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A HISTORICAL VIEW OF LIMITED PARTNERSHIP ROLL-UPS: CAUSES, ABUSES, AND PROTECTIVE STRATEGIES

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INTRODUCTION

The limited partnership has a long history as an investment vehicle and business organizational form.[1] In the 1970s and 1980s, Congress enacted statutory changes intended to alter the limited partnership's conceptualization as an investment vehicle and business organization to reflect more accurately both the tax incentives of the investor and the financing requirements of the limited partnerships.[2] Section I of this Article describes the limited partnership's history. Section II discusses the impact of the various partnership statutes on the reorganization of limited partnerships.

Economic conditions in the latter half of the 1980s had a major impact on

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1. ALAN R. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP § 2 (1968). Bromberg indicates that partnerships, as profit seeking arrangements, date back to Babylonia and continue through classical Greece and Rome. Limited partnerships as a specialized form were recognized in the courts of England, using equity principles, and were known as the Commenda or Societe en Commandite in continental Europe. Later cases were decided by common law courts using mercantile customs supplemented by the civil law. The extensive use of partnerships in the nineteenth century resulted in codification to reduce confusion and uncertainty. In the United States the Uniform Partnership Act and the Uniform Limited Partnership Act were completed in 1914 and 1916 respectively. *Id.* § 2, at 10-13.

2. *See* 3 ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 11.02(c)-(d) (1994). In 1976, the National Conference of Commissioners on Uniform State Laws ("the Conference") adopted a revision to the Uniform Limited Partnership Act of 1916 ("ULPA") intending to modernize the ULPA after sixty years of experience and major economic change in the United States. REV. UNIF. LTD. PARTNERSHIP ACT, 6 U.L.A. 347-48 (1976) (prefatory note). In 1985, the Conference adopted amendments to the 1976 Act. *See* REV. UNIF. LTD. PARTNERSHIP ACT, 6 U.L.A. (1985).

The Uniform Limited Partnership Act of 1916 and the Revised Uniform Limited Partnership Act of 1976 and 1985 are discussed throughout this article. The 1916 Act will be cited as the "U.L.P.A. (1916)." The 1976 revision will be cited as the "R.U.L.P.A. (1976)." The 1985 amendments will be cited as the "R.U.L.P.A. (1985)."

The Uniform Partnership Act of 1914 and 1993 will be cited as the "U.P.A. (1914)" and the "U.P.A. (1993)" respectively.

the asset values of many limited partnerships.[3] During the same period, Congress changed the Internal Revenue Code, radically reducing the tax advantages of using the limited partnership form.[4] Section III details the manner in which these variables provided incentives for the use of limited partnership roll-up transactions.

Economic and tax changes resulted in a wave of reorganization and attempted reorganization.[5] These reorganizations, often described as "roll-ups," take several technically distinguishable forms.[6] For purposes of this introductory discussion, the term "roll-up" will generally describe the reorganization of one or more limited partnerships into a new investment vehicle. Many investors involved in a roll-up suffered large economic losses.[7] It is not clear what portion of those losses may be ascribed to the reorganization transaction[8] and what portion resulted from the forced market recognition of the diminished value in the underlying assets.[9]

The long history of limited partnerships as investment vehicles and organizational forms provides a testament to their societal value.[10] Maintaining this value mandates that investors in limited partnerships requiring reorganization be afforded adequate protection from unscrupulously and incompetently planned roll-ups.[11] This protection must not, however, jeopardize this valuable form of business organization. Section IV describes the various attempts, through legislation and regulation, to accomplish such "efficient" protection.

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3. *See infra* part III.A.

4. *See infra* part III.B.

5. *See infra* part III.C.

6. The reorganization "roll-up" transaction extends the life of a limited partnership, combines two or more limited partnerships into a limited partnership with a longer term, or reorganizes one or more limited partnerships into a new entity. *See infra* part II.

7. Anthony Carideo, *More Roll-ups Likely to Leave Investors Feeling Rolled Over*, STAR TRIB., Feb. 17, 1991, at D1; Kirstin Downey, *Partnership "Roll-ups" Leave Some Investors Down*, WASH. POST, Feb. 15, 1991, at F1; Laura Evenson, *Probers Turn Attention to Real-estate Roll-ups Technique Said to Cost Investors $1.6 Billion*, S.F. CHRON., Oct. 3, 1990, at C1; David Satterfield, *Roll-ups are Financial Deals that Often End in More Losses*, MIAMI HERALD, Apr. 21, 1991, at K1; Richard D. Wollack, *Partnership Roll-ups Hurt Small Investors, Economy*, S.F. CHRON., Feb. 24, 1992, at D5.

8. As a result of the multiple roll-up transactions available and the fees and costs inherent in such transactions it is difficult to isolate the economic impact of the transaction itself. *See infra* part II.

9. In a setting of diminished value in the underlying assets and costs of the transaction itself, it is difficult to specifically quantify the proportional source of the investor's loss. *See infra* part III.A.

10. *See supra* note 1.

11. *See* Deborah A. Demott, *Rollups of Limited Partnerships: Questions of Regulation and Fairness*, 70 WASH. U.L.Q. 617 (1992); Larry E. Ribstein, *Unlimited Contracting in the Delaware Limited Partnership and Its Implications for Corporate Law*, 16 J. CORP. L. 299 (1991); Craig B. Smith, *Limited Partnerships — Expanded Opportunities Under Delaware's 1988 Revised Uniform Limited Partnership Act*, 15 DEL. J. CORP. L. 43 (1990); Kenneth R. Hillier, Note, *Rolling Down the Curtain on "Roll-ups": the Case for Federal Legislation to Protect Limited Partners*, 90 MICH. L. REV. 155 (1991); John A. Sellers, Comment, *Publicly Traded Limited Partnerships: are the Limited Partners Being Rolled Over in Roll-ups?*, 69 U. DET. MERCY L. REV. 627 (1992).

This Article features a survey of the Limited Partnership Roll-up Reform Act of 1993 and assesses the impact of remedial efforts in the context of a balanced response which provides investor protection without destroying the efficacy of an evolving useful reorganizational tool.

I. DEVELOPMENT OF THE LIMITED PARTNERSHIP AND ITS STATUTORY REGULATION

A historical view of the limited partnership provides insight into its value as an investment vehicle and an organizational tool. The common law developed the general partnership as the basic model for organization of a business enterprise.[12] In 1902, the Conference of Commissioners of Uniform State Laws ("the Conference") set out to codify these developments. By 1914 the Uniform Partnership Act (UPA) was recommended to the states.[13] The virtues of the general partnership included its ease of formation,[14] informality of operation,[15] and potential for internal flexibility resulting from the partnership agreement.[16] However, unlimited personal liability[17] and the fragility of the organization[18] created unacceptable risks for some investors.

The historical alternative to the general partnership was the chartered corporation, of the eighteenth and nineteenth centuries, succeeded by the statutory corporation of the late nineteenth and twentieth centuries.[19] This organizational model provided limited liability for passive investors, continuity of life, and formal operations.[20] Prior to broad acceptance of the close corporation, however, the public corporation model proved cumbersome and ill-suited to a business organization lacking the characteristics of a large public corporation.[21]

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12. *See* LARRY E. RIBSTEIN, BUSINESS ASSOCIATIONS § 1.04 (2d. ed. 1990).

13. *See* 1 BROMBERG & RIBSTEIN, *supra* note 2, § 1.02(b).

14. *See* U.P.A. § 6 (1914) (defining a partnership as "an association of two or more persons to carry on as co-owners a business for profit"); U.P.A. § 7 (1914) (providing rules for determining the existence of a partnership).

15. *See* U.P.A. § 18(e) (1914) (providing that "[a]ll partners have equal rights in the management and conduct of the partnership business").

16. *See* U.P.A. § 18 (1914) (providing that "[t]he rights and duties of the partners in relation to the partnership shall be determined, *subject to any agreement between them*") (emphasis added).

17. U.P.A. § 15 (1914) provides: "[a]ll partners are liable (a) Jointly and severally for everything chargeable to the partnership under sections 13 [partner's wrongful acts] and 14 [partner's breaches of trust]. (b) Jointly for all other debts and obligations of the partnership."

18. *See* U.P.A. § 29 (1914): "[t]he dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business."

19. *See* RIBSTEIN, *supra* note 12, § 1.04.

20. *See id.* § 1.02[C][3]; REV. MODEL BUSINESS CORP. ACT § 6.22 (1984) (providing for limited liability of shareholders); REV. MODEL BUSINESS CORP. ACT § 8.01(b) (1984) (providing the affairs of the corporation be managed by a board of directors).

21. A famous, oft-quoted opinion recognizing the need for broad recognition of close corporation concepts is Galler v. Galler, 203 N.E.2d 577 (Ill. 1964).

The limited partnership offered a model for investors dissatisfied with the polar models.[22] The limited partnership was used most often by passive investors desiring protection from creditors, and by non-public ventures of a limited duration in need of protection from unexpected dissolutions.[23] Nineteenth-century state experiments with statutory models resulted in the Conference's recommendation of the Uniform Limited Partnership Act of 1916 (ULPA).[24] Courts generally measured compliance with this unique statute in a strict manner.[25]

The development of potential pitfalls under the ULPA resulted in a less than uniform application among the adopting states.[26] Difficulties centered around a series of provisions. First, the formality of formation made entry or exit before dissolution difficult. In order to form a limited partnership each member had to sign and swear to a certificate of limited partnership which was filed with the state.[27] Any addition or substitution of limited partners required all members of the partnership to sign and swear to an amendment to the certificate.[28] In addition, a limited partner could only assign his or her interest to a substituted limited partner (requiring unanimous consent of the other partners) or to an assignee with limited rights.[29] Second, the conditioning of limited liability on a limited partner's non-participation in control of the business[30] resulted in ambiguous interpretations and potential oppression of limited partners.[31] This second factor also diminished the importance of the limited partnership agreement, because attempts to provide voting protection for limited partners risked exposing such limited partners to unlimited liability.[32] Finally, the absence of provisions governing potential litigation to correct abuses created intolerable conflicts.[33]

Three models—general partnership, limited partnership, and the corporation—represented options for business organization and investment in the early twentieth century. Choices were relatively straightforward. Balancing advantages and disadvantages of each form resulted in a choice for investors and entrepreneurs as to which form best suited their perceived needs. From the standpoint of the entrepreneur, an appropriate business organizational form provided a managerial model consistent with the business enterprise and at-

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22. *See* 3 BROMBERG & RIBSTEIN, *supra* note 2, § 11.01(b)-(c) (comparing limited partnerships with general partnerships and corporations).

23. *See id.* § 12.01 (discussing the nature, definition, and scope of limited partnerships).

24. *See* U.L.P.A. (1916).

25. BROMBERG, *supra* note 1, § 26(a), at 144 & n.25.

26. *See id.* § 2, at 13-14.

27. U.L.P.A. § 2 (1916).

28. U.L.P.A. § 8 (1916) (requiring amendment to certificate for addition of limited partners); U.L.P.A. § 25(1)(b) (1916) (requiring amendment to certificate adding or substituting limited partners be signed and sworn to by all members, the added or substituted limited partner, and the assigning limited partner in the case of substitution).

29. U.L.P.A. § 19 (1916).

30. U.L.P.A. § 7 (1916).

31. *See* BROMBERG, *supra* note 1, § 26(c).

32. *See* 4 BROMBERG & RIBSTEIN, *supra* note 2, § 15.15(f).

33. *See generally* U.L.P.A. (1916).

tractive to potential investors in that particular economic area. For a small managerial group desiring substantial control over the enterprise, the general partnership was of some utility, but unlimited liability made it a flawed model. On the other hand, unless the business enterprise was large and carried a high likelihood of success, the corporate model could prove too expensive and speculative to attract capital.

Thus, because the general partnership proved unattractive to potential investors and the corporate form proved to be economically risky, the limited partnership was attractive to investors and management. For the investor desiring limited liability and no active participation in management, the limited partnership offered possibilities unavailable in a statutory corporation.[34] The passive investor could assure limitation of the nature of the economic project,[35] limitation on the duration of the project,[36] and a dissolution and liquidation which would conform to a predetermined statutory model.[37]

Beginning in the mid-1930's, the fact that typical state statutes' restrictions on public corporations, while appropriate for public corporations, were less well suited to corporations which were more private in nature began to be recognized.[38] Thus arose the "close" corporation.[39] This term referred to a business organization possessing characteristics which enabled a court to interpret legislative models less restrictively.[40] Eventually, legislatures recognized this need and developed statutory close corporations.[41] Absent other external developments, the popularity of, and need for, the limited partnership might have been destroyed by the rise of the close corporation.

The increases in individual marginal income tax rates and corporate tax rates were the major external developments reinforcing the continuing need for limited partnerships. These two significant external events impacted heavily on

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34. *See* 3 BROMBERG & RIBSTEIN, *supra* note 2, § 11.01(c) (comparing corporations and limited partnerships); RIBSTEIN, *supra* note 12, § 2.04[A] (discussing reasons for selecting limited partnerships).

35. *See* U.L.P.A. § 2(1)(a)(II) (1916) (requiring the character of the partnership business be included in the certificate of limited partnership); U.L.P.A. § 24(2)(f) (1916) (requiring amendment to certificate for "change in the character of the business of the partnership"); U.L.P.A. § 25(1)(b) (1916) (requiring amendment to certificate to be signed and sworn to by all members of the partnership).

36. *See* U.L.P.A. § 2(1)(a)(V) (1916) (requiring the term for which the partnership is to exist be included in the certificate of limited partnership); U.L.P.A. § 24(2)(h) (1916) (requiring amendment to certificate for change in the time for dissolution of the partnership); U.L.P.A. § 25(1)(b) (1916) (requiring amendment to certificate to be signed and sworn to by all members of the partnership).

37. *See* U.L.P.A. § 23 (1916).

38. *See* CHARLES R. O'KELLEY, JR. & ROBERT B. THOMPSON, CORPORATIONS AND OTHER ASSOCIATIONS 359-60 (1992) (noting that corporate law norms may be less suitable for the typical closely held corporation than for publicly held firms).

