issues relating to the termination, assumption and assignment of partnership agreements by debtors in possession and by trustees illustrates the difficulty of applying section 365 constructs to the resolution of partner bankruptcy issues. The Commission has recognized that the need to address such issues may have diverted the courts from the essential inquiries and decisions required to appropriately balance the competing interests and concerns of debtor and nondebtor parties to partnership agreements. [81] Accordingly, the Commission has elected to treat the subject of the partner as debtor in a new section apart from section 365, in order to better isolate the group of problems and concerns relating solely to partnership agreements. [82]

III. Treatment of Partnership Agreements Apart From Other Contracts

The Report states that partnership agreements will no longer be subject to the test of "executoriness," which presently must be satisfied in order for a contract to be dealt with under section 365. [83] This change to the Code will mean that even if all of a debtor's obligations under a partnership agreement have been satisfied and the agreement is therefore no longer "executory," the agreement nevertheless may be "assumed" (the debtor electing to remain a partner) or "rejected" (the estate electing to abandon the partnership interest) under the revised Code. [84] This proposal properly recognizes that the property rights of a debtor partner under a partnership agreement must be dealt with in the context of a case under the Code, notwithstanding that the contractual relationship among the partners may have progressed to the point where the intervention of the court is not required.

However, the Report does not expressly address the consequences to the debtor partner and the partnership of the "rejection" (i.e., abandonment) of a partnership agreement and a partnership interest. [85] Although a separate part of the Report deals with the buyout of a partner that desires to transfer its partnership interest to a third party, [86] the Report does not discuss any buyout mechanism relating to an abandoned partnership interest. [87] It is perhaps implicit that abandonment will constitute a breach of a partnership agreement, with the consequences to the debtor partner and its estate to be governed by the partnership agreement and applicable state law. [88] If this supposition is correct, then state law will govern the enforceability of a below−market buyout provision of a rejected partnership agreement. The existence of an enforceable below−market buyout provision will simply constitute an attribute of the group of property rights comprising a debtor's interest in a partnership. [89] The anticipated receipt by the estate of a below−market payment for a debtor's interest in a partnership will be part of the mix of considerations underlying the estate's decision to perform or abandon a partnership agreement and interest. The Report also does not address the question of enforceability of partnership interest pledge agreement provisions prohibiting the breach or abandonment by a debtor of a partnership interest. [90] Here again, it may be implicit that the enforceability of such a provision is to be governed solely by state law, with the pledgee to obtain protection only under a recognition agreement between the pledgee and the nondebtor partners.

IV. The Unenforceability of Ipso Facto Provisions in Partnership Agreements

The Commission has determined that there is no compelling interest served by the automatic dissolution of a partnership or the buyout of a partner's interest solely by reason of the filing of a Bankruptcy Code petition by or against a general partner of a partnership. [91] Accordingly, the Report sets forth a Recommendation that bankruptcy termination and modification provisions (denominated "*ipso facto* provisions" in the Report) in all partnership agreements should be rendered unenforceable. [92] *Ipso facto* provisions are described in the Recommendation as those based on insolvency, financial condition, commencement of a voluntary or involuntary case under title ll, or the appointment of a trustee or custodian. [93] The Recommendation also provides that "non−*ipso facto* provisions" that limit a partner's rights, relationship or interest, or that permit expulsion on a basis other than insolvency or the other enumerated clauses of an *ipso facto* provision would remain enforceable. [94]

The concern here is that nondebtor partners would employ so−called "non−*ipso facto* provisions" to terminate or modify the rights of a debtor partner while in fact effecting such termination or modification by reason of the debtor's Bankruptcy Code filing. [95] In the case of partnership agreements of professional partnerships, the provisions for expulsion and for adjustment of partner compensation may be based on factors other than the default of a debtor partner. These factors may be relatively subjective, and could be employed to adversely affect the rights of a debtor partner solely by reason of the status of such partner as a debtor under the Code, without overtly employing the *ipso facto* provisions of the partnership agreement. [96] However, given the sensitive nature of the relationship among professional partners, the judgment of the nondebtor partners to expel or otherwise impair the interests of a debtor partner should be respected by the bankruptcy courts if the action does not violate the terms of the partnership agreement or any provision of state law.

Most business partnership agreements provide for expulsion, dissolution or modification of a partner's interest in the partnership only upon the occurrence of a breach by a partner of its obligations under the agreement. [97] Such breaches are usually as objectively determinable as are any breaches under any other form of contract. Therefore, the enforcement by nondebtor partners of non−*ipso facto* default provisions in business partnership agreements by

nondebtor partners does not appear to give rise to concerns that such provisions will be employed as disguised *ipso facto* termination provisions. It should be noted, however, that if the present executory contract provisions of the Code were to apply to partnership agreements, then the estate would be afforded the opportunity to cure such a non−*ipso facto* default upon assumption of the agreement. [98] The Commission's proposal to recognize the enforceability of such non−*ipso facto* defaults appears to eliminate a debtor partner's opportunity to cure a default arising from a failure of payment or contribution of other value.

The Recommendation to permit enforceability of state law termination and modification provisions arising from a prepetition payment default, without the opportunity to cure afforded under the Code in the case of ordinary executory contracts and unexpired leases, warrants further consideration. Although it may be argued that partnership agreements involve more sensitive and important relationships and commitments than do ordinary executory contracts and leases, and therefore should be more readily terminable, [99] it should also be noted that there are executory contracts and leases involving very substantial sums of money, and which form the basis and, indeed, constitute collateral for loans extended by third parties. The breach by Bankruptcy Code debtors of such contracts and leases, and the delays and financial consequences suffered by the nondebtor parties thereto (as well as the creditors of such nondebtor parties), arising from such breaches and the effect of the automatic stay and the existence of cure rights under the Code, may be equally as adverse to such nondebtor parties as uncured payment defaults would be to nondebtor partners under partnership agreements.

If the Commission's Recommendation were supplemented to permit cure of non−*ipso facto* defaults by debtor general partners under partnership agreements, the election to perform a partnership agreement (an "assumption" under the current terminology of the Code) could be made subject to satisfaction of the following standards:

> A) cure of outstanding defaults or the provision of adequate assurance of prompt cure of such defaults;
>
> B) provision of adequate assurance of future performance of the debtor's obligations under the partnership agreement, regardless of whether a prepetition default has occurred under the partnership agreement;
>
> (C) there shall not have occurred any "non−*ipso facto*" event (other than a default susceptible to cure under clause A above) that would under the partnership agreement or applicable nonbankruptcy law entitle the nondebtor partners to expel the debtor from the partnership or otherwise modify the rights of the debtor under the partnership agreement.

