Partner Bankruptcy and Partnership Dissolution: Protecting the Terms of the Contract and Ensuring Predictability

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NOTES

PARTNER BANKRUPTCY AND PARTNERSHIP DISSOLUTION: PROTECTING THE TERMS OF THE CONTRACT AND ENSURING PREDICTABILITY

INTRODUCTION

The dissolution of a partnership is defined as a change in the relation of the partners caused by any partner ceasing to be associated in the partnership business.\(^1\) Dissolution thus designates the point in time when all of the partners cease to carry on the business together.\(^2\)

Both the Uniform Partnership Act\(^3\) ("UPA") and the Revised Uniform Limited Partnership Act\(^4\) ("RULPA") provide that the bankruptcy of a general partner causes a partnership\(^5\) to be dissolved.\(^6\) Because these

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2. See UPA § 29 official comment, 6 U.L.A. 364-65 (1969). Upon dissolution, the partnership is not immediately terminated but continues to exist until all partnership affairs are settled. See id. § 30, 6 U.L.A. 367 (1969). This post-dissolution settling process is known as "winding up." See id. § 29 official comment, 6 U.L.A. 364-65 (1969).
5. A "general" partnership is one in which all the partners are "general partners," each sharing the profits and losses as well as the management equally. See Black's Law Dictionary 1120-21 (6th ed. 1990). A "limited" partnership is a partnership consisting of "one or more general partners and one or more limited partners." RULPA § 101(7), 6 U.L.A. 271 (Supp. 1991). The general partner(s) in a limited partnership are solely responsible for the management of the partnership, and are liable for partnership debts as if
dissolution provisions have been adopted into the partnership law of almost every state, federal bankruptcy courts have generally enforced the

in a general partnership. See RULPA §§ 403(a), 403(b), 6 U.L.A. 345 (Supp. 1991); Black's Law Dictionary 1121 (6th ed. 1990). In contrast, the limited partner(s) generally do not participate in the management of the partnership, and are not liable to third parties for the obligations of the partnership. See RULPA § 303, 6 U.L.A. 325 (Supp. 1991); see also Bromberg, supra note 2, at 640 n.52 (discussing limitations on limited partners).

Despite this distinction, this Note will use the term "partnership" to refer inclusively to both general and limited partnerships. Among other reasons, this practice is justified because dissolution on account of a general partner's bankruptcy applies equally to limited and general partnerships. See Bromberg, supra note 2, at 642; infra note 6; see also UPA § 6(2), 6 U.L.A. 22 (1969) (where the ULPA or RULPA is silent on an area of partnership law, gap is filled by reference to the general UPA); RULPA § 1105, 6 U.L.A. 413 (Supp. 1991) (same); R. Haft, Investment Limited Partnerships: And Other Pass-Through Vehicles Pt. I § 15.03 (1989) (ULPA is silent on causes and effect of dissolution and gap is filled by UPA).


Unless the partners otherwise agree, the RULPA specifically requires dissolution of a limited partnership upon a general partner's voluntary or involuntary bankruptcy, initiated under either Chapter 7 of the Bankruptcy Code (liquidation), Chapter 11 (reorganization), or Chapter 13 (adjustment of debts of an individual). See RULPA §§ 402(4), 402(5), 801, 6 U.L.A. 341-42, 375 (Supp. 1991). In so doing, the RULPA reflects a judgment that limited partners can rid themselves of a general partner who is in such dire financial straits that he is the subject of bankruptcy proceedings. See RULPA § 402 comment, 6 U.L.A. 342 (Supp. 1991). Three provisions of the RULPA regulate dissolution. Section 801(4) provides that a limited partnership is dissolved upon the withdrawal of a general partner. See RULPA § 801(4), 6 U.L.A. 375 (Supp. 1991). Sections 402(4) and 402(5) then define an "event of withdrawal" to include the voluntary and involuntary filing of a petition in bankruptcy seeking reorganization, readjustment or liquidation of a general partner. See RULPA §§ 402(4), 402(5), 6 U.L.A. 341-42 (Supp. 1991).


7. Partnerships are created pursuant to, and are largely governed by, state law. See 59A Am. Jur. 2d Partnerships § 22 (1987); see also L. King, Collier Bankruptcy Manual ¶ 303.03[2], at 303-14 (3d ed. 1990) ("[a]s a general rule, state statutes and decisions on partnership law control the question as to whether there is in fact a partnership").


The 1976 version of the RULPA, for its part, has been adopted by 46 states and the District of Columbia. See RULPA, Table of Jurisdictions Wherein Act Has Been Adopted, 6 U.L.A. 239-40 (Supp. 1991). Although the RULPA has not been adopted by every state, the dissolution of limited partnerships upon the bankruptcy of the general partner is still the rule in those non-adopting states. First, every remaining state except Louisiana has adopted the ULPA. See Ale, Substantive Law and Special Problems of General and Limited Partnerships, in Partnerships: UPA, ULPA, Securities, Taxation, and Bankruptcy 1, 56 (ALI-ABA 1990); Kennedy, Partnerships and Partners Under the Bankruptcy Reform Act and the New (Proposed) Bankruptcy Rules, 27 St. Louis U.L.J.
UPA and RULPA dissolution provisions as incorporated in state law, and have held partnerships to be dissolved upon the filing of a bankruptcy petition by a general partner. In addition to these state laws, partnership agreements commonly contain clauses that effect the same result. These built-in dissolution provisions are known as "ipso facto" dissolution provisions.


See O'Dea & Roseen, supra note 6, at 521; see also Kaster & Cymbler, The Impact of a General Partner's Bankruptcy Upon the Remaining Partners, 21 Real Prop. Prob. Tr. J. 539, 539 (1986) ("Most real estate partnership agreements contain provisions dealing with the possible bankruptcy of the general partner."); Fogel, Executory Contracts and Unexpired Leases in the Bankruptcy Code, 64 Minn. L. Rev. 341, 347 (1980) (contracting parties often add bankruptcy clauses to their arrangements to insure the benefit of their
clauses or simply “bankruptcy” clauses.\textsuperscript{11}

Despite both the broad acceptance of the UPA and RULPA dissolution provisions and the prevalence of bankruptcy clauses within partnership agreements, some courts have held that a general partner's bankruptcy does not dissolve a partnership.\textsuperscript{12} One group of cases argues that section 365(e)(1)\textsuperscript{13} of the Federal Bankruptcy Code,\textsuperscript{14} which nullifies bankruptcy termination clauses in executory contracts, prohibits partnership dissolution on account of a general partner's bankruptcy, and overrides contrary state law by virtue of the Supremacy Clause\textsuperscript{15} of the United States Constitution.\textsuperscript{16} A second group of cases, focusing on

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\textsuperscript{13} The relevant text of section 365(e)(1) is as follows:

\begin{quote}
Notwithstanding a provision in an executory contract . . . or in applicable law, an executory contract . . . of the debtor may not be terminated or modified, and any right or obligation under such contract . . . may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract . . . that is conditioned on - (A) the insolvency or financial condition of the debtor at any time before the closing of the case; (B) the commencement of a case under this title; or (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.
\end{quote}

\textsuperscript{11} U.S.C. § 365(e)(1) (1988) (emphasis added); \textit{see also infra} text accompanying notes 27-39 (further explaining this provision).


\textsuperscript{15} The United States Constitution provides that “[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land.” U.S. Const. art. VI, cl. 2 (the “Supremacy Clause”). Thus, any state law contrary to the laws of Congress are invalid. See Gibbons v. Ogden, 22 U.S. (9 Wheat) 1, 22 (1824). As Congress has the power to establish a uniform bankruptcy law, see U.S. Const. art. I, § 8, cl. 4, the United States Supreme Court has held that the supremacy clause applies to federal bankruptcy law. See Perez v. Campbell, 402 U.S. 637, 649-52 (1971).

situations where a general partner seeks "reorganization" under Chapter 11 of the Code, has rejected dissolution on the grounds of statutory construction and public policy. A split in bankruptcy authority and commentary therefore exists on whether partnership dissolution occurs when a general partner files an individual petition for bankruptcy. This disagreement has created confusion regarding the practical effect of a general partner's bankruptcy on a partnership, and has generally de-stabilized the relationship between partnership and bankruptcy law.

This Note argues that dissolution should be controlled by the provisions of partnership agreements, including the relevant state law that is implicitly a part of such agreements. This argument rests on the dual notion that (i) partnership agreements are excepted from section 365(e)(1) of the Code by virtue of the effect of section 365(e)(2), and (ii) there are compelling public policy arguments and practical reasons for upholding the terms of the partnership agreement that mandate dissolution.