39. *See* Galler v. Galler, 203 N.E.2d 577 (Ill. 1964) (discussing close corporations); Clark v. Dodge, 199 N.E. 641 (N.Y. 1936) (for an early ambiguous case on close corporations).

40. *See Galler*, 203 N.E.2d at 584.

41. *See, e.g.*, REV. MODEL BUSINESS CORP. ACT (1984) (providing an example of an integrated statute).

business organizational forms. High individual marginal tax rates created a need to "shelter" distributions to individual investors. The second development, higher corporate rates (which worsened the "double taxation" phenomenon) reduced investors' after-tax income.[42] This created substantial tax disincentives to the use of the close corporation, especially when distributions to "passive" investors were needed to make their investments attractive.[43] This second problem could be solved by "passing through" the income of the business organization to individual investors, avoiding double taxation to individuals. The basic system of taxation for partnerships allowed income to "pass through."[44] As a result, this externality to issues of business organization became an important driving force in the choice of business organizational form. The entrepreneur found her choice dominated by the external tax impact on the needed passive investors. The renewed prominence of the limited partnership as a tax sheltering business organizational form in the 1970s and 1980s resulted in changes to the governing uniform statute.[45] These changes took place in a number of substantive areas, each of which will be discussed separately.

First, there was change in the uniform statute's requirements in the certificate of limited partnership. The ULPA operated on the premise that limited partnerships existed only by statutory authorization.[46] Necessary for compliance with statutory requirements was the partners' sworn execution and recorded filing of a certificate of limited partnership.[47] Section 2 of the ULPA required the inclusion of substantial detail in that document.[48] Consequently,

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42. *See* WILLIAM H. PAINTER, CORPORATE AND TAX ASPECTS OF CLOSELY HELD CORPORATIONS 10-11 (2d ed. 1981). The "double taxation" concept is straightforward. The net taxable income of the corporation is subject to tax at a rate dependent upon the level of income. Any distributions to investors would be made from the after-tax income of the corporation and would then again be subject to taxation at the rate applicable to the distribution receiving investor. *See id.* The details of the deduction available and the tax computation are complex, but the basic concept is straightforward.

43. *See id.* (noting that the double taxation of close corporations is a disadvantage). Since 1982 there has been tax relief available for subchapter S corporations but only under the details of qualification for such an election. *See* I.R.C. §§ 1361-1379 (West 1994). These limitations are restrictive to the formation and operations of the business organizational model.

44. *See* I.R.C. § 701 (West 1994) which provides: "[a] partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities."

45. *See* R.U.L.P.A. (1976); R.U.L.P.A. (1985).

46. *See* U.L.P.A. § 1 (1916) defining a limited partnership as: "A limited partnership is a partnership formed by two or more persons *under the provisions of Section 2*, having as members one or more general partners and one or more limited partners." (emphasis added). Thus, its existence is dependent upon meeting the provisions of U.L.P.A. § 2 (1916).

47. *See* U.L.P.A. § 2 (1916).

48. U.L.P.A. § 2(1)(a) (1916) required:

(1) Two or more persons desiring to form a limited partnership shall

(a) Sign and swear to a certificate, which shall state

I. The name of the partnership,

II. The character of the business,

III. The location of the principal place of business,

the limited partnership certificate became the dominant governing document for the operation of the business organization. Rigid detail was further complicated by statutory requirements relating to the amendment of the certificate.[49] Such rigid requirements reduced the flexibility of operation and created substantial "hold-out" power for each investor. Both the 1976 Revised Uniform Limited Partnership Act and the 1985 amendments substantially reduced the required inclusions in the formal certificate.[50] The 1985 amendments reduced required inclusions in limited partnership certificates to the partnership name and address, the name and address of general partners, and the latest date for dissolution.[51] Such changes meant that the partnership agreement replaced the limited partnership certificate as the critical governing document.[52] This change in the formal requirements removed one of the disincentives to the use of limited partnerships and provided broad latitude for negotiating the terms of the relationships of the partners *inter se*.[53]

> IV. The name and place of residence of each member; general and limited partners being respectively designated,
> V. The term for which the partnership is to exist,
> VI. The amount of cash and a description of and the agreed value of the other property contributed by each limited partner,
> VII. The additional contributions, if any, agreed to be made by each limited partner and the times at which or events on the happening of which shall be made,
> VIII. The time, if agreed upon, when the contribution of each limited partner is to be returned,
> IX. The share of the profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution,
> X. The right, if given, of a limited partner to substitute an assignee as contributor in his place, and the terms and conditions of the substitution,
> XI. The right, if given, of the partners to admit additional limited partners,
> XII. The right, if given, of one or more of the limited partners to priority over other limited partners, as to contributions or as to compensation by way of income, and the nature of such priority,
> XIII. The right, if given, of the remaining general partner or partners to continue the business on the death, retirement or insanity of a general partner, and
> XIV. The right, if given, of a limited partner to demand and receive property other than cash in return for his contribution.

Id.

49. *See* U.L.P.A. § 25 (1916) (requiring a sworn writing signed by all members of the partnership).

50. *See* R.U.L.P.A. § 201(a) (1985).

51. *Id.*

52. R.U.L.P.A. § 201 cmt. (1985) provides:

> The 1985 Act requires far fewer matters to be set forth in the certificate of limited partnership than did Section 2 of the 1916 Act and Section 201 of the 1976 Act. This is recognition of the fact that the partnership agreement, not the certificate of limited partnership, has become the authoritative and comprehensive document for most limited partnerships. . . .

Id.

53. The flexibility resulting from the use of the partnership agreement as the critical document is recognized in other sections of the 1985 Act as well. *See, e.g.*, R.U.L.P.A. § 302 (1985) (providing that "the partnership agreement may grant to all or a specified group of the limited partners, the right to vote"); R.U.L.P.A. § 401 (1985) (providing that "additional general partners may be admitted as provided in writing in the partnership agree-

Second, there was a change in the limited liability of the limited partner. Under the ULPA, limited liability was dependent upon the passive nature of the investor.[54] Section 7 of the ULPA provides, "[a] limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business."[55] The ambiguity of this broad statement made protection of the passive investor hazardous. Consultation with, or decision making by, limited partners created the risk of participation in the "control of the business."[56] Section 303 of the RULPA, while retaining the general preclusion of participation in the control of the business, changed its scope in two ways.[57] First, liability as a result of participation in control requires reliance on the limited partner's conduct as a general partner.[58] Second, the statute now identifies a list of acts which by themselves do not constitute participation in the control of the business.[59] Significant items on this list are: (1) managerial roles of a corporate general partner; (2) consulting with, or advising, the general partner; (3) participating in a derivative action on the part of the partnership; (4) requesting or attending a meeting of partners; (5) proposing and voting on matters related to dissolution, sale or exchange of partnership assets, incurring partnership indebtedness other than in the ordinary course of business, a change in the nature of the business, membership of general or limited partners, acts to amend the partnership agreement or certificate of partnership; or (6) participating in approval of matters designated in the partnership agreement as subject to limited partner approval or disapproval.[60] Thus, outside of daily management activities, limited partners may become extensively involved in policy planning and approval, and more effectively protect their investments, without risking general liability to creditors.

Third, there was a change in the limited partner's ability to insure an early return of funds invested in the organization. Under the ULPA the formal certificate of limited partnership was required to identify the term of the partner-

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ment"); R.U.L.P.A. § 503 (1985) (providing that "profits and losses of a limited partnership shall be allocated among the partners, and among classes of partners, in the manner provided in writing in the partnership agreement").

54. U.L.P.A. § 1 cmt. (1916) (noting that one fundamental principle of the ULPA is that a limited partner is a partner in all respects, except that to retain limited liability he or she must comply with the statutory requirements of the certificate and refrain from participation in the conduct of the business).

55. U.L.P.A. § 7 (1916).

56. *See* Stephen I. Burr, *The Potential Liability of Limited Partners as General Partners*, 67 MASS. L. REV. 22, 23-27 (1982) (discussing judicial decisions concerning the meaning of "control of the business").

57. *See* R.U.L.P.A. § 303 (1985).

58. R.U.L.P.A. § 303(a) (1985) provides that "if the limited partner participates in the control of the business, he [or she] is liable only to the persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner."

59. R.U.L.P.A. § 303(b) (1985).

60. *Id.*

ship,[61] the time for return of contribution if agreed,[62] and the right (if available) and terms of limited partner substitution.[63]

Significantly, amendment of these restrictions was conditioned upon the unanimous agreement of all partners,[64] creating in each partner veto power over any change in the term of the investment. Furthermore, the restrictions on alienation rendered uncertain any limited partner's attempt to recoup an investment by transferring the limited partnership interest for consideration. Assigning an interest to a substitute limited partner would require either permission in the certificate to substitute limited partners,[65] or the unanimous amendment of the certificate.[66] Finally, although the statute provided for assignment of a limited partnership interest without substitution[67] (avoiding a unanimous vote) the assignee's limited rights[68] made such assignments difficult to negotiate.

The illiquidity resulting from these statutory proscriptions received special attention by the drafters of the RULPA and its 1985 amendment. The model for resolution of the problem was incorporated into several parts of the RULPA. First, the certificate of limited partnership no longer requires either the names of, nor sworn execution by, limited partners.[69] Thus, no statutory unanimous execution of the certificate is required. In its place, the partnership agreement becomes the governing document.[70]

Under the RULPA, the partnership agreement may now identify in writing the date or events that permit withdrawal by any limited partner.[71] As a result of this provision, unless the partnership agreement provides otherwise, the withdrawing limited partner "is entitled to receive, within a reasonable time after withdrawal, the fair value of his [or her] interest in the limited partnership as of the date of withdrawal."[72] Additionally, partnership interests are now assignable in the absence of preclusion by the partnership agreement.[73] More importantly, the agreement itself can create the power in the assignor to grant limited partner status in the assignee.[74] Thus, the negotiated partnership

61. U.L.P.A. § 2(1)(a)(V) (1916).
62. U.L.P.A. § 2(1)(a)(VIII) (1916).
63. U.L.P.A. § 2(1)(a)(X) (1916).
64. U.L.P.A. § 25(1)(b) (1916).
65. U.L.P.A. § 2(1)(a)(X) (1916).
66. U.L.P.A. § 25 (1)(b) (1916).
67. U.L.P.A. § 19(1) (1916).
68. U.L.P.A. § 19(3) (1916).
69. R.U.L.P.A. § 201 (1985).
70. *See* R.U.L.P.A. § 201 cmt. (1985) (noting that the partnership agreement has become the authoritative document of limited partnership).
71. R.U.L.P.A. § 603 (1985) (providing a limited partner with the right to withdraw from the partnership at the happening of events specified in the partnership agreement or upon six months notice to each general partner if the partnership agreement does not specify a definite time for dissolution or specific events for withdrawal).
72. R.U.L.P.A. § 604 (1976).
73. R.U.L.P.A. § 702 (1976).
74. R.U.L.P.A. § 704 (1985) provides that "[a]n assignee of a partnership interest . . . may become a limited partner if and to the extent that (i) the assignor gives the assignee that right in accordance with authority described in the partnership agreement, or (ii) all other partners consent." *Id.*

agreement could make alienation possible and practical. This third alternative of distribution to all partners upon early dissolution appeared to require unanimity under the ULPA[75] or a judicial dissolution,[76] neither of which were of much aid to liquidity. In an attempt to clarify the right to dissolution, the RULPA provided for non-judicial dissolution either at the time specified in the certificate[77] or upon the happening of events specified in the partnership agreement.[78] Under the RULPA, judicial dissolution is permissible when "it is not reasonably practicable to carry on the business in conformity with the partnership agreement."[79] Thus, one could negotiate terms for a dissolution, perhaps as a liquidity option of last resort.

Fourth, there was a change in the concept of standing. The ULPA did little to clarify the historically confused concept of standing in the partnership context. The ULPA provided that "[a] contributor, unless he is a general partner, is not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to the partnership."[80] Thus, except in those narrow circumstances where the substantive theory was based upon a duty owed directly to the limited partner *and* the injury was sustained directly by the limited partner, a limited partner did not have standing in a proceeding by or against a partnership.

With the advent of the flexibility resulting from the predominance of the partnership agreement, this ambiguity concerning the source of the power to bring causes of action required clarification. The RULPA drafters chose the entity concept unambiguously and provided for the addition of derivative actions in limited partnerships.[81] As a result, limited partners had the statutory power to act, irrespective of the complications of entity theory, because the action could be instituted in the form of a class action or derivative suit as the theory required, while retaining the financial efficiency of a multi-party action.[82]

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75. *See* U.L.P.A. § 2(1)(a)(V), (VIII) (1916) (requiring the certificate of limited partnership to include the partnership term and the time for contribution); U.L.P.A. § 25(1)(b) (1916) (requiring unanimous consent to any amendment of the certificate).

76. The limited partner's right to judicial dissolution was narrow and ambiguous. U.L.P.A. § 10(1)(C) (1916) provides that "[a] limited partner shall have the same rights as a general partner to . . . [h]ave dissolution and winding up by decree of court." However, the ULPA did not grant specific statutory powers to a general partner to "have a dissolution." Section 16 of the ULPA allowed the limited partner to demand return of contribution or dissolution only when he or she could rightfully do so under the certificate of limited partnership. U.L.P.A. § 16 (1916).

77. R.U.L.P.A. § 801(1) (1985).

78. R.U.L.P.A. § 801(2) (1985).

79. R.U.L.P.A. § 802 (1985).

80. U.L.P.A. § 26 (1916).

81. *See* R.U.L.P.A. § 1001 (1985):

> A limited partner may bring an action in the right of a limited partnership to recover a judgment in its favor if general partners with authority to do so have refused to bring the action or if an effort to cause those general partners to bring the action is not likely to succeed.

Id. For details of the procedure under this section see, R.U.L.P.A. §§ 1002-04 (1985).

82. *See* R.U.L.P.A. §§ 1001-04 (1985).

