

# PRACTITIONER

## The Accidental Partnership

### *Getting Into, Avoiding, and Getting Out of, De Facto Partnerships*

By David Herzog



*David Herzog, a certified tax specialist through the State Bar of California, is an associate at San Francisco's Pinnacle Law Group. He focuses his practice on general business and tax law, advising small business, startups, and emerging companies on business entity formation, corporate governance and compliance, mergers and acquisitions, commercial leasing, tax, securities, and intellectual property issues. He can be reached (415) 394-5700 or [info@pinnaclelawgroup.com](mailto:info@pinnaclelawgroup.com).*

#### INTRODUCTION

Intentional business relationships can be difficult enough (the benefits of collaboration notwithstanding). But entering them haphazardly can result in liabilities, duties and obligations beyond expectation.

#### WHAT IS A PARTNERSHIP?

Whenever a partnership is formed by "accident", it is a general partnership.

All other forms of partnership in California are created by an intentional filing with the California Secretary of State.

A partnership is an association of two or more persons to carry on as co-owners a business for profit. California Corporations Code §16202(a). General partnerships formed under California law are governed by the Uniform Partnership Act of 1994 §§16100-16962, generally known by the acronym RUPA (for "Revised Uniform Partnership Act").

Under RUPA, a partnership is considered an entity distinct from the partners. §§16201.

A general partnership has the following characteristics:

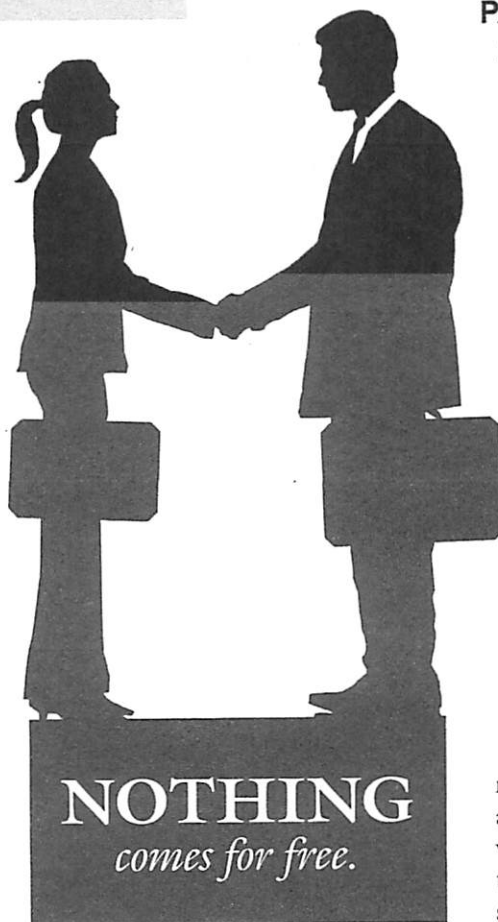
- Each partner is an agent of the partnership and can bind the partnership in its ordinary course of business (Corp Code §16301(1));
- Each partner is personally liable for the obligations of the partnership (Corp Code §16306);
- The partnership may be dissolved by the express will of at least half of the partners even in contravention of a written agreement to the contrary §§16801(1).

#### PARTNER PRESUMPTION: SHARE OF PROFITS

A person who receives a share of the profits of a business is presumed to be a partner in the business, unless the profits were received for certain reasons enumerated in California Corporations Code §16202(c)(3), such as in payment of a debt by installments or otherwise, services as an independent contractor, or in payment of rent. This is why the owner of a startup should always pay for rent, computers and server space, and not accept favors from seemingly well-intentioned friends and relatives. Nothing comes for free.

#### PURPORTED PARTNERS

Quoting the statute, "If a person, by words or conduct, purports to be a partner, or consents to being represented by another as a partner, in a partnership or with one or more persons not partners, the purported partner is liable to a person to whom the representation is made,



if that person, relying on the representation, enters into a transaction with the actual or purported partnership.” Cal Corp Code §16308.

## STANDARD OF REVIEW

The question when a defendant is alleged to be an ostensible partner is whether the acts and conduct of an individual were factually and legally sufficient to lead another person to believe he was a copartner and assumed responsibility for such. (J. C. Wattenbarger & Sons v. Sanders (1963) 216 Cal.App.2d 495, 500-501) (Found that partnership did not exist where filing of partnership certificate stating limited partnership status trumps filing fictitious business name statement with no such statement.)

The representations or acts need not be motivated by the actual intent to deceive; it is sufficient if the course of conduct is such as to induce a reasonable and prudent person to believe that which the conduct would imply. (Crabbe v. Mires (1952) 112 Cal.App.2d 456, 459) (Found that partnership existed where ostensible partner merely arranged for credit for dredging company, court determined that knowledge of the appellants of the ostensible partner’s acts were sufficient to preclude them from denying partnership existed with him.)