Part I of this Note examines the argument that partnerships do not dissolve upon a general partner's bankruptcy. Part II addresses the "no dissolution" argument based on Code section 365(e)(1) and refutes the notion that the section mandates such a result. Part III addresses and

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18. See, e.g., In re Safren, 65 Bankr. 566, 570 (Bankr. C.D. Cal. 1986) (formulating the analysis only with regard to a partner's Chapter 11 case). In other words, this analysis does not apply to general partner liquidation cases under Chapter 7 of the Code, 11 U.S.C. §§ 701-766 (1988).
20. See, e.g., O'Dea & Roseen, supra note 6, at 521, 526-27 (warning those who draft partnership agreements to pay careful attention to termination and dissolution provisions, given uncertain state of law regarding partnership dissolution); see also Kaster & Cymbler, supra note 10, at 559 (warning lawyers that courts have produced contradictory results regarding "whether a partnership agreement is an assumable and assignable executory contract").
22. See supra note 13.
23. Specifically, section 365(e)(2) states:
   Paragraph (1) of this subsection does not apply to an executory contract . . . if - (A)(i) applicable law excuses a party, other than the debtor, to such [a] contract . . . from accepting performance from or rendering performance to the trustee or to an assignee of such contract . . . and (ii) such party does not consent to such assumption or assignment . . . .
11 U.S.C. § 365(e)(2) (1988) (emphasis added); see also infra text accompanying notes 52-90 (further explaining use of section 365(e)(2)).
counters the public policy "no dissolution" argument, and sets forth the policy and practical reasons that favor upholding the dissolution provisions of partnership agreements.

I. EXAMINING THE TWO BRANCHES OF "NO DISSOLUTION" CASES

Many federal courts applying the provisions of the Bankruptcy Code have found partnerships to be dissolved by a general partner's insolvency. Some courts, however, have rejected both state law and the actual partnership agreements in refusing to allow dissolution upon the bankruptcy of general partner. These cases generally follow two lines of reasoning.

A. Section 365(e)(1) of the Bankruptcy Code, and the Preemption of State Partnership Law and Bankruptcy Dissolution Clauses

Section 365 of the Bankruptcy Code enables a trustee or debtor in possession to assume or to reject any "executory contract" of the

24. Most of these courts have simply followed the black-letter partnership law of the state under which the partnership was formed. See, e.g., Connolly v. Nuthatch Hill Assoc. (In re Manning), 831 F.2d 205, 207 (10th Cir. 1987) ("[u]nder Colorado law, a bankruptcy filing by any partner effects an automatic dissolution of the partnership"); Turner v. Lee (In re Minton Group, Inc.), 46 Bankr. 222, 224 (S.D.N.Y. 1985) (New York partnership law "dictates that upon the bankruptcy of any partner, a partnership dissolves"); Holcomb v. Fulton (In re Fulton), 43 Bankr. 273, 276 (Bankr. M.D. Tenn. 1984) (partnership "was dissolved by operation of [Tennessee] law"); Houchen v. Gadberry (In re Gadberry), 30 Bankr. 13, 13 (Bankr. C.D. Ill. 1983) (Illinois partnership law "mandates dissolution").

25. See supra note 12.


28. A trustee is a disinterested third party appointed to represent the debtor's estate in a Chapter 7 liquidation case, and in some cases in a Chapter 11 reorganization case. See 11 U.S.C. §§ 323, 701, 702, 1104 (1988); see also Kennedy II, supra note 7, at 570-71 (discussing nature and election of trustee). The trustee is a different entity legally and physically from the debtor. See 11 U.S.C. §§ 1101, 1105 (1988) (distinguishing between trustee and debtor or debtor in possession).

29. In a Chapter 11 case, the debtor frequently remains in charge of administering his or her own estate in bankruptcy, in lieu of a court-appointed trustee. See A. Hertzog & L. King, Collier Bankruptcy Code § 1104 comment, at 585-86 (1990-91). When this occurs, the debtor becomes known as the "debtor in possession." See id. at § 1101 comment, at 572; King, supra note 7, ¶ 1101.02, at 1101-2. A debtor in possession has the same rights and obligations as a trustee, both generally and particularly in reference to section 365. See 11 U.S.C. § 1107 (1988).

30. Historically, "executory contracts" include all contracts that are not completely performed. See 1 S. Williston, A Treatise on the Law of Contracts § 1:19 at 49 (4th ed. 1990). Thus, a contract is either executory or it is fully performed; if the latter, it is no longer a contract. See id.

The historical definition of executory contract is too broad to be useful in the bankruptcy context. See T.G. Motors, Inc. v. C.M. Turtur Invs., Inc. (In re C.M. Turtur
debtor.\(^\text{31}\) By allowing the estate representative to pick and choose among the debtor’s pre-petition agreements, the provision is designed to assist the debtor in reorganization or liquidation.\(^\text{32}\)

Section 365(e)(1) preserves executory contracts for an estate that...
otherwise would be terminated or modified on account of the general partner's bankruptcy.\textsuperscript{33} Section 365(e)(1) states that an executory contract may not be terminated or modified solely because a contract provision is conditioned on the commencement of a bankruptcy case\textsuperscript{34} or because of any law providing for the same.\textsuperscript{35}

The argument applying section 365(e)(1) to partnership agreements begins with the notion that partnership agreements are executory contracts.\textsuperscript{36} Treating partnership agreements as executory contracts, coupled with the fact that dissolution modifies the partnership agreement, leads to the conclusion that section 365(e)(1) prohibits the dissolution of a partnership on account of a general partner's bankruptcy.\textsuperscript{37} Furthermore, because the Bankruptcy Code is federal law, this "no dissolution" argument asserts that section 365(e)(1) preempts the conflicting state partnership law and renders any express bankruptcy dissolution clauses unenforceable.\textsuperscript{38}

365 is an integral facet of the bankrupt's ability to restructure its business operations in an economically viable format).

This "assistance" is accomplished in two ways. First, section 365 allows for the assumption of those contracts that will benefit the estate, and provides a means whereby the debtor can force others to continue to do business with it when "a bankruptcy filing might make them reluctant to do so." Richmond Leasing Co. v. Capital Bank, N.A., 762 F.2d 1303, 1310 (5th Cir. 1985); see In re Hardie, 100 Bankr. 284, 285 (Bankr. E.D.N.C. 1989); In re Compass Van & Storage Corp., 65 Bankr. 1007, 1010 (Bankr. E.D.N.Y 1986); In re G-N Partners, 48 Bankr. 462, 465 (Bankr. D. Minn. 1985). Alternatively, section 365 relieves the debtor's estate from burdensome or disadvantageous contractual obligations. See In re Hardie, 100 Bankr. at 285; Silk Plants, Etc. Franchise Sys., Inc. v. Register (In re Register), 95 Bankr. 73, 74 (Bankr. M.D. Tenn.), aff'd, 100 Bankr. 360 (M.D. Tenn. 1989); In re Sun City Invs., Inc., 89 Bankr. 245, 248 (Bankr. M.D. Fla. 1988).

33. See supra note 13.


35. See supra note 13.

36. There appears to be a consensus that partnership agreements are executory contracts. See In re Priestley, 93 Bankr. 253, 258-59 (Bankr. D.N.M. 1988); Burley v. American Gas & Oil Investors (In re Heafitz), 85 Bankr. 274, 284 (Bankr. S.D.N.Y. 1988); In re Corky Foods Corp., 85 Bankr. 903, 904 (Bankr. S.D. Fla. 1988); Skee v. Harms (In re Harms), 10 Bankr. 617, 618 (Bankr. S.D. Colo. 1981); see also In re Sunset Developers, 69 Bankr. 710, 712-13 (Bankr. D. Idaho 1987) (finding partnership agreement to be executory contract and still finding partnership dissolved); In re Rittenhouse Carpet, Inc., 56 Bankr. 131, 132-33 (Bankr. E.D. Pa. 1985) (assuming without analysis that partnership agreement was executory contract covered by section 365); Kaster & Cymbler, supra note 10, at 545 (under result-oriented test, all real estate limited partnership agreements are potentially executory); Kennedy & Smith, supra note 6, at 865-67 (discussing cases in which courts have found partnership agreements to be executory contracts).

For the purpose of analysis, this Note assumes that partnership agreements are executory.

37. The clearest and most succinct statement of this analysis was made by the court in Corky Foods, 85 Bankr. at 904.

38. See supra note 15; see also Bruder v. Peaches Records and Tapes, Inc. (In re Peaches Records and Tapes, Inc.), 51 Bankr. 583, 590 (Bankr. 9th Cir. 1985) (termina-
B. The "Public Policy Cases" and the Argument for "No Dissolution"

The second argument rejecting partnership dissolution on account of a general partner's bankruptcy exclusively concerns instances in which a general partner files for Chapter 11 Reorganization. This view, founded upon In re Safren, relies upon statutory construction and public policy.

In rejecting dissolution, the Safren court stated that the applicability of UPA section 31(5) to a partner's Chapter 11 case is an "open question." Because liquidation was the only existing form of bankruptcy when the UPA was promulgated in 1914, the Safren court reasoned that the UPA did not contemplate the application of its dissolution provisions where a partner filed for Chapter 11 reorganization.

While the Safren court did not consider this gap in statutory history fatal, the lack of clear legislative intent allowed the court to examine policy concerns in determining whether UPA section 31(5) should be extended to cover an individual partner's Chapter 11 case. The court reasoned that a partner attempting to reorganize should not be faced with the "dissolution of all the partnerships in which he is a partner," in light of the "administrative and tax complications" that attend dissolution. In the alternative, the Safren court discerned "no benefit under
partnership law from the automatic dissolution of a partnership upon the filing of a [general partner's] Chapter 11 case.

Safren and its progeny do not claim that Chapter 11 preempts UPA section 31(5). Rather, the rationale underlying this view is that the effects of partnership dissolution should not deter partners from seeking the benefits of Chapter 11 reorganization.