The requirement for adequate assurance of future performance, whether or not a prepetition default shall have occurred, is intended to provide comfort to the nondebtor partners that the debtor will satisfy its executory obligations for capital calls and other financial commitments. The enforceability of non−*ipso facto* default clauses, as recognized in clause (C) above, reflects the Commission's Recommendation to permit enforcement of such provisions contained in a partnership agreement or otherwise provided for under state law. Enforcement of such provisions will assure that nondebtor partners will not be compelled to continue a partnership relationship with a debtor who has theretofore committed an act that justifies expulsion from the partnership.

In addition to non−*ipso facto* termination provisions relating to payment defaults and termination provisions relating to matters of professional performance, many partnership agreements provide that they may be terminated and the partnership dissolved upon the vote of all of the partners. [100] The Commission has proposed that under certain circumstances a debtor or its trustee not be permitted to

vote the interest of the estate under a partnership agreement. [101] If a debtor partner or its trustee is to be disenfranchised and the nondebtor partners permitted to vote under a non−*ipso facto* dissolution provision, then the nondebtor partners could elect to dissolve the partnership, reconstitute, and continue the business of the partnership without the debtor partner or its trustee. [102] This would be a simple evasion of the prohibition against enforcement of *ipso facto* dissolution provisions and may be addressed by expressly providing in a revised Bankruptcy Code that debtor partners and their trustee may vote on the issue of voluntary dissolution.

V. Composition of the Estate of a Debtor Partner

The Commission has recommended that the property of the estate of a debtor partner include all rights attendant to its partnership interest, including management, voting and economic rights. [103] The economic rights of a debtor partner are deemed to include goodwill, the right to share in profits and losses, and any other right to payment. [104] This should preserve for those general partners receiving fee income for management and other services rendered to a partnership the continued right to receive such income, thus preserving an asset for the estate. The Commission has also specified that in the case of an individual debtor partner (1) who continues employment with the partnership after entry of the order for relief, and (2) whose estate is likely to receive the "buyout price" (discussed *infra*), all amounts paid or payable to such partner following entry of the order for relief shall be deemed received on account of personal services rendered and do not become property of the estate. [105] This Recommendation reflects the provisions of section 541(a)(6) of the Code, [106] and appears appropriate if understood to relate to payments received by a partner in connection with his or her employment. [107]

VI. Transferability of Partnership Interests

One of the Recommendations that will engender considerable comment relates to the transferability to third parties of the partnership interest of a debtor partner. [108] The Commission has proposed that non−*ipso facto* restrictions on transferability of a partnership interest be given effect only if the partnership pays to the estate the "buyout price." [109] The buyout price is defined as the highest price provided for in the partnership agreement for under a non−*ipso facto* provision relating to a buyout of a partner. [110] If no such price is provided for in a partnership agreement, the "buyout price" is to equal "fair buyout value" as determined by the court. [111] The court is authorized to fashion payment terms for a buyout that balance the cash needs of the estate against the liquidity and working capital requirements of the partnership, and which ensure receipt by the estate of the buyout price. [112]

The Report states that the buyout price proposal constitutes an "attempt to reconcile the need to maximize estate assets for creditors with the interest in enforcing the benefit of the nondebtor partner's bargain." [113] The Report refers to provisions of the Uniform Partnership Act requiring that partners continuing a partnership after a wrongful dissolution to pay to the partner causing such dissolution the liquidation value of its partnership interest, less any damages resulting from the dissolution. [114] The Report further refers to the Revised Uniform Partnership Act, which provides that if the nondebtor partners elect to continue the partnership following the bankruptcy of a partner, the remaining partners are required to pay to the estate a buyout price calculated as though the assets of the partnership were sold for an amount equal to the greater of liquidation or going concern value. [115]

The Recommendations and related discussion state that non−*ipso facto* restrictions on transferability of the interest of a debtor partner will not be enforceable unless the nondebtor partners pay the buyout price to the estate. [116] As noted above, the Recommendations and Report do not address the enforceability of a non−*ipso facto* buyout provision in the absence of a proposed transfer of a debtor partner's interest in a partnership. [117] The references in the Report to the buyout provisions of the UPA and the RUPA deal with the buyout of a partner upon bankruptcy, but not with a buyout of a partner's interest as a means of forestalling an otherwise prohibited transfer of a partnership interest. [118]

In circumstances in which a partnership agreement restricts or prohibits transfer of a partnership interest and does not provide for a right of first refusal, the Commission is proposing the imposition under the Code of a right of first refusal as the sole means available to the nondebtor partners to prevent a partnership interest transfer to a third party. The import of this proposal is that if nondebtor partners are unable to provide the funds necessary for a buyout, or unable to agree among themselves as to the provision of such funds, a trustee or debtor in possession may effect a transfer of the debtor's partnership interest to any third party prepared to purchase such interest and may require that such party be admitted as a partner to the partnership. With respect to professional partnerships, the Report states that:

> [f]or the majority of professional partnerships, this provision is likely to have an *in terroram* effect, compelling the partnership to 'buyout' the interest in accordance with the terms of the Recommendation. Otherwise, the court may transfer all of the debtor partner's rights (including management rights) to a third party. Most partnerships would rather buy−out the interest than risk a court−ordered sale of the partnership interest to a third person. [119]

The Recommendation as to the transferability of partnership interests and the forced admission of a third party into a nondebtor partnership raises a number of concerns. [120] The Recommendation provides no protection to nondebtor partners and partnerships that are unable or unwilling to pay a buyout price. The Recommendation subjects these partners to the prospect that a new partner not of their choosing will be admitted to the partnership. This result is not acceptable in the context of a professional partnership or of any other partnership in which the identity, skills, expertise and integrity of a successor general partner are material to the continued functioning and well−being of the partnership.

The Recommendation does not take into account the differences in the composition, business requirements and inter−partner relationships among various partnership entities. For example, a small professional or retail store partnership entails a relationship between the partners based on personal compatibility and reliance upon the integrity and skills of each partner. [121] The transfer of the interest in such a partnership of a debtor general partner in the face of an objection by the nondebtor partner should not be permitted. In contrast, a large real estate limited partnership that owns a fully−tenanted project managed under a third party management agreement does not necessarily give rise to a personal relationship between the limited partners and the general partner, and the functions of the managing general partner could be performed by any one of a number of experienced real estate developers or operators. The transfer of the interest in such a partnership of a debtor general partner to a new general partner experienced in the operation and management of similar real estate partnerships, even in the face of an objection thereto b a limited partner, would not materially and adversely affect the nondebtor limited partners, but would bring value to the debtor's estate.