II. TRANSACTIONAL MODELS FOR REORGANIZING LIMITED PARTNERSHIPS

While the ULPA served a useful purpose, modern business organization and finance had become too sophisticated for the 1916 statute.[83] In order to retain the efficiency of limited partnerships a more flexible enabling statute was required. With the development of increased marginal tax rates and the consequent need for sheltering income, the need for revision became more pressing. The RULPA and its amendments represented reactions to these developments. The RULPA's flexibility and reliance upon the partnership agreement constituted a reasoned response to this need.

The impact of the RULPA and its amendments on the subsequent and unanticipated need for reorganization of the limited partnership entity seems inadvertent but rational within the developed scheme. The RULPA created a system in which a bargained-for agreement could meet the developing needs of a changing economy.[84] The measure of rigidity retained by the 1976 Act was intended to protect creditors, not parties to the bargain, in their dealings with the limited partners.[85]

Typically, passive investors would be reasonably economically successful, with a desire for cash flow, negligible income, and/or pass-through losses. The partnership would create (or purchase and manage) assets which would produce those results for a limited period of time and which, at the end of that period, could be sold to return the investment with tax advantages.[86] Certain events, however, could frustrate the cash flow objectives and render unsound the anticipated sale of the assets at the scheduled time of dissolution and subsequent distribution. In such a circumstance, a postponement of liquidation, through some form of reorganization, appears desirable.[87] There are a number of transactional models for reorganization of limited partnerships for the pur-

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83. One of the major developments which radically changed one use of limited partnerships was the potential for their change in size. As opportunities for large scale economic developments in real estate, oil and gas, and other large projects offered tax sheltering advantages, due to tax pass-throughs of expenses, the potential for large groups of limited partners presented itself. In one format the passive investors received traditional limited partnership interests usually in private placements. Another format for the large offering was to place the limited partnership interest in trust and have the trustee offer participation units in the trust. This format, most commonly referred to as a master limited partnership, could provide registration and trading in these resultant limits. The transactions available in this modern setting were inconsistent with smaller privately held enterprises which were provided for by the ULPA. Thus, a Revised Act suitable to these potential transactions was needed.

84. *See* R.U.L.P.A. § 201 cmt. (1985) (noting that the partnership agreement has become the authoritative document of the limited partnership).

85. *See, e.g.*, R.U.L.P.A. § 303 (1985) (liability to third parties); R.U.L.P.A. § 403(b) (1985) (liabilities of general partners); R.U.L.P.A. § 607 (1985) (limitations on distribution); R.U.L.P.A. § 804(1) (1985) (priorities in the distribution of assets).

86. This is a paradigm of the persons involved in a limited partnership tax shelter and their traditional desires.

87. The concept described is predicated upon a judgment that the assets have value, but due to external conditions they are temporarily undervalued. Liquidation at the scheduled time would be financially undesirable and there should be reason to believe that the ability to postpone the liquidation would have economic benefits to the investors.

pose of postponement of liquidation. In discussing the transactional models for reorganization, it is helpful to compare the statutory impact of the ULPA and the RULPA on such reorganizations.

A. *Pure Extension by Amendment*

The most straightforward approach to reorganization is to extend the term of the partnership and establish a new date for the asset sale and subsequent dissolution. Even this simple transaction proved difficult under the old ULPA, primarily because the basic governing document was the certificate of limited partnership.[88] The ULPA required the term of the partnership and the time for return of the limited partner's contribution to be included in the certificate of limited partnership.[89] A change in the certificate required an amendment signed and sworn to by all members of the partnership.[90] This could prove both cumbersome and exceedingly difficult in many situations. If the dates in the certificate were ignored and no attempt to amend was made, each limited partner would be entitled to demand return of the contribution[91] or, if the demand was unsuccessful, dissolution of the partnership.[92]

The RULPA provides a less formal means of accomplishing the pure extension by amendment. It requires the certificate of limited partnership state the last time at which the limited partnership may dissolve.[93] However, amendment may be made for a proper purpose at the discretion of the general partners.[94] Additionally, due to the informality under the RULPA, the certificate no longer requires the sworn execution of all the partners.[95] Thus, changes in the partnership term are less difficult under the RULPA than under the ULPA.

In certain situations, however, the specific term of the partnership would be important to the partnership's marketability. Under the RULPA, which provides wide latitude as to provisions *inter se* in the agreement,[96] the specific term of the partnership could be included in the partnership agreement. Thus, the term of the partnership and the means by which that term could be modified could be provided in the negotiated partnership agreement. The only

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88. *See supra* notes 46-48 and accompanying text.

89. U.L.P.A. § 2(1)(a)(V), (VIII) (1916).

90. U.L.P.A. § 24(2)(h) (1916) (requiring amendment to certificate for a change in the time for dissolution or return of a contribution); U.L.P.A. § 25(1)(b) (1916) (requiring amendment to be signed and sworn to by all members of the partnership).

91. U.L.P.A. § 16(2)(b) (1916).

92. U.L.P.A. § 16(4)(a) (1916); *see also* U.L.P.A. § 10(1)(c) (1916) (providing the limited partner with the same rights as a general partner to "[h]ave a dissolution and winding up by decree of court").

93. R.U.L.P.A. § 201(a)(4) (1985).

94. R.U.L.P.A. § 202(d) (1985).

95. *See* R.U.L.P.A. § 201(a) (1985) (not requiring sworn execution by all members of the partnership or inclusion of the limited partners names in the certificate); R.U.L.P.A. § 204(a)(1) (1985) (requiring only general partners to sign certificate).

96. *See, e.g.*, R.U.L.P.A. § 302 (1985) (providing wide discretion for the partnership agreement to grant or restrict voting power of the limited partners).

major limitation on the power of the partnership agreement to provide for the term of the partnership would be the provision for judicial dissolution.[97]

The ULPA made it extremely difficult to extend the life of a limited partnership absent unanimous consent of all the partners. The RULPA, though not specifically intended to resolve the extension-of-term problem, did so by providing the discretion necessary to accomplish an extension.

B. *Buyout of Limited Partners*

The term of the partnership could also be modified by a buyout of the old limited partners. A straightforward cash purchase would be a voluntary transaction. A cash price based upon the present value of the partnerships's assets would not be conducive to such a voluntary sale.[98] Rather, the transaction could be structured as an exchange offer of an interest in a new enterprise, resulting in a delayed liquidation of the old limited partnership assets.[99] The unanimity required by the ULPA, however, would render the transaction impractical.[100]

The alternative to unanimity is some form of "cramdown" that would force recalcitrant limited partnership holders to accept the transaction or some "fair" substitute.[101] There seems to be no such direct relief in any of the uniform partnership acts. The RULPA, however, permits substantial latitude for governance in the partnership agreement.[102] An implication of the power to include such a transaction in the agreement would require the combination of concepts from a number of sections in the RULPA.[103] Section 303 specifical-

97. R.U.L.P.A. § 802 (1985) provides for judicial dissolution "[o]n application by or for a partner . . . whenever it is not reasonably practicable to carry on the business in conformity with the partnership agreement." Non-judicial dissolutions are controlled by the partnership agreement. R.U.L.P.A. § 801 (1985).

98. The problem posited which creates the need for an extension is based upon an asset with temporarily reduced value. The intent is to postpone a present liquidation at a substantial loss in the hope that changing conditions will create a better value for a subsequent liquidation.

99. For examples of recent litigation concerning the buyout form of reorganization, see Coleman v. Global Ultimacc Systems, Inc., No. 85 Civ. 8467 (LLS), 1986 WL 5804 (S.D.N.Y. May 16, 1986); Enserch Corp. v. McLane Gas Co., 633 A.2d 369 (Del. Super. Ct. 1993).

100. *See* U.L.P.A. § 2 (1916) (requiring all partners to sign and swear to the certificate of limited partnership); U.L.P.A. § 25(1)(b) (requiring all partners to sign and swear to any amendment to the certificate). To the extent that even one limited partner holds out, a cash buy out of that partner could prove exceedingly expensive and totally counter productive in terms of its impact on other partners. The problem is worse in the real world of large modern tax shelter limited partnerships due to the large number of interests involved.

101. While variations of "cram downs" are commonplace in other reorganizations, such as insolvency, the term can have a broader meaning indicating the forced acceptance of a transaction when some predefined level of voluntary acceptance has been reached.

102. *See, e.g.*, R.U.L.P.A. § 302 (1985) (providing wide discretion for the partnership agreement to grant or restrict voting power of the limited partners).

103. R.U.L.P.A. § 302 (1985) (providing the authority of the partnership agreement to allocate voting power of limited partners); R.U.L.P.A. § 303 (1985) (describing actions which may be taken by limited partners without participating in control of the business).

ly provides that limited partners may vote on matters which transfer all or substantially all of the assets of the partnership without destroying their limited liability status.[104] Thus, RULPA seems to contemplate terms in partnership agreements providing for a common form of business reorganization: the sale, lease, or exchange of all or substantially all of an entity's assets, not in the regular course of business.[105]

In this manner, the partnership agreement could provide for a successful reorganization buyout. First, a successful exchange offer to limited partnership members would give interests in the new company to a majority (or supermajority) of limited partners. As a result of the exchange, the new company would own more than the required number of "old" limited partnership interests. Second, the "cramdown" would be accomplished by selling the assets of the old limited partnership to the new company, while the "old" limited partnership would receive interests in the new company equivalent to those accepted in the voluntary exchange. Finally, the transaction would be completed by the dissolution of the "old" limited partnership and a distribution in kind[106] of the interests in the new company to the remaining recalcitrant limited partners, thus completing the cramdown.

In summary, the RULPA, through its liberal approach to flexible control via the partnership agreement, allows for the reorganization of a limited partnership through a voluntary exchange of interest, provided a sufficiently large voluntary transaction can be accomplished.

C. *Sale of Assets*

A third avenue for modifying the term of a limited partnership is the negotiation of a sale of the limited partnership's assets to a new entity, through the old owners.[107] There are two problems with this form of reorganization.

First, a disclosure documents would be required explaining the complex implications of this simple transaction, including an explanation of the assets sold and the new interests purchased.[108] Furthermore, if the general partner(s) received different consideration than the limited partners, complex descriptions of the difference and equivalence would need to be included. Even if the general partner(s) received the same form of consideration as the limited partners, description of equivalency would be complex.[109] In addition, the disclo-

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104. R.U.L.P.A. § 303(b)(6)(ii) (1985).

105. *Id.* This traditional form of reorganizations is found in all corporate statutes and is one recognized form of reorganization in the Internal Revenue Code. I.R.C. § 368(a)(1)(C) (1988).

106. R.U.L.P.A. § 605 (1985) (indicating substantial latitude in the partnership agreement as to provisions for distributions in kind).

107. The RULPA permits this type of reorganization by allowing limited partners to vote on matters concerning the sale, exchange, or other transfer of all or substantially all of the limited partnership's assets without losing limited liability. R.U.L.P.A. § 303(b)(6)(ii) (1985).

108. The disclosure document would be required for the limited partners' information and accurate record keeping. *See* R.U.L.P.A. §§ 105, 305 (1985).

109. This transaction as an artificial model is complex due to its two-step nature. The

sure itself creates risks of misrepresentation and the sale arguably contains risks of indirect unfairness.

The second problem with an asset sale would involve the efforts required to procure votes in favor of the transaction. The complexity of the information might require professional solicitation of positive votes. Even without such outside assistance, the process would be costly.

If these difficulties are surmounted, dissolution of the old partnership would result in a distribution in kind. The dissolution could take place on the natural date of dissolution in the certificate of limited partnership.[110] Alternatively, the transaction may render the old limited partnership subject to judicial dissolution because no assets would be available to "carry on the business in conformity with the partnership agreement."[111] A distribution in kind would be essential,[112] and depending upon the assets received as consideration for the sale, flexibility would exist[113] once all creditors were paid.[114]

The asset sale approach would obviate the tender offer described in Section II.B. The tender offer, with incentives, might be a possible alternative if the necessary votes for a sale of assets are in doubt.

D. *Merger*

If several limited partnerships exist, either independently or in affiliation, the sale of assets model becomes unnecessarily complex.[115] Extending the dissolution dates of such a number of entities, however, may also be accomplished by a merger.[116]

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sale of assets must result in the receipt by the old limited partnership entity of interests in the new entity as consideration for the physical assets sold. These interests, which would be the only assets of the old entity, would be distributed in kind upon the dissolution of the old limited partnership. Because the old limited partnership had at least two different kinds of owners that distribution would be complex depending upon the intended capitalization of the new entity.

110. R.U.L.P.A. § 801(1) (1985).

111. R.U.L.P.A. § 802 (1985).

112. R.U.L.P.A. § 605 (1985) (implying that the partnership agreement may compel acceptance of a distribution in kind).

113. Statutory limitations on distributions inter se are conditioned by the partnership agreement and thereafter subject to proportionality of interests. Under U.L.P.A. § 23 (1916) priorities between limited and general partners made this form of distribution extremely complicated. Under R.U.L.P.A. § 804(2)-(3) (1985), the lack of priority makes distributions in kind less complicated.

114. R.U.L.P.A. § 804(1) (1985).

115. The multiple organizations may have differing dissolution dates, different voting procedures, different distribution agreements, different general partnership requirements, all of which, when folded into the formal sale of assets/distribution in kind model, result in too complex a transaction.

116. *See, e.g.*, REV. MODEL BUSINESS CORP. ACT § 11.01(a) (1984) (providing for statutory mergers). Common law courts also recognize the concept of a merger. *See, e.g.*, Farris v. Glen Alden Corp., 143 A.2d 25 (Pa. 1958) (recognizing de facto mergers). Additionally, the Internal Revenue Code includes mergers within its definition of corporate reorganizations. I.R.C. § 368(a)(1)(A) (West 1994).

Neither the UPA, ULPA, nor the RULPA provide explicit authorization for mergers. However, the UPA, arguably, provides implicit authorization for such transactions. The process for finding such implied authorization is not straightforward, but it can be persuasive in the event of a challenge.