## HOW TO BECOME PARTNERS BY MISTAKE

The following are some examples of how an individual can become a partner unwittingly:

- Accepting someone’s services without paying them, Mercado v. Hoefler, 190 Cal. App. 2d 12. E.g., a sibling does some bookkeeping;
- Accepting someone’s participation in management
- Accepting someone’s “loan”
- Accepting someone’s capital contribution
- Accepting someone’s idea (their trade name, their computer program . . . )
- Letting someone raise money for the startup; letting someone shake hands on behalf of an owner
- Not paying rent for space
- Co-signing a lease
- Opening a joint bank account
- Representing that someone has authority to speak on your behalf
- Making promises to share profits
- Keeping things “simple”

## CONSEQUENCES OF BEING A GENERAL PARTNER:

The consequences of being a partner are numerous: First comes duty . . .

- Duty of Care
- Duty of Loyalty
- Duty to Account
- Duty to Refrain From Self-Dealing
- Duty not to Compete
- Obligation of Good Faith and Fair Dealing

. . . and Rights . . .

- The right to a properly maintained capital account.
- The right to equal sharing of partnership profits, with a partner’s share of losses generally chargeable in proportion to the partner’s share of the profits.
- The right to be reimbursed for payments made and the right to be indemnified for liabilities incurred in the ordinary course of business of the partnership or for preservation of partnership property.
- The right to reimbursement for advances to the partnership beyond required capital contributions.
- The right to have payments and advances treated as loans to the partnership that accrue interest from the date of payment of advance.
- Equal rights in the management and conduct of the partnership business.
- The right to become a partner only with the consent of all of the existing partners.



. . . and Obligations .

- The obligation to use or possess partnership property only on behalf of the partnership.
- The inability to be paid for services performed for the partnership, other than reasonable compensation for services in winding up the partnership business.
- Resolution of partnership disputes regarding matters in the ordinary course of business requires a majority vote of the partners; acts outside the ordinary course of business of a partnership and any amendments to the partnership agreement require unanimous consent.

## JOINT VENTURES (THE CASUAL GENERAL PARTNERSHIP)

If it walks and talks like a partnership, then it is a partnership. “Joint Venture” is not a description that makes an association exempt from the partnership rules.

## JOINT VENTURE DEFINED

A joint venture is a business association formed for the purpose of engaging in a particular business transaction or conducting business for a set period of time. Joint ventures result when co-owners

of a business agree to share the profits, losses, and control of that business. *Connor v Great W. Sav. & Loan Ass'n* (1968) 69 C2d 850, 73 CR 369. Joint ventures can be formed orally or in writing, or from the acts of the parties, just like a general partnership.

## WHAT ARE THE ALTERNATIVES?

If one business is associating with another, then the affiliation can be structured as:

- Contractual relationship; do not form a legal entity
- Strategic alliances
- Collaboration agreements
- Joint development agreements
- Co-marketing agreements
- Revenue-sharing agreements

These kinds of relationships may be brief and informal or long-term and complex, depending on the parties' objectives. They are more flexible and dynamic than a new joint venture entity. The parties can amend the terms of their relationship, and are much easier to terminate. No dissolution and unwinding of a separate legal entity is required.

## AVOIDING A PARTNERSHIP RELATIONSHIP

In addition to all the guidance in this article, business associations should also use "Not a partnership" clauses in important initial documents, including:

- Nondisclosure agreements
- Memoranda of understanding
- Letters of intent
- Term sheets

## CONCLUSION

Ostensible partners are exposed, and expose other ostensible partners and third parties, to a variety of liabilities, duties, obligations and rights. Business arrangement should be entered into with purpose and clear intent.

## Submit Your Activities!

*Let us know when you speak,  
write, win, appear, present, or anything else.*

*We want to hear from you!  
Editor@LMillerconsulting.com*



**Eleanor Southers**  
Attorney at Law

Practicing Attorney  
for Over 24 years

Offering

## PROFESSIONAL LEGAL COACHING

For Attorneys who want to change, grow or  
more effectively manage their careers

**"My Agenda is Your Success"**

For more information go to

**www.southerslaw.net**

or call

**831-466-9132**

Serving Santa Cruz, Monterey and Santa Clara Counties

## NOLD INTELLECTUAL PROPERTY LAW

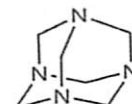
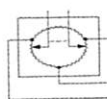


Charles R. Nold

Patents  
Trademarks  
Trade Secrets

U.S. and International Patent and Trademark Protection

All Attorneys are former U.S. Patent Examiners  
Experienced Patent Attorneys for all Technologies



NoldLaw.com (510) 704-8993 CNold@NoldLaw.com  
101 California Street Suite 2450 San Francisco CA 94111