On their face, the arguments favoring "no dissolution" seem to be logically sound. They are not convincing, however, when examined in light of traditional contract and partnership principles, as recognized both without and within the Bankruptcy Code.

II. PARTNERSHIP AGREEMENTS AS EXCEPTIONS TO CODE SECTION 365(e)(1)

In drafting section 365, Congress excepted certain types of contracts from the section's effect. While section 365(e)(1) invalidates bankruptcy dissolution clauses and preempts contrary state law, section 365(e)(2) provides that subsection (e)(1) does not apply where "applicable law" excuses the non-debtor party to the contract from accepting performance from a non-contracting party.

Partnership agreements clearly fall within the section 365(e)(2) exception. As executory "personal service" contracts, they are the kind of contracts for which applicable law prohibits substitute performance. Furthermore, whether assumption of the partnership agreement is by a trustee, a debtor in possession or an assignee, such assumption will result in performance by a non-contracting party, and therefore qualifies as prohibited substitute performance.

Section 365(e)(2) thus liberates

48. Id.
49. See supra note 19.
50. Indeed, the Safren court specifically stated that "the Court does not reach the issue of whether it [section 31(5)] is preempted by Chapter 11." Safren, 65 Bankr. at 570, n.5. But see In re Corky Foods Corp., 85 Bankr. 903, 904 (Bankr. S.D. Fla. 1988) (nevertheless construing Safren as holding that UPA section 31(5) was inconsistent with the reorganization policies of Chapter 11 of the Bankruptcy Code and hence was preempted by federal law).
51. See Safren, 65 Bankr. at 569-70.
52. See, e.g., 11 U.S.C. § 365(e)(1)(A) (1988) (prohibiting trustee or debtor in possession from assuming or assigning an executory contract where "applicable law" excuses the non-debtor party "from accepting performance from or rendering performance to an entity other than the debtor or debtor in possession"); id. § 365(e)(2) (providing exception to section 365(e)(1) under same circumstances).
53. See supra text accompanying notes 13-38.
54. See supra note 23.
55. See infra notes 63-69 and accompanying text.
56. See Smith, supra note 2, at 667; infra notes 61-63, 70-74 and accompanying text.
57. When a partner enters bankruptcy, only three possible scenarios relate to the potential assumption of the partnership agreement. These are assumption by (i) the trustee, (ii) the partner as debtor in possession, or (iii) by an assignee of the contract. See infra Section II(B).
58. See infra notes 77-89 and accompanying text.
partnership contracts from the invalidating effects of section 365(e)(1) and enables partnerships to dissolve according to state law or to the provisions of their agreement.

A. Partnership Agreements as Contracts For Which "Applicable Law" Prohibits Substitute Performance

As employed by section 365(e)(2), "applicable law" refers to non-bankruptcy law under which contractual obligations are non-delegable. This language has been interpreted to preclude the assumption or assignment of personal service contracts, which by their nature are non-delegable under the law of contracts.

Because of the relationship among partners, partnership agreements are precisely the type of non-delegable, personal service contracts covered by the 365(e)(2) exception. A partnership agreement creates a fiduciary relationship among its members, and is a contract based upon good faith, personal trust and confidence. Implicit in this fiduciary relationship is the idea that each partner must repose trust and confidence in the other and exercise a corresponding degree of fairness and good faith.

59. This argument has been employed only recently by proponents of dissolution. See In re Cardinal Indus., Inc., 116 Bankr. 964, 976 (Bankr. S.D. Ohio 1990); see also Smith, supra note 2, at 667 (embracing application of 365(e)(2) to partnership agreements). Although the Cardinal court in this case rejected the argument, see Cardinal, 116 Bankr. at 981-82, its reasoning is suspect. See infra notes 87-88.

60. See In re Pioneer Ford Sales, Inc., 729 F.2d 27, 28-29 (1st Cir. 1984); Pension Benefit Guaranty Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 700 F.2d 935, 943 (5th Cir. 1983); see also In re Memphis-Friday's Assoc., 88 Bankr. 830, 834 (Bankr. W.D. Tenn. 1988) ("‘applicable non-bankruptcy law’ is state law").


63. See, e.g., Kennedy I, supra note 26, at 275 ("[t]he fiduciary relationship underlying a partnership agreement renders the rights and obligations thereunder nonassignable"); Kennedy II, supra note 7, at 546 n.196 (although section 365(e) may nullify a bankruptcy termination provision, a partnership agreement cannot be assumed or assigned by a partner's trustee contrary to its terms).

64. A "fiduciary relation" is "[a] relation subsisting between two persons in regard to a business . . . of such a character that each must repose trust and confidence in the other and must exercise a corresponding degree of fairness and good faith." Black's Law Dictionary 626 (6th ed. 1990) (emphasis added); see also Restatement (Second) of Agency §§ 13, 13 comment, 14A (1958) (partner is an "agent" of partnership and therefore has a wide range of fiduciary duties).

65. Contracts calling for a personal and/or fiduciary relationship are routinely considered to be non-delegable, personal service contracts. See J. Calamari & J. Perillo, supra note 62, at 761. Examples of non-delegable duties are those that "involve a close personal relationship, such as . . . an attorney to his client, or a physician to his patient." Id. The same is true for contracts based on personal trust or good faith. "[I]t is often held that a party to a contract who has expressly or impliedly promised to act in 'good faith' or to use his 'best efforts' may not delegate that duty." Id.

duty to other partners is an obligation to conduct partnership affairs in such a manner as to avoid damage to another partner's or the partnership's interests. A partner's fiduciary duty extends beyond dissolution and is operative during the winding-up process. The duty ends only upon the partnership's termination.

As with all personal service contracts, partnership law unconditionally grants non-debtor partners the right to refuse performance from a substitute partner. Section 18(g) of the UPA provides that "[n]o person can become a member of a partnership without the consent of all the partners." Similarly, under the ULPA, RULPA and relevant case law, limited partners need not accept performance from a general partner with whom they have not contracted.

The most significant effect of this rule against delegability is the limitation on a general partner's ability to assign his or her partnership rights.

See generally Beane, The Fiduciary Relationship of a Partner, 5 J. Corp. L. 483 (1980) (discussing at length the fiduciary relationships created by partnership arrangements).


75. A partner in a general partnership, and the general partner of a limited partner-
right to participate in partnership management without the consent of their fellow partners.76

"Applicable" contract and partnership law therefore prohibits the substitute performance of partnership agreements, satisfying the first requirement of section 365(e)(2).

B. Assumption By a Trustee, Debtor in Possession, and/or Assignee as Substitute Performance

The trustee of an insolvent partner's estate is a different physical and legal person than the pre-bankruptcy partner.77 Consistent with the law

ship, have three types of partnership rights: (i) rights in specific partnership property; (ii) an "interest" in the partnership; and (iii) a right to participate in the management of the partnership. See UPA § 24, 6 U.L.A. 324 (1969); see also RULPA § 403, 6 U.L.A. 345 (Supp. 1991) (rights and limitations of a general partner in a limited partnership are the same as those of a partner in a general partnership).

A partner is a co-owner of specific partnership property and holds such property as a tenant in partnership. See UPA § 25(1), 6 U.L.A. 326 (1969). This right to specific property is not assignable, see id. § 25(2)(G), because under the entity theory of partnerships, the incidents of a partner's tenancy in partnerships are "negligible." Connolly v. Nuthatch Hill Assoc. (In re Manning), 37 Bankr. 755, 758 (Bankr. D. Colo. 1984), aff'd in part, 831 F.2d 205 (10th Cir. 1987); accord Turner v. Lee (In re Minton Group, Inc., 46 Bankr. 222, 224-26 (S.D.N.Y. 1985); Venture Properties, Inc. v. Norwood Group, Inc. (In re Venture Properties, Inc.), 37 Bankr. 175, 176 (Bankr. D.N.H. 1984). But see Kennedy & Smith, supra note 6, at 839-44 (arguing that bankrupt partner should be able to compel sale of partnership property).

An "interest" in the partnership, which is defined as a partner's "share of the profits and surplus," is considered to be personal property of the partner. UPA § 26, 6 U.L.A. 349 (1969). This interest is assignable without the consent of the other partners, although the assignee receives no right to interfere in the management of the partnership or to inspect the partnership books. See UPA § 27, 6 U.L.A. 353 (1969); ULP A § 19(3), 6 U.L.A. 603 (1969); RULPA § 702, 6 U.L.A. 369-70 (Supp. 1991); accord In re New Era Co., 115 Bankr. 41, 44 (Bankr. S.D.N.Y. 1990), aff'd, 125 Bankr. 725 (S.D.N.Y. 1991); In re Priestley, 93 Bankr. at 257-58; see also Bromberg, supra note 2, 637 n.31 (assignment of partner's interest is accompanied by his withdrawal from management of the partnership).

As a corollary to this last rule, a partner's management interest is not assignable without the other partners' consent. See Tip O Texas, 87 Bankr. at 198; Tyler v. Walde (In re Walsh), 14 Bankr. 385, 386-87 (Bankr. D.C. 1981).