Two arguments support the idea that the UPA impliedly authorizes mergers. First, since no actions prior to the merger itself seem to serve as a basis for a judicial decree of dissolution under the UPA,[117] it can be argued that such mergers are authorized. The UPA defines a dissolution as "a change in the relation of the partners caused by any partner ceasing to be associated in the carrying on . . . of the business."[118] Under this definition, a merger would not seem to cause a dissolution, because a partner does not necessarily have to discontinue her association with the business after the merger.

The second argument supporting the notion of "implied authorization" is dependant on the first; it can only be argued if it is agreed that a merger does not effect a dissolution of the partnership. If it is agreed, the resolution of the legal issues incident to the merger would be governed by section 5 of the UPA,[119] and section 29 of the ULPA,[120] which state that the rules of law and equity, including the law merchant, are to govern. Accordingly, unless a court determined that conduct prior to the merger violated some rule of law or equity, the merger would be permissible under the UPA and ULPA. It should be noted that under the RULPA, such a merger would be permissible if the terms for approving it were specified in the partnership agreement or its provisions for amendment.[121]

In corporate reorganizations, proposals to merge usually require approval

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117. Section 32 of the UPA states the instances in which a judicial decree of dissolution is required; mergers are not specifically mentioned. U.P.A. § 32 (1914). Arguably, however, actions prior to a merger could trigger a judicial decree of dissolution under the "catch-all" provision listed in section 32. *See* U.P.A. § 32(1)(f) (1914) (stating that on application by or for a partner the court shall decree a dissolution whenever circumstances render a dissolution equitable); *cf.* R.U.L.P.A. § 802 (1985) (stating that a court may decree a dissolution whenever it is not reasonably practicable to carry on the business in conformity with the partnership agreement); *see also* R.U.L.P.A. § 801(1) (1985) (stating that the certificate of limited partnership can specify a time for dissolution); R.U.L.P.A. § 801(2) (1985) (stating that a partnership can be dissolved upon the happening of events specified in writing in the partnership agreement). Under the RULPA, then, the partners can agree in advance, either in the certificate of limited partnership or in the partnership agreement, that certain events preceding a merger will trigger a dissolution. Absent such a written provision, however, RULPA, like the UPA, offers judges little guidance to help them determine whether to decree a dissolution.

118. U.P.A. § 29 (1914).

119. U.P.A. § 5 (1914).

120. U.L.P.A. § 29 (1916).

121. *See* R.U.L.P.A. § 301(b)(1) (1985). This section states that a person can acquire a partnership interest directly from the limited partnership if the partnership agreement so provides. *Id.* Because RULPA includes corporations, associations, trusts, estates, and other limited partnerships within its definition of "person," a merger of one or more limited partnerships would be permissible under RULPA if it was provided for in the partnership agreement. *See* R.U.L.P.A. § 101(11) (1985) (defining person for purposes of the Act).

by management,[122] and subsequent approval by some agreed-upon majority or super-majority of shareholders.[123] In a limited partnership scenario, the parallel for management approval is approval by the general partners, and the equivalent of shareholder approval is approval by the limited partners.

Under old state statutes shareholders were required to approve a merger by at least a majority of the shares.[124] With the advent of non-voting shares newer state statutes, and the Revised Model Business Corporation Act, only require a vote of "shareholders entitled to vote."[125] Corporations can use this provision to substantially limit the classes of shareholders entitled to vote, unless some outside agency requires otherwise.[126]

Similarly, under the RULPA, limited partnerships can limit the classes of limited partners entitled to vote.[127] The Act expressly states that the partnership agreement "may grant to all or a specified group of limited partners the right to vote (on a per capita or other basis) upon any matter."[128] Arguably, a court of equity applying equitable considerations could place limitations on such a voting procedure. Thus, under the RULPA, the partnership agreement can provide that a certain voting procedure be used in the event of a merger. If the procedure is used to restrict certain limited partners' right to vote, it may be possible to extend the life of the limited partnership.

E. *Outsider Transactions*

All of the previously discussed methods for extending the life of a limited partnership have assumed general partners or other internal investors are the moving force behind the transaction. The impetus for the transaction, however, may also come from "outsiders."

Certain circumstances must ordinarily be present, however, for an "outsider" to take an interest in extending the life of a limited partnership. First, some incentive must stimulate the interest of the outsider. If the underlying assets are be currently depressed, the future of the assets must appear bright. Second, the outsider must believe that the cost of interests in the extended entity (old or new) will be based upon relative present values. Third, because most of the entities under consideration will be controlled by one or more general partners,[129] a deal must be struck whereby the outsider is admitted as a general

122. *See* REV. MODEL BUSINESS CORP. ACT, § 11.03(b) (1984).

123. *See* REV. MODEL BUSINESS CORP. ACT, § 11.03(e) (1984).

124. *See, e.g.*, ILL. ANN. STAT. ch. 32, para. 52 (Starr & Curtiss 1885) (requiring a two-thirds vote of the shareholders to consolidates a business).

An exception to the rule requiring majority approval, arises when a parent corporation attempts to merge with one of its subsidiaries and the parent corporation owns 90% or more of the subsidiary's stock. In such circumstances, no vote of the shareholders is statutorily required. *See, e.g.*, REV. MODEL BUSINESS CORP. ACT § 11.04 (1984).

125. *See, e.g.*, REV. MODEL BUSINESS CORP. ACT § 11.03(b)(2) (1984).

126. Stock exchange or self regulatory organizations can provide additional protection for shareholders of corporations traded under their auspices. *See, e.g.*, *American Stock Exchange, Constitution and Rules* (CCH 1993).

127. R.U.L.P.A. § 302 (1985).

128. *Id.*

129. *See* R.U.L.P.A. § 403(a) (1985) (stating that a general partner of a limited partner-

partner and control of the entity is shifted to her.[130]

Certain ULPA provisions governing dissolutions, however, can make the "outsider" approach both risky and problematical. For instance, section 20 states that the retirement, death, or insanity of a general partner will dissolve the partnership.[131] Additionally, section 16 states that a limited partner may have the partnership dissolved when she rightfully demands the return of her contribution,[132] or when the partnership is insolvent and she is entitled to the return of her contribution.[133] Thus, under the ULPA, the "outsider" method for extending the life of a limited partnership can result in an unintended dissolution.

Outsider intervention under the RULPA is also risky. A partnership may be dissolved under RULPA: (1) upon the happening of events specified in the partnership agreement;[134] (2) with the unanimous consent of all members;[135] (3) upon the withdrawal of a general partner if there is no continuation agreement;[136] and (4) when a judge, in her discretion, finds that it is impracticable to carry on the business in conformity with the partnership agreement.[137] Absent persuasive terms in the partnership agreement, therefore, outsider intervention under the RULPA may also result in an unintended dissolution. However, the partnership agreement can be written to largely limit this risk under the more flexible RULPA.

F. *"Special" Statutory Regulation*

Although the Uniform Acts have been instrumental in shaping modern partnership law, many state partnership statutes differ significantly from the Acts. Craig Smith, one of the drafters of the 1988 revision to the Delaware limited partnership statute, has noted that the Delaware statute was revised to provide for the reorganization of limited partnerships.[138] In addition to Del-

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ship, unless otherwise provided, has the same rights and powers as she would have if she were in a partnership without limited partners); *see also* U.P.A § 18(e) (1914) (stating that all partners have equal rights in the management and conduct of the partnership business); *cf.* R.U.L.P.A. § 303(a) (1985) (stating that a limited partner will lose her limited liability, and be liable as a general partner, if she participates in the control of the business).

130. Under the ULPA, the admission of an additional general partner requires the written consent or ratification of all the limited partners. U.L.P.A. § 9(1)(e) (1916). However, under the RULPA, the partnership agreement can provide a procedure for admitting additional general partners without the consent or ratification of the limited partners. R.U.L.P.A. § 401 (1985).

131. U.L.P.A. § 20 (1916). There are two exceptions to this rule of automatic dissolution. First, the partnership will not be dissolved if the partnership agreement explicitly provides for continuation of the business under the circumstances. Second, the partnership will not be dissolved if all members consent to its continuation. *Id.*

132. U.L.P.A. § 16(4)(a) (1916).

133. U.L.P.A. § 16(4)(b) (1916).

134. R.U.L.P.A. § 801(1) (1985).

135. R.U.L.P.A. § 801(3) (1985).

136. R.U.L.P.A. § 801(4) (1985).

137. R.U.L.P.A. § 802 (1985).

138. Craig B. Smith, *Limited Partnerships—Expanded Opportunities Under Delaware's*

aware, Eight other states and the District of Columbia have revised their codes to allow for limited partnership reorganizations.[139] Because these ten jurisdictions expressly provide for limited partnership mergers, an "implied" analysis, as described earlier,[140] is unnecessary.

In Delaware, limited partnerships, irrespective of whether they survive, are permitted to merge or participate in a consolidation with corporations, other limited partnerships, trusts, limited liability companies, and other partnerships.[141] The Delaware statute also includes formal procedures for recording the merger or consolidation,[142] and a protective provision to avoid the risk of dissolution.[143] All of these procedures, however, are subject to broad variation by agreement.[144]

Importantly, however, statutes that expressly provide for limited partnership reorganizations are relatively new, and appear in very few states. Whether such a reorganization will be allowed in a particular state will depend on that state's interpretations of the ULPA and the RULPA. As stated earlier, these two Acts, at best, only impliedly authorize mergers and other forms of reorganization.

III. CAUSES OF LIMITED PARTNERSHIP REORGANIZATIONS

It is useful to identify the economic events and changes in the tax law which brought into focus the dire straits of many limited partnership investors.[145] The recognition that an effective limited partnership tax shelter re-

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Revised Uniform Limited Partnership Act, 15 DEL. J. CORP. L. 43, 51-58 (1990).

139. *See, e.g.*, D.C. CODE ANN. § 41-428 (1990 & Supp. 1994); GA. CODE ANN. § 14-9-206.1 (1994); IND. CODE ANN. § 23-16-3-12 (Burns 1989); KAN. STAT. ANN. § 56-1609 (1994); MD. CODE ANN., CORPS. & ASS'NS § 10-208 (1993 & Supp. 1994); MISS. CODE ANN. § 79-14-211 (1989); S.C. CODE ANN. § 33-42-320 (Law Co-op. 1990); TENN. CODE ANN. § 61-2-211 (1989 & Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 6132a-1 (West Supp. 1995).

140. *See supra* text accompanying notes 119-23.

141. DEL. CODE ANN. tit. 6, § 17-211(a)-(b) (1993 & Supp. 1994).

142. *See* DEL. CODE ANN. tit. 6, § 17-211(c) (1993).

143. *See* DEL. CODE ANN. tit. 6, § 17-211(h) (1993) (stating that, unless otherwise agreed, the merger or consolidation of a limited partnership shall not require the dissolution of that partnership).

144. *See* DEL. CODE ANN. tit. 6, § 17-211(b) (1993) (stating the procedure for approval of a merger but recognizing that the partnership agreement may set forth a different procedure).

Thus, according to the Delaware Code, if a partnership agreement contains a provision restricting the right of limited partners to vote on a merger, the restriction is binding. *Id.* Such a procedure for extending the life of a limited partnership may be of utility to general partners who desire to merge but do not believe they have the support of the limited partners.

145. It is premature at this point in the article to attempt to identify the proportion of limited partnership investors' losses which resulted from reorganization transactions and the proportion which resulted from economic conditions prior to those transactions. The problem is exaggerated by the lack of a market for the interests involved. When the transaction occurs, it often creates a market, which for the first time since purchase, objectively defines the value of the interest.

quires a combination of certain characteristics is necessary to this analysis. First, the optimal investment would include as many investors as possible. The underlying assets in operation would produce a reasonable cash flow, returnable to the investor in periodic payments. In the tax shelter setting, these payments would not constitute a taxable event. Second, the operational use of those assets would result in substantial taxable deductions avoiding substantial pass-through tax liability for investors, and perhaps even creating pass-through tax *losses* to shelter investors' other taxable income. Deductions could include interest expenses in highly leveraged operations, large depreciation or depletion allowances, and any other deductions which could be loaded into the early years of the investment, especially if the actual cash drain for the deduction would be postponable. Finally, assets would ideally retain value and be subject to sale subsequent to the final liquidation of the limited partnership. That sale might constitute a taxable event due to reduced bases in assets, but it would occur at an advantageous tax rate for the pass-through investor.

For the high tax-rate investor, this shelter would ideally provide a period of regular cash flow with little or no tax liability, or even tax losses followed by a cash draw at an attractive tax rate.

One of the most traditional investments used to accomplish these goals was commercial real estate, including office buildings, shopping centers, industrial properties, urban hotels, and resorts.[146] A second category of such investments lay in the oil and gas industry, including exploration, drilling, ownership of fields, and production.[147]

The effectiveness of limited partnerships as tax shelter investment vehicles led to a wider, even exotic, range of investments. Limited partnerships invested in: computers and computer software;[148] residential real estate;[149] and horse breeding.[150] Changes in the climate surrounding these investments, however, began to take their toll in the mid-1980s.

146. The Equitec partnerships provide an example. These real estate partnerships were rolled up into a master limited partnership known as Hallwood Realty Partners. Hallwood now has more than 3,000 limited partners, and in 1990 owned, directly or indirectly through joint ventures, 19 major properties in 9 states. *See* Amy Friedman, *Rolling Peter to Pay Paul*, INVESTMENT DEALERS' DIGEST, Jan. 7 1991, *available in* LEXIS, Merger Library, IDD File.

147. An example of such an investment would be Mesa Limited Partnerships. This complex investment in the oil and gas industry has been transformed back and forth from a corporation to a limited partnership and back to a corporation again. *See* Odmark v. Mesa Ltd. Partnership, No. 3:91-CV-2376-X, 1992 WL 203541 (N.D. Tex. June 5, 1992).

148. An example a limited partnership established to sell IBM compatible equipment and software is STC Ultimacc associates which was eventually rolled up into Global-Ultimacc Systems. *See* Coleman v. Global Ultimacc Sys., Inc., No. 85-CIV-8467 (LLS), 1986 WL 5804, (S.D.N.Y. May 16, 1986).