The imposition by statute of a right of first refusal as the means of forestalling the transfer of a debtor partner's interest in a partnership may engender resentment on the part of nondebtor partners compelled to provide funds to prevent a transfer to an unwanted new partner. [122] This resentment will be most keenly felt in the case of small partnerships involving personal relationships between the partners, and in the case of professional partnerships of any size in view of the degree of dependence and reliance of and by each partner on the skills, expertise and integrity of each other partner. A bankruptcy or other court should never be given the authority to authorize a forced transfer and new partner admission with respect to such partnerships.

However, as discussed above, there are certain types of partnerships that entail primarily business and financial arrangements rather than personal or professional relationships, and with respect to which the transfer of a debtor−partner's interest and admission of a new partner could be authorized without material detriment to the nondebtor partners. Such transactions could be authorized by the court in a manner similar to any other disposition under section 363 of the Code, subject to (a) the satisfaction of the standards (suggested above) for the assumption of the partnership agreement, and (b) determination by the court that (1) the subject partnership is the type which does not require management and direction solely by the debtor by reason of the debtor's special knowledge, experience or expertise, and (2) the knowledge, experience and expertise of the proposed assignee will enable the partnership to continue in all material respects the operation of its business in the ordinary course.

VII. Postpetition Management Rights of a Debtor Partner

The Commission has also adopted a Recommendation dealing with the management rights of a debtor partner. [123] The Commission proposes that a debtor in possession in a chapter 11 case and an individual debtor in a chapter 12 or 13 case should, pending "assumption" or "rejection" of a partnership agreement, exercise all management and voting rights granted to it under the agreement, subject to any non−*ipso facto* limitations set forth in the agreement and applicable state law. [124] In a case in which a trustee has been appointed and there is a nondebtor general partner in the partnership, the trustee is to have no rights of management except to the extent necessary to constitute a quorum or to satisfy a minimum majority provision of the partnership agreement or of applicable law. [125] If there is no nondebtor general partner, then the trustee is to exercise all management and voting rights. [126] The Commission further proposes that in all cases where an individual debtor continues to function as a partner after the order for relief and the estate receives or is more likely than not to receive the buyout price, then the individual debtor (to the exclusion of the trustee) should be empowered to exercise management and voting rights after the order for relief. [127]

The Commission's proposals relating to partnership management by a debtor partner or trustee relate only to the period following entry of an order for relief and prior to the determination for retention or disposition of the debtor's

partnership interest. [128] Nevertheless, the Commission should recognize that no debtor partner should be permitted to exercise management functions if it has theretofore breached any of its fiduciary obligations under the partnership agreement or otherwise committed an act in the nature of an incurable default under the partnership agreement or applicable law (other than the acts described in an *ipso facto* clause) that would warrant expulsion from the partnership.

The proposal to vest trustees with management authority in the absence of a nondebtor general partner gives rise to the concern that the nondebtor partners may be compelled to accept governance by a person that does not have the necessary expertise to manage the business of the partnership. The Commission's Recommendation should be modified to provide that nondebtor partners will be given the opportunity to appoint a new managing general partner, or to otherwise provide for the governance of the partnership and the management of its business, before being compelled to accept management by a bankruptcy trustee.

VIII. The Dissent

The Honorable Edith H. Jones has filed a dissent to the Commission's Recommendations in the area of the Partner as Debtor. [129] In her dissent, Judge Jones acknowledges and adopts the position advocated by Professor Ribstein to the effect that *ipso facto* termination and dissolution provisions in partnership agreements should be respected and that state law should govern all aspects of partnership breakups. [130] Professor Ribstein asserts that the law of partnership breakups should not be federalized, and that the carefully considered private agreements of the parties to a partnership agreements − including provisions for below−market buyouts − embody the best resolution of the issues arising in a partnership breakup. [131] Judge Jones and Professor Ribstein further assert that the interposition of federal courts in the partnership breakup arena fosters inefficiency and gives rise to unnecessary litigation expense. [132]

Many practitioners and academicians who have worked with the provisions of the Bankruptcy Code for almost twenty years have accepted the principal that the filing of a petition under the Code by or against a debtor should not in itself give rise to a forfeiture of the debtor's assets to nondebtor parties. In the area of unexpired leases, the Code does not recognize the effect of bankruptcy termination clauses inasmuch as (1) the business of a debtor may depend upon its continued use and possession of one or more leased locations, (2) landlords are not entitled to windfalls arising from the early termination of below−market leases, especially under circumstances in which the trustee or debtor is prepared to continue performance of a debtor's obligations under the lease, and (3) landlords, like other nondebtor contract parties, may suffer delays and other difficulties as the result of the filing by a tenant of a petition under the Code. But, Congress has determined that the balance of interests among estates and their creditors dictates that landlords are to suffer these detriments short of a material loss of their bargain, in deference to the interests of the debtor and its employees, creditors, partners and perhaps its owners. In the area of assignability of unexpired leases, Congress has also made the judgment that anti−assignment provisions should not be enforced so that (a) dispositions of a debtor's leased locations may be effected as part of the sale of assets on a going business basis, and (b) dispositions of leaseholds of abandoned locations may bring value to the estate, may avoid the realization of windfalls by landlords, and are preferable to the estate's rejection of such leases and the possible incurrence of damage claims resulting therefrom. [133]

Similar considerations pertain to the rules governing the unenforceability of bankruptcy default and anti−assignment provisions of most executory contracts. [134] The existence and application of these provisions of the Code has resulted in the federalization of certain aspects of real estate and contract law, has created delay, inefficiency and expense, as well as considerable consternation on the part of nondebtor parties to such leases and contracts. There is no indication that the Commission has recommended a change to the foregoing rules.

There are many partnership agreements with respect to which the filing of a petition under the Code will give rise to or reflect the existence of a conflict of interest between the debtor partner and the nondebtor partner, especially with respect to capital calls which may be needed by the partnership and its creditors but which the debtor general partner may be unwilling or unable to either make or satisfy. There are professional partnerships with respect to which the bankruptcy of a general partner will result in the inability of that partner to perform its responsibilities, or will alienate the clients of the firm unless the partner is expelled. In these and similar circumstances, the enforcement of an *ipso facto* dissolution provision is probably appropriate. On the other hand, there are partnerships with respect to which the

status of a general partner as a debtor under the Code would not give rise to an inherent conflict of interest, and would not result in the failure of the partnership to perform its obligations to third parties. The best example of this type of partnership is the mature real estate partnership that owns a property that is fully tenanted, properly financed, and not unusually difficult to manage. In such a circumstance, it is not appropriate to confer upon the nondebtor partners the power to use the general partner's status as a debtor under the Code as a lever with which to extract from the debtor−in−possession or a trustee concessions and transfers of value to the nondebtor partners, or to enforce a forfeiture provision against the debtor.