77. The trustee must be considered a different "legal" entity than the pre-petition partner, because any other result would undermine the fiduciary nature of partnership arrangements. While a partner stands in a fiduciary relationship to his fellow partners, see supra notes 65-67 and accompanying text, a trustee stands in a fiduciary relationship to the debtor's creditors and must manage the estate to maximize their benefit. See United States v. Aldrich (In re Rigden), 795 F.2d 727, 730 (9th Cir. 1986); Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 462 n.8 (6th Cir. 1982); Wheels, Inc. v. Otasco, Inc. (In re Otasco, Inc.), 111 Bankr. 976, 984 (Bankr. N.D. Okla. 1990); In re Haugen Constr.
governing partnership contracts, therefore, assumption of the partnership agreement by the trustee would amount to substitute performance and is prohibited. The same result would attach if the partnership agreement was assumed by an unrelated assignee, because such an assumption would amount to a material change in the identity of the person rendering performance.

Where the debtor in possession seeks to assume the partnership agreement by continuing as a general partner, arguably this assumption also amounts to prohibited substitute performance. Although the pre-petition debtor and debtor in possession are the same physical person," courts have often treated the two as separate legal entities for bankruptcy purposes because the debtor in possession not only receives the powers

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78. See supra notes 65-76 and accompanying text.

79. This position was explained most clearly in Skeen v. Harms (In re Harms), 10 Bankr. 817, 821 (Bankr. D. Colo. 1981); accord In re Cardinal Indus., Inc., 116 Bankr. 964, 979 (Bankr. S.D. Ohio 1990); In re Fidelity Am. Fin. Corp., 43 Bankr. 74, 77 (Bankr. E.D. Pa.), aff'd in part and vacated in part, 62 Bankr. 798 (E.D. Pa. 1984); Schefer v. CRS Architectural Metals Corp. (In re CRS Architectural Metals Corp.), 1 Bankr. 729, 731 n.2 (Bankr. E.D.N.Y. 1979); see also Kennedy II, supra note 7, at 546 n.196 (trustee cannot assume or assign partnership agreement); Smith, supra note 2, at 667 (section 365(e) does not avoid dissolution when trustee assumes partnership contract).


The holding of the Supreme Court in National Labor Relations Board v. Bildisco, namely that a debtor in possession is to be considered the same legal entity as the prepetition debtor for the purpose of rejecting a collective bargaining agreement, is distinguishable and does not change the foregoing analysis. See Bildisco, 465 U.S. at 528. Because of the Court’s focus on rejection as opposed to assumption powers, and considering
and rights of a trustee, but actually stands in the shoes of the trustee in every way. Thus, like a trustee, a debtor in possession stands in a fiduciary relationship to his creditors and must run the estate for their benefit. As an entity with new fiduciary allegiances and subject to the supervision of the bankruptcy court, the insolvent partner faces an inherent conflict of interest that precludes him from remaining as a general partner or from assuming the partnership agreement without the

that it was not dealing with a “personal service” executory contract, it did not face the conflict-of-interest problems inherent in the assumption of a partnership contract, and thus its application here is questionable. See Washington Medical Center, Inc. v. Holle, 573 A.2d 1269, 1278, 1280 n.17 (recognizing Bildisco while still finding the “conflict-of-interest” reasoning to be sound where a bankrupt general partner continues to operate the partnership).

83. See supra note 29 and accompanying text.


85. See supra note 79.


87. See In re Sunset Developers, 69 Bankr. 710, 713 (Bankr. D. Idaho 1987); See v. Harms (In re Harms), 10 Bankr. 817, 822 (Bankr. D. Colo. 1981). In fact, it is well established that a general partner ceases to be a general partner upon filing for bankruptcy. See, e.g., UPA §§ 33, 35(3)(b), 37, 6 U.L.A. 423, 430, 444 (1969) (eliminating right of bankrupt partner to act on behalf of or bind partnership); RULPA § 402(4)-(5), 6 U.L.A. 341-42 (Supp. 1991) (“a person ceases to be a general partner of a limited partnership upon the . . . filing of a voluntary petition in bankruptcy . . . [or] after the commencement of any proceeding against the general partner seeking reorganization . . . [or] liquidation”).

One case, going against the weight of partnership law and authority, has disputed the idea that “potential conflicts of interest” justify removal of the debtor as general partner. See In re Cardinal Indus., Inc., 116 Bankr. 964, 984 (Bankr. S.D. Ohio 1990). Specifically, the court stated: “it appears theoretically possible for an entity to appropriately hold fiduciary duties to more than one group so long as the two groups' interests are not actually adverse to one another.” Id. at 984 (emphasis added).

The Cardinal court's reasoning is unconvincing. First, while it is theoretically possible to hold fiduciary duties to more than one group, this is unlikely to occur where the groups are creditors and partners. See, e.g., House Report, supra note 30, at 198, reprinted in 1978 U.S. Code Cong. & Admin. News at 6159 (recognizing potential conflicts of interest where one trustee services the estates of both a bankrupt partner and partnership); Kennedy I, supra note 26, at 227 (same); Kennedy II, supra note 7, at 577-78
other partners' consent.\textsuperscript{89}

\textsuperscript{(same); see also} Washington Medical Center, Inc. v. Holle, 573 A.2d 1269, 1280 n.17 (D.C. 1990) (recognizing possibility of divided loyalties where general partner continued to operate limited partnerships during his bankruptcy). Creditors want to reach the personal assets of the insolvent partner, which also serve as a potential source for discharging partnership liabilities. \textsuperscript{See} UPA § 15, 6 U.L.A. 174 (1969) (partners' liability for partnership debts is joint and several); Rosenberg, \textit{Partnership Reorganization Under the Bankruptcy Reform Act: Filling in the Interstices}, 56 N.Y.U.L. Rev. 1173, 1179 (1981) (because liability is joint and several, any partnership creditor may look to assets of individual partners for satisfaction). Thus, by reducing the insolvent partner's assets, the other partners' liability for partnership debts increases, and partnership liabilities may remain unpaid.

Second, there is no way to predict what actions a debtor in possession will be required to take in administering the estate. Consequently, there is no way to determine whether those actions will be "actually adverse" to the partnership. As one commentary has noted, conflicts of interest \textit{invariably} arise when the affairs of a partnership and any partner are jointly administered in bankruptcy. \textsuperscript{See} Kennedy & Smith, supra note 6, at 873 (emphasis added). Indeed, consistent with the underlying rationale of relevant partnership laws and authority, \textsuperscript{see} supra notes 65-76 and accompanying text, the presumption should be that at some point those interests \textit{will} conflict.

Third, the \textit{Cardinal} theoretical approach does not provide a clear standard and is likely to promote inconsistent rulings in an area greatly in need of predictability. \textsuperscript{See infra Section III(B).}

\textsuperscript{88} An interesting twist occurs where the trustee assumes the partnership agreement and allows the insolvent partner to continue to perform as general partner subject to the trustee's supervision. This was the situation in \textit{In re Cardinal Industries}, which took the position that because performance will be rendered by the same entity that was a party to the contract, the non-debtor party was not prejudiced, nor the "essential bargain" affected by the assumption. 116 Bankr. at 981-82.

The \textit{Cardinal} decision contravenes well-settled principles that allow partners to reject performance by a substitute partner. \textsuperscript{See supra} notes 75-76 and accompanying text. It also undercuts its own reasoning by admitting that performance will be rendered by the debtor partner "as managed by the Trustee." \textit{Cardinal}, 116 Bankr. at 981. Under the trustee's management, the bankrupt partner's performance will not be the same as prior to the bankruptcy, because the debtor will no longer be able to exercise independent discretion in making partnership management decisions. Even more importantly, the scenario envisioned in \textit{Cardinal} is fraught with the same inherent conflicts of interest as when the debtor in possession attempts to perform the partnership contract. \textsuperscript{See supra} notes 83-87 and accompanying text. As the \textit{Cardinal} court actually stated, the "debtor, whether in possession of the estate or being managed by an operating trustee, \textit{acts for different interests than it acted for prior to the filing} . . . [namely] for the benefit of the creditor body." \textit{Cardinal}, 116 Bankr. at 981 (emphasis added); \textsuperscript{see also} Fanelli v. Hensley (\textit{In re Triangle Chemicals, Inc.}), 697 F.2d 1280, 1290 (5th Cir. 1983) (no distinction exists between "debtor" and "debtor in possession" with regards to acts performed on its behalf \textit{subsequent} to filing of reorganization petition); \textit{In re Chapel Gate Apartments, Ltd.}, 64 Bankr. 569, 575-76 (Bankr. N.D. Tex. 1986) (same).

\textsuperscript{89} In \textit{In re Harms}, the court pursued a similar line of reasoning in finding that a limited partnership was dissolved by the filing of a bankruptcy petition by its general partner. \textsuperscript{See} Skeen v. Harms (\textit{In re Harms}), 10 Bankr. 817, 821-22 (Bankr. D. Colo. 1981). The court held a partnership dissolved for lack of a general partner, because the debtor ceased to be general partner upon bankruptcy, and because neither trustee nor debtor in possession could assume "personal service" partnership agreement. \textsuperscript{See id.} Unlike the present analysis, however, the \textit{Harms} court relied upon Code section 365(e). \textsuperscript{See id.} At that time, section 365(e) prohibited the assumption or assignment of certain executory contracts under terms identical to the present version of section 365(e)(2). \textit{Compare} 11 U.S.C. § 365(e)(1) (1979) \textit{with} 11 U.S.C. § 365(e)(2) (1988).