149. An example of limited partnerships which invested in federally insured residential mortgages are AIM 86 and AIM 88 which were the target of a tender offer by a Real Estate Investment Trust. American Insured Mortgage Investors, Inc. v. CRI, Inc., 1991 Fed. Sec. L. Rep. (CCH) ¶ 95,730 (S.D.N.Y. 1991).

150. An example of limited partnerships which invested in breeding stock are the Kinderhill limited partnerships whose interests were privately placed and eventually rolled up into a master limited partnership. Bruce v. Martin, 691 F. Supp. 716 (S.D.N.Y. 1988).

A. *Economic Events*

In the oil and gas industry, one of the modes of choice for limited partnerships, prices generally plummeted after 1985:[151]

Yearly Consumer Price Index for Energy

1980	86.0	1981	97.71
1982	99.2	1983	99.9
1984	100.9	1985	101.6
1986	88.2	1987	88.6
1988	89.3	1989	94.3

The drop-off in natural gas and petroleum crude was even more dramatic:[152]

Average Prices for Mineral Products

Year	*Natural Gas* ($/1000cu ft)	*Petroleum* ($/bbl.)
1980	1.6	21.6
1981	2.0	31.8
1982	2.5	28.5
1983	2.6	26.2
1984	2.7	25.9
1985	2.5	24.1
1986	1.9	12.5
1987	1.7	15.4
1988	1.7	12.6
1989	1.7	15.9

Because of the drop in prices investments dependent upon natural gas or crude oil were negatively impacted. Limited partnerships investing in this industry typically generated lower cash flows after 1985. Additionally, those partnerships that were due for liquidation during this period were often forced to liquidate their assets at a greatly reduced value.

Similarly, investments in commercial real estate suffered from increased office building vacancy rates during this period.[153]

Yearly Office Building Vacancy Rates (% of available space)

1980	4.6	1983	13.5

151. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 478 (1991).

152. *Id.* at 488.

153. *Id.* at 732 (rates for 1981 and 1982 are not available).

1984	15.5	1985	16.9
1986	18.6	1987	19.0
1988	18.6	1989	19.5

Major cities, home to many limited partnerships, reflected similar trends:[154]

Office Building Vacancy Rates in Selected Cities

Atlanta, Georgia:	4.6% in 1980; 21% in 1985
Boston, Massachusetts:	7.2% in 1980; 15.9% in 1986
Chicago, Illinois:	7.0% in 1980; 19.6 in 1986
Dallas, Texas:	8.6% in 1980; 30.9% in 1986
Los Angeles, CA:	0.9% in 1980; 19.0 in 1987
San Francisco, CA:	0.4% in 1980; 16.6% in 1986

From 1988-89, leasable space growth in large shopping centers also declined. While smaller centers grew at an 8.9% rate, centers with 800,000 to 1,000,000 square feet of leasable space grew at only 3.7%, and those with over 1,000,000 square feet grew at only 5.1%.[155] The weak economy and the reduced growth of large shopping centers helped contribute to the 0.2% overall reduction in retail sales per square foot that occurred between 1988 and 1989.[156]

Thus, the value of various assets underlying many limited partnerships declined during the 1980's. Two specific impacts must be noted. First, unless the partnership was a publicly traded partnership, no information was available about this reduction in value through the marketplace. Thus, limited partnership investors had no means of quantifying the diminution of their investments' value. Second, for those interests that were due for liquidation during periods of asset devaluation, the forced nature of the sale exacerbated that decline in value.

In order to avert these potential disasters, limited partnerships would engage in "roll-up" transactions. "Roll-ups" would reduce risk by combining the assets of multiple limited partnerships into a single, larger, and more diversified, "liquidation-extended" entity. The "roll-up" itself would require some form of investor approval and some disclosure of diminished values. The surviving entity of the "roll-up" would often include liquid resulting interests, thereby causing an immediate market disclosure of highly reduced investment value.

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154. *Id.*
155. *Id.* at 777.
156. *Id.*

B. *Changes in the Law*

During the 1980s, the federal government addressed the need to raise more revenue and reacted to wealthy taxpayers' manipulation of tax shelters. The government focus on these areas resulted in a major modification of the taxation of limited partnerships and their investors.

The basic model for the partnership tax scheme is established by subchapter K of the Internal Revenue Code ("IRC").[157] According to the IRC, the partnership, as an entity, is not required to pay taxes.[158] Rather, the partnership's taxable income is allocated to the individual partners for inclusion in their individual returns.[159] Thus, taxes "pass through" the partnership to reach the individual. While this tax scheme appears simple, it becomes more complex when "distributive shares"[160] are passed through as both income and deductions.

The partnership taxation model has many advantages, including: (1) taxes are only paid by the partner, in contrast to the corporate form in which taxes are paid twice; once by the corporation as an entity; and once by the individual shareholders if and when they receive dividends from the corporation;[161] (2) if a partnership is engaged in business with deferred income cash flow distributions to partners, the partners may be able to avoid an immediate tax;[162] (3) if the partnership business is highly leveraged and/or produces non-cash expenses such as depreciation or depletion resulting in entity losses, these losses are immediately deductible to the partner;[163] and (4) because after the dissolution and sale of the partnership assets the final distribution is taxed as a current distribution, the possibility for capital gains treatment exists. These generalizations are, of course, subject to limitations; a detailed discussion of which is beyond the scope of this article.[164]

While partnerships continue to enjoy many tax advantages today,[165] the Tax Reform Act of 1986,[166] and the Revenue Act of 1987,[167] eradicated many of the tax advantages partnerships had previously enjoyed. These two acts were equally as devastating to limited partnerships as the economic

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157. I.R.C. §§ 701-61 (West 1994).

158. I.R.C. § 701 (West 1994). *But see* I.R.C. § 7704 (West 1994) (stating that certain publicly traded partnerships may be given corporate tax treatment).

159. I.R.C. § 701 (West 1994).

160. *See* I.R.C. §§ 702, 704 (West 1994) (concerning distributive shares).

161. I.R.C. § 701 (West 1994).

162. I.R.C. § 731(a) (West 1994).

163. I.R.C. § 704(d) (West 1994).

164. While a full discussion of these limitations is beyond the scope of this article, they do not affect the basic concepts underlying the tax treatment of limited partnerships .

165. *See generally* Donna D. Adler, *Master Limited Partnerships*, 40 U. FLA. L. REV. 755 (1988) (discussing the Tax Reform Act of 1986 and the Revenue Act of 1987, and their respective impacts on the tax treatment of master limited partnerships).

166. Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of 26 U.S.C.).

167. Pub. L. No. 100-203, 101 Stat. 1330-382 (codified as amended in scattered sections of 26 U.S.C.).

changes discussed in Section III.A were.

The IRC now places tight restrictions on the ability of a partner to utilize partnership deductions. For instance, § 704(d) limits a partner's distributive share of the partnership's capital and non-capital losses.[168] A partner can only deduct partnership loss to the extent of the adjusted basis of the partner's interest in the partnership at the end of the partnership year in which the loss occurred.[169] Any loss distributed to the partner in excess of the adjusted basis is suspended, for personal deduction purposes, until an increased basis becomes available.[170]

A similar loss limitation is found in § 465, which limits losses allowable under § 704(d).[171] This additional limitation applies to losses resulting from deductions which exceed income from the partner's distributive share.[172] Section 465 limits these losses to the partner's interests at risk. The losses, however, can exceed the partner's adjusted basis because they include, in addition to the partner's investment, those debts for which the partner is liable. Section 465 has less of an impact on limited partnerships, however, because of the limited liability of limited partners.

The passive activity loss provisions of § 469 carry much stronger meaning for limited partnership interests. It defines "passive activity" as "any activity which involves the conduct of a trade or business, and, in which the taxpayer does not materially participate."[173] This definition includes normal business activity, but excludes purely passive income resulting from portfolio transactions that do not constitute a trade or business activity.[174] Such passive income or loss is treated specially: passive losses may only be offset against passive income.[175] This creates a major limitation on the use of distributive losses generated by tax shelter partnerships.

Other portions of section 469 carry even stronger consequences for limited partnerships. First, limited partnership interests can never become material participation in the activity of the partnership.[176] Second, in a publicly traded limited partnership, losses cannot be offset against passive income.[177] Third, the section severely limits a partner's ability to utilize losses from special activities typical of tax shelter limited partnerships.[178] Additionally, the section limits a partner's ability to deduct investment interest (a considerable expense in tax shelters).[179]

Finally, new limitations exist on the according of partnership tax status to

168. I.R.C. § 704(d) (West 1994).
169. *Id.*
170. *Id.*
171. I.R.C. § 465 (West 1994).
172. *Id.*
173. I.R.C. § 469(c)(1)(A)-(B) (West 1994).
174. *Id.*
175. I.R.C. § 469(d)(1) (West 1994).
176. I.R.C. § 469(h)(2) (West 1994).
177. I.R.C. § 469(c)(1) (West 1994).
178. I.R.C. § 469(i) (West 1994).
179. I.R.C. § 163(d) (West 1994).

publicly traded limited partnerships, regardless of their legal status as limited partnerships.[180] If a secondary market is maintained for interests, the publicly traded limited partnership risks being taxed as a corporation. To escape this treatment, the partnership must realize 90% of its income from statutorily defined sources of passive "qualifying" income, or income resulting from the disposition of capital assets held for the production of income.[181]

These tax changes proved devastating to limited partners. Investment programs designed to generate pass-through losses resulted in losses unavailable to shelter other income. Attempts to create liquidity, by creating markets for the interests, resulted in greater restrictions on the use of these losses to shelter even other passive income. Publicly traded partnerships risked treatment as a corporation for tax purposes. From a tax perspective, the value of these investments deteriorated substantially. In many situations, the absence of a market for the interests masked the extent of the erosion in value.

C. *Roll-ups: Strategies and Reactions*

The economic events and tax changes of the late 1980s forced those with partnership interests into a reactive mode. General partners, investment advisors, and financial specialists who marketed these interests, devised a strategy including two goals: (1) the extension of liquidation dates to avoid liquidation in a depressed market; and (2) the combination of entities to attempt diversification and provide liquidity. The strategy most often used to address these economic and tax problems was the roll-up of limited partnerships.

1. The Roll-up Strategy

The procedure employed to roll-up limited partnerships created fertile grounds for abuse.[182] One aspect of the procedure that was often abused concerned disclosure. A typical roll-up required disclosure of information material to limited partners' interests, including analysis of present risk, analysis of risks involved in extending liquidation and maintaining the investment, and analysis of the risks implicit in negotiating with lenders in highly leveraged enterprises. Many of these items were often not disclosed.

Another area of abuse concerned the solicitation of investor approval for the roll-up. In order to garner the affirmative votes required, solicitation of formal approval was often necessary. Independent market professionals, whose fee depended on a successful solicitation, often employed aggressive tactics to gain the requisite votes for approval.

Another aspect of the procedure that was often abused concerned the valuation of general partners' interests; disclosure of the results was geometrically more complex than the problem of valuing limited partners' interests. In addition to valuation, new management compensation agreements were

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180. *See* I.R.C. § 7704 (West 1994).

181. *Id.*

182. *See infra* note 197.

needed. They required some compensation for termination of the old agreement, for services performed in accomplishing the roll-up, and for future management services to the new entity. Even more complexity resulted from the merging of multiple entities. Underlying this entire procedure was the risk that a conflict of interests could arise during the creation of the new relationship and negotiation of the successful transaction. It is easy to see how these problems created a fertile ground for abuse.

2. Reactions to Roll-up Abuses

Three independent forums verified the reality of these potential problems. As the transactions began to occur, the financial press began documenting the abuses.[183] Thereafter, congressional hearings detailed the abuses,[184] and finally, the Securities and Exchange Commission (SEC) reported the results of its roll-up studies to Congress.[185] Selected documentation from each of these sources describes a pattern of intentional and fraudulent activity in some cases, and inept mismanagement in others. The reports also criticized the inherent complexity of the roll-up transaction. This documentation ultimately created a perception of abused investors suffering overwhelming investment losses.

a. The Financial Press

The financial press has been generally critical of the results of roll-ups. A 1988 article in *Forbes* magazine posited that:

> Last October's market crash and 1987 tax law change have made roll-ups into master limited partnerships much less palatable these days . . . [N]othing in the tax law is likely to change a long standing rule of limited partnership investment: The operator almost always does well, even if the investors fare terribly.[186]

The National Realty, L.P. roll-up, for example, involved 20,000 limited partners in 35 limited partnerships. Assets were represented to investors to have appraised values of $10 per share in the new roll-up. After approval, the interests opened on the American Stock Exchange at a little over $3 per unit, a shattering 70% discount from the appraised value.[187] The article further documented the benefits received by the general partners of the rolled-up limited partnerships.[188] "'Every single roll-up done to date has done harm to the investors,' said Barry Vinocur, editor of *Stanger's Investment Advisor*, which follows the investment industry. 'There are varying degrees of disaster, but they've all worked out badly.'"[189]

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183. *See infra* part III.C.2.a.
184. *See infra* part III.C.2.b.
185. *See infra* part III.C.2.c.
186. Howard Rudnitsky, *Roll-Up as Rip-Off*, FORBES, Jan. 1988, at 254.
187. *Id.*
188. *Id.* at 254-256.
189. Mary Rowland, *Your Own Accounts; The Hazards of Roll-Ups*, N.Y. TIMES, July 22, 1990, at A3.