There are contractual relationships apart from the partnership context that entail a degree of interdependence between the parties that may be greater than that obtaining in some partnerships. The relationship between the owner of a small shopping center and an anchor tenant at the center under a lease with low fixed rent and a percentage rent provision may result in a greater degree of reliance by the landlord, and a greater sense of "partnership," than will be found in the relationship between a limited and a general partner in a partnership with one hundred unrelated limited partners and a general partner that is a subsidiary of a large real estate company. If an *ipso facto* termination provision should be enforceable for such a partnership, then certainly such a provision should be enforceable for the benefit of a landlord under the circumstances described above. Thus if the dissent's position is correct with respect to partnership agreements, the Commission should be reexamining the entire area of *ipso facto* clause enforceability under contracts and leases generally.

The position advocated by the dissent − to enforce all *ipso facto* breakup provisions in partnership agreements − is overly inclusive, and could render impossible the reorganization of many real estate companies that hold general partner positions in a number of separate partnerships. The Commission's formulations, although not free of problems, appears to reflect a more balanced approach.

Conclusion

The Commission's Recommendations in the area of the partnership as debtor are fundamentally sound and should result in welcome additions to the Code. The Commission's Recommendations in the area of the partner as debtor have provided an excellent framework for consideration of the issues generally encountered in debtor partner cases. The proposal to eliminate the section 365 constructs of "executoriness," and of assumption and rejection, insofar as partnership agreements are concerned, facilitates focus upon the actual issues involved in the retention or disposition of a general partnership interest held by a debtor under the Code.

The Recommendations relating to the election by a debtor in possession or trustee for a debtor partner to perform a partnership agreement should be supplemented to (1) permit the postpetition cure of prepetition payment defaults, and (2) deny the right to make such an election where the debtor has breached its fiduciary duties to the nondebtor partners or has otherwise committed an act (other than an act described in a typical *ipso facto* clause) that would permit the nondebtor partners to expel the debtor under the partnership agreement or applicable nonbankruptcy law. Additional consideration should be given to the Recommendations relating to transferability of a general partnership interest and the imposition of a new general partner upon the nondebtor partners. Additional consideration should also be given to the Commission's proposal to permit a trustee to perform the management functions of a debtor general partner in the absence of any other nondebtor general partner.

FOOTNOTES:

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[1] *See* Nat'l Bankr. Rev. Comm'n, Bankruptcy: The Next Twenty Years, Final Report 378−79 (1997) [hereinafter Commission Report] (stating "[s]ince the 1978 Bankruptcy Code, the use of partnerships as well as the partnership form has changed substantially and the Bankruptcy Code does not adequately address the complex issues that can arise when a bankruptcy petition is filed by or against a partnership").Back To Text

[2] *See id.* at 378−79. Although there have been many cases under the Bankruptcy Code involving partnerships as debtors, (*See* Carlton J. Eibl, *Strategies for Partners Under the Bankruptcy Code When the Partnership is Insolvent*, 61 Amer. Bankr. L.J. 37 (1987)), the greatest difficulties have arisen in general partnership cases involving a group of general partners with personal liability to creditors. Many of these cases involve professional partnerships in dissolution and individual partners that have gone their own way and are resistant to demands for contribution of money to the partnership and its creditors. The trustee in such cases has at times been required to enforce claims against a number of partners through a series of separate actions. Section 723 of the Bankruptcy Code addresses some of the issues involved in the enforcement of claims of a partnership's trustee against general partners, but does not provide a comprehensive mechanism for the administration of a general partnership case. *See* 11 U.S.C. § 723 (1994) (entitled "Rights of a Partnership Trustee against General Partners"). Moreover, there is no counterpart to section 723 in any other chapter of the Code.Back To Text

[3] *See* Commission Report, supra note 1, at 417.

> Courts and commentators generally acknowledge three aspects of a partner's relationship with the partnership: (1) specific rights in partnership property; (2) share of the partnership profits and surplus; and (3) the right to participate in the management of the partnership. Clarifying the effect of a partner's bankruptcy filing on each of these three aspects of the partner relationship is the focus of the Commission's 'partner as debtor' recommendations.

Id.Back To Text

[4] *Compare, e.g.*, Laurence Cherkis, Collier Real Estate Transactions and the Bankruptcy Code ¶ 4.07[2] at 4−71−4−77 (Matthew Bender 1997), *with* Letter from Professor Larry E. Ribstein, GMU Foundation Professor of Law, George Mason University, to Stephen H. Case, Advisor, National Bankruptcy Review Commission (May 27, 1997) [hereinafter "Ribstein Letter"].Back To Text

[5] *See* Commission Report, supra note 1, at 372−77.Back To Text

[6] *See* id. at 379 (stating "[a] clear mechanism is needed for providing a complete resolution of the liability of general partners to partnership creditors . . . in connection with the bankruptcy case of the partnership. Such a mechanism should provide rules that govern both liquidation and reorganization").Back To Text

[7] *See* id. at 383 (discussing recommendation 2.3.2).Back To Text

[8] *See* id. at 385 (discussing recommendation 2.3.4).Back To Text

[9] *See* id.Back To Text

[10] *See* Commission Report, supra note 1, at 383−85 (discussing recommendation 2.3.3).Back To Text

[11] *See* id. at 389−90; s*ee also* 11 U.S.C. § 723(b) (1994) (empowering court to order any nondebtor general partner to indemnify estate or to not dispose of property pending determination of deficiency).Back To Text

[12] *See* Commission Report, supra note 1, at 387 (stating "[s]ection 723 currently applies only in [c]hapter 7 partnership cases . . . . The 'best interests of creditors' test embodied in sections 1129(a)(7) and 1225(a)(4), however, makes the principles embodied in section 723 relevant in chapter 11 and 12 cases").Back To Text

[13] *See* id. at 389 (stating "[c]urrent law is ambiguous as to whether general partners must pay partnership obligations for which they are personally responsible in connection with partnership bankruptcy cases filed under any chapter other than chapter 7") .Back To Text

[14] *See* id. at 391−96 (discussing recommendation 2.3.6).Back To Text

[15] *See* 11 U.S.C. § 723(a) (1994).Back To Text

[16] *See* id. § 723(c).Back To Text

[17] *See* Commission Report, supra note 1, at 392.

> The law is unclear and arguably provides for a dichotomous treatment of partnership claims depending upon whether or not the general partner is a debtor in bankruptcy . . . . The recommendation makes the two provisions [section 723(a) and (c)] consistent as it clarifies that a claim of a partnership trustee against the estate of a debtor general partner is limited to those claims that are allowed under applicable nonbankruptcy law.