In 1984, section 365(e)(1) was amended to state that a trustee may not assume an
Partnership agreements meet both elements of section 365(e)(2). The section therefore removes partnership agreements from the invalidating effect of section 365(e)(1), and allows partnerships to be dissolved under the terms of the contract or according to state partnership law as incorporated by the contract.90

executory contract if applicable law excuses the non-debtor party from accepting performance from “an entity other than the debtor or the debtor in possession.” 11 U.S.C. § 365(e)(1)(A) (1988) (emphasis added). Although the section still precludes the trustee or an assignee from becoming a substitute general partner, one case has read the amendment as providing that a debtor partner can assume a partnership agreement, so long as that partner continues to perform either as debtor in possession or under the supervision of the trustee. See In re Cardinal Indus., Inc., 116 Bankr. 964, 979 (Bankr. S.D. Ohio 1990). Another court, however, has reached the opposite conclusion. Reading the amendment literally, this court argued that if non-bankruptcy law prohibits assignment to a third party (i.e. to someone “other than the debtor or debtor in possession”), then neither the trustee nor the debtor in possession can assume the contract under section 365(c). See In re West Elec., Inc., 852 F.2d 79, 83-84 (3d Cir. 1988). Thus, under this interpretation, it makes no difference who ultimately assumes the partnership contract, and In re Harms is still good law. See, e.g., In re Sunset Developers, 69 Bankr. 710, 713 (Bankr. D. Idaho 1987) (following Harms and arguing that section 365(c) still prevents a debtor in possession from assuming or assigning a partnership contract).

Even if the first analysis of section 365(c) is correct, the argument of this Note under section 365(e)(2) does not suffer the same fate as the In re Harms analysis. Unlike section 365(e)(1), which was the basis of the Harms reasoning, section 365(e)(2) has not been amended. Furthermore, dissolution under section 365(e)(2) is not dependant upon the absence of a general partner within the limited partnership. Rather, because section 365(e)(2) renders section 365(e)(1) inapplicable, dissolution occurs under the state law equivalent of UPA section 31(5) or by the explicit terms of the partnership agreement. This argument actually expands the result in Harms to include general as well as limited partnerships.

90. Because this reasoning is based on a statutory interpretation of the language of section 365(e) and avoids a conflict between state partnership law and the federal Bankruptcy Code, the supremacy clause of the United States Constitution is not implicated.

There is, however, a question as to whether dissolution (and hence ultimate termination of the agreement) can occur immediately or must overcome the restrictions of the Code’s automatic stay provisions. See 11 U.S.C. § 362 (1988).

Some cases have argued that because executory contracts do not automatically vest in the bankrupt’s estate and must be assumed by the trustee or debtor in possession, they are not stayed by section 362. See Tonry v. Herbert (In re Tonry), 724 F.2d 467, 468-69 (5th Cir. 1984); In re Bofill, 25 Bankr. 550, 552 (Bankr. S.D.N.Y. 1982); In re New Town Mall, 17 Bankr. 326, 329 (Bankr. D.S.D. 1982). But see Computer Communications, Inc. v. Codex, Inc. (In re Computer Communications, Inc.), 824 F.2d 725, 730 (9th Cir. 1987) (rejecting this position explicitly); Wegner Farms Co. v. Merchants Bonding Co. (In re Wegner Farms Co.), 49 Bankr. 440, 444-45 (Bankr. N.D. Iowa 1985) (same). Similarly, another line of cases has held that a contract for personal services is excluded from the estate of the debtor by virtue of Code sections 541(a)(6) and 365(e), and hence the trustee or debtor in possession obtains no “legally cognizable interest” in the contract. See In re West Elec., Inc., 852 F.2d 79, 83-84 (3d Cir. 1988); Ford, Bacon & Davis, Inc. v. Holahan, 311 F.2d 901, 904 (5th Cir. 1962), cert. denied 373 U.S. 913; In re Carrere, 64 Bankr. 156, 158-59 (Bankr. C.D. Cal. 1986); Bofill, 25 Bankr. at 552; In re Noonan, 17 Bankr. 793, 797-78 (Bankr. S.D.N.Y. 1982); see also 11 U.S.C. § 541(a)(6) (1988) (excluding from estate post-petition proceeds from personal service contracts); 11 U.S.C. § 365(e)(1) (1988) (precluding trustee from assuming or assigning personal service contract). Under either line of cases, then, the remaining non-debtor partners would be free
III. Policy Considerations and an Argument for Predictability

Despite the reasoning of the Safren court, the more persuasive policy
to wind up the partnership and terminate the agreement without the automatic stay restriction. See Smith, supra note 2, at 666; Kennedy I, supra note 26, at 258-59 n.146.

In contrast, many cases have held that executory contract rights are property of the debtor that are included in the bankruptcy estate. See In re Herschell, 43 Bankr. 680, 682 (Bankr. E.D. Wis. 1984); In re Coast Trading Co., 26 Bankr. 737, 740 (Bankr. D. Or. 1982). Under this interpretation, cancellation or termination of such a contract is prohibited by the automatic stay as an "act to obtain possession of property of the estate." Coast Trading, 26 Bankr. at 740 (quoting language of 11 U.S.C. § 362(a)(3)); accord Computer Communications, 824 F.2d at 728-31; In re American Cent. Airlines, Inc., 52 Bankr. 567, 570 (Bankr. N.D. Iowa 1985). Under this approach, even if the non-debtor party has a valid reason for terminating the contract, such as where the contract cannot be assumed by the trustee or debtor in possession, it can only be terminated pursuant to the terms of the automatic stay provision. See Computer Communications, Inc., 824 F.2d at 730; Wegenner Farms, 49 Bankr. at 444; see also 11 U.S.C. § 541(c)(1) (1988) (providing that interest of debtor in property is part of debtor's estate notwithstanding any contractual provision or non-bankruptcy law).

Despite this second group of cases, non-debtor partners should be able to obtain relief from the automatic stay. Code section 362(d)(1) allows the bankruptcy court to grant relief from the automatic stay to a "party in interest" for "cause, including the lack of adequate protection." 11 U.S.C. § 362(d)(1) (1988). "Cause is an intentionally broad and flexible concept...[designed] to permit the courts to respond...to inherently fact-sensitive situations." In re Sentry Park, Ltd., 87 Bankr. 427, 430 (Bankr. W.D. Tex. 1988); accord Norton v. Hoxie State Bank, 61 Bankr. 258, 260 (D. Kan. 1986); Rich v. Maryland Nat'l Bank, 42 Bankr. 350, 354 (D. Md. 1984); In re Ashton, 63 Bankr. 244, 247 (Bankr. D.N.D. 1986). As such, courts exercising bankruptcy jurisdiction may recognize equitable and due process principles, including the impact of the stay on non-debtor parties, in fashioning relief. See Scrima v. John Devries Agency, 103 Bankr. 128, 132 (W.D. Mich. 1989); General Data Corp. v. Phelis Assoc. (In re Phelis Assoc.), 17 Bankr. 66, 69 (Bankr. W.D. Ky. 1981). Non-debtor partners should be able to obtain relief from the automatic stay for cause. See, e.g., In re Priestley, 93 Bankr. 253, 261-62 (Bankr. D.N.M. 1988) (court lifted stay to allow limited partners to remove general partner and wind-up partnership). Applying the automatic stay to the partnership agreement would prohibit the remaining partners from making any managerial decisions regarding the partnership, because any such decision is likely to affect the debtor partner's "interest in the partnership and would constitute interference with the estate's property. Freezing the partnership's operations in this manner harms both the overall partnership and the individual partners' interests. This is particularly so because a partner's individual bankruptcy case does not stay actions on partnership obligations or against property owned by the partnership. See Turner v. Lee (In re Minton Group, Inc.), 46 Bankr. 222, 225 (S.D.N.Y. 1985); In re Fairfield Group Partnership, 69 Bankr. 318, 320 (Bankr. E.D. Tenn. 1987); Venture Properties, Inc. v. Norwood Group, Inc. (In re Venture Properties, Inc.), 37 Bankr. 175, 176 (Bankr. D.N.H. 1984); Dominican Fathers of Winona v. Dreske (In re Dreske), 25 Bankr. 268, 271 (Bankr. E.D. Wis. 1982). Additionally, Congress did not intend the stay to apply to such situations. See Senate Report, supra note 30, at 52, reprinted in 1978 U.S. Code Cong. & Admin. News at 5838. Indeed, as stated in the legislative history: "Generally, proceedings in which the debtor is a fiduciary...need not be stayed because they bear no relationship to the purpose of the automatic stay, which is protection of the debtor and his estate from his creditors." Id.; accord Holtkamp v. Littlefield (In re Holtkamp), 669 F.2d 505, 508-09 (7th Cir. 1982); see also Computer Communications, 824 F.2d at 729 (automatic stay is meant "to give the debtor a breathing spell from creditors").

91. See supra notes 43-48. The Safren court reasoned that the potential administrative and tax complications resulting from dissolution would deter partners from seeking
reasons allow the partnership to dissolve according to the terms of the partnership agreement. This approach relies on the interrelated notions (i) that the fiduciary nature of the partnership relation requires that partners receive the full benefit of their bargain, and (ii) that predictability is a substantive goal of contract and partnership law and must be protected.