A 1991 article in *Investment Dealers Digest* quotes roll-up critics as saying:

> [G]eneral partners have paid themselves lavish fees, ranging from acquisition fees for each property bought for a partnership to ongoing management fees for upkeep and maintenance that sometimes exceeded the cash flow available from the leases. Then, when the partnerships were mere carcasses, with the most properties sold and the worst given back to the lenders. . . The general partners proposed to change the agreements by 'rolling up' a group of partnership into one investment, ostensibly to improve liquidity, allow the assets to work harder for the limited partners and create (or enhance) the available cash flow.[190]

A 1991 *Boston Globe* article described in detail the specific losses of individual investors and noted that over 300,000 investors lost $1.6 billion in five years.[191] A *Los Angeles Times* article the same year cited Richard Wollack, Chairman of Liquidity Fund, in noting that limited partners' interests dropped an average of 44% on their first day of trading following 13 different roll-ups.[192] A 1992 *Financial World* article posited:

> Roll ups in themselves are not bad. Some have served investors well. . . During the 14 months ended Dec. 31, shares of traditional real estate investment trusts climbed 32%, but those of roll ups fell 11%. And the 20 roll ups completed in 1991 lost almost 50% of their initial value before years end. Clearly something has gone dreadfully wrong with the roll up concept.[193]

Finally, a 1992 *San Francisco Chronicle* article produced the most extreme commentary:

> The stain of abusive roll-ups . . . started spreading across America in the 1980's. To date, more than 500,000 limited partners have witnessed their equity plummet an average of 70 percent in these ill-fated 'deals', every single one of which has been a loser for victimized investors. However, roll-ups have been a bonanza for general partners and investment bankers, who have reaped tens of millions of dollars in fees.[194]

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190. Amy Friedman, *Rolling Peter to Pay Paul*, INVESTMENT DEALERS' DIGEST, Jan. 7, 1991, *available in* LEXIS, Merger Library, IDD File.

191. Michael K. Frisby, *Loopholes, Investor Losses Spur House Probe of "Roll-ups"*, *Boston Globe*, Mar. 20, 1991, at 1.

192. Catherine Collins, *Washington; Proposals Aim to Protect Investors When Partnerships Are "Rolled-up"*, L.A. TIMES, July 28, 1991, at D2.

193. Ronald Fink, *Rollup Roundup*, FIN. WORLD, Mar. 31, 1992, at 100.

194. Richard G. Wollack, *Partnership Roll-ups Hurt Small Investors, Economy*, S.F. CHRON., Feb. 24, 1992, at D 5.

b. Congressional Hearings

Testimony at congressional hearings provided a major source for the overwhelmingly negative information in the financial press about roll-up abuses. Excerpts from some of these hearings are set forth below.

On October 3, 1990, the Subcommittee on Telecommunications and Finance, of the House of Representatives Committee on Energy and Commerce, held hearings on limited partnerships. Testimony was given regarding not only roll-up abuses, but also the importance of reorganization transactions to investors. Two of the witnesses emphasized the value of properly structured "roll-ups," and the pressing need to eradicate abuses in the process to preserve the "roll-up" as an effective reorginazational tool.

Christopher Davis, President of the Investment Partnership Association, testified early in the hearings. His organization was described as a trade group for limited partnership program sponsors and their principal selling organizations. With an openly disclosed bias, his organization claimed to represent the "interests of approximately 10 1/2 million Americans."[195] The needs cited for limited partnership reorganizations included the long-term nature of interests, the depressed value of assets due to their illiquidity, and the financial difficulties of managing general partners.[196] After discussing claims regarding abuses of the process and recommendations for controlling the specific abuses,[197] Davis stated the position of his organization:
"as in all matters of public policy and debate among differing interests, the IPA believes the issue of partnership roll-ups or consolidations is one of balance. Policy makers must distinguish between abusive practices and the efforts of general partners to improve the performance of inadequately performing investments."[198] The organization's recommendations included improved disclosure to protect both investors and important economic transactions.

Cezar Froelich, a partner in the law firm of Shefsky and Froelich in Chicago, also testified.[199] Froelich emphasized the need for roll-up transactions. He argued that new layers of regulation would operate to the disadvantage of investors.[200] In place of restrictive regulation, Froelich argued for increased

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195. *Limited Partnerships: Hearings Before the Subcomm. on Telecommunications and Finance*, 101st Cong., 2d Sess. 44-45 (1990) [hereinafter *House Hearings*] (statement of Mr. Christopher Davis).

196. *Id.* at 45.

197. The specific abuses recognized in the testimony were inadequate disclosure generally, inadequacy of research supporting fairness opinions, lack of recognition of the impact of market effects on underlying assets and the form of resulting interests from the roll-up, problems between finite and infinite life investments, lack of a system for appraisal rights, problems inherent in voting requirements, lack of board of independent trustees, and payment for votes approving transactions. *Id.* at 51-52.

198. *Id.* at 52.

199. *House Hearings*, *supra* note 196, at 92 (statement of Mr. Cezar Froelich).

200. *Id.* at 97 n.12. The cited advantages include: (1) creation or enhancement of investors' liquidity, (2) diversification of underlying assets, (3) increased access to capital sources, (4) potential for growth, (5) increased distributions to investors, and (6) cost savings and operating efficiencies. *Id.*

disclosure to resolve perceived detriments,[201] and maintain adequate investor protection.[202]

Hearings before House[203] and Senate[204] committees were held again in 1991. Frank Wilson, of the National Association of Securities Dealers ("NASD"),[205] argued before the Senate that agencies and Self-Regulatory Organizations ("SROs") had the rule-making power to address roll-up abuses.[206] Dee Harris, of the North American Securities Administrators Association, indicated that state regulations already effectively policed this problem.[207]

c. The SEC's Response

The second round of hearings included the SEC's study, results, and position.[208] Chairman Richard Breeden testified that the SEC had serious concern about roll-up abuses. Breeden stated that $150 billion in limited partnership interests were registered with the SEC and tens of billions more were sold in unregistered private placements during the 1980s.[209] He added that "[s]ince 1985, 65 roll up transactions involving approximately 1200 entities with an aggregate exchange value of about $6.9 billion have been registered with the Commission."[210]

The SEC prepared a major report on those transactions in February 1991.[211] Subsequent SEC reports were issued in March 1991[212] and April

201. *Id.* (identifying as detriments: (1) securities selling at discounts after the transaction, (2) increased super-majority voting requirements to protect managers after the transaction, (3) lack of dissenter rights in the transaction, (4) paid solicitation of votes, (5) extended or perpetual life durations of new entities, and (6) dilution of investor interests).

202. *Id.* at 101.

203. *Limited Partnerships: Hearings Before the Subcomm. on Telecommunications and Finance*, 102d Cong., 1st Sess. 44-45 (1991) [hereinafter *House Hearings #2*].

204. *See Limited Partnership Reorganizations, or "Roll-ups:" Hearings Before the Senate Subcomm. on Securities of the Comm. on Banking, Housing, and Urban Affairs*, 102d Cong. 1st Sess. (1991) [hereinafter *Senate Hearings*].

205. *See id.* at 111 (statement of Mr. Frank Wilson, executive Vice President of NASD).

206. *See id.* at 120 (statement of Mr. Frank Wilson):

> As a general matter the NASD prefers the flexibility of agency and self regulatory organization rule making to the rigidity of legislation. To the extent that government agencies or self regulatory organizations do not have the authority to make the changes discussed above, we would recommend that they be given the necessary rule making authority.

Id.

207. *Senate Hearings*, *supra* note 205, at 135 (statement of Mr. Dee Harris) ("For the federal government is largely reserved the role of coping with truly national and market-wide problems, including insider trading and mergers and acquisitions. To this list of national marketplace issues has been added the current roll-up crises.").

208. *Senate Hearings*, *supra* note 204, at 71; *House Hearings #2*, *supra* note 203, at 187, 419.

209. *Senate Hearings*, *supra* note 204, at 73.

210. *Id.*

211. *See id.* at 102.

212. *See House Hearings #2*, *supra* note 203, at 140.

1991,[213] detailing several critical points. The SEC admitted that the "roll-up" problem was significant, but contended that investor losses had been exaggerated by reliance on "exchange values" which did not indicate true value.[214] Second, protective devices were available for investors: (1) adequate information requirements to enable investors to understand the consequences of proposed transactions, (2) state law fiduciary duties of managers owed to passive investors, (3) voting rights protections for extraordinary transactions, and (4) recourse to the courts to enforce these protections.[215] Breeden indicated that the SEC and the SROs had launched attempts to protect investors and noted that the SEC preferred these initiatives to legislation.[216]

IV. PROTECTIVE REACTIONS

Section III detailed the economic and legal causes of roll-ups, as well as investors' losses from roll-up transactions. Recent years have seen various attempts by the NASD, the SEC, and, more recently, Congress, to protect investors from these losses. This Section will survey these three areas of protective efforts.

A. *The National Association of Securities Dealers*

The NASD was concerned that legislative controls could result in overprotection of investors and the destruction of economically valuable transactions in which many NASD members were vitally involved. Due to these concerns, the NASD proposed rules in January 1992 in hopes of forestalling congressional action.[217]

The NASD Board of Governors approved amendments to its own rules[218] and proposed a new rule for SEC approval.[219] If adopted, these rules would permit NASD member participation in roll-up transactions and allow the resulting securities to be listed for trading on the NASDAQ, contingent upon compliance with a series of restrictions. First, general partners or sponsors of a proposed roll-up would be required to provide the prior limited partners with a right to: (a) receive compensation based upon an appraisal of the partnership assets of the pre-existing limited partnership; or (b) receive or retain a security with rights, privileges and preferences similar to their prior units. Second, the transaction's terms could not unfairly reduce or abridge the voting rights of the prior limited partners. Third, the old investors could not be required to bear an unfair portion of the costs or the transaction. Finally, no

213. *See id.* at 419.
214. *Id.* at 141-43.
215. *Id.* at 188.
216. *Id.* at 210.
217. *See* 24 Sec. Reg. & L. Rep. (BNA) 17 (Jan. 3, 1992).
218. *See* 24 Sec. Reg. & L. Rep. (BNA) 1772 (Nov. 20, 1992). The amendments were made to "Appendix F to Article III, § 34 of the NASD's Rules of Fair Practice, and Schedule D to the Bylaws, National Association of Securities Dealers. *Id.* at 1772-73.
219. *See* 25 Sec. Reg. & L. Rep. (BNA) 189 (Feb. 5, 1993).

inappropriate restrictions could be imposed on general partner or sponsor compensation.[220]

Transactions in violation of the rules might still occur because non-NASD member solicitation specialists could provide roll-up services, and the NASDAQ is not the only forum available to trade the new entity's interests. Weak sanctions, combined with ambiguous compliance standards which could "chill" fair roll-up transactions, severely dilute the value of the NASD's proposal to investors.

B. *The Securities and Exchange Commission*

The SEC did not wait for SRO action before proposing its own form of investor protections. Its first step was an interpretive release clarifying the impact of existing rules on roll-up abuses, accompanied by a release proposing new rules to supplement existing regulation.[221]

Predictably, the SEC's protective scheme centered on improved disclosure to investors. In the June 1991 release, the SEC identified two critical transactions already covered by current disclosure regulation. First, Section 14 of the Securities and Exchange Act of 1934 ("the 1934 Act") governed approval of roll-up transactions,[222] if pre-existing interests in a limited partnership were registered under section 12 of the 1934 Act.[223] Regulation 14A[224] and Schedule 14A[225] would provide guidance on information required for disclosure. This scheme, however, would not encompass the solicitation of interests not registered under section 12 of the 1934 Act.

Second, and more likely to trigger investor protection disclosure, were issues of new securities resulting from the roll-up. Section 5 of the Securities Act of 1933 ("the 1933 Act")[226] prohibits the offer, delivery, or sale of a security, absent registration or use of an exemption under the 1933 Act. In the absence of an exemption[227] both the registration statement[228] and the prospectuses[229] used in the transactions must provide the disclosure.

The SEC had previously developed a large body of instructional regulation regarding statutory disclosure requirements. The required information in a

220. *Id.*

221. Limited Partnership Reorganizations and Public Offerings of Limited Partnership Interests, Exchange Act Release Nos. 33-6900, 34-29314, 56 Fed. Reg. 28,979 (1991).

222. 15 U.S.C.A. § 78n (West Supp. 1994). This section authorizes the Securities and Exchange Commission to promulgate rules for the protection of investors in connection with the solicitation of any proxy or consent or authorization in respect of any security registered pursuant to § 78*l*. *Id.*

223. 15 U.S.C.A. § 78*l* (West Supp. 1994).

224. 17 C.F.R. § 240.14a-1 to 240.14a-14 (1994).

225. 17 C.F.R. § 240.14a-101 (1994).

226. 15 U.S.C. § 77e (1988).

227. *See* 15 U.S.C.A. § 77c (West Supp. 1994); 15 U.S.C. § 77d (1988).

228. 15 U.S.C.A. § 77f (West Supp. 1994).

229. 15 U.S.C. § 77j (1988). This section details required information for prospectuses, which are defined in 15 U.S.C. § 77b(10) (1988).

registration statement can be found in three sources. First, Regulation C[230] describes the form of registration statements and the content of prospectuses. Second Regulation S-K[231] contains the basic instructions for filing disclosure forms with the SEC. Third. the regulations designated Form S-4 as the primary document to be used as a registration statement in reorganization transactions, including roll-ups, regulated by Rule 145.[232]

In its June 1991 interpretive release, the SEC identified specific concerns regarding its present requirement as applied to disclosure in roll-up transactions. Identifying "readability" as the key to adequate disclosure, the release emphasized pre-existing standards which would have special application to roll-up transactions. As disclosure regulation is primarily designed to provide investors with "clear, comprehensible and complete information regarding the issuer, security, offering transaction and the risks of the investment,"[233] the complexity of roll-up transactions requires meticulous care.[234] The release also emphasized the importance of a "clear, concise and coherent 'snapshot' description of the most significant aspects of . . . the transaction or partnership offering"[235] in the required summary.[236]

The release further highlighted significant issues in roll-up transactions, including names and descriptions of the entities involved; a brief description of the transaction itself; existing investor voting rights and any significant changes resulting from the transaction; changes in the business plans; changes in management or management compensation; the likelihood that new securities would trade at substantial discounts from disclosed "exchange" valuations; dissenters' approval rights; reports, opinions or appraisals which served as the basis for the transaction; a clear description of the risks and benefits of the proposed transaction; and the importance of the quality or readability of the disclosure.[237]

The SEC next supplemented the existing rules with special roll-up transaction disclosure rules, primarily by adding subpart 900 to Regulation S-K. These new rules clarified and significantly altered the prior disclosure scheme. First, they carefully identified the new roll-up disclosure rules as applying only to combinations or reorganizations of two or more finite limited partnerships, newly identified "other finite entit[ies]," and reorganizations of one finite limited partnership or entity into a new entity.[238] The new rules thus do not

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230. 17 C.F.R. §§ 230.400-.479 (1994).