Id. *See also* 11 U.S.C. §§ 723(a), (c). Back To Text

[18] *See* Commission Report, supra note 1, at 392.Back To Text

[19] *See* id. at 391−96 (discussing recommendation 2.3.6−2.3.8).Back To Text

[20] The expenses of administration of a partnership case are costs of the estate and not debts of the partnership. *See* 11 U.S.C. § 503 (1994); *cf.* Shopmen's Local Union No. 455 v. Kevin Steel Prods., Inc., 519 F.2d 698, 704 (2d Cir. 1975) (asserting "[a] debtor−in−possession under Chapter XI or under Chapter X, a trustee under the latter chapter, or a trustee in a straight bankruptcy proceeding is not the same entity as the pre−bankruptcy company").Back To Text

[21] *See* Commission Report, supra note 1, at 394−96 (discussing recommendation 2.3.8). Back To Text

[22] *See* id. at 380−81.Back To Text

[23] *See* Commission Report, supra note 1, at 381 (noting "[b]ecause the definition is a status−based definition, the term does not include an entity that may be liable solely by virtue of guaranteeing a partnership obligation"). Back To Text

[24] *See* id. at 422−50. Back To Text

[25] *See* id. at 393−94. In Recommendation 2.3.7, the Commission explains the Jingle Rule as being:

> [A] rule of priority which evolved from the common law during the nineteenth century and was codified in . . . the Bankruptcy Act . . . [and] later incorporated into the Uniform Partnership Act . . . so that state partnership law would correspond to bankruptcy law. The rule provided that the partnership assets were to be distributed first to creditors of the partnership; and the assets of an insolvent general partner were to be distributed first to the personal creditors of the general partner.

Id. at 393.Back To Text

[26] *See* 11 U.S.C. § 723(c) (1994).Back To Text

[27] *See* Commission Report, supra note 1, at 394 (noting section 723(c) does not entirely repeal jingle rule but applies only in chapter 7 cases and operates when partnership and at least one of its general partners is debtor). Back To Text

[28] *See* id. Back To Text

[29] *See* id. "Eliminating the 'jingle' rule in all cases results in *pari passu* treatment of a partnership trustee with the debtor general partner's nonpartnership creditors." Id.Back To Text

[30] *Compare* 11 U.S.C. § 723 (stating "[t]he claim of the trustee under this section is entitled to distribution in such partner's case under section 726(a) of this title the same as any other claim of a kind specified in such section"), *with*

Commission Report, supra note 1, at 394 (stating "[t]he Recommendation also definitively extends the application of the principles of section 727(c) and the repeal of the jingle rule to all other chapters of the Code").Back To Text

[31] *See* Commission Report, supra note 1, at 394. Back To Text

[32] *See* id. at 399.Back To Text

[33] *See* id. at 371, 400.Back To Text

[34] *See* id. at 400.Back To Text

[35] *See* 11 U.S.C. § 303(h) (1994) (requiring court to order relief against debtor in involuntary case under which petition was filed where petition is not timely controverted).Back To Text

[36] *See* Commission Report, supra note 1, at 400 (stating "other protections in section 303 provide a certain amount of protection for nondebtor general partners"). *See generally* 11 U.S.C. § 303.Back To Text

[37] *See, e.g.*, In re Del H. Reed, Jr., 11 B.R. 755, 757 (Bankr. S.D. W.Va. 1981) (involving creditors filing of involuntary petition against debtor who was not paying debts as they became due).Back To Text

[38] *See* Commission Report, supra note 1, at 402−07 (discussing recommendation 2.3.14).Back To Text

[39] *See* id. at 406.Back To Text

[40] *See* id. at 402−03.Back To Text

[41] *See* id. at 407 (discussing recommendation 2.3.15).Back To Text

[42] *See id.* at 407.Back To Text

[43] *See* Commission Report, *supra* note 1, at 405.Back To Text

[44] *See id.* at 408 (discussing recommendation 2.3.16).Back To Text

[45] *See id.* at 411 (asserting that nondebtor partners will contribute more if provided protection from future creditor claims).Back To Text

[46] *See* supra note 7 and accompanying text (discussing bankruptcy courts' jurisdiction to adjudicate liabilities of general partners to trustee or debtor partnership and to each other).Back To Text

[47] *See* Commission Report, *supra* note 1, at 411 (stating that recommendation is narrowly tailored to give relief only to certain nondebtor partners). Back To Text

[48] *See* 11 U.S.C. §§ 541(c)(1)(A)(1994) (providing that interest of debtor in property becomes estate property notwithstanding *ipso facto* clause in underlying agreement or applicable nonbankruptcy law, which restricts or conditions such transfer); 365(b)(2) (allowing assumption); 365(e)(1) (providing that *ipso facto* clauses are not enforceable in debtor's executory contracts or unexpired leases); 363(b)(1) (providing that trustee may use, sell, or lease property notwithstanding otherwise applicable *ipso facto* provision that would divest debtor's interest in property); *see also* S. Rep. No. 95−989, at 58 (1978), *reprinted in*, 1978 U.S.C.C.A.N. 5787, 5844 (stating that under Code section 365 trustee must cure any default and provide adequate assurance of future performance before assuming contract, however, "this provision does not apply to defaults under *ipso facto* or bankruptcy clauses"); Summit Inv. & Dev. Corp. v. Leroux, 69 F.3d 608, 610 (1st Cir. 1995) (stating Code invalidated contractual *ipso facto* provisions for reason that automatic termination of debtor's contractual rights "frequently hampers rehabilitation efforts" by depriving chapter 11 estate of valuable interests at time debtor and estate need them most) (citing S. Rep. No. 95−989,

at 59 (1978), *reprinted in* 1978 U.S.C.C.A.N 5787, 5845).Back To Text

[49] *See* Commission Report, *supra* note 1, at 423 (stating that recommendations attempt to reconcile voluntary nature of partnership law with Bankruptcy Code).Back To Text

[50] *See generally* Sally S. Neely, *Partnerships and Partners, Limited Liability Companies and Members: What Happens in* Bankruptcy, 71 Am. Bankr. L.J. 101 (forthcoming 1998); *see also* In re Wolsky, 53 B.R. 751, 754 (Bankr. D. N.D. 1985) (discussing elements of partnership relationship).Back To Text

[51] *See* Commission Report, supra note 1, at 424−28 (discussing similar treatment to be accorded to debtor members of member managed LLCs and to debtors managers of manager managed LLCs).Back To Text

[52] *See* Larry E. Ribstein, The Emergence of the Limited Liability Company, 51 Bus. Law 1, 3 (1995) (reporting that 48 states had adopted LLC statutes between 1988 and 1994).Back To Text