A. Protecting the Terms of the Contract

A partnership is among the most intimate of all business relationships. It is an association of co-owners, formed by consent and im

reorganization. See In re Safren, 65 Bankr. 566, 569-70 (Bankr. C.D. Cal. 1986). It is difficult, however, to discern the complications to which the Safren court was referring. From an administrative standpoint, dissolution of the partnership arguably simplifies the insolvent partner’s affairs. Because dissolution terminates the ability of the debtor partner to act on behalf of the partnership and allows only the non-bankrupt partners to wind up its affairs, see supra note 2, the debtor partner (as debtor in possession) can concentrate on marshalling assets and effecting reorganization. Furthermore, because dissolution may lead to termination of the partnership, or to the purchase of the debtor’s partnership interest, it also may require a determination of the debtor’s partnership interest, and hence contribute to a more effective reorganization. For a discussion of the post-dissolution rights and liabilities of general partners, see UPA §§ 34, 36, 38, 40, 6 U.L.A. 427, 436, 456-57, 468-69 (1969).

As for tax consequences, the Internal Revenue Code provides that a partnership continues to exist until it is “terminated,” or more specifically, until (i) “no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners,” or (ii) 50% or more of the partnership capital and profits are sold within a twelve-month period. See 26 U.S.C. § 708 (1988). This provision clearly indicates that a partnership is not terminated for tax purposes merely because it is dissolved. See W. McKee, W. Nelson & R. Whitmire, Federal Taxation of Partnerships and Partners ¶ 12.01, at S12-3 (abr. ed. cum. supp. 1989) (emphasis added). Thus, dissolution of the partnership is a non-event under tax law, producing no immediate adverse tax consequences. See Bromberg, supra note 2, at 644, 659. Furthermore, because only what follows dissolution produces tax consequences, it is significant that few post-dissolution scenarios have adverse effects upon the debtor partner. For example, even a nominal amount of continuing business or financial activity prevents a partnership from terminating for tax purposes, even if its primary purpose has been abandoned. See McKee, supra, ¶ 12.02, at S12-4. In fact, the continuation of a partnership business by a newly organized partnership may avoid a “termination” of the prior partnership if the two entities have any common partners. See 26 U.S.C. § 708(b)(1)(A) (1988); McKee, supra, ¶ 12.02, at S12-5. In addition, there are no new tax consequences where the partnership is continued and the debtor partner retains a partnership interest. Bromberg, supra note 2, at 660. The debtor simply continues to be taxed upon the basis of his “distributive share.” See 26 U.S.C. §§ 701, 702 (1988); see also Bromberg, supra note 2, at 663-64 (where partnership buys debtor’s interest in partnership, it is generally at book value and is principally tax free). In the rare event that the partnership is terminated, the tax consequences still may have a beneficial or neutral effect. See McKee, supra, ¶ 12.01, at S12-3 to -4. For a detailed discussion of the tax consequences of termination, see id. ¶ 12.05, at S12-19 to -38.


94. See Beane, supra note 66, at 483; see also 2 S. Williston, A Treatise on the Law of Contracts § 307A, at 448 (3d ed. 1959) (“a partnership is created and exists only by mutual agreement of the partners”).
bued with fiduciary obligation. It is, in short, the business form most closely resembling a "family" or marriage.

The partnership agreement controls the partnership's intra-family relationship. Like all contracts, the partnership agreement presupposes that the parties have exercised their free will, chosen the parties with whom they wish to contract and defined the significant terms of the contract for themselves. Because of the fiduciary nature of the partnership relation, the most important elements of this "freedom of contract" include the partner's ability to determine when the partnership will dissolve, and under what circumstances a new member will be permitted to join the partnership family. Thus, when courts nullify dissolution clauses or allow the trustee or debtor in possession to assume a partnership agreement, they violate the expectations of the non-debtor partners and arguably undermine the established notions of freedom of contract and enjoying the benefit of one's bargain.

A second problem in allowing the insolvent partner to avoid dissolution and to retain management interests in the partnership is that such a result does not adequately protect the interests of the non-debtor partners. The debtor partner, whether in possession or not, owes a fiduciary obligation to his creditors and must manage the estate for their benefit. This inherent conflict of interest both prejudices and complicates the insolvent partner's management abilities, and can easily

95. See supra notes 64-69 and accompanying text.
96. See M. Volz, supra note 92, at XV.
98. See M. Volz, supra note 92, at XV.
99. See, e.g., J. Calamari & J. Perillo, supra note 62, at 6, 338 (contract law is premised upon parties "hammering out an agreement" and on the notion of free will); Nimmer, supra note 11, at 514-15 (underlying premise of legal system is the promotion of voluntary contracts, which "is best promoted when the parties are able to define significant terms of the contract themselves").
100. The position taken here is not that Congress or the courts interpreting the Code lack the power to impair partnership agreements, but simply that they should not do so for the reasons discussed. Congress may in fact pass laws pursuant to its bankruptcy authority that impair or alter contractual obligations. See United States v. Creditthrift of Am., Inc. (In re Webber), 674 F.2d 796, 802 (9th Cir.), cert. denied, 459 U.S. 1086 (1982); Security Pacific Fin. Corp. v. Barto (In re Barto), 8 Bankr. 145, 149 (Bankr. E.D. Va. 1981), aff'd sub nom. United States v. Security Pacific Fin. Co., 704 F.2d 142 (4th Cir. 1983). As one court has recognized, however, "[i]n the interest of public policy and in order to preserve the special nature and character of partnerships, the Court will uphold the sanctity of partnership agreements." In re Sovereign Group, 1984-21 Ltd., 88 Bankr. 325, 329 (Bankr. D. Colo. 1988).
101. See supra note 88.
102. See supra notes 86-88 and accompanying text.
103. Specifically, a bankrupt general partner must marshall the assets of his personal estate, take action under the supervision of the bankruptcy court, answer to creditors, and possibly defend a number of adversarial disputes. These pressures not only create physical barriers to the continued effective management of the partnership, but also legally hamper the debtor partner's ability to manage the partnership for the other partners' benefit. See Kennedy & Smith, supra note 6, at 914; see also id. at 873 ("the
harm the non-debtor partners.\textsuperscript{104}

Both courts and commentators have repeatedly recognized the need to balance the rights of the debtor and non-debtor parties to contracts,\textsuperscript{105} even when protecting the non-debtor partners infringes on the debtor partner's estate.\textsuperscript{106} In addition, protecting the non-debtor partner's interest is not only a consideration of partnership law;\textsuperscript{107} it is also a recognized part of the Bankruptcy Code.\textsuperscript{108} For example, Code section 365(e)(2)\textsuperscript{109} gives effect to bankruptcy termination clauses and similar state laws in the area of personal service contracts.\textsuperscript{110} In fact, the legisla-

\textsuperscript{104} See, e.g., In re Rittenhouse Carpet, Inc., 56 Bankr. 131, 132-34 (Bankr. E.D. Pa. 1985) (debtor general partner attempted to bind limited partnership to unfavorable lease, which would have benefited debtor's estate); Holcomb v. Fulton (In re Fulton), 43 Bankr. 273, 275-76 (Bankr. M.D. Tenn. 1984) (debtor general partner attempted to secure partnership asset for personal estate); CP Yorketown, Inc. v. Fidelity Am. Mortgage Co. (In re Fidelity Am. Mortgage), 10 Bankr. 781, 783 (Bankr. E.D. Pa. 1981) (limited partners sought to replace debtor general partner for wrongful diversion of partnership assets to itself); Washington Medical Center v. Holle, 573 A.2d 1269, 1279-80 (D.C. 1990) (debtor general partner found to have breached fiduciary responsibility to limited partners by selling partnership real estate for personal estate use); see also Kennedy & Smith, supra note 6, at 914 (it is common for a debtor partner to pay separate creditors from partnership borrowing).

\textsuperscript{105} See, e.g., In re Libson Shops, Inc., 24 Bankr. 693, 695 (Bankr. E.D. Mo. 1982) (court must "balance the congressional intent [behind the Bankruptcy Code] with the parties' right to rely on the enforceability of a bargained-for agreement"); In re Lafayette Radio Elec. Corp., 12 Bankr. 302, 307 (Bankr. E.D.N.Y. 1981) (court must consider whether rights of other parties to contract are receiving "due recognition and protection" before allowing assumption); Nimmer, supra note 11, at 522 (Section 365 must balance the "internal goals" of bankruptcy including debtor rehabilitation "with general contract law policies that encourage or reinforce [the] use of contractual relationships"); Rosenberg, supra note 87, at 1207 (Chapter 11 does not create a right of successful reorganization in all cases, but only in appropriate cases where "competing principles of public policy are not unduly prejudiced").


\textsuperscript{107} See, e.g., 11 U.S.C. § 365(c) (1988) (not allowing assumption of executory personal service contracts); id. § 365(e)(2) (validating ipso facto clauses in personal service contracts); id. § 362(d) (granting relief from automatic stay for a party in interest).