231. 17 C.F.R. §§ 229.10-.802 (1994).

232. 17 C.F.R. § 230.145 (1994).

233. Limited Partnership Reorganization and Public Offerings of Limited Partnership Interests, *supra* note 221, at 28,980.

234. *Id. See In re* Franchard Corp., 42 S.E.C. 163 (1964) (discussing requirements for clear, concise and understandable disclosure).

235. Limited Partnership Reorganization and Public offerings of Limited Partnership Interests, *supra* note 221, at 28,981.

236. *See* 17 C.F.R. § 229.503(a) (1994) (discussing required information for summaries included in complex prospectuses); 17 C.F.R. § 229.801(e) (1994) (explaining which guide to follow with respect to preparation of registration statements relating to limited partnerships).

237. 17 C.F.R. §§ 229.901-.915 (1994).

238. *See* 17 C.F.R. § 229.901(c)(1) (1994).

apply to roll-ups or reorganizations of infinite life entities, REITs, or 1940 Investment Company Act entities.

If the new roll-up definition does not eliminate a transaction, the recently adopted 900 series regulations impact disclosure in at least three ways. First, if two or more entities are included in the transaction, a separate supplementary disclosure document for each entity is required.[239] This document provides investors in each rolled-up entity with special disclosure of significant information concerning the investor's own entity as well as special risks associated with its roll-up.

Second, the new rules mandate the inclusion of specific disclosure in a required summary to be located in the forepart of each disclosure document.[240] These summary items identify the critical issues subject to abuse. Accordingly, clear, concise, comprehensible summaries of these issues set out in the forepart of the disclosure documents should alert investors to these critical issues. Moreover, the 900 series regulations not only identify the specific areas of required disclosure in detail,[241] but also expand the information provided in the required summaries and add other critical technical data not summarized. Finally, due to the complexity of the transactions and the newly required disclosures, the SEC required a minimum solicitation period of sixty days.[242]

The effectiveness of disclosure as a method of protection is dependent upon one of three assumptions. First, the investor may vote his own self-interest once the information to make an appropriate judgment about that self-interest is available. This theory's weakness is evidenced by the SEC's recognition of the complexity of the transaction. Second, adequate disclosure may permit study by sophisticated market professionals who will understand these complex transactions. This theory, however, ignores the fact that no market price is available to broadly disseminate the resultant advice in a timely manner. Finally, adequate disclosure may serve as a disincentive to unfair transactions, because insiders not wanting to disclose this information will forgo the transaction completely. This theory, overlooks disclosure's potential chilling effect on fair transactions. As a result, increased disclosure adds to the cost of the transaction without assurance that investors will benefit from the information.

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239. 17 C.F.R. § 229.902 (1994).

240. 17 C.F.R. § 229.903 (1994). This section requires disclosure of material risks of the roll-up transaction in a summary statement. Examples of material risks include changes in business plans, voting rights, cash distributions, ownership interest, general partner conflicts of interest with the roll-up, material terms of the transaction, and outside parties' assessments regarding fairness of the opinions. *Id.*

241. *See* 17 C.F.R. § 229.904-.915 (1994). Items listed in these sections include risk factors, comparative information, allocation of roll-up consideration, background of roll-up transaction, conflicts of interest, fairness, reports, opinions and appraisals, sources and amounts of funds and transactional expenses, other provisions in the transaction, pro forma financial statements and federal income tax consequences. *Id.*

242. *See* 17 C.F.R. § 240.14c-2(c) (1994). This requirement may only be altered by an applicable state law permitting a shorter period. *Id.* Note that the sixty-day minimum applies to Williams Act tender offers as well. 17 C.F.R. § 240.14e-1(a) (1994).

Even less clear is the new disclosure rules' impact on litigation under the federal securities statutes. As most entities rolled up into new, larger entities will not have been registered under section 12 of the 1934 Act,[243] implied causes of action[244] for disclosure violations of Proxy Rule 14(a)9[245] will be unavailable. Because registration will usually[246] be required under the 1933 Act, however, misleading disclosure in the registration statement[247] or other media may give rise to liability.[248] In cases involving non-disclosure (the majority of cases), the new, itemized disclosure rules could make it difficult to prove the materiality of facts not specifically mentioned in the rules.

In sum, the SEC's new disclosure rules potentially provide an increased, more readable flow of information to the investor, without destroying the potential benefit roll-ups afford. While disclosure skeptics may doubt the added value of the new rules to investors, increases in disclosure undoubtedly remediate the extreme abuses identified in the congressional hearings.

C. *Congress*

Congress's interest in protecting investors injured in roll-up transactions began in 1990. The first bill, which was virtually ineffective, to combat roll-up transactions was introduced in May 1990.[249] However, April 1991 saw the introduction of a substantial bill regulating roll-ups.[250] The proposal largely survived as the bill eventually passed by the House in November 1991.[251] Interestingly, the Chairman of the SEC urged Congress to set aside this proposal until the SEC had an opportunity to act.[252] In June 1991, however, Senator Dodd introduced a major roll-up reform measure in the Senate.[253] The Office of Management and Budget reported the Bush Administration's opposition to this legislation,[254] based on the notion that (1) it would infringe

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243. 15 U.S.C.A. § 78*l* (West Supp. 1994).

244. *See* J.I. Case Co. v. Borak, 377 U.S. 426, 430 (1964) (recognizing that private parties have a right to bring suit for violations of § 14(a) of the Securities and Exchange Act of 1934).

245. 17 C.F.R. § 240.14a-9 (1994):

246. 15 U.S.C. § 77e(c) (1988) requires that all prospectuses shipped in interstate commerce and mails be registered.

247. *See* 15 U.S.C. § 77k (1988). This section imposes civil liability upon those making false registration statements. *Id.*

248. *See* 15 U.S.C. § 77*l*(2) (1988). This section imposes civil liability upon those issuing prospectuses which include untrue statements or material omissions. *Id.*

249. *See* Daily Report for Executives (BNA) (May 2, 1990).

250. 23 Sec. Reg. & L. Rep. (BNA) 551 (Apr. 19, 1991). (reporting on HR 1885).

251. 23 Sec. Reg. & L. Rep. (BNA) 1613 (Nov. 8, 1991).

252. *See* Kevin G. Salwen, *SEC Chief is Wary of Measure to Curb "Roll-Up" Abuses*, WALL ST. J., Apr. 24, 1991, at C9. The SEC began discussing its potential involvement in the area as early as the previous February. *See* 23 Sec. Reg. & L. Rep. (BNA) 317 (Mar. 1, 1991). By June 21, the SEC proposed rule changes for comment. *See* 23 Sec. Reg. & L. Rep. (BNA) 954 (June 21, 1991).

253. *Securities - Senator Dodd Introduces Bill to Curb Abuses in Limited Partnership Rollups*, Wash. Insider (BNA) (July 1, 1991).

254. 23 Sec. Reg. & L. Rep. (BNA) 1613 (Nov. 8 1991).

on state partnership law, and (2) the SEC proposal provided adequate protective regulation under existing legislation. The Dodd bill eventually languished in the Senate.

Soon afterward, however, the Clinton Administration's desire for legislative enhancement of investor protection revived Congress's interest.[255] The House passed a new version of the previous bill in March 1993,[256] and by November 1993, after a new bill was introduced in the Senate,[257] a joint bill passed both houses and was sent to the president.[258] On December 17, 1993 President Clinton signed into law the Limited Partnership Roll-up Reform Act of 1993 (hereinafter "the LPRRA" or "the Act").[259]

The LPRRA affected limited partnership roll-ups by making several amendments to the 1934 Act.[260] Comments prior to the House vote indicate this congressional response to the roll-up debacle considered the SEC's and NASD's remedial actions.[261] The LPRRA was a product of gaps in that activity, codifying and expanding the rulemaking of these two regulatory bodies. It is therefore useful to identify those changes.

LPRRA combines patterns of regulatory methods developed under the 1933 and 1934 Acts. The basic substantive regulatory provisions resulted from an amendment to section 14 of the 1934 Act[262] and became the new section 14(h).[263] Section 14 provides the SEC with authority to promulgate rules for transactions in which persons seek proxies,[264] renders it "unlawful" to engage in such activities in contravention of those rules,[265] and limits the application of those rules to transactions in certain securities.[266] New section 14(h)[267] is

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255. *See* 25 Sec. Reg. & L. Rep. (BNA) 267 (Feb. 26, 1993).

256. *See* 25 Sec. Reg. & L. Rep. (BNA) 292 (Mar. 5, 1993) (reporting passage of H.R. 617 on Mar. 2, 1993).

257. 25 Sec. Reg. & L. Rep. (BNA) 268 (Feb. 26, 1993) (reporting the introduction of S424 by Senators Dodd, Riegle and D'Amato).

258. 25 Sec. Reg. & L. Rep. (BNA) 1605 (Dec. 3, 1993) (reporting passage of S422 on Nov. 22, 1993, and H.R. 617 on Nov. 23, 1993).

259. 25 Sec. Reg. & L. Rep. (BNA) 1708 (Dec. 24, 1993).

260. The Amendments to the 1934 Act are a new addition to Section 14, 15 U.S.C.A. § 78n (West Supp. 1994), two new additions to Section 15A(b), 15 U.S.C.A. § 78o-3(b) (West Supp. 1994), and an addition to Section 6(b), 15 U.S.C.A. § 78f(b) (West Supp. 1994).

261. *See* 139 CONG. REC. S422, 10,956-69 (daily ed. Nov. 22, 1993 (comments of Congressman Mackey).

262. 15 U.S.C.A. § 78n (West Supp. 1994).

263. 15 U.S.C.A. § 78n(h) (West Supp. 1994).

264. Section 14(a) applies to the solicitation of proxies, consents, or authorizations. 15 U.S.C.A. § 78n(a) (West Supp. 1994). Section 14(d) applies to tender offers. 15 U.S.C.A. § 78n(d) (West Supp. 1994). Section 14(e) applies specifically to disclosures in connection with tender offers. 15 U.S.C.A. § 78n(e) (West Supp. 1994). Section 14(f) adds Section 13(d) insiders' reports to the regulation. 15 U.S.C.A. § 78n(f) (West Supp. 1994).

265. Each major subdivision of the Section uses the phrase "it shall be unlawful for any person to . . . ," thereby creating the potential for Commission Civil action or Justice Department Criminal action under other sections of the Act. *See, e.g.*, 15 U.S.C.A. § 78u (West Supp. 1994) (civil proceedings) and 15 U.S.C.A. § 78ff (West Supp. 1994) (criminal penalties). For a discussion of issues regarding private causes of action, see J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

266. Sections 14(a)-(d) are specifically limited to transactions related to securities regis-

entitled "Proxy Solicitations and Tender Offers in Connection With Limited Partnership Roll-Up Transactions,"[268] and states that "[i]t shall be unlawful for any person to solicit any proxy, consent or authorization concerning a limited partnership roll-up transaction, or to make any tender offer in furtherance of a limited partnership roll-up transaction, unless such transaction is conducted in accordance with rules prescribed by the Commission."[269] This provision incorporates the express civil investigatory power and SEC causes of action from section 21[270] and the express criminal penalties available to the Justice Department under section 32.[271] The availability of implied private civil causes of action remains subject to judicial application of the standards adapted by the Supreme Court in 1975.[272]

Unlike the previously adopted subsections of section 14, the LPRRA now specifically identifies substantial and specific mandatory disclosures to be included in the Commissioner's rules. Thus, the Commission's rulemaking power in the area of these disclosures will be limited to interpreting the mandates and adding "such other matters deemed necessary or appropriate."[273]

First, the SEC's rules should mandate the standard for disclosure to be "clear, concise and comprehensible" in distributed solicitation materials.[274] These materials must include: (1) changes in the business plan, voting rights, form of ownership, or general partner compensation from the original limited partnerships; (2) any conflicts of interest of the general partner; (3) expectations of any significant differences between disclosed exchange values of the limited partnership interests and trading prices of the securities to be issued; (4) valuation of the limited partnerships involved, the method used in that valuation, and the valuation of the interests to be exchanged in the transaction; and (5) the differing risks and effects of completing the transaction with less than all of the solicited partnerships.[275]

Subject to the same standard is a required statement by the general partner as to whether the proposed roll-up is fair to the investors in each limited partnership, including a discussion of the basis for the conclusion. The general partner's statement is also required to include an evaluation and description of the alternatives to the roll-up, including liquidation.[276] While it seems unlikely that a general partner would describe the proposed transaction as unfair to one of the entities to be rolled up, a discussion of the basis for determining fairness involves some discussion of the relative exchange value computations.

tered under Section 12 of the Act. 15 U.S.C.A. § 78n(a)-(d) (West Supp. 1994).

267. 15 U.S.C.A. § 78n(h) (West Supp. 1994).

268. *Id.*

269. 15 U.S.C.A. § 78n(h) (West Supp. 1994).

270. 15 U.S.C.A. § 78u (West Supp. 1994).

271. 15 U.S.C.A. § 78ff (West Supp. 1994).

272. *See* Cort v. Ash, 422 U.S. 66 78 (1975), and its securities law progeny, Piper v. Chris-Craft Indus., 430 U.S. 1 (1977).

273. 15 U.S.C.A. § 78n(h)(1)(D)(vii) (West Supp. 1994).

274. 15 U.S.C.A. § 78n(h)(1)(D) (West Supp. 1994).

275. 15 U.S.C.A. § 78n(h)(l)(D)(i)-(v) (West Supp. 1994).

276. 15 U.S.C.A. § 78n(h)(l)(E) (West Supp. 1994).

Significantly, the description and evaluation of the alternatives to the transaction may prove a mine field of disclosure traps.

The LPRRA also requires SEC rules regarding disclosure of outside opinions, appraisals or reports (other than those of counsel) materially related to the transaction, subject to the same readability standards and required to be included in solicitation materials.[277] Due to the significance of the external evaluations, substantial disclosure is mandated,[278] including (1) an analysis of the transaction, the scope of the review, the preparation of and basis for the opinion, and representations and undertakings included;[279] (2) the identity and qualifications of the preparer, the methods used in the selection process, and material past, existing or contemplated relationships between that person and others involved in the transaction;[280] (3) any compensation contingent on approval of the transaction;[281] (4) any limitations imposed on the preparer's access to personnel, premises or records;[282] (5) reasons for limitations on access;[283] (6) if not included, reasons why a valuation opinion is unnecessary for an informed decision;[284] and (7) an open-ended opportunity for the SEC to add other protection disclosures to this list.[285]

These statutory provisions may mean that transactions included under these regulations will be time consuming and expensive. The extent of deterrence to valuable transactions is difficult to assess at this early stage; however, the LPRRA requires an evaluation by the Comptroller General within eighteen months of the statute's operation regarding the usefulness of the disclosure to limited partnership investors.[286]

As mentioned earlier, the statute's implementation of required disclosure borrows from the 1933 Act.[287] The first section of the LPRRA outlaws participation in a roll-up transaction absent compliance with the listed disclosure rules.[288] Thereafter, it broadly defines a limited partnership roll up transaction, as one "involving the combination or reorganization of one or more limited partnerships, directly or indirectly,"[289] provided the transaction also results in the following: (1) issued securities will be traded on a national ex-

277. 15 U.S.C.A. § 78n(h)(l)(F) (West Supp. 1994).

278. While these external evaluations are of substantial value in aiding the successful solicitation of approvals, the degree of disclosure required could potentially discourage solicitation of such valuable information. However, non-use requires an explanation of why an external evaluation is unnecessary. *Id.*

279. 15 U.S.C.A. § 78n(h)(l)(F)(i) (West Supp. 1994).

280. 15 U.S.C.A. § 78n(h)(1)(F)(ii) (West Supp. 1994).

281. 15 U.S.C.A. § 78n(h)(1)(F)(iii) (West Supp. 1994).

282. 15 U.S.C.A. § 78n(h)(1)(F)(iv) (West Supp. 1994).

283. 15 U.S.C.A. § 78n(h)(1)(G) (West Supp. 1994).

284. 15 U.S.C.A. § 78n(h)(1)(H) (West Supp. 1994).

285. 15 U.S.C.A. § 78n(h)(1)(K) (West Supp. 1994).

286. *See* Limited Partnership Rollup Reform Act of 1993, P.L. 103-202, § 302(c), 1993 U.S.C.C.A.N. (107 Stat.) 2363-64.

287. *See* 15 U.S.C.A. § 77b-e (West Supp. 1994) (discussing definitions, exempted securities, exempted transactions and prohibitions, respectively).

288. 15 U.S.C.A. § 78n(h)(l) (West Supp. 1994).

289. 15 U.S.C.A. § 78n(h)(4) (West Supp. 1994).

change or the national market system,[290] (2) the interests to be exchanged have not been traded as of the filing date,[291] (3) investors involved are subject to change regarding voting rights, term, management compensation, or investment objectives,[292] and (4) no investors have an option to retain the security under the same terms and conditions as the original issue.[293]

Continuing the pattern of the 1933 Act, the new statute follows the broad definition of a roll-up transaction with a group of specific exemptions entitled "Exclusions from definition."[294] The exclusions include (1) transactions involving limited partnerships which retain funds for reinvestment, rather than distribution;[295] (2) transactions in which the exchange of interests was included in the terms of the original limited partnership and the new operating company was also identified in the original agreement;[296] (3) transactions in which the newly issued securities do not require registration under the Securities Act of 1933;[297] (4) transactions involving issuers not required to report under section 12 of the 1934 Act;[298] (5) transactions resulting in roll-ups generated by non-affiliated outsiders requiring approval by no less than two-thirds of the outstanding units and existing general partners receiving no extraordinary compensation;[299] and (6) transactions in securities under a plan declared effective before the enactment of the Act.[300]

Based upon these exclusions, Congress was not concerned with small or private transactions resulting in the issuance of non-publicly traded interests. Thus, under reorganizations effected to extend the life of a limited partnership without creating a new market for the interests, investors receive no new protection. There is also no additional protection for investors involved in reorganizations of infinite life partnerships or investors in limited partnerships in which the takeover (reorganization) transaction was effected by an outside interest. Apparently, new protections are only available in cases of roll-ups of limited partnerships generated by general partners (or sponsors affiliated with general partners), who choose not only to extend the life of the limited partnership but also to create a trading market for the resulting interests.

Certain realities, however, support the definitional exclusions in the LPRRA. First, it would be difficult to gain approval of roll-ups without creating a market for resale of the new interests. If market creation is an incentive to encourage the roll-up transaction, substantial disclosure is required.[301]

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290. 15 U.S.C.A. § 78n(h)(4)(A) (West Supp. 1994).
291. 15 U.S.C.A. § 78n(h)(4)(B) (West Supp. 1994).
292. 15 U.S.C.A. § 78n(h)(4)(C) (West Supp. 1994).
293. 15 U.S.C.A. § 78n(h)(4)(D) (West Supp. 1994).
294. 15 U.S.C.A. § 78n(h)(5) (West Supp. 1994).
295. 15 U.S.C.A. § 78n(h)(5)(A) (West Supp. 1994).
296. 15 U.S.C.A. § 78n(h)(5)(B) (West Supp. 1994).
297. 15 U.S.C.A. § 78n(h)(5)(C) (West Supp. 1994).
298. 15 U.S.C.A. § 78n(h)(5)(D) (West Supp. 1994).
299. 15 U.S.C.A. § 78n(h)(5)(E) (West Supp. 1994).
300. 15 U.S.C.A. § 78n(h)(5)(F) (West Supp. 1994).
301. Unfortunately, since no market exists to reflect the values identified by the mandated disclosures until after the transaction, investors can benefit only if the decision to approve is based on an understanding of the disclosure documents, rather than the opportuni-

Second, locked-in investors have little to lose, and disclosure protects new investors from paying an excessive price for the new interests via the market's reaction to the mandated disclosure in pricing the new securities. This latter cynical (but realistic) assumption indicates the old disclosure scheme's failure to protect against those injuries most clearly identified in the congressional hearings.

The final piece of the disclosure scheme enacted in the new legislation responds to the latter observation;[302] it provides for special SEC rulemaking to assure that holders of interests in proposed roll-up transactions can engage in preliminary communications with fellow interest holders without the rigors of section 14(a) proxy restrictions.[303] Under this provision, the SEC must promulgate rules requiring issuers to provide such investors with lists of other investors who will be involved in the transaction's approval.[304] Finally, recognizing the complexity of the disclosed information, the LPRRA requires a minimum solicitation period of sixty days.[305]

In addition to basic disclosure rules, the LPRRA also attempts to provide some indirect protections. First, in an attempt to remedy abuses identified in the congressional hearings regarding compensation of proxy solicitors, the Act goes beyond the NASD rules[306] and prohibits "compensating any person soliciting proxies, consents or authorizations . . . contingent on the approval, disapproval or completion of the limited partnership roll-up transaction."[307]

As a second indirect protection, the LPRRA extends the rules governing the registered securities associations' rules of fair practice[308] by imposing limits on its members' participation in roll-up transactions.[309] These members' participation is conditioned on the transaction bearing certain characteristics, including dissenters' rights, protection of voting rights, fair transactional cost distribution, and restrictions on general partners' contingent interests.[310] The mandatory alternative dissenters' rights include: (1) appraisal and compensations; (2) a new security offering substantially the same terms as the old security; (3) approval by no less than 75% of the outstanding interests of each limited partnership; (4) use of an "independent committee" approved by a majority of the interests of each participating partnership with authority to action behalf of the limited partners; or (5) comparable rights prescribed by the registered association designed to protect dissenters.[311] Only if dissenters

ty to "bail out" in a subsequent sale. This assumption is speculative at best.

302. *See* 15 U.S.C.A. § 78n(h)(1)(A)-(B), (J) (West Supp. 1994).

303. 15 U.S.C.A. § 78n(h)(1)(A) (West Supp. 1994). This section also places limitations on the availability of such assurances and limitations on potential abuses. 15 U.S.C.A. § 78n(h)(1)(A)(i)-(ii) (West Supp. 1994).

304. *See* 15 U.S.C.A. § 78n(h)(1)(B) (West Supp. 1994).

305. 15 U.S.C.A. § 78n(h)(1)(J) (West Supp. 1994).

306. 25 Sec. Reg. & L. Rep. (BNA) 189 (Feb. 5, 1993).

307. 15 U.S.C.A. § 78n(h)(1)(C) (West Supp. 1994).

308. 15 U.S.C.A. § 78o-3 (West Supp. 1994).

309. 15 U.S.C. § 78o-3(b)(12) (West Supp. 1994).

310. *See* U.S.C.A. § 78o-3(b)(12)(A)-(D) (West Supp. 1994).

311. 15 U.S.C.A. § 78o-3(b)(12(A)(i)-(iv) (West Supp. 1994).

are permitted one of these five options may members of registered associations participate in the roll-up transaction.

A third type of indirect protection results from amendments to the statutory requirements for listing on national securities exchanges[312] and statutory standards for admission to the automated quotation system.[313] The listing and quotation standards mandated by the LPRRA are those dissenters' rights required for participation of members of registered associations. It is, of course, difficult to predict the effect of a statutory amendment on the heels of its adoption; however, some matters are readily apparent. The amendment will only impact roll-ups designed to result in the public trading of interests formerly privately held. Such transactions will be subjected to the time and expense involved in tailoring them to the new statutory mandates. The disjunctive nature of the requirements, however, will allow lawyers to design transactions which comply with only one alternative while providing substantial likelihood of approval by interest holders. Nonetheless, the combination of disclosure, dissenters' rights alternatives, and veto power created by delay and inter-investor communications, will add expense to already costly transactions. Public investors purchasing new interests from old investors in the preexisting partnerships may still purchase them at greatly discounted prices. As a result, old investors will face a Hobson's choice: denying the transaction and receiving substantially discounted liquidation values, approving the transaction and acquiring greatly discounted prices for their interest, or holding a new form of their old investment, which has the potential of a market but which also was created at substantial expense. It is not clear that the new statutory amendments offer old investors anything more than a clearer view of a larger loss.

CONCLUSION

This article has attempted to provide an overview of the debacle suffered by investors in some limited partnership roll-ups. This overview is dependent upon a background understanding of the various alternative transactions which can result in the roll-up. Additionally, awareness of the changes in the state statutes which regulate the limited partnership and how they facilitate or frustrate these alternative transactions is essential.

The substantial losses suffered by limited partnerships, and consequently by investors, resulted from the confluence of several legal and economic variables. As limited partnerships became highly desirable business organization forms, the modernization of governing state statutes unintentionally laid the groundwork for unanticipated subsequent reorganizations. The elimination of prior tax advantages also contributed to unexpected diminutions in value of these investments, which were often difficult to quantify. Almost simultaneously, economic conditions negatively impacted the value of the assets underlying these entities' investments, and the lack of a market for the individual investors' interests masked such losses.

312. 15 U.S.C.A. § 78f(b) (West Supp. 1994).

313. 15 U.S.C.A. § 78o-3(b)(13) (West Supp. 1994).

The sponsors and general partners of these entities were the first, and perhaps most informed, witnesses to these changes. For a variety of reasons, including the pressures of required imminent asset liquidation and reduced liquidation distributions to investors, these managers sought means to postpone forced losses and to diversify their investors' risks. Roll-up reorganizations of these limited partnerships offered that opportunity. Press recognition of investors' losses from tax changes and economic impacts, as well from excesses in the reorganization transactions themselves, created a demand for new protections from these transactions.

The economic conditions leading to the use of roll-ups, as well as abuses in roll-up transactions, have generated investor-protective reactions from several sources. State legislatures have not been particularly instrumental in developing protective devices. The self-regulatory organizations in the securities industry have developed limited rules to regulate the most abusive conduct of their members. None of these initiatives, however, have had major impact, and large portions of the roll-up problem seem outside the control of these organizations.

The SEC has clarified and expanded its regulation of these transactions. Its protective scheme revolves around increased disclosure requirements. Opinions differ regarding the effectiveness of disclosure as a direct investor protective device which protects by increasing investor awareness of risk; nonetheless, heightened disclosure may indirectly dilute roll-up sponsors' excesses. Indirect disincentives created by more extensive mandated disclosures include increased costs and increased delays in needed transactions.

Indicating either its lack of confidence in the effect of the SEC's expanded rulemaking or its political need to respond to the roll-up debacle, Congress has amended the Securities Exchange Act of 1934 to add to the investor-protective arsenal with the Limited Partnership Roll-up Reform Act of 1993 ("LPRRA"). These changes, added to the SEC's earlier disclosure mandates, have intensified the regulations' financial impact on roll-up transactions. The investors whom the LPPRA seeks to protect may, however, ultimately bear the costs of the new statutory regime.

Ultimately, if public systems of prevention prove inadequate, private litigation offers perhaps the final hope for investor protection. Because roll-up transactions represent a relatively new phenomena, the litigation they have generated has not yet developed into a consistent body of substantial analysis tested by appellate scrutiny. Common law claims for breach of fiduciary duty represent one potential approach to future litigation. Undoubtedly, the LPRRA will generate additional theories of litigation, but the federal courts' willingness to imply those causes of action must first be developed.

The multiple sources of recently-developed protective devices will mean substantially greater lawyer involvement in planning roll-up transactions, which should become even more complex in the wake of the LPRRA. Increased complexity implies increased cost. If these developments become prohibitively expensive, our economy will see the loss of a valuable investment vehicle. This article provides a framework for evaluating these various effects. As litigation and rulemaking develops under the LPRRA, it is hoped

that subsequent analysis will be forthcoming.