[53] *See* Unif. Partnership Act §§ 24 (1914), 6 U.L.A. 697−98 (1995 & Supp. 1997) (stating property rights of a partner are (1) his rights in specific partnership property, (2) his interest in partnership, and (3) his right to participate in management) and 25 (stating that partner is co−owner with his partners of specific partnership property holding as tenant in partnership); *cf.* Rev. Unif. Partnership Act § 501 (1994), 6 U.L.A. 66 (1995 & Supp. 1997) (partner is not co−owner of partnership property and has no interest in partnership property that can be transferred). Back To Text

[54] *See* Laurence D. Cherkis, *The Best Entity for Doing the Deal: The Effect of a General Partner's Bankruptcy on the Partnership and its Creditors*, 937 PLI/Corp 473, 481 (1996).Back To Text

[55] *See* id. at 481−82.Back To Text

[56] *See* id.Back To Text

[57] *See* id. at 482−83.Back To Text

[58] *See* id. at 483. Back To Text

[59] Examples in the law of partnership are found in: Rev. Unif. Partnership Act § 601(6)(I) (1994), 6 U.L.A. 72−73 (1995 & Supp. 1997) (allowing disassociation of partner for "becoming a debtor in bankruptcy") and Rev. Unif. Ltd. Partnership Act §§ 402(4)(iii) (1976), 6 U.L.A. 172 (1995 & Supp. 1997) (adjudication as bankrupt or insolvent), and 402(5) (commencement of proceeding against general partner because seeking reorganization, arrangement, composition, readjustment, liquidation, or dissolution).Back To Text

[60] *See* Unif. Partnership Act § 31(5) (1914), 6 U.L.A. 771 (1995 & Supp. 1997) (bankruptcy of any partner of the partnership causes dissolution of partnership).Back To Text

[61] *See* Rev. Unif. Partnership Act § 801 (1994), 6 U.L.A. 92 (1995 & Supp. 1997) (partnership not compelled to dissolve and wind up affairs as a result of a Bankruptcy Code filing by a partner).Back To Text

[62] *See* Cherkis, Collier Real Estate Transactions and the Bankruptcy Code (1985) (limited partnership agreement may provide that upon bankruptcy of general partner his interest should be converted into that of a limited partner retaining economic interest without managerial rights).Back To Text

[63] *See* Rev. Unif. Partnership Act § 701(a) (1994), 6 U.L.A. 81 (1995 & Supp. 1997).Back To Text

[64] A good example of a conflict of interest is found in Skeen v. Harms (In re Harms), 10 B.R. 817, 821−22 (Bankr. D. Colo. 1981); *see also* Lawrence J. LaSala, Partner Bankruptcy and Partnership Dissolution: Protecting the Terms of the Contract and Ensuring Predictability, 59 Fordham L. Rev. 619, 633 (1991) ("the insolvent partner faces an inherent conflict of interest that precludes him from remaining as a general partner or from assuming the partnership

agreement"). *But see* Summit Inv. & Dev. Corp. v. Leroux, 69 F.3d 608, 614 (1st Cir. 1995) (holding bankruptcy court is required to determine whether *actual* conflict of interest arising out of debtors assumption would bar assumption of partnership agreement) (emphasis in original). *Back To Text*

[65] *See* In re Sunset Developers, 69 B.R. 710, 712 (Bankr. D. Idaho 1987) (holding that debtor partner, as debtor−in−possession, has no authority as general partner); Gerald K. Smith, *Issues in Partnership and Partner Bankruptcy Cases and Reorganization of Partnership Debtors*, 86 A.L.I./A.B.A. 639, 665 (1996) ("partnership agreements and statutory provisions terminating managerial powers on the filing of a bankruptcy case are enforceable"); *see also* Jerry S. Williford et al., *Uncertainty Clouds the Tax Consequences of the Bankruptcy of a* General Partner, 10 J. Partnership Tax'n 26, 30 (1993) (noting that under Revised Uniform Limited Partnership Act, general partner ceases to be such after filing for bankruptcy). *But see* In re Cardinal Indus., Inc., 116 B.R. 964, 982 (Bankr. S.D. Ohio 1990) (holding that debtor−partner's management interest does not terminate upon bankruptcy filing).Back To Text

[66] 11 U.S.C. § 365(e)(1) (1994).Back To Text

[67] *See* Martin J. Bienenstock, *Executory Contracts and Unexpired Leases Under the Bankruptcy Code*, 388 PLI/Real 57, 61 (1993) (Congress, through the Bankruptcy Code, was trying to serve Reorganization Policy and Equity Policy by allowing debtor−in−possession to assume or reject contracts); Martin J. Bienenstock, *Executory Contracts and Unexpired Leases*, 382 PLI/Real 61, 88 (1992) (executory contracts and unexpired leases may be rejected to avoid depletion of the estate); George A. Hahn & Joshua I. Divack, *Executory Contracts, Including Leases, Intellectual Property, Licensing Agreements and Collective Bargaining Agreements*, 514 PLI/Comm 7, 9 (1989) (observing that the Bankruptcy Code, which provides for assumption or rejection of executory contracts and unexpired leases, allows the trustee to obtain benefits or eliminate burdens of continued performance).Back To Text

[68] *See* 11 U.S.C. §§ 365(c)(1)(A)—(c)(4) (stating that bankruptcy trustee may not assume or assign executory contract or unexpired lease of debtor if: (1)(a) nonbankruptcy law excuses a party other than debtor from accepting or rendering performance and (b) the party other than debtor does not consent to assumption or assignment; (2) contract is for debt financing, financial accommodation, or issuing a security to or for the benefit of debtor; (3) lease is for nonresidential real property has been terminated; or (4) lease is for aircraft terminal or aircraft gate); 11 U.S.C. § 365(e)(2)(A)(i) and (ii) (executory contract or unexpired lease may be terminated or modified if law excuses party other than debtor from accepting or rendering performance or party other than debtor does not consent to assumption or assignment).Back To Text

[69] *See* Summit Inv. & Dev. Corp. v. Leroux, 69 F.3d 608, 614 (1st Cir. 1995) (holding that section 365 renders unenforceable contractual *ipso facto* clauses and preempts *ipso facto* provisions of Massachusetts law); In re Antonelli, 148 B.R. 443, 448−449 (D. Md. 1992) (assumability of management rights in partnership hinges upon "the materiality of the identity of the partners to the performance of the obligations remaining to be performed under the partnership in question"), aff'd per curiam, 4 F.3d 984 (4th Cir. 1993) (unpublished disposition); In re Daugherty Constr., Inc., 188 B.R. 607, 613−614 (Bankr. D. Neb. 1995) (applying *Summit* and *Antonelli* holding to debtor managing member of limited liability companies); In re Cardinal Indus., Inc., 116 B.R. 964, 982 (Bankr. S.D. Ohio 1990) (*ipso facto* clauses in partnership agreements should not be given effect because nonbanktuptcy law does not prohibit assumption of partnership agreements by trustee even if they are not assignable to third party). *But see* Breeden v. Catron (In re Catron), 158 B.R. 629, 635 (E.D. Va. 1993) (debtor−partner's partnership agreement was executory contract that was not assumable by debtor−in−possession unless non−debtor parties consented), aff'd, 25 F.3d 1038 (4th Cir. 1994).Back To Text