\textsuperscript{108} See supra note 23.
tive history discussing section 365(e)\textsuperscript{111} directs courts to withhold approval of the assumption of an agreement under section 365(a)\textsuperscript{112} if the performance to be rendered will fail to give the non-bankrupt party the benefit of his bargain.\textsuperscript{113} Considering the personal service nature and fiduciary obligations\textsuperscript{114} of partnerships, in conjunction with the potential conflict-of-interest problems\textsuperscript{115} created by non-party assumption, it is unlikely that the trustee or debtor in possession will be able to guarantee his performance or assure the non-debtors' benefit of the bargain.\textsuperscript{116} Furthermore, the non-debtor partners not only lose a term for which they bargained; they also remain bound by an agreement that they likely would have rejected without the termination clause.\textsuperscript{117}

Balancing provisions similar to those of section 365(e)(2) are found in section 365(c),\textsuperscript{118} which prohibits the assumption of executory personal service contracts, and section 362(d),\textsuperscript{119} which grants relief from the automatic stay to a party in interest.\textsuperscript{120}

A third problem with a rule invalidating dissolution is that it extends or imposes a fiduciary relationship upon the non-debtor partners, who are likely to object to such an imposition. This rule is particularly troublesome because it forces non-debtor partners to remain in the partnership

\textsuperscript{112} Id. § 365(a).
\textsuperscript{113} The legislative history states in relevant part:
[Section 365(e)] will require the courts to be sensitive to the rights of the nondebtor party to executory contracts. . . . If the trustee is to assume a contract or lease, the courts will have to insure that the trustee's performance under the contract . . . gives the other contracting party the full benefit of his bargain.
\textsuperscript{114} See supra notes 77-79, 84-88, 101-104 and accompanying text.
\textsuperscript{115} See supra notes 63-69 and accompanying text.
\textsuperscript{116} See, e.g., Note, supra note 11, at 1058 ("trustee cannot adequately assure performance of a unique personal services contract").

One commentator has suggested that a non-debtor party can protect himself by specifically defining the performance expected from the debtor, and thereby requiring the trustee or debtor in possession to act accordingly. \textsuperscript{See Fogel, supra note 10, at 350. This idea fails for partnership contracts, because the potential performance of a partner (and thereafter the trustee or debtor in possession) is impossible to define or predict, and the personal service and fiduciary nature of partnership agreements renders substitute performance unacceptable. \textsuperscript{See supra notes 63-74 and accompanying text. Further, while it is possible for the non-debtor party to protect himself by terminating the contract when the debtor's bankruptcy is imminent, see Fogel, supra note 10, at 350-51, such a policy would provide non-debtor partners with the Hobson's choice of terminating a viable going concern, or enduring a potentially damaging assumption of the agreement.

117 One commentator has stated in the context of non-ipso-facto dissolution clauses that such a result "could not run more contrary to the Congressional desire that courts assure the nonbankrupt party the full benefit of his bargain." Note, supra note 11, at 1055.
\textsuperscript{117} One commentator has stated in the context of non-ipso-facto dissolution clauses that such a result "could not run more contrary to the Congressional desire that courts assure the nonbankrupt party the full benefit of his bargain." Note, supra note 11, at 1055.
\textsuperscript{119} Id. § 362(d) (1988).
\textsuperscript{120} For a discussion of the effect of the automatic stay and section 362(d) on partner bankruptcy and partnership dissolution, see supra note 90.
relationship and to incur liability for unwanted partnership expenses. Such a result violates fundamental precepts of partnership and contract law, and is not supported by bankruptcy policy.

There is little to indicate that allowing dissolution or termination of the insolvent partner’s management rights would seriously impair the reorganization prospects of the debtor partner, and thereby contradict the policy underlying Chapter 11. Under section 541 of the Code, the commencement of a bankruptcy action causes all “legal or equitable interests” of the debtor to become property of the debtor’s estate. These interests unquestionably include the debtor partner’s right to receive a portion of the partnership’s profits and surplus. If the underlying business is profitable, the remaining partners will most likely try to con-

121. It is fundamental that a partnership is terminable at the will of any partner. See UPA §§ 31(1)(b), 31(1)(c), 31(2), 6 U.L.A. 376 (1969); ULPA § 20, 6 U.L.A. 604 (1969); RULPA §§ 602, 603, 6 U.L.A. 362-63 (Supp. 1991); Smith, supra note 2, at 667; see also 2 S. Williston, A Treatise on the Law of Contracts § 307A, at 447 (3d ed. 1957) (personal element is of utmost importance in partnerships, and partners cannot be compelled to continue in the relationship).

122. As a rule, “a bankruptcy court may not extend a contract beyond its original terms.” In re Advent Corp., 24 Bankr. 612, 614 (Bankr. 1st Cir. 1982); accord White Motor Corp. v. Nashville White Trucks, Inc. (In re Nashville White Trucks, Inc.), 5 Bankr. 112, 117 (Bankr. M.D. Tenn. 1980). If a non-debtor party had a right to terminate the arrangement, that right survives the bankruptcy of the other contracting party. See Thompson v. Texas Mexican Ry., 328 U.S. 134, 142 (1946). Furthermore, promises to render personal services are not specifically enforced as a rule. See Restatement (Second) of Contracts § 367(1) (1981). Some courts and commentators have suggested that requiring the non-debtor partners to continue the partnership with a substitute partner may amount to involuntary servitude in violation of the thirteenth amendment. See In re Noonan, 17 Bankr. 793, 797-99 (Bankr. S.D.N.Y. 1982); J. Calamari & J. Perillo, supra note 6, at 860, see also U.S. Const. amend. XIII, § 2 (“[n]either slavery nor involuntary servitude ... shall exist within the United States”).

123. It is “difficult to argue that bankruptcy policy warrants a categorical approach that in effect commits any [partner] ... to a permanent and irrevocable relationship at the option of any partner who becomes a debtor under the bankruptcy laws[,]” nor is it the “function of bankruptcy law ... to impose relationships on persons.” Kennedy & Smith, supra note 6, at 872-73, 916; see also In re Waldron, 36 Bankr. 633, 638 (Bankr. S.D. Fla. 1984) (Section 365(c) carries out bankruptcy policy against use of “legal compulsion” to force a non-debtor party to accept or render personal services from or to the debtor or the trustee).


126. While opinion differs on whether the management rights of a partner become part of the debtor’s estate in bankruptcy, the sounder position is consistent with partnership law, and holds that such rights are non-assignable. See In re Priestley, 93 Bankr. 253, 259 (Bankr. D.N.M. 1988); L. Cherkis & L. King, Collier Real Estate Transactions and the Bankruptcy Code, 4-60.1 (1990); see also supra notes 75-76 and accompanying text (discussing partnership rights in general and non-assignability of management rights in particular). But see In re Cardinal Indus., Inc. 116 Bankr. 964, 982 (Bankr. S.D. Ohio 1990) (property of estate includes right to manage); Quarles House Apartments v. Plunkett (In re Plunkett), 23 Bankr. 392, 394 (Bankr. E.D. Wis. 1982) (same).
continue the partnership as a going concern\textsuperscript{127} rather than to proceed from dissolution to termination.\textsuperscript{128} This continuation may offer the debtor partner a choice in maximizing the return on his partnership interest; the debtor partner can retain the partnership interest and continue to receive the proceeds from partnership,\textsuperscript{129} or he can consent to a buy-out of his interest by the remaining partners\textsuperscript{130} or a third party.\textsuperscript{131} Where the partnership is unprofitable, however, the partners may follow dissolution through to termination or have the partnership file for bankruptcy protection.\textsuperscript{132} In either event, because the non-debtor partners will want to

\textsuperscript{127} "As a practical matter, dissolution no longer occurs in many large partnerships." 59A Am. Jur. 2d, \textit{Partnership} § 892 (1990).

\textsuperscript{128} The non-dissolving partners have a right to continue the partnership under both state partnership law, see UPA § 38(2)(b), 6 U.L.A. 456 (1969); ULPA § 20, 6 U.L.A. 604 (1969); RULPA § 801(4), 6 U.L.A. 375 (Supp. 1991), as well as under most partnership agreements. \textit{See} Kennedy II, \textit{supra} note 7, at 537 n.154; \textit{see also} Bromberg, \textit{supra} note 2, at 653 (UPA give partners a wide choice in formulating continuation agreements); 59A Am. Jur. 2d, \textit{Partnership} § 892 (1987) (causes of dissolution do not preclude the remaining partners from continuing the partnership); \textit{In re} Gibson, 67 Bankr. 957, 963 (Bankr. E.D. Mich. 1986) ("there is no sensible policy reason to require the liquidation, and hence, the sacrifice of a going concern when its owners are happy").

\textsuperscript{129} This result is consistent with the law of partnerships, which allows a partner to assign his right to receive the profits and surplus of a partnership without the consent of the other partners. \textit{See supra} notes 75-76 and accompanying text. Where the debtor is the general partner of a limited partnership, the debtor's interest can simply be converted from a general to a limited interest. \textit{See}, e.g., \textit{In re} Ancor Exploration Co., 30 Bankr. 802, 804-05 (N.D. Okla. 1983) (court upheld limited partnership agreement that provided for conversion of general partner to limited partner upon bankruptcy); L. Cherkis & L. King, \textit{supra} note 126, § 4.07 at 4-61 (economic rights of a bankrupt general partner can be protected by transformation into a limited partner's interest).

In some cases, as where the debtor partner's expertise or management skills are crucial to success, the non-debtor partners may actually consent to the debtor continuing as a general partner. This is always an option under section 365(c) and 365(e)(2). See 11 U.S.C. §§ 365(c)(1)(B), 365(e)(2)(A)(ii) (1988).

\textsuperscript{130} \textit{See}, e.g., \textit{Normandin} v. \textit{Normandin} (\textit{In re} Normandin), 106 Bankr. 14, 15 (Bankr. D. Mass. 1989) (partners may control by agreement method for determining price to be paid to outgoing partner); Connolly v. Nuthatch Hill Assoc. (\textit{In re} Manning), 37 Bankr. 755, 760 (Bankr. D. Colo. 1984) (upholding provision of partnership agreement allowing non-debtor partners to purchase partnership interest of partner causing dissolution), \textit{aff'd in part}, 831 F.2d 205 (10th Cir. 1987); \textit{see also} Eibl, \textit{supra} note 6, at 38 n.5 (partners can avoid dissolution by purchasing the entire partnership interest of the debtor partner). \textit{See generally}, Kennedy & Smith, \textit{supra} note 6, at 829-32 (discussing enforceability of buy-out provisions in partnership agreements).

Furthermore, should the partner consent to a buy-out by the remaining partners, the law clearly provides that the debtor partner must receive a fair price for his share. \textit{See} RULPA § 604, 6 U.L.A. 364 (Supp. 1991); \textit{see also} \textit{In re} Gibson, 67 Bankr. 957, 964 (Bankr. E.D. Mich. 1986) (partners must "agree on a fair settlement of their interests"); Bromberg, \textit{supra} note 2, at 668 (suggesting that continuation agreements can protect debtor partner even further by providing for "such vital tax features as the timing, amount, and character" of the outgoing partner's share); Kaster & Cymbler, \textit{supra} note 10, at 555 (although courts will enforce buy-out provisions, they must "carefully scrutinize the fairness of the buy-out price to be paid to the estate") (quoting L. Cherkis & L. King, \textit{supra} note 126, at 4-58).

\textsuperscript{131} \textit{See} \textit{supra} note 129.

\textsuperscript{132} Unless the partnership is experiencing financial difficulties, the non-debtor partners have little incentive to seek termination, because a partner is not entitled to demand
maximize the value of their own partnership interests, the debtor partner's economic interests remain aligned with those of the remaining partners and will be adequately protected.\(^{133}\) To the extent that the debtor's reorganization interests are impaired by dissolution and the loss of management rights, such impairment does not outweigh the non-debtor partners' interests in receiving the bargained-for benefits of the partnership agreement.\(^{134}\)

B. Ensuring Predictability

Predictability is a substantive goal of both contract and partnership law.\(^{135}\) Predictability requires that parties entering a contract anticipate certain events and expect to rely upon the terms of the contract should those events occur.\(^{136}\)

Decisions nullifying dissolution provisions of partnership contracts damage the predictability of those agreements. In light of the current state of the law, it is hard to tell whether the dissolution\(^{137}\) and non-assignability\(^{138}\) provisions of partnership agreements will be enforced and receive an interest in the liquidating partnership until after all assets are liquidated and all partnership debts are paid. See UPA § 40(b), 6 U.L.A. 469 (1969).

133. Should the debtor partner believe that winding-up by the non-debtor partners will prejudice his partnership interest, he can obtain judicially supervised liquidation if cause can be shown. See UPA § 37, 6 U.L.A. 444 (1969).

134. Put simply, a "bankruptcy filing may alter the fundamental elements of a bargain by changing the parties involved." Nimmer, supra note 11, at 537. The only "appropriate" remedy is to "release" the non-bankrupt party and allow him to "re-assess the continued desirability of the agreement in light of the changed circumstances." Id.; see also Kennedy & Smith, supra note 6, at 915-16 (suggesting an amendment to section 365 allowing state partnership law and the partnership agreement to control questions of dissolution and assumption of the partnership agreement).

135. Because parties normally will not enter into a contract if they are unable to foresee accurately their rights and liabilities under the contract, predictability is a prime objective of contract law. See Restatement (Second) Conflict of Laws § 187 comment e (1971). This objective manifests itself in two ways. First, parties will seek predictability in the contractual formation stage, by defining rights and allocating risks (such as a partner's bankruptcy) in as clear and as comprehensive a manner as possible. Second, predictability requires that parties be able to rely upon their agreement. To the extent that courts do not honor the provisions of such agreements or of applicable law, uncertainty replaces predictability, with the result that the incentive for certain contractual formulations disappears and commerce breaks down. See Comment, Lender Liability for Breach of the Obligation of Good Faith Performance, 36 Emory L.J. 917, 970 (1987); see also Goetz & Scott, The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms, 73 Calif. L. Rev. 261, 301 (1985) (an important goal of contract drafters is "to create a contract that a court will interpret in a predictable way").

136. As one commentator has explained, "a set of voluntary decisions and negotiations precede the creation of the underlying contract. These negotiations and decisions are influenced by the perceived risks of the proposed transaction, including the risk that one party will file [for] bankruptcy." Nimmer, supra note 11, at 507.

137. Compare cases upholding partnership dissolution, supra note 9, with cases not allowing dissolution, supra note 12.

138. Compare In re Tip O Texas RV Village, 87 Bankr. 195, 198 (Bankr. M.D. Fla. 1988) (holding that partner's management interest is not assignable); Tyler v. Walde (In
On a practical level, this has created significant confusion for partners and partnership drafters alike.\textsuperscript{139} Non-dissolution decisions have also undermined basic tenets of partnership law, including a partner's right to dissolve the partnership relation at will,\textsuperscript{140} the dissolution of the partnership upon the bankruptcy of a general partner,\textsuperscript{141} and the partners' ability to reject substitute performance of the partnership agreement.\textsuperscript{142} In so doing, these decisions have decreased the degree to which parties interested in forming partnerships may rely upon the protections of the well-established body of partnership law in formulating their agreements. Such decisions have also de-stabilized the delicate balance between partnership and bankruptcy concerns currently embodied in the Code. The drafters of the Code could not have intended such a result.\textsuperscript{143}

Finally, the fiduciary nature of partnership relations requires that partners be allowed to determine who will be members of their partnership family and when that relationship will come to an end. By undermining this basic provision of partnership law, and by protecting the interests of the debtor over non-debtor partners, courts have unjustifiably increased the risks and the uncertainties facing partners.\textsuperscript{144}

\textsuperscript{139} See supra note 20 and accompanying text.

\textsuperscript{140} See supra note 121 and accompanying text.

\textsuperscript{141} See supra notes 12-19 and accompanying text.

\textsuperscript{142} See supra note 88.

\textsuperscript{143} The partnership is a highly desireable and prevalent form of business organization, offering flexibility and unique benefits not found in other business forms. See Bromberg, supra note 2, at 668. See generally Volz, supra note 92, §§ 1.03-1.04 at 2-14 (comparing and discussing benefits of corporation and partnership business forms). In enacting the Bankruptcy Code, therefore, it is unlikely that Congress intended to subvert the underpinnings of partnership law or to undermine the partnership as a reliable and attractive form of business organization. Nor is it likely that such a result would be permissible. As one court has stated: "[b]ankruptcy legislation . . . cannot be applied so as to render an equally well-intended body of state law to be nugatory." Williams v. Holt (In re Holt), 40 Bankr. 1009, 1011 (S.D. Ga. 1984); see also City of New York v. Quanta Resources Corp. (In re Quanta Resources Corp.), 739 F.2d 912, 919 (3d Cir. 1984) ("goals of the federal bankruptcy laws, including rehabilitation of the debtor, do not authorize transgression of state laws setting requirements for the operation of the business even if the continued operation of the business would be thwarted by applying state laws") (emphasis added), aff'd sub nom., Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Protection, 474 U.S. 494 (1986); Nimmer, supra note 11, at 552 ("federal Bankruptcy Code cannot be examined solely on the basis of [its] internal effects within the bankruptcy system and [its] impact on individual parties," but also must be examined on the basis of its effect on "more general and economic and social processes").

\textsuperscript{144} Ironically, these risks and uncertainties may pose significant problems for future debtor partners. For example, Professor Nimmer hypothesizes that the invalidation of relatively inexpensive termination clauses will lead to more costly alternatives, see Nimmer, supra note 11, at 554, while Professor Fogel suggests that parties to personal service contracts (i.e. partners) should abandon the contract when a party's bankruptcy seems imminent. See Fogel, supra note 10, at 350-51.
CONCLUSION

While many courts have upheld the dissolution provisions of state partnership law and of the partnership agreements themselves, others have relied upon section 365(e) of the Bankruptcy Code and public policy arguments to prohibit dissolution when a general partner files for bankruptcy.

Section 365(e)(2), however, must be read to relieve partnership agreements from the nullifying effect of section 365(e)(1). Partnership agreements are personal service contracts and are non-delegable under both general contract and partnership law. Furthermore, whether assumption of the agreement is by the trustee, the debtor in possession or a third-party assignee, each of these scenarios amounts to prohibited substitute performance. This conflict, therefore, precludes the possibility that the debtor partner can assume or continue to perform the partnership agreement.

The bankruptcy courts should specifically enforce the dissolution provisions of partnership agreements, including the relevant state law provisions that are implicit in every partnership agreement. Such a standard will recognize the fragile, fiduciary nature of the partnership relation, while balancing the rehabilitative interests of the debtor partner with the interests of the non-debtor partners in protecting the benefit of their bargain. Finally, and perhaps most importantly, strict adherence to dissolution provisions will promote predictability for specific partnership agreements, and will stabilize the interplay between partnership and bankruptcy law.

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