[70] *See* Summit, 69 F.3d at 614 (stating that general partner in limited partnership does not create inherent conflict of interest by filing Bankruptcy Code petition and becoming a debtor−in−possession); Antonelli, 148 B.R. at 448 (noting that whether or not management power is assignable depends upon relationship between partners and nature of remaining obligations); Cardinal, 116 B.R. at 982 (holding partner's management rights did not terminate upon filing of petition); Daugherty, 188 B.R. at 613 (debtor−member's management rights do not terminate upon filing of petition).Back To Text

[71] *See* Claude D. Montgomery & Suzanne D.T. Lovett, *Professional Partnership Bankruptcy Issues*, 715 PLI/Comm 531, 541 (1995) (noting that most partnership bankruptcies end in liquidation, especially service partnerships such as those of lawyers and accountants); Larry E. Ribstein, *The Illogic and Limits of Partner's Liability in* Bankruptcy, 32 Wake Forest L. Rev. 31, 49 (1997) (noting that liquidation, not reorganization, occurred in all major professional partnership bankruptcies because non−human−capital assets were absent); Joseph Samet, *Proposed Amendments to the Bankruptcy Code Relating to Partnerships*, 736 PLI/Comm 1063, 1077 (1996) (observing that "[a]ll professional partnership bankruptcy cases have thus far been liquidating Chapter 11 cases").Back To Text

[72] *See* In re Antonelli, 148 B.R. 443, 450−56 (D. Md. 1992) (confirming reorganization plan of real estate partnership after management power had been transferred); In re Hawkins, 113 B.R. 315, 316−17 (Bankr. N.D. Tex. 1990) (bankruptcy of general partner does not automatically cause dissolution of partnership, which may be reorganized by remaining partner); *see also* Connolly v. Nuthatch Hill Assocs. (In re Manning), 37 B.R. 755, 758−60 (Bankr. D. Colo. 1984) (bankruptcy trustee cannot force partnership to dissolve by selling real property owned by partnership if partnership wishes to reorganize).Back To Text

[73] *See* In re West Elecs. Inc., 852 F.2d 79, 83 (3d Cir. 1988); Catron, 158 B.R. at 634−38; Thomas H. Jackson, Bankruptcy, Non−Bankruptcy Entitlements, and the Creditors' Bargain, 91 Yale L. J. 857, 890 (1982) (stating that presence of *ipso facto* clauses introduces "inevitable problem"). Back To Text

[74] The enumerated issues are discussed more fully in Cherkis, supra note 4, at ¶ 4.07.Back To Text

[75] *See* Calvin v. Siegal (In re Siegal), 190 B.R. 639, 643 (Bankr. D. Ariz. 1996) (partnership agreement is executory contract); Weaver v. Nizny (In re Nizny), 175 B.R. 934, 936 (Bankr. S.D. Ohio 1994) (asserting that courts are in agreement that partnership agreements are executory contracts); Catron 158 B.R. at 634 (assuming, in accordance with majority view, that partnership agreement is executory contract).Back To Text

[76] *See* Summit Inv. & Dev. Corp. v. Leroux (In re Leroux), 167 B.R. 318, 322 (Bankr. D. Mass. 1994) (discussing and finding inapplicable, section 365(e)(2)(A)), aff'd, 69 F.3d 608 (1st Cir. 1995); Catron, 158 B.R. at 639 (discussing section 365(e)(2)(A)); In re Cardinal Indus., 116 B.R. 964, 971−72 (Bankr. S.D. Ohio 1990) (discussing section 365(e)(2)(A) in relationship to partnership agreements).Back To Text

[77] *See* Leroux, 167 B.R. at 320−21 (discussing ability to assume partnership agreement under section 365(c)); Nizny, 175 B.R. at 936 (discussing whether partnership agreements are assumable under section 365(c)); Catron, 158 B.R. at 639 (stating that partnership agreements cannot be assumed under section 365(c)).Back To Text

[78] *See* In re Cardinal Indus., Inc., 116 B.R. 964 (Bankr. S.D. Ohio 1990).Back To Text

[79] *See* Catron, 158 B.R. at 626−28; In re Minton Group, Inc., 27 B.R. 385, 390 (Bankr. S.D.N.Y. 1983), aff'd, 46 B.R. 222 (S.D.N.Y. 1985); Skeen v. Harms (In re Harms), 10 B.R. 817, 821−22 (Bankr. D. Colo. 1981). Back To Text

[80] *See* In re Map 1978 Drilling Partnership, 95 B.R. 432, 435 (Bankr. N.D. Tex. 1989) (discussing whether partnership can be compelled to admit new partner); In re Sovereign Group 1984 −21 Ltd., 88 B.R. 325, 330 (Bankr. D. Colo. 1988) (discussing whether or not to admit new partner); Harms, 10 B.R. at 821 (discussing whether or not partnership can be compelled to admit new partner).Back To Text

[81] *See* Commission Report, supra note 1, at 428−431.Back To Text

[82] *See* id. at 428 (stating "[a] new section concerning partnership and LLC governing documents and relationships should be added to the Bankruptcy Code"). *Back To Text*

[83] *See* id. at 428−29 (noting "[p]artnership agreements are generally treated in the case law as 'executory'"); id. at 429 n.1046 (citing cases finding partnership agreements executory and therefore subject to section 365); *see also* id. at 431 (explaining under "section 365 recommendations 'executoriness' will no longer be a prerequisite for a debtor in possession or trustee to assume or reject a prepetition contract"). Back To Text

[84] *See* Commission Report, supra note 1, at 430−31. Back To Text

[85] *See* id. at 428−31.Back To Text

[86] *See* id. at 438−42 (discussing transferability and valuation of partnership or LLC interest).Back To Text

[87] *See* id. at 437−42. Back To Text

[88] The dissolution of a partnership is the change in the partners' relation caused by a partner's ceasing to be associated in the carrying on, as distinguished from the winding up, of the business. *See* Scott Rowley, Rowley on Partnership 587−88, 597−600, § 31.1(d) (2d ed. 1960). Back To Text

[89] Hon. Edith H. Jones, *Dissent to the Commission's Recommendations: Partner as Debtor, in* Commission Report, supra note 1, ch. 5, Individual Commissioner Views 6 [hereinafter *Dissent*] (asserting that Commission's proposals might create value for debtor's estate that did not exist under state law).Back To Text

[90] *See* Commission Report, supra note 1, at 437−42.Back To Text

[91] *See* id. at 435−36.Back To Text

[92] *See* id. at 432.Back To Text

[93] *See* id. Back To Text

[94] *See* id. Back To Text

[95] *See* Dissent, supra note 89, at 8.Back To Text

[96] *See* id. at 7−12.Back To Text

[97] *See generally* Alan R. Bromberg & Larry E. Ribstein, II Bromberg and Ribstein on Partnership § 7 (1997) [hereinafter Bromberg and Ribstein] (discussing partnership agreement provisions relating to dissolution and winding up).Back To Text

[98] Enforcement by a nondebtor party of its rights under a contract in default is stayed under section 362(a) of the Code, and the opportunity to cure a default upon assumption of an executory contract is provided for in section 365(b)(1) of the Code. See 11 U.S.C §§ 362(a), 365(b)(1) (1994).Back To Text

[99] *See* Dissent, supra note 89, at 7−8.Back To Text

[100] *See generally* Bromberg and Ribstein, supra note 97, at § 7.Back To Text

[101] *See* Commission Report, supra note 1, at 442.Back To Text

[102] *See* id. at 442−46.Back To Text

[103] *See* id. at 437.Back To Text

[104] *See* id.Back To Text

[105] *See* id. (providing that there should be presumption that individual debtor is likely to receive buyout price for estate).Back To Text

[106] Section 541(a)(6) of the Code provides that the debtor's estate includes, "[p]roceeds, product, offspring, rents or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case." 11 U.S.C. § 541(a)(6) (1994).Back To Text

[107] *See* Commission Report, supra note 1, at 437−38 (distinguishing between proceeds related to services and profits from partnership interest). *Compare, e.g.,* Turner v. Avery, 198 B.R. 192, 197−98 (E.D. La. 1996) (post−petition fee−splitting payments to insolvent partner were part of estate), *with, e.g.,* In re Angobaldo, 160 B.R. 140, 147 (Bankr. N.D. Cal. 1993) (not all earnings were related to debtor partner's equitable share of profits and proceeds); *see also* Commission Report, supra note 1, at 438 n.1074 (comparing Fitzsimmons v. Walsh (In re Fitzsimmons), 725 F.2d 1208, 1211 (9th Cir. 1984) with Altcheck v. Altcheck (In re Altcheck), 124 B.R. 944, 956−57 (Bankr. S.D.N.Y. 1991)).Back To Text

[108] *See* Commission Report, *supra* note 1, at 438−39 (recognizing *ipso facto* clauses as not enforceable under 11 U.S.C. § 363(1) while non−*ipso facto* clauses have been enforced to restrict alienability of partnership interest or giving right of first refusal to remaining partners); *see, e.g.,* In re Patient Educ. Media, Inc., 210 B.R. 237, 242 n.9 (Bankr. S.D.N.Y. 1997) (*ipso facto* clause invalid under section 363(1) of the Code); s*ee also* 3 Collier on Bankruptcy ¶ 363.10, at 62−63 (Lawrence P. King et al. eds., 15th ed. rev. 1997) (discussing *ipso facto* clauses and relationship between sections 541 and 303).Back To Text

[109] *See* Commission Report, supra note 1, at 437.Back To Text

[110] *See* id. at 437−38 (definition of buyout price). Back To Text

[111] *See* id. at 438.Back To Text

[112] *See* id. at 440−41. Back To Text

[113] Id. at 440−41. *Back To Text*

[114] If a bankrupt partner wrongfully dissolves the partnership, section 38(2)(c)(II) provides that the partnership may continue if the solvent co−partners pay to the insolvent partner the value of his interest in the partnership, less any damages caused to his co−partners by the dissolution. The payment is to be made in cash, or secured by bond approved by the court, and the disengaging partner is to be released from all existing liabilities of the partnership. The value of the good−will of the business is not to be considered in determining the value of the interest of the disengaging partner. *See* § 38(2)(c)(II), 6 U.L.A. 881 (1995 & Supp. 1997).Back To Text

[115] *See* Commission Report, supra note 1, at 439. The Commission Report cites to RUPA § 701(b), which states:

> The buyout price of a dissociated partner's interest is the amount that would have been distributable to the dissociating partner under Section 807(b) if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on a sale of the entire business as a going concern without the dissociated partner and the partnership were wound up as of that date. Interest must be paid from the date of dissociation to the date of payment.

Revised Unif. Partnership Act § 701(b) (1994), 6 U.L.A. 81 (1995 & Supp. 1997).Back To Text

[116] *See* Commission Report, supra note 1, at 439.Back To Text

[117] *See generally* id. at 437−42; *Dissent, supra* note 89, at 15.Back To Text

[118] *See* Commission Report, supra note 1, at 441−42; *Dissent, supra* note 89, at 15−16.Back To Text

[119] *See* Commission Report, supra note 1, at 441.Back To Text

[120] *See generally Dissent, supra* note 89, at 7−16.Back To Text

[121] *See* In re Antonelli, 148 B.R. 443, 449 (D. Md. 1992) (providing examples of partnership structures where identity of general partner is critical); *see also* Bromberg & Ribstein, *supra* note 97, § 6:03(d), at 73−74 (noting reasons for approval of new partners by existing partners).Back To Text

[122] Section 363 of the Code allows for the right of first refusal. *See* 3 Collier, supra note 108, ¶ 363.01 at 8−9. Back To Text

[123] *See* Commission Report, supra note 1, at 442−43 (addressing management rights of debtor or debtor−in−possession of partnership or LLC).Back To Text

[124] *See id.* at 442.Back To Text

[125] *See id.* at 442−43.Back To Text

[126] *See* id.Back To Text

[127] *See* id.Back To Text

[128] *See* Commission Report, *supra* note 1, at 442.Back To Text

[129] *See Dissent, supra* note 89, at 1.Back To Text

[130] *See* id.Back To Text

[131] *See id.* at 11−12.Back To Text

[132] *See id.* at 10−11.Back To Text

[133] *See* 11 U.S.C. § 365(f)(1).Back To Text

[134] *See* Morris W. Macey & James R. Sacca, *Reconciling Sections 365(c)(1) and (f)(1) of the Bankruptcy Code: Should Anti−Assignment Laws Prohibit Assumption of Contracts by a Debtor in Possession?,* 100 Com. L.J. 117, 117−21 (1995).Back